Company Name: Anadolu Efes
Company Ticker: AEFES TI
Date: 2017-11-03
Event Description: Q3 2017 Earnings Call

Market Cap: 14,068.42
Current PX: 23.76
YTD Change($): +6.13
YTD Change(%): +34.770

Bloomberg Estimates - EPS
Current Quarter: 0.040
Current Year: 0.666
Bloomberg Estimates - Sales
Current Quarter: 2338.000
Current Year: 12381.667

Q3 2017 Earnings Call

Company Participants

- Çiçek Usakligil Özgünes
- John Gavin Hudson
- Onur Çevikel

Other Participants

- Ece Mandac■ Baysal, CFA
- Robert Bonte-Friedheim
- Frans Høyer
- Hanzade Kilickiran
- Walid Bellaha
- Tristan van Strien

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, welcome to Anadolu Efes Beer Operations Nine Months 2017 Results Conference Call and Webcast. Today's speaker will be Mr. Gavin Hudson, CEO; Mr. Onur Çevikel, CFO.

I will now hand over to our host, Çiçek Özgünes, Investor Relations and Treasury Director. Madam, please go ahead.

Çiçek Usakligil Özgünes

Thank you. Hi, everyone. Welcome to Anadolu Efes' Beer Operations Third Quarter Results Conference Call and Webcast. Before we start, I would like to kindly request you to refer to our notes in our presentation regarding the forward-looking statements.

Today, we have our CEO on the call, Mr. Gavin Hudson; and our CFO, Mr. Onur Çevikel. Now, I'm leaving the floor to Gavin, please.

John Gavin Hudson

Thank you, Çiçek. Good afternoon. Welcome and thank you for joining us this afternoon. I'll get straight into the key highlights for Anadolu Efes on a consolidated basis. Our growth momentum continued in our international beer and soft drinks operations with performance in line with our guidance of mid single-digit growth. Sales volumes were up to 4.9% in the third quarter and 4.6% for the nine months in 2017 this prior. Revenue continued outperforming volume growth at 23.5% in the third quarter and 23.3% for the nine months in 2017, driven by higher volumes, pricing and a positive translation effect of local currencies of our international operations to the Turkish lira.

EBITDA BNRI saw a 22-basis point margin expansion to 20.6% and grew by 24.9% in the third quarter and increase by 17% to a little over TRY 1.8 billion in the nine months of 2017 with a margin of 17.8%. Our bottom line was slightly down to TRY 343.9 million versus TRY 364.2 million in 2016. Although operating profitability grew in the period, our net FX losses [ph] was (02:29) higher year-on-year, mostly due to non-cash losses recorded on borrowings.

Our free cash flow was up from TRY 757.3 million in 2016 to TRY 958.1 million in 2017 for the nine months. And our consolidated net debt-to-EBITDA BNRI is at 1.5 times for the nine months compared to 1.8 times in the prior year.

Our soft drinks volume development, Turkey saw a 5% growth in the third quarter and a 3.7% growth for the nine months in 2017. The international soft drinks delivered 6.3% growth in quarter three and 5.7% for the nine months in 2017. This driven mainly by Pakistan and Central Asia with Pakistan growing 3.6% on quarter three of 2017 and cycling a massive 15.4% growth in quarter three of the previous year. Central Asia maintained momentum of 8.4% growth for the third quarter in 2017, underpinned by significant growth in Kazakhstan and Azerbaijan, which is in the mid-20%. Iraq's growth of 10% was also largely driven by sparkling.

From a beer volume perspective, we saw the total beer group up by 2.2% in the third quarter and 4.1% for the nine months in 2017. The overall Russian beer market is estimated to be down mid single-digit for the nine months in 2017 driven by the ongoing effects of the PET regulation and downsizing impact, the weaker consumer sentiment, low disposable income and an extremely cold and wet winter and year for that matter. They haven't had much summer in Russia.

The Turkish beer market remained flat for the nine months in 2017 with ongoing pricing pressure, impacting consumer affordability and a lower than expected recovery in tourism. And this is mostly driven by the mix of tourists versus the absolute number.

The Turkey domestic volumes were slightly up at 0.6% in the third quarter of 2017. This assisted through the relaunch of Efes Pilsen as we discussed previously, execution improvements at point of sale and a focus on our tourist strongholds during summer.

Our international beer operations were up 3.3% for the third quarter, this despite cycling an 11% growth in the previous year. This is driven by strong performance in Russia, Kazakhstan and Georgia. Russia continues to grow share and volume in a declining market with our share now up to 15% versus 13.6% for the nine months to maintaining a strong position in the modern trade with a focus on the upper mainstream and premium portfolio. Russia has also increased participation in the DIOT channel, that's the draft in off-trade channel which has also delivered a good volume growth for this business.

In conclusion, the group strategy remains with an ongoing focus on our brands, our execution in the market, our efficiency in value chain, and building relationships with our customers and key stakeholders.

I'll hand over to Onur for the financial overview. Onur?

Onur Çevikel

Thank you very much, Gavin, and good morning and good afternoon, ladies and gentlemen. We are very happy to host you in our nine months results conference call today. I will take you through our financial results for the first nine months of 2017 as usual, starting with Anadolu Efes consolidated numbers.

As mentioned by Gavin briefly, our volumes were recorded at 73.7 million hectoliter with a strong 4.6% growth. As compared to first nine months of 2016, this is both thanks to our soft drinks and beer segments. Our revenue [indiscernible] (07:21) strong 23.3%, reaching up to TRY 10,188.6 million. EBITDA BNRI was recorded as TRY 1,810.5 million, which represents a strong 17% increase compared to same period of prior year.

At the same time, EBITDA BNRI margins was recorded at 17.8%, a slight decline of 96 basis points compared with the same period of the prior year. Finally, our net income was recorded as TRY 343.9 million in the first nine months of 2017.

Talking to our beer group segments, I will start with our Turkey beer operations as usual. Our volumes in Turkey was recorded at 4.4 million hectoliters with a 5.7% decline in the first nine months of 2017. It is important to mention that our volumes were flattish in the third quarter with a slight growth in Turkey domestic market. Our net revenue has reached TRY 1,146.4 million. [ph] It's a (08:43) 3.5% increase compared with the same period of prior year on the back of price increases and mix impacts.

Our EBITDA BNRI was recorded as TRY 2,729.9 million, representing a 14.3% decline [ph] and an (09:02) EBITDA BNRI margins of 23.8% for the period. Our net income was TRY 32.4 million by the end of third quarter 2017. Continuing with our international beer segments, volumes have reached to 11.9 million hectoliters with 8.1% strong growth compared to the same period of prior year, mostly attributable to our Russian operations' performance.

Our net revenue has reached to TRY 2,153.5 million with an increase of 47.6% in the first nine months of 2017. Translation impact from local currencies to TL plays an important role on this increase. If we go to look on a constant currency basis, this increase would have been limited to around 6%. Our EBITDA BNRI number was TRY 358.7 million with a total 6% increase, which brings us to 16.7% EBITDA margin in the first nine months of 2017.

Finally, talking about our beer group results. Our volumes have reached to 16.3 million hectoliters with a 4.1% increase in the first nine months of 2017. Our revenues grew by 28.3%, reaching up to TRY 3,324 million. Again, if we were to look at this growth on a constant currency basis, we would be seeing a growth around 5%.

Our EBITDA BNRI has reached to TRY 601.7 million with a 9.2% growth in the first nine months of 2017, meaning an EBITDA margin of 18.1%. As you are all aware, since you have been [ph] probably spending these calls (11:19) for a long time, free cash flow is a major priority for us in all our business segments. Our free cash flow generation for our beer group in the first nine months of 2017 had been TRY 255 million, a stronger performance than prior year's strong TRY 187.1 million.

On the balance sheet of Anadolu Efes and beer group, if we need to briefly talk, net debt-to-EBITDA BNRI ratio has improved to 1.5 times on consolidated level, improving both compared to prior year and first half of 2017. Similarly, beer group performance on net debt-to-EBITDA BNRI was also improved to 1.5 times, again, improving both compared to prior year and first half of 2017. We are very happy to reach this healthy net debt-to-EBITDA multiple, despite the challenges that we had faced in the macroenvironment.

On the borrowing mix and liquidity profile, we have a relatively easily manageable debt repayment schedule with an average maturity of debt in beer group being four years and on the consolidated being 3.7 years of average maturity. On the interest breakdown, we continue to have fixed interest rates for more than 85% of our debt.

And talking about on the latest consolidated free cash flow, we are particularly happy to announce another very strong free cash flow quarter performance. Strong free cash flow generation being one of major priorities, we are very pleased to announce a TRY 958 million free cash flow in the first nine months of 2017 with a strong improvement over the nine months of 2016 free cash flow generation of TRY 737.3 million.

Finally, talking about our financial priorities, which hasn't changed much, is sustaining consolidated cash flow to focusing on working capital, optimizing the CapEx, and making sure that we have a tight balance sheet management. Efficiency improvements, deleveraging, managing impact of FX volatility on operations, and commitment to investment-grade ratings will continue to be our financial priorities.

So this concludes my presentation on the financial results. I will hand over to Gavin for his closing remarks.

John Gavin Hudson

Thanks, Onur. And just in closing, our long-term priorities remain unchanged for both beer and soft drinks, and we continue to generate value through margin improvement and free cash flow generation. Our long-term priorities for beer are capitalizing on our strong brand portfolio and working with partners, our new partners, achieving optimal brand and SKU mix across our geographies, excelling in execution with a big focus on that. We focus on quality market share, both volume and value share, and a focus on strong free cash flow generation as mentioned by Onur. And for our soft drinks, we focus on accelerating our revenue and our margin growth, equally winning at point of sales and our sales force effectiveness across our geographies.

Our 2017 guidance remains largely unchanged. From a sales volume, mid single-digit growth on a consolidated basis. Previously, it was low to mid single-digit growth. On total beer, mid single-digit growth, previously low single-digit growth. The Turkish beer market remains flattish. Turkey-owned beer down low single-digit, which was previously flattish. The Russian beer market down low single-digit, which was previously flattish with Russian-owned beer outperforming the beer market. And consolidated soft drinks at mid single-digit growth with Turkey soft drinks low single-digit growth and our international soft drinks with high single-digit growth.

Revenue, we focus to outperform sales volume across all our business lines. And EBITDA margin flattish on a consolidated basis, slightly lower margin for the beer group, which was previously flattish. And flat to slight improvement in EBITDA margin for soft drinks. CapEx as a percentage of net sales at high single-digit on a consolidated basis and then our positive free cash flow in both beer and our soft drinks.

Okay. Thank you. Thank you very much. I think we'll move on to Q&A now. So I'll hand over to Çiçek and...

Çiçek Usakligil Özgünes

Okay. Now, we are ready to take your questions please.

Q&A

Operator

[Operator Instructions] Our first question is from Ece Mandac■ from Tacirler Investment. Please go ahead.

<Q - Ece Mandac■ Baysal, CFA>: Hi. Thank you for the presentation. I'd like to ask two questions if I may. First one is about the profitability in your CIS operations. Could you please provide some more insight regarding the price increases and margin pro forma especially Kazakhstan because you mentioned in the first half results that there was a negative impact of the negative [indiscernible] (17:44) factor of the currency devaluation in [ph] these countries (17:47). But as we look at the third quarter margin performance for [ph] EBA (17:53) operations overall, we are seeing an improvement, so was there such an improvement in Kazakhstan or other CIS countries and what was the reason behind that? That's my first question. And also in your report you also mentioned about one-off expenses related to the closure of Merter plant. So is this one-off to continue in the fourth quarter? And could you please also mention how much is the size of these one-off expenses? Thank you.

<A - John Gavin Hudson>: All right. Thank you for your question. I'll hand over to Onur to answer on both accounts.

<A - Onur Çevikel>: Okay. So let me start with the Merter question. As you know, we announced that we have suspended our operations in our Istanbul plant at Merter. And we are looking for our options on what we are going to be and how we are going to be using this plant as you might all remember we were closing our Istanbul operations because of the plant being right in the middle of the city and creating issues both for operational wise as well as creating issues for both the city and environment and a bit of social responsibility with that.

As I said, we are now looking at our options. And we are going to be announcing, if anything, any new development that will be coming on the Merter issue. Yes, there has been no change from our latest announcement that we have made in – about the closing of the brewery. So, if there will be any changes, we will announce that publicly. The second question will be [ph] about on (20:00) the profitability of EBI particularly on Kazakhstan. As you remember, we were saying that the lagged impact of devaluation is impacting our businesses because the devaluation happening at once. However, it takes for us some time to reflect those inflationary issues into the market as part of the price increases as well as part of the cost efficiency studies that we are having.

And we have already said that this goes through a lagged impact [ph] of those (20:40). Because as you know, when a devaluation happens, that devaluation is mostly reflected in inflation, but those price increases as well as efficiency issues take some time. That's why we say that there's a lagged impact of the devaluation issues. That's what we are [ph] trying coming (21:02) through actually in Kazakhstan.

We're also performing quite nicely in Kazakhstan and we're quite happy with our operations. So the volume performance that we have been seeing in Kazakhstan also makes us quite happy. So these two impacts have a positive impact on our third quarter results. But I mean, make no mistake on our international business, Russia plays a very important role. So most of those numbers are basically affected from our Russian operations. I hope this covers the points you have on the questions.

<Q - Ece Mandac■ Baysal, CFA>: Thank you very much for your detailed answers. Regarding the Merter plant, I think in the third quarter in Turkish beer operations, you have one-off expenses related to this closure. Can I learn how much was the number of these one-off expenses for the third quarter under the operating expenses?

<A - Onur Çevikel>: That's – well, actually, we haven't disclosed that. But to give you a guidance, this would be somewhere around TRY 2 million in the third quarter.

<Q - Ece Mandac■ Baysal, CFA>: Okay. Thank you very much.

Operator

Our next question is from Robert Bonte from BlueCrest Capital. Please go ahead.

<Q - Robert Bonte-Friedheim>: Good afternoon, everyone, and thanks for taking the questions. Two questions if I may about Russia. The first question is, Gavin, could you please remind us what are industry estimates of how much the beer market this year has suffered because of the bad weather, first, the cold winter, and then the very wet summer in Russia?

<A - John Gavin Hudson>: Thanks for the question, Robert. The expectation from the industry is between 5% and 8%. It depends on how we calculate that. Remember that there's – this DIOT volume is generally not always fully picked up in the Nielsen estimate. So we look at two numbers. We look at both what Nielsen's telling us and we look at the consolidated numbers that the Russian Beer Union collects off the manufactured volume in Russia, of which, probably around 23% to is not included from the microbrewery. So it's really difficult to get an exact number. That's why we say sort of the upper single-digit decline in the Russian beer market.

<Q - Robert Bonte-Friedheim>: Got you. Got you. Okay. Thank you. And the second question was, when I look over your Russian history, I guess on a quarterly basis, your Russian sales were declining until middle of last year. And since then, every quarter has been growing, so 3Q, 4Q, 1Q, 2Q, and again 3Q. And if I look at the rough numbers, I think in the last five quarters or so, since you started growing this, on five quarters, you've actually grown by an average probably of 12% in the beer market. That's probably been shrinking high single-digit, if not double-digit. So you've outperformed the market by, give or take, 20%, 20% plus/minus. Can you just remind us because I guess we're all struggling with thinking how to incorporate the future? Next year, the World Cup and the merger with ABI. But it's more – in order to think about the future, I'm just trying to understand, can you help us in how you've managed – how your outstanding Russian team has managed to beat the market by 20% for five quarters?

<A - John Gavin Hudson>: Well, I suppose the answer is twofold. The one is previously there was a decision to take a bit of value. There was massive price wars going on in Russia, which have continued for some time in the Russian beer market. And a decision was made to try and premiumize the portfolio and I think with some impact on the volume going back a couple of years. The problem is you become too small to be really relevant and to maintain your portfolio presence across the country. So we needed to increase our footprint. So we increased our participation in the modern trade as well as expanded the traditional trade as far as possible in terms, what we call, numeric distribution or availability of our products across the full spectrum of the country.

Over and above that, [ph] we are testing (25:41) to this DIOT, this draft in the off-trade. We expect that to be around 10 million hectoliters in the Russian beer market. And we were underrepresented or largely underrepresented in that DIOT space. So we've invested into DIOT and started participating in that, and specifically, in the [ph] east of the (26:03) country and we've seen some good volume growth coming out of that.

So I hope that answers some of your question. What does it look like going forward? Obviously, you get to a point where you're getting to diminishing returns, and I think, for us, we're happy with our performance to-date. And we will maintain our shares around 15% to 15.5% and I think we'll be happy with that share performance for the time being. And we continue focusing on premiumizing our portfolio at the mainstream and the premium side of the business, where you've seen significant growth. And that's obviously helped us fund our ongoing expansion in the Russian market.

<Q - Robert Bonte-Friedheim>: Okay. Outstanding. Thanks. Thanks, and I hope you pay those guys good bonuses. I'll go back in the queue.

<A - John Gavin Hudson>: We all look after them. Thanks.

Operator

Our next question is from [ph] Hank Karl from UCB Bank (27:01). Please go ahead.

<Q - Frans Høyer>: That could be me, Frans Høyer of Jyske Bank in Denmark. I was just hoping to get a little more idea of the management situation in Russia now under the new partnership. And also actually on the previous question, I understood that you are happy with your current 15%, 16% market share in Russia. I noticed that you've been, as far as I can tell, the price mix has been negative in the nine-month period but positive in the last quarter. It looks as if you are sort of pulling in the horns a little bit on the aggressive pricing and taking – maybe shifting focus to take out prices in line with inflation. How would you describe that going forward?

<A - John Gavin Hudson>: Let me get the first question. I think around what's happening in Russia with ABI. As you know, we've signed a non-binding agreement. And so we really have nothing else to offer except that we have got regulatory approval in Russia for the deal so far, which was announced in the last 10 days. We're still waiting for approval in Ukraine. So there's no additional news to comment on outside of – that we're busy with diligence at the moment and integration planning. And certainly, as we progress this and we get regulatory approval, we'll be ready to announce further information to the market, which we're hoping to close in the first quarter of 2018.

<Q - Frans Høyer>: Okay.

<A - John Gavin Hudson>: So I think that answers your first question.

<Q - Frans Høyer>: Thank you.

<A - John Gavin Hudson>: The second question was around pricing. And there is a slight price increase coming now at the latter part of the year. There's been no additional increase in our excise. And that's helped us sort of keep up pricing relatively low. And I think that's a positive. But we continue looking at opportunities within our portfolio around our premium in terms of [ph] pack (29:28) and in terms of expanding [ph] multi-packs (29:31) in our modern trade format. So, obviously, trying to maintain affordability or drive affordability as far as we can to increase our overall volume and share and then drive premiumization for value growth. I hope that answers you question.

<Q - Frans Høyer>: Just I didn't quite hear what you said about the market share. Was it right that you sort of aim to stay at the 15.5% percent level?

<A - John Gavin Hudson>: Yeah, absolutely. And I wouldn't say we aim to stay at 15.5%. As you know, one of our long-term key strategic priorities is to focus on quality market share. So, as long as we can maintain our profitability and our market share growth, we'll continue to do so. But we don't want to get into diminishing returns. So, at the moment, I think we've done exceptionally well by maintaining profitability whilst growing our market share. And if we can continue doing that, we will. But I think, we probably feel it around 15%, 16% is where we need to hang on for the time being.

<Q - Frans Høyer>: Would you say that your capacity utilization is where you wanted to be?

<A - John Gavin Hudson>: No. Certainly, not. I mean, the whole Russian capacity utilization, the whole beer industry in Russia's capacity utilization is probably between 50% and 60%. So, certainly, we have excess capacity. But that's a huge geography, and our ability to grow significant share and remain profitable at the moment, being a distant number two, I would call it, to Carlsberg is challenging. But it doesn't mean we don't have aspirations to continue growing. We just want to so responsibly and make sure we remain profitable.

<Q - Frans Høyer>: Thank you very much. Thank you. Helpful.

Operator

Our next question is from Hanzade Kilickiran from JPMorgan. Please go ahead.

<Q - Hanzade Kilickiran>: Thank you. Thank you for the presentation. After all Russian questions, actually, I have a question about the Turkish market. You mentioned about flat volume in Turkey, but I remember last year, third quarter was really bad quarter because of all political stuff in the Turkish market. And you launched the Efes brand in July as far as I remember. So I was expecting a little bit better performance in the Turkish market with the new product launches and also better tourism. So what happened, I mean, what did go wrong or maybe not wrong, but I mean, what did go not in the way that we were expecting in Turkey? And do you think that this is a sustained trend in the Turkish market going forward? And how much price increase did you do in Turkey? Do you expect another price increase as well because of the regulation changes or taxes?

<A - John Gavin Hudson>: Okay. Thanks for the question, Hanzade. I think let me start with tourism. I mean, tourism was a lot better this year, and obviously, touch wood, we didn't have the same sort of disruptions through terrorism this year that we had last year. But as I mentioned in my note, the tourism, whilst we had the numbers back, we didn't have the right mix. Previously, we had a very strong German and Dutch tourist base which helps our consumption significantly. We had huge influx of the Russian tourists where consumption isn't as big and it wasn't as widespread as we previously had. So, certainly, we're happy with the fact that tourism is back and that we had a better year in terms of terrorism, et cetera. But it takes a while for the consumer confidence, not just inside the country but certainly from our external visitors to improve. And we continue seeing a nice improvement in the summer of this year and we look forward to building on that into next year.

In terms of our market share and the Efes relaunch, I think it's important to note that the Efes brand has been in decline for some time in the last couple of years. Our relaunch efforts culminated in a big bang relaunch in the beginning of July. I think, to put in perspective, [ph] we're only sort of (34:04) three months into the relaunch from the time that we put it into the market. We've done significant work in Turkey. We fondly phrase it, painting Turkey or turning Turkey – making Turkey blue where we've relaunched the brand across thousands of retail outlets. We've rebranded coolers. We've rebranded outlet signage. We've obviously spent a huge amount of time, one-on-one engaging with the retailers and talking to consumers.

The early indication in terms of consumer feedback has been very positive, but this is a lag effect. We're talking about an FMCG brand and to rebuild the confidence with the consumer will take time. Our expectation is anything from six to eight months is the process or timing we need to follow with ongoing efforts to make – to actually get the brand working for us. But we have seen share growth, specifically in traditional trade where our focus has been very strong and where we want to win by the way for our Efes Pilsen brand. And we've had very positive feedback from both our retailers and our consumers [ph] and that'll affect (35:14) the consumer awareness of the Efes [indiscernible] (35:19) campaign has been the highest recorded in the shortest space of time for any brand launched or relaunched in the Turkey market.

In terms of the pricing increase, affordability, there was a massive excise increase at the end of last year in December with another big increase at the end of June this year, bringing our total pricing increase to 20%, which is significantly higher than inflation. And I think we can all do the maths, that puts pressure on affordability. So, again, our strategy currently and going forward is very much around driving affordability to meet the needs of the general consumer, whilst driving up our premiumization of our brand. There will also be – we're expecting probably an 8% pricing increase in the next month related to excise. So we will also review that once we know what the excise increase will be, but that's around, generally around at 8% to 10%.

<Q - Hanzade Kilickiran>: Gavin, if there will be, I mean, another excise tax like this, 8%, do you think that this may put further pressure on Turkish market or Turkish market is now on a turnaround or not? I'm trying to understand if it would be able to see a real volume growth in Turkey or this is a [ph] new term (36:45) for Turkey that their market size is stabilized now.

<A - John Gavin Hudson>: No, I think, the one thing about competition that's good for the beer market, and certainly, the Turkey business is on the front foot in terms of competing. We've got really nice plans for 2018. Our strat planning from 2018 to 2020 is robust and we believe that with us putting a lot of effort into our portfolio, our mainstream and our premium portfolio in the market, we will assist the market to grow. And equally, our competitors will compete and we think that that stimulate ongoing growth in the market. So I think we were not thinking that we are optimistic for the Turkey market going forward, certainly, in the short- to medium-term. And I think, next year, we will see a lot more tourism in the Turkey market as well as an increasing consumer confidence. We've really had a good year this year in terms of no disruptions, should I call it, say it like that.

<Q - Hanzade Kilickiran>: Okay. Thank you very much.

<A - John Gavin Hudson>: Pleasure.

Operator

Our next question comes from Walid Bellaha from Barclays. Please go ahead.

<Q - Walid Bellaha>: Hi, good afternoon. Thank you very much for your presentation, and congratulations on the results. I have two questions if I may. The first one is just if you could give us an indication on the early Q4 trading in terms of the beer group in both Turkey and Russia? Do you see any – I know it's a relatively small quarter, but just to have an idea on where the trend is going year-on-year. And my second question is regarding – so, next year, with the World Cup in Russia, what's your expectations or rough expectations for margins and growth? Do you expect to have to do a lot more promotions next year? And my last question will be, so you mentioned that the non-binding agreement, there is still in sort of – the regulatory process is still in progress with regard the merger of Ukrainian and Russian operations of AB InBev, and those of Efes. Would you be able to give us just an idea of sort of the net leverage that you would expect for the combined beer group following this transaction?

<A - John Gavin Hudson>: Yeah, I think just start to the last question. Thank you for the questions firstly. I mean it's still early days. And I think we've only just signed the non-binding agreement, so it's a little premature for us to give any guidance in terms of where we see future potential partnership with ABI in the Russian market. And as I mentioned early on, once we get full agreement in Ukraine to continue with the deal, we will be ready to come to the market with our estimations on what we think the future looks like in terms of the short- to medium-term strat planning. So I don't think I can give you any more information at the moment in terms of that.

<A - Onur Çevikel>: Yeah, and let me take over on – I mean what are going to be our expectations in Russia in line with the World Cup and the rest of the staff. As Gavin has said, we are yet cycling the fourth quarter and then we are going to be getting into 2018, yet we are not providing any guidance for 2018 and we have already said that we expect the deal to be closed by the end of first quarter 2018. And after that, we are going to be able to talk about more about what will be our target for the Russian beer market. But having said that, you will all remember that we have been already saying that our target in our international markets is to be somewhere close to 20% of EBITDA margin in the midterm. And as you can see from the numbers, we are getting closer to those numbers. So we will generally guiding 15% to 20% of an EBITDA margin. So we are in the middle of that journey.

And unfortunately, I'm not able to comment much about on the combined business leverage ratios because we are going to be cycling only after we close the deal. Having said this, our guidance on the leverage has always been the same like, not going over 2.5 times of net debt-to-EBITDA. And you're seeing that we have been deleveraging the company and we have reached to 1.5 times on net debt-to-EBITDA levels. But I mean, and we have already announced that the deal that we do in Russia is going to be mostly a non-cash deal. But on the net numbers or what will be the leverage, we are going to be disclosing only after when we close the deal.

<Q - Walid Bellaha>: Thank you. And regarding the early Q4 trading in the beer segment in both Russia and Turkey, what kind of trends do you see?

<A - Onur Çevikel>: Well, I mean, as we have said, I mean, the trading that we see seems that that's going to be in line with our guidance. So that's really what we can say about it.

<Q - Walid Bellaha>: Okay. Thank you very much.

Operator

Our next question is from Tristan van Strien from Redburn Partners. Please go ahead.

<Q - Tristan van Strien>: Good afternoon, guys. Three questions if I may. One, Gavin, I just want to follow-up on DIOT. You said, I think it was 10 million hectoliters. What is your share currently? Are you aiming to get to your fair share and how would you define, I think, you use the word appropriate participation, what does that mean exactly? The second question is what's the status of your Miller franchise in both Russia and Turkey? Do you still have it in your portfolio or have you given that up now? And then, the third bit, I guess on Turkey, a lot of discussion around tourism. I just want to know, at its peak, what share volume went through tourism and what is it today? So what's the size of the price really if tourism comes back?

<A - John Gavin Hudson>: All right. Thanks. Hi, Tristan. Nice to hear your voice. In terms of DIOT, yeah, the DIOT market, to be honest, Nielsen never read the DIOT market. We did a lot of research to understand the size of it and to understand how we get, participate in the DIOT trade. Our share is relatively very small, probably around 5% at the moment of the DIOT market. This is dominated by what we commonly refer to as the microbreweries in Russia. There are about 900 to 1,000 microbreweries across Russia. And they generally capture that market, which is around 23% to 26% share of the Russian beer market. And generally, these are scattered throughout the east of the country.

So the point is what is fair share and how big do we want to get. I'll answer in two ways. The first is we [ph] don't want it done (44:48). We don't necessarily like the DIOT because I think it commoditizes beer largely. So we lobby on the one hand through the Russian Beer Union with the authorities to try and clamp down on the DIOT beer because I think it's largely unregulated. And it generally comes to cheap and nasty beer. And it goes into the PET by the way. So, whilst you're restricting PET sales on the one hand, on packaged beer, this DIOT is just another format of selling PET at point of sale. So we could probably really stretch a lot harder in DIOT, but I think we've reached a point now where we're comfortable, that we have a representative share across the market or the key areas that we want to play in. And we will maintain that in the meantime to continue our volume participation, and as I mentioned, continue lobbying.

In terms of your second question, Miller, we have a very good relationship with Molson. And we maintain our Miller relationship in Russia as well as Turkey. And we're very pleased with the performance of the Miller brand, which has seen significant growth in the Russian market and have seen nice growth in Turkey. So, yes, Miller remains important to us across our business.

And in the Turkey tourism, at its peak, I think it was around 8% of volume. And it's probably down to about 2% now. So, if we get the right mix of tourists back into Turkey, be it – as you know, the German and the Dutch tourists seem to stay away from Turkey this year largely. And I think next year, we're already gearing off of an increase in bookings coming through. So we look forward to the return of the full mix and value of the tourists into Turkey. I think this year, maybe was a bit of trial year after the disastrous year we had previously. So I think we're probably hoping to get to about 6%, and hopefully 8% [ph] share again (47:02). And we focus simply on the tourist hot spots across a longer coast of the Turkey market.

<Q - Tristan van Strien>: That's very insightful. Let's go back on the DIOT. Of those microbreweries, are all of those within the excise tax net or is there or something don't – or how regulated are those micro breweries?

<A - John Gavin Hudson>: The Russia, and let's be honest here, the Russian market is very regulated, what we call the Big Four, the Big Five brewers. In the recent years, they've implemented very strict measurement processes which start in our brewery, in actual fact, measuring how much volume we brew, package, et cetera. [ph] And have tracked (47:47) that's along the whole value chain, right, to the point of sale. But certainly in the microbrewery, we don't believe [ph] this is (47:57) well controlled as it could be. I don't mean – we haven't – I haven't personally been an investigator, but certainly, I think there are loopholes. And that's one of the reasons why we lobby through the Russian Beer Union to try and increase the regulation.

<Q - Tristan van Strien>: Thanks, Gavin.

Operator

Our next question is from Robert Bonte from BlueCrest Capital. Please go ahead.

<Q - Robert Bonte-Friedheim>: Hello again. Just wanted two questions. One on Turkey, one on Russia. On Turkey, now Gavin, just looking back, if I look at the Turkish market for this year, you're on track to have somewhere around 5.8 million hectoliters, which is probably down 33% from your peak back in 2012. And I'm just wondering and the reason I say that is because that was a timing sort of about eight, nine years ago when you had 40% EBITDA margins in Turkey. And I guess now, so [ph] you've launched it (48:54) on 33%. You've begun to take costs out. You shut down the one brewery. And I'm just wondering, I mean, as you rebase your cost base to fit the much lower production in coming years, what kind of margin should we look for?

So I have margin this year around ballpark low-20s. I mean, if I model out a couple years, assume you can kind of rightsize the cost base to the volume, should we be thinking of high 20s, low 30s, mid 30s? What is the medium-term EBITDA margin we should be thinking about for your Turkish operations?

<A - John Gavin Hudson>: Yeah, I mean, I like the number 50 to be honest and I think that's really where we're aspiring to low 50s. And it takes some time to rebase the business. Coming off, as you mentioned, the highs when we were up at 70% market share and there has been a decline in the market share and obviously volume that's come out. But we're clearly confident that there are probably some areas that we weren't as aggressive in terms of the market that we could have been. And I think, equally, in terms of our cost base, we weren't as aggressive in terms of taking out the costs when we should have. These things take time to rebase and adjust. So I'd really look towards the early 50s in terms of our EBITDA margin. And I think these are achievable and we'll work towards that.

<Q - Robert Bonte-Friedheim>: And could you give us a range of by when it's achieved in terms of best case, worst case if we say just low 30s or 30%?

<A - John Gavin Hudson>: Yeah, we're busy with our strat planning right now. As I talk to you, literally, the team are working next door. So I think, as we give guidance going into next year, we'll be able to give a better guidance in terms of that. But from our perspective, I see us starting the journey very aggressively in 2018 through to 2020. So I think you will start seeing some improvements come through relatively soon.

<Q - Robert Bonte-Friedheim>: Okay. Thank you for that. And the question about Russia is, again, I know you can't talk about the deal per se. But I'm just wondering, can you remind us how many breweries each you and ABI have in Russia? And what the capacity utilizations are of yours and ABIs in Russia

<A - John Gavin Hudson>: Combined, there are 11 breweries in Russia between both ourselves and ABI. We have six, they have five. The capacity utilization, I could talk for ourselves, is the early mid 50s. So that's around 55%. I can't talk specifically for ABI at this point in time. But I will imagine that it's in the range of 50s to early 60s at best. Again, we're busy with the integration planning in Russia. The teams are working in cleanrooms, et cetera, fairly aggressively. So I think once they've worked through the footprint optimization possibility, et cetera, we will be in a better position to give you a view on what the future looks like. I personally don't know that [indiscernible] (52:05) outside of the cleanroom.

<Q - Robert Bonte-Friedheim>: I'm just wanting to back into that because the question we're all asking ourselves, how many breweries you can shutdown, right. Is it going to be two, three or four? And I'm wondering, I want to back into that, just think about in terms of the, what is – what would you say is the optimal or the appropriate capacity utilization with room for expansion in Russia? Would you hope to get to high 60s, mid 70s? What is the number that we would put as sort of in an ideal world?

<A - John Gavin Hudson>: I mean, I supposed the deck of the cigarette box calculation will be to look at your brewery capacities and divide your volume into that, to get the ideal number of brewery closures. But the Russian market isn't as simple as that. Excuse me, the logistics in Russia are significant with massive distances between Vladivostok, Urfa, Moscow, [ph] St. Pete (52:58), et cetera. So, the top of work we need to do needs to be one of saying, what's the maximum utilization you can squeeze out your breweries looking forward. And then you've got to overlay what the optimal logistical network optimization plan you can attach to that.

So it's not one or the other. It's a bit of a blend between the two. So, whilst you might say, jeez, we should be closing three breweries optimally or four breweries, it's not as simple as that because sometimes keeping a brewery open because of the network potential is a better value proposition than just merely filling up breweries with volume.

So, again, there certainly, there is opportunity I think we know that. You don't need to be a rocket scientist to work that out. There is clearly opportunity. To what extent that opportunity looks like in breweries is not as obvious. You really, really got to look at the network, the distribution network whilst looking at brewery optimization. And we have many teams working hard [indiscernible] (54:06). By the end of November, we believe we will be ready to answer all the questions once we get regulatory approval in Ukraine. We'll be ready to go. So, in the first quarter, it could be in a great space.

<Q - Robert Bonte-Friedheim>: And could you perhaps that when you get the approvals, maybe host a conference call and then walk us through sort of I guess the ranges of synergies. Because again we're struggling how to model this. We know there's upside but no one knows how much.

<A - John Gavin Hudson>: Sure, sure. I think as we get closer, I think it's the right thing to do. So I think once we get the approval, we will be talking to the market to give them a sort of a view on what the future looks like [indiscernible] (54:42).

<Q - Robert Bonte-Friedheim>: I understand the uncertainties. But if you just give us ranges, best case, worst case, over [ph] 3 to 5 (54:48), whatever the number is, again that would help us all a huge amount. So we would really appreciate that. Thank you very much.

<A - John Gavin Hudson>: Absolutely. We will do that. Thanks.

Operator

Our next question is from Walid Bellaha from Barclays. Go ahead.

<Q - Walid Bellaha>: Hi again. Just a follow-up question that's in for currency volatility. So we've seen some volatility in the Turkish lira in the past months, so just wanted to understand if you could remind us like level of hedging that you have in your cost of goods.

<A - Onur Çevikel>: Well, let me answer this question. So, when we look at our volatility in our operational hedging, what we have been telling you through was we have been having operational hedges going to in order to make sure that we have visibility going forward on our FX exposures. So we are mostly hedged in our Turkish operations to the end of the year, so we don't have a major problem there.

And we also have some hedges that goes beyond 2017 to 2018, which we are going to be sharing with you, the levels when we are going to be giving the guidance for 2018, when we are announcing the 2017 results. But for 2017, we are [ph] mostly hedged (56:26) from the operational level – on the operational level. However, as we have been always saying on the balance sheet level, we don't have hedges that goes to the balance sheet, so we are mostly hedged on the operational side. However, they are unhedged on the balance sheet side.

<Q - Walid Bellaha>: Okay. And just so I understand the nature of these hedges that you have by year end, is it just like sort of contract with fixed prices or do you use any financial instruments to basically hedge yourself?

<A - Onur Çevikel>: Well, there are a couple ways of doing that. [ph] They provide (57:07) designations as well as [ph] forwards (57:13) and financial instruments. So, as you can think about, it's not just one way going forward. There are different ways of doing that, but we are using most of these instruments and making sure that we keep ourselves more prepared for returning to fluctuations.

<Q - Walid Bellaha>: Thank you very much.

Operator

[Operator Instructions] We have no further questions. Dear speakers, back to you for the conclusion.

John Gavin Hudson

Okay. Well, first of all, thank you all for dialing in. It's been a pleasure spending the afternoon with you. And I trust you will have a good weekend and all the very best. We look forward to talking to you soon again. Thank you. Thank you, team. Thanks to everyone.

Onur Çevikel

Thank you very much for joining us today. Thank you.

Operator

This concludes today's conference call. Thank you all for your participation. You may now disconnect.