Company Name: Anadolu Efes
Company Ticker: AEFES TI
Date: 2018-11-07
Event Description: Q3 2018 Earnings Call

Market Cap: 11,782.89
Current PX: 19.90
YTD Change($): -4.30
YTD Change(%): -17.769

Bloomberg Estimates - EPS
Current Quarter: 0.100
Current Year: 0.517
Bloomberg Estimates - Sales
Current Quarter: 4652.000
Current Year: 17877.500

Q3 2018 Earnings Call

Company Participants

- Asl■ K■l■ç Demirel
- John Gavin Hudson
- Onur Çevikel

Other Participants

- Nikolay Kovalev
- Tristan van Strien
- Hans Gregersen

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, welcome to Anadolu Efes Beer Operations Third Quarter 2018 Financial Results Conference Call and Webcast.

I'll now hand it over to the Investor Relations Manager, Ms. Asl■ Demirel. Please go ahead.

Asl■ K■l■ç Demirel

Hi, everyone. Welcome to Anadolu Efes beer operations 2018 third quarter results conference call and webcast. Before we start, I would like – I would kindly request you to refer to our notes in our presentation regarding forward-looking statements.

Now, I'm leaving the ground to Mr. Gavin Hudson, Anadolu Efes' CEO. Sir?

John Gavin Hudson

Thanks very much, Asl■. Well, firstly, good morning and good afternoon, and a special welcome to all who have joined us today. We are extremely happy to report a solid quarter with around 3% volume growth and close to 40% revenue growth year-on-year on a pro forma basis. This was largely driven by Turkey beer and our CCI businesses.

Consolidated EBITDA exceeded TRY 1.2 billion in the quarter with flattish margins. We have also generated around TRY 1.4 billion of free cash flow, improving our net leverage to 1.6 times and this was despite around a 60% devaluation of our local currency. In our Turkey beer business, our quarter three saw the highest growth achieved in the last 14 quarters to 7.3%. This growth was supported by improved tourism, good weather and additional local vacation days during the summer period.

This also reflects our ongoing focus on meeting the consumer demand through our expanded portfolio and our strategic intent of winning at every point of sale through excellent market execution. Our two new launches of Budweiser or as we refer to [indiscernible] (00:02:08); Bud and Varum, a local innovation from our marketing team here in Turkey exceeded our expectations and have delivered impressive volumes in just a few months; thus, contributing to our portfolio with relevant market share gains. Equally, our flagship Efes brand continues to perform well and maintains its significant market share in this market.

As you know, product quality and freshness continues to remain a primary focus area and, here, we continue to improve our metrics on an ongoing basis. Our international beer operations have also continued to perform exceptionally well with a special mention for Russia and Ukraine who have delivered solid results for the quarter. I'm also very content with the ongoing performance, integration, and cost synergy efforts from ABInbev Efes business. The Russian beer market has benefited from the World Cup and exceptional weather over this period. Our market share remains stable at around 27% and an actual factor with some slight improvements in market share, emphasizing our strong position in this market.

On a nine-month for 2018, we also have save some really good highlights with our consolidated sales volume up to just under 5.5%, our consolidated sales revenue up to just under 50% on a pro forma performance basis, and our consolidated EBITDA before nonrecurring items up 32% on a pro forma basis and, as mentioned, a consolidated free cash flow at little over TRY 1.4 billion.

So, [indiscernible] (00:04:02) happy with the results for the quarter and on a year-to-date basis. Our overall focus areas remain largely unchanged. We continue focusing on renovating of core brands, plus expanding our portfolio for ongoing revenue and share growth. And as has been displayed in our Turkey and in many of our businesses across the group, we continue driving quality as a non-negotiable across all our geographies, and we continue enabling our four pillars of our digital strategy where we are already starting to see some lost traction, and we continue focusing in our people and the improved capabilities obviously to sustain our business into 2019 and beyond.

I'll hand it over to Onur, our CFO, for more details in our financials. Thanks. Onur?

Onur Çevikel

Good morning and good afternoon, ladies and gentlemen. Welcome to Anadolu Efes' nine month 2018 results call. I will briefly take you through our financial results. As usual, I will start with Anadolu Efes consolidated results. Our volume has reached 5.3 million hectoliters in the first nine months of 2018, representing a 5.4% growth compared with the same period of 2017.

Our net sales revenue was ordered as TRY 14,643.7 million with a strong growth of 27.2% in the first nine months of 2018. Our EBITDA BNRI was recorded to be TRY 2,520.8 million with a strong growth of 32% compared with the same period of previous year. Our EBITDA BNRI margin was 17.2% with 17.2%, they are 63 basis points improvement. Finally, our net income are recorded to be a minus TRY 51.1 million, mostly due to noncash FX loss.

Continuing and going to the different segment of our business. Again, as usual, I will start with our Turkey operations. Our volumes in Turkey beer operation were 4.3 million hectoliters in the nine months of 2018 period, with a 1.8% decline compared to the same period of previous year. We were particularly pleased with the third quarter performance of 7.3% growth in the domestic market from the back of [indiscernible] (00:06:41) good weather conditions, Ramadan impact as well our corporate expansion strategy and the execution on the top of favorable dynamics.

Our next sales has increased by 17.2% and reached to TRY 1,343 million in the first nine months of 2018. The increase is mostly attributable to price increases as well as for premiumization and mix impact. Our EBITDA BNRI has reached TRY 305 million with a growth of 11.7% compared to the same period of previous year. EBITDA BNRI for margin was 22.7%, recovering some of the margin losses that was reported by the first half 2018 results.

Continuing with our international beer segment. Our volumes have recorded as 19.4 million hectoliters in the first nine months of 2018 with a growth of 0.9%, almost 1% compared with the same period of 2017 on a pro forma basis.

As mentioned by Gavin, the combined Russia and Ukraine business are firing on track with no major disruption and encouraging year-to-date volume performance, as well as World Cup performance, excellent execution and good weather conditions [indiscernible] (00:08:15) beer operations right in line with our plans [indiscernible] (00:08:21).

Our EBITDA BNRI in the first nine months of 2018 was recorded to be at TRY 525.5 million, a growth of 14.7%. Our EBITDA BNRI margin was recorded to be 11.6%, which is [ph] 167 (00:08:43) basis points over than the same period 2017, obviously on a pro forma basis. The decline in EBITDA margin is mostly attributable to cost pressures, depreciation of rubble against U.S. dollar, as well as some other local currencies, short-term integration-related expenses, higher marketing expenses due to World Cup execution, and certain phase-in impact.

Finally, consolidated total beer group based – beer group volumes were recorded to be 23.7 million hectoliters with a slight growth of 0.4%. Our revenues were reported to be TRY 5.9053 billion with a strong growth of 26.9%. Our EBITDA BNRI was recorded to be TRY 797.4 million with a 13.7% growth with an EBITDA BNRI margin of 13.5%.

Net income for the beer group was recorded to be a minus TRY 36.1 million on the back of currency devaluations in mostly noncash. Going forward, as you already know now, free cash flow generation is a major priority focus areas for Anadolu Efes as well as our beer group. Our free cash flow generation before investing activities for the nine months of 2018 was recorded to be TRY 656.5 million for the beer group which is basically a result of our commitment to free cash flow and as well as tight balance sheet management.

Obviously, free cash flow will continue to be our priority in the coming quarters. However, seasonality as well as FX impacts and phasing impacts may have a negative impact on the coming quarters. As said, we are actively managing headwinds in the form of hedging FX exposure as well as using net investment hedged as we have spoken in our last conference call.

Talking a bit about the balance sheet management, on our net-debt-to-EBITDA BNRI ratio of moderate 1.6 times by the end of nine months 2018 on a consolidated Anadolu Efes level despite the significant devaluation of TL in the past 12 months as mentioned by [ph] John (00:11:31). Likewise, net-debt-to-EBITDA BNRI for the beer group for the nine months of 2018 was recorded to be more than 1.7 times despite the significant TL devaluation.

On a consolidated level, more than 70% of the cash is [indiscernible] (00:11:53). Most of our debt is [indiscernible] (00:11:55) currency as well as 83% of that has fixed interest rates which keep our subs safe for the increase of the interest rate or the possible increases on the interest rate.

On the debt side, there's an easily manageable debt repayment schedule for the coming periods. Also, average maturity of all that is a good three years for the beer group and a good four years for the Anadolu Efes consolidated results.

Totaling that Anadolu Efes free cash flow numbers. As mentioned earlier, free cash flow generation that major priority for Anadolu Efes and both segments of our businesses positively contributes to free cash flow. As a result, we were able to generate a positive free cash flow of TRL 1.407 billion in the first nine months of 2018 which particularly has pleased us.

Finally, talking about the financial priorities, there are no major changes in our financial priorities moving forward which basically are managing and delivering efficiency improvements, managing the volatility especially on the fixed side on operations. Free cash flow generation and obviously as a result, deleveraging with commitment to credit rating.

So this basically concludes my presentation. I will hand over to Gavin for the closing remarks.

John Gavin Hudson

Thanks, Onur. Given our strong performance in the third quarter, which is in line with our expectations, we are reaffirming our guidance for 2018. We do, however, see some upside to our guidance on a consolidated and total beer group basis due to positive translation effects. We keep our operational profitability margin expectation intact. And in addition, I remind you that if we continue operating in a very dynamic and competitive environment.

Our focus firmly remains on keeping operations lean and more efficient while maintaining our strongly liquidity. As Onur mentioned, the long maturities of our borrowings and the significant cash balance we holding in our currencies mitigate against foreign exchange volatility.

And then, finally, just before moving to Q&A, as many of you would have read, I will be leaving Anadolu Efes as of the end of 2018. This a personal decision after completion of my contract with the company and is taken in conjunction with the board.

I'm very pleased that Mr. John Tucker has been appointed as my successor. John has extensive experience in the Anadolu Group, and in actual fact Anadolu Efes and has been working very closely with the business and the various businesses over many years.

We're fortunate that we have already been able to spot a handover for the balance of the year, and we are spending a huge amount of time aligning on our 2019 and beyond strategic objective the business planning process, etcetera, so I'm feeling very comfortable in actual fact that this will be a smooth transition from myself to John. At the same time, you would have read that Onur, our current CFO, has been promoted and will, in actual fact, be taking over the vacant role that John leaves as CFO of the Anadolu Group. And I think this also plays to a consistent handover in that Onur will in actual effect still be indirectly looking after Anadolu Efes' finances as we transition with additional appointments in the business.

So, well done, Onur. And certainly, to the team, I want to thank the team in advance for their ongoing support. So, let's move over to Q&A. Thanks very much.

Q&A

Operator

Thank you. [Operator Instructions] Our first question comes from Nikolay Kovalev, VTB capital. Please go ahead.

<Q - Nikolay Kovalev>: Yes. Hello. I have two questions on profitability. We saw quite a sizeable dilution in margins for international beer. So, I was wondering if you can comment on how the margins for Anadolu Efes and AB InBev compare in Russia and where do you expect them to progress and potentially, would they or should they converged in the future.

<A - Onur Çevikel>: Well, this is this is the question, right? So, you said two questions, as I was...

<Q - Nikolay Kovalev>: Clearly.

<A - Onur Çevikel>: As I was. Well...

<Q - Nikolay Kovalev>: Yeah. This is the first question.

<A - Onur Çevikel>: Okay, okay. If you want to get out the second question so that we answer both of them.

<Q - Nikolay Kovalev>: Okay. My second question was on your future [indiscernible] (00:17:45) as we see globally, we see uptick in price for soft commodities and your key raw materials. So, I was wondering for 2019, to what extent do you already understand the cost base? And what kind of margin correction we all should anticipate due the highest of commodity prices?

<A - Onur Çevikel>: Okay. I now understand why you left the second question to the – after the answer because they are actually related. Well, answering your first question, the profitability of our international business has been a bit under pressure especially on the third quarter, and this has gone to – this has a couple of reasons behind them.

The measured ones has been due to the devaluation on ruble, the FX pressures, having pressure on our cost [indiscernible] (00:18:50) impacted obviously our profitability despite some of the hedges that we were having, as well as the sales mix and the channel mix on the products that we have been selling has been also playing a role on this. And obviously, going further, we do expect to improve our profitability due to the fact that we expect synergies to be kicking in in the coming periods, which we do think that is going to be having a positive impact on the profitability.

Unfortunately, I'm not going into too much detail of the profitability of the prior year 2018 of FX profitability. We move turn to – look to the future and make sure that we improve our margins because there has been a lot of imports, there's been a lot of mix shifts and stuff like that which make these comparisons a bit more complex and it really looks like.

And on the future term costs, well, obviously we see an inflationary environment especially in Turkey which we expect that will be creating some events in the coming period on our costs but we will be sharing our 2019 guidance in a broader term while we also – and also our year-end results so they are going to be elaborating more on the costs in the coming conference call rather than this one.

<Q - Nikolay Kovalev>: Okay. Thank you very much.

<A - Onur Çevikel>: Sure.

Operator

[Operator Instructions] Our next question comes from Tristan van Strien, Redburn Partners. Please go ahead.

<Q - Tristan van Strien>: Hi. Good morning, guys. Congratulations both Gavin and Onur, well done. Just two quick questions from me, please. One just Gavin can you just give a bit more color on the ABI integration which seems to be going well, just give a little bit of color what is going well and why is it different than the one five years ago with SABMiller? What lessons have you learned from that? I think particularly just in terms of integration of the distributors as well, have you been able to combine the [indiscernible] (00:21:45) a bit of overlap there? What's happening around that?

And then, second is just the pricing environment in Turkey versus the competition as well. You think you were able to make up some of the pricing after the devaluation that's happened over the last quarter?

<A - John Gavin Hudson>: Thanks. Thanks, Tristan. Yes. Certainly, we are comfortable with integration to-date in Russia and Ukraine in actual fact. I think two ways to answer the question The first is we obviously have a learnings from previous integration in Russia and largely related to the modern trade and, equally, in our route to market partner. So, when we were building up, we were doing the business plans for the integration. We spent a huge amount of time focusing on the prior weaknesses that we had identified.

Over and above that, we also had ABI as a partner and we leveraged the global experience on integration. So, we were able, I suppose, in summary bring the best of our learnings and their learnings together with the expertise that they have developed across the globe.

In terms of our progress to date, I think the consolidation of our route to market has been very successful in that we were able to leverage again the best of both worlds. We were able to compare the different models that existed between the two different companies. And in actual fact was our plans were to finalize their consolidation of our route to market by the end of the year, we, in actual fact, are able to achieve that slightly ahead of plan in actual fact. As we speak at the moment, we are close to finalizing that process.

And you had – the big challenge really was around Moscow and [indiscernible] (00:23:38) operations, the logistics are fairly complex. Then outside of that, I think a big hats off to the team in terms of the human resource integration around our people. This has been very successful in that we were able to again combine two really good groups of talent into one, and we were able to once again select the best of both worlds both in terms of a talent, capability and obviously learnings on ways of doing business in Russia and Ukraine. So, again very happy. And as you know, this is the first year, still relatively small in terms of our overall cost synergy. We'll certainly see a lot more of the value coming through in 2019 as [indiscernible] (00:24:27).

And the second point around pricing, certainly we've just taken a price increase in our Turkey business last month where we were able to cover some of the impact that we're feeling in terms of [indiscernible] (00:24:46) inflation. And there's no doubt that we will see additional excise increase coming through in the early part of 2019.

And historically, we usually do take a price increase in January. So, I think from a timing perspective, we'll be aligned. And in terms of the final amount, we don't have that numbers yet because we're still busy finalizing the COGS makeup, as you know the currencies all over the place at the moment. And we will evaluate that right through until the back end of this year before we will be finalizing. But, yes, our intention is obviously to try and take reasonable price. We are also very cognizant of the price elasticity impact of taking too much price in the market.

<Q - Tristan van Strien>: And do you see your competition following you, or is there a bit of delay at the moment?

<A - John Gavin Hudson>: No, no. Historically, the competition has always followed us. And in actual fact, in the most recent price increase, they followed us literally within, I want to say, hours, but within days of us taking our price. So, certainly, I think they're feeling the same headwind as us and that – and we see them following in the future.

<Q - Tristan van Strien>: Right. Thank you.

Operator

Our next question comes from Hans Gregersen, Nordea.

<Q - Hans Gregersen>: Okay. Good afternoon. Three questions, please. If we look on the integration, if we separate that into, let's say, supply chain operations and sales operations, and you, on an index, let's say, from 0 to 100, indicate how far are you currently on the integration of those two areas was the first question.

Second question goes, if I got your Q3 [indiscernible] (00:26:40) correct, your recorded margins for the international brewing operations [indiscernible] (00:26:42) integrations costs, if we look on the margin erosion, how much should we strip out to get a picture of the clear underlying performance? And thirdly, if we look on the pricing environment, Russia, it seems that we're having a quite steep discounting going on last year. What is your expectation in terms of pricing for yourself and the company for next year? Thank you.

<A - John Gavin Hudson>: All right. Thanks, Hans. I'll tell tackle the first and the third, and I'll leave the second for Onur and the team. In terms of the third, yeah, in terms of how far we've progressed in terms of integrations, from a sales – and as I mentioned on a question to Tristan, from a sales perspective, we basically fully – we basically complete or fully integrated in terms of our sales in our frontline salespeople at this point in time. Obviously, there are still many moving parts that we're putting together. But in terms of the overall process, we're complete.

From a route to market perspective, in terms of our dealers and distributors, we're basically completing that as we speak at the moment. So, by the end of this year, we will 100%. And then, from a supply chain and a grid optimization, we haven't finalized that as yet, and we're still in the process of doing the analysis and finalizing the analysis to clearly understand the impact of our new portfolio.

We know we're looking at our 2019 to 2021 business planning process to understand what our portfolio strategy will be. So, literally, in the next two months, we will be finalizing our supply and our grid optimization process, which will then be implemented as soon as we have approved that piece of work.

<A - Onur Çevikel>: Well, on the profitability side, on the part of your question [indiscernible] (00:28:51) Q2 and Q3, international profitability has been impacted due to several elements which, as we had discussed, mix impact, the channel mix impacts has been one of those evaluations across the local currencies in the countries that we operate, which has ended up with increased COGs, has been another one.

The increased marketing expenses due to the seasonality, as well as the World Cup execution, has been another one. Some of the phasing has been another one and some of the integration costs that has been included like some consultancy expenses and stuff like that had been on a yearly basis had been impactful on the profitability. So, it's not – we are not going to be disclosing to details of what is being this impact on a broader basis. However as we have said going further we are again to make sure that our synergies kick in as well and we definitely want to improve our margins going forward.

<A - John Gavin Hudson>: And then finally, just in terms of pricing I mean our intention in Russian-Ukrainian beer market is certainly not to destroy value. Our intention is and there has always been that we are not keen on discounting. So I think whilst there has been some aggressive market behavior over time, I think we must realize that we are in a competitive space and that there is I supposed largely a fight for share within each of the price segments. But our ambition is not to create price wars. We don't follow price wars and we certainly don't condone any price wars in the market. I think fair competition aside we obviously want to protect the value and the profit pool in that market.

<Q - Hans Gregersen>: Thank you.

Operator

[Operator Instructions] We have no other questions.

Mr. Gavin Hudson, back to you for the conclusion.

John Gavin Hudson

So, thank you very much. Thank you for the questions. We appreciate them as always. Once again, thanks for the team for the efforts. And certainly, I look forward to our paths crossing hopefully in the distant future. Cheers. Have a good rest of your day. Cheers.

Onur Çevikel

Thank you very much. Have a good day.

Operator

This concludes today's conference call. You may now disconnect.