ANADOLU EFES

CONFERENCE CALL TO DISCUSS ANADOLU EFES Q3 2022 RESULTS

Company: Anadolu Efes

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Participants:

- Aslı Demirel, Head of Investor Relations
- Can Çaka, Beer Group President & Anadolu Efes Chief Executive Officer
- Mr. Gökçe Yanaşmayan, Chief Financial Officer

Aslı Demirel:

Ladies and gentlemen, welcome to Anadolu Efes' third quarter 2022 Financial Results Conference Call and Webcast. My name is Aslı Demirel and I am the Investor Relations Director of Anadolu Efes. Our presenters today, Mr. Can Çaka; the CEO and Mr. Gökçe Yanaşmayan, the CFO.

All participants will be in a listen-only mode. Following the first part of this call, there will be a Q&A session where you will be able to write-down your questions on the question box of your web screen during the presentation. For those who would like to ask questions, please write your questions before the Q&A session, because it takes some time for us to seem them on our screen.

Just to remind you, this conference call is being recorded and the link will be available online.
Before we start, 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. Can Çaka, Anadolu Efes CEO. Sir?

Can Çaka:

Thank you, Aslı. Hello all. Like Aslı's usual disclaimer statement, let me start with my usual, we're proud statement as well. Putting aside the joke, we are really proud with what we are delivering and it's especially making it for the third consecutive quarter. And that is also much more important in a period where we have lots of challenges. As you would recall, in our prior calls we discussed this at the end of last year, we discussed this, I mean right after the exit of the pandemic, the supply chain disruptions, inflationary environment, was putting a lot of challenges for every business, not only on ours.

And basically, we were expecting that to reflect into consumers' disposable income and further to their confidence as well as a declining mode. On top of that, certainly what's the happenings in the region has also put a lot of challenges and continue to put a lot of challenges. However, we were able to accelerate our momentum through the season actually the most important quarter for our business.

And we obviously during the first half, we benefited from obviously COVID impacted lower base of 2021 and yet on the third quarter, our last year's volume base was quite strong, so and you would recall, during August when we were talking about the first-half results, we were cautious, let's say reasonably cautious for the rest of the year. And today, we are for obviously much more clear. We had managed to perform this last year's high base with a very good momentum and we have received strong results in Türkiye, Kazakhstan, Georgia in Beer Group and when we look into the soft drink side, also that's supported by Uzbekistan.

So, on top of the volumes, obviously volume side was an important contributor to our business. But as we discussed, again pricing, would that be the most important part of the, let's say the performance for this year, given the increase in cost base and potential increases on the inflation would have an impact. So, we manage that very strongly.

We had much stronger topline growth, obviously that is supported with our timely and very smart pricing decisions. We have also supported our top line with the revenue growth management initiatives that we have taken through the year. And we are also constantly improving our effective discount management, promotion management all through the business line. So, we also benefited from the foreign currency translations or I may say the strengthening of the local currencies of our international businesses versus the domestic businesses, and that is obviously a result of our well-diversified geographic footprint.

So, with the support of the strong topline, we obviously achieved a much better operating leverage. We also backed our disciplined OpEx management and that also together with the use of hedge mechanisms that we are effectively implementing every other year, that also contributed to the operational profitability.

So, with the higher operational profitability and good momentum in payables performance and postponed investments to the last quarter, we had an outstanding level of free cash flow generation at the end of 9 months. Therefore, our consolidated leverage ratio has shown significant improvement as well and was realized as below 1x.

And having said that, payables performance, we expect it to be normalized, partly in the last quarter. And also, as we are discussing, as many businesses you are hearing from, the lead times are getting longer. That's why we are going to accelerate our CapEx for the 2023 and even beyond 2023. So, that will have an impact in the last quarter. However, with our very strong results seeing 9 months, they are ahead of our expectations, ahead of our initial plans, especially in the Beer Group that led us to improve our Beer Group outlook and that is also reflected into the consolidated results or expectations, guidance. And I will be talking about it at the end of the presentation.

So, looking a little bit more into the volume part, different markets and Beer operations, our reported volume declined by 1% this quarter, that's impacted by Ukraine obviously. However, if we exclude Ukraine where we didn't have operations through the seven months of the year now, Beer Group sales volume grew more than 3 percentage points compared to last year, mainly driven by successful momentum, as I mentioned at the beginning, of Türkiye and Georgia, and partly Kazakhstan I would say.

In Russia, the markets slowed down after the peak season with a mid-single digit decline in the quarter. The market was affected by high price adjustments, as we all had at the beginning of the year. And that is slightly offset by the favorable weather conditions, especially in August, but yet the current pricing level is putting pressure on the consumer demand.

Cycling a high base of high single-digit growth last year, our own volumes performed slightly below the market, yet some of our key brands in core segments in Russia performed and contributed throughout the period, that's a positive sign, that's a positive momentum, which we are following very closely.

We are obviously very dedicated to our strategy of focusing on volume and profitability balance, and moving towards our long-term goal, so in terms of increasing our return on investments in Russia specifically. As I mentioned in our previous quarter calls, we are aiming to resume operations in our Chernigiv brewery in the Ukraine. And as we speak now, that our brewery in the central part of country is operational. We are producing beer and starting to get out from shelf space in the country.

Other than Russia and Ukraine, in other CIS operations, particularly Kazakhstan and Georgia, sustained their growth momentum. The average growth in CIS was low-single digits in the third quarter. Kazakhstan grew by slightly year-on-year basis, thanks to especially having support from both the premium and affordable segment in our portfolio.

Only in Moldova our volumes declined around low-teens. That is partially based on rising inflation. Moldova has one of the highest inflation in the region and putting a lot of pressure on the consumer demand, as a result of the consumers' purchasing power affected with the higher inflation, higher necessity spending.

Mid to high-teens growth achieved in Georgia, supported by positive market momentum as a result of the strong season performance. But we gained market share also in Georgia in both beer and soft drinks operations, and both soft drinks and beer contributed to the volume growth.

And finally Türkiye, we recorded a significant growth of 24%, even exceeding the strong growth achieved in the first half. Obviously, that is supported by the recovery on the on-trade channel as well as a very good tourism season in Türkiye through the season those all supported, but also we are very pleased with our successful new brand launch. That was at the beginning of the summer period and that showed contributed with solid volume potential, gaining significant market share. And at the same time, our core brand Efes Malt also showed a resilient performance through the quarter.

So with all said, our consolidated sales volume grew by slightly higher than 1% on a reported basis. With the contributions of the Soft Drinks operations, we reached to more than 36 million hectoliters in the third quarter, bringing our 9 months volume growth to 9%. We do discuss partly Beer Group volumes anyway. Excluding Ukraine was only down by 1%, supported by the continued strong momentum in Türkiye and Kazakhstan and Georgia in the third quarter, offsetting the volume decline, as I mentioned, in Russia. So in 9 months, excluding Ukraine, beer volumes grew by more than 3%. Soft Drinks. I will likely touch base with Soft Drinks on the next slide.

And a few words, obviously I'm sure you have heard our colleagues earlier this week cycling a historically best quarterly performance of the last year. Our Soft Drinks consolidated sales volumes grew by 7.5%, with solid growth achieved, especially in international operations. The consolidation impact of Uzbekistan offset the volume decline in Türkiye.

Good news also on the sparkling category, continued its high momentum and grew by almost 11% on the back of strong Coca-Cola and Fanta performance. The Stills category recorded a similar growth rate, around slightly higher than 7%, with strong ice tea and energy drinks performance. Water category declined around 14%, that's in line with the Company's focus on the small packs and value generation strategy, and again cycling of a high base of last year.

Türkiye domestic volumes declined by slightly less than 8% due to the impact of high inflationary environment and lower consumer confidence obviously, and also to some extent lower can purchase compared to last year's summer season also contributed to this. And international operations recorded almost 20% volume growth on a reported basis. Pakistan, Kazakhstan and Uzbekistan were again the main contributors to the growth of international operations, and Uzbekistan was the fastest-growing operation among CCI countries, recording more than 40% growth rate.

So with that said, obviously I'm trying to emphasize the revenue growth over the volume growth, so as the disruption in let's say, as we cannot operate in Ukraine, we were expecting the volume performance impacted, obviously high inflation and higher price taking, also we expected certain limitations on the consumer demand.

But again, I think the important factor or important criteria for us was to be able to support the topline growth. And as I mentioned at the beginning, we had, let's say, a conscious decision in terms of taking pricing even earlier starting to the year. And with those smart decisions and also with revenue growth management initiatives and again, very effective promotion management through the quarter, we had an outstanding performance in our topline this year, which contributed to the very strong profitability filtering through our P&L.

Our consolidated net sales revenue increased by 153%. Obviously, we benefited from the translation of international operations into TL, however even we exclude the FX impact, on a constant currency basis we have very strong growth rate.

Price increases implemented obviously in order to cover the cost inflation, excise tax increases also again those were very timely and together with the hedges, together with the, let's say, increased inventories at the beginning of the year to lower the cost base or smoothen the cost increases, those are all helped us. And we also supported the topline with the revenue growth management, as I tried to mention, including smart sizing, SKU privatization, focusing on certain elements, and in that perspective and obviously our emphasis for the last couple of years, improving our discount and promotions management, we're making it much more effective much more linked to the volume performance as well. Those are all working properly and supporting the topline growth.

The growth achieved in Beer Group was around 147% in 3Q. Almost same contributions in Türkiye and international operations. And while volume growth was contributed to some extent, being especially in Türkiye, international beer benefited from price adjustments and strong ruble against TL as well. So and on the Soft Drinks side, sales revenues increased by 156% in the third quarter. The Uzbekistan consolidated accounted for 20% of reported growth.

So all said, in terms of the volume and revenue, those translated in an exceptional profitability expansion. I would like to mention again; we are very pleased to deliver such results in 3Q. As we went through before, Anadolu Efes revenues grew more than 150% and Soft Drinks margins performance was impacted partly with the high base of last year as well as from the pressure from FX volatility and commodity and energy price inflation.

However, despite all these factors, the EBITDA expansion that we delivered on the Beer Group was much stronger. Our margin expansion was more than 930 basis points and that translated into more than 250 basis points expansion at Anadolu Efes consolidated level. Net profitability reached TL2.1 billion in 3Q, more than tripling its level what we had last year. Strong improvement in the operational profitability led to a solid improvement in the net profitability, obviously overcoming the impact of the higher financial expenses. Gökçe will anyhow will give you much more color on this.

And finally, before I leave the ground to Gökçe for further elaboration on the financial performance, obviously, we have a very strong all-time high free cash flow generation around TL7.1 billion in 9 months of the year. And as I noted at the beginning, we improved our let's say, our guidance while we are improving our performance and balance sheet health.

So, let me leave the ground to Gökçe. And I'll be back with the guidance at the end of the presentation.

Gökçe Yanaşmayan:

Thank you, Can. Good morning and good afternoon. Welcome to our conference call for third quarter results of 2022. Obviously, I'm also very happy and proud to present very strong set of numbers in 3Q. Let me get into the Beer results and underline them a bit more and elaborate on them.

In 3Q, we are looking at a volume decline of 13% almost, though this number would have been 1% decline only if we were to exclude Ukraine operations. Yet Beer Group sales revenue has significantly increased by 147% and reached TL12.3 billion in 3Q. We see similar growth in Türkiye and international beer operations. While international beer revenues expanded by 148%, Türkiye's revenue grew by 145%. That actually means that we have maintained our revenue growth momentum and achieved an increase of 128% year-on-year in 9 months and reached TL27.3 billion.

On the cost side, we have observed inflationary pressure in our cost base more than previous quarters, primarily in packaging materials and energy prices. Actually, the cost pressures shift from commodities to energy. And the level of pressure varied from one country to another operating country. However, as a general comment, I can say that, effective use of commodity and currency hedging together with successful pricing strategy helped us to outperform the increase in topline.

Gross profits grew by 188% and reached TL5.6 billion while gross margin expanded by 645 bps. This resulted to a growth of 163% for 9 months, with a margin improvement of 562 bps. Another good news, Beer Group EBITDA performance was ahead of gross profitability. EBITDA grew by 309% and reaching to TL2.9 billion. As a result, 9-months' EBITDA were up by 289% to TL5.4 billion, with a margin improvement of 814 bps. Free cash flow also expanded in 3Q and reached to TL759 million and in 9 months we are looking at a free cash flow generation of TL5.8 billion versus TL1.5 of last year.

And in the following slides, let me show you EBITDA and free cash flow bridges to give you a bit of more detail. In EBITDA bridge, we again see our growth algorithm working successful in 3Q. That means revenue is growing more than cost of goods sold and operating expenses. Price adjustments, revenue growth management initiatives and effective discount management that we have previously mentioned enabled us to grow revenues by 37% on FX neutral basis, while this number remained as 21% and 22% for cost of goods sold and operating expenses, respectively, thanks to our discipline in cost and expense management and ZBB, zero-based budgeting effort basically.

Conversion still has a very positive impact as Turkish lira remains weaker and ruble, stronger versus last year. Overall, another very strong EBITDA performance for the third quarter.

When it comes to free cash flow, we also have an increase in free cash flow generation in 3Q. But in this quarter, the increase is primarily driven by better profitability. You will remember that we had noted in our first-half call that we were expecting working capital to get normalized with lower payables levels and increased stock level. As this has happened in line with our planning and expectation, we see the reflection of this in our free cash flow bridge for 3Q. Yet in 9 months' results, we continue to have a record level of free cash flow.

And again in the following slides, let me touch base to balance sheet and risk management. By the end of third quarter, 50% of our cash we hold was hard currency denominated in Beer Group and this was 58% for Anadolu Efes consolidated. We are looking at a very healthy leverage ratio at the end of 3Q, thanks to significant EBITDA growth. Our net-debt-to-EBITDA has also improved significantly and declined to 0.7x, both for Beer Group and Anadolu Efes consolidated.

And finally, let me update you about the Beer Group hedges. Basically from the commodities that we can hedge, we have hedged already 88% aluminum and 100% of PET, and 93% of barley exposure for 2022. This number is 50% of hedged for Türkiye and CIS countries actually for 2023. And on the FX side, we are pretty covered for this year's P&L. And for 2023, we have already hedged around 60% to 70% of Türkiye's exposures as well.

So, this concludes my presentation. Thank you.

Can Çaka:

Thank you, Gökçe. Let me go through the guidance updates. As we discussed in prior calls, early at this call as well, the operating environment was kind of difficult throughout the year. We have faced unprecedented challenges obviously. We would never foresee this when we were doing our budget at the beginning of the year. But one of the most important operation became operational in February unfortunately and we faced an enormous inflationary pressures across the board. And that is valid for any business, I would say. On top of that, yes, we see some commodity prices are softening, but still the energy prices are very high and energy prices are impacting obviously the packaging cost in every other operation. Grain prices are still higher than historical levels and we see increased prices.

So, despite all these difficulties, we managed to beat our estimations, plans during the quarter. Therefore, we are making another improvement in our, especially Beer Group guidance and which also have an impact on the consolidated outlook as well.

So, we improved our Beer Group volume, decline expectation from mid-teens to low-teens, primarily due to the very good momentum we achieved in Türkiye. Therefore, on a consolidated basis, we now expect our volumes to grow by low to mid-single digits, which initially was low-single digit guidance.

We improved our Beer revenue growth expectation from high-teens to low to mid-20s on FX-neutral basis, with improved volume guidance as well as stronger ruble and performance in international operations. On a consolidated basis, this translates into our revenue growth to be around low-40s on an FX-neutral basis. Again here, the initial guidance was mid-30s at the beginning of the year.

And in terms of the profitability, Beer Group EBITDA margin outlook, we make a very strong improvement here and we now expect our margins to improve around 400 basis points compared to a year ago, which was at the beginning of the year, stay flat to slight margin expansion. So, that also has an impact on the consolidated margin expectations. So, we now expect our margins to stay flattish or to expand 100 basis points. Again, the initial expectations were more on the stay flat at the beginning of the year.

So, thank you for your interest and patience through the presentation. And now we are ready to take your questions. We see a lot of interest, a lot of questions. Let us start. For the convenience of the audience, I would ask Aslı to read the questions, then we will, either me or Gökçe, and hopefully more Gökçe, will respond to these.

Questions and Answers

Aslı Demirel:

We have a couple of questions. Thank you. We have a couple of questions. Some of them are already published, so perhaps we don't have the same questions over and over again. The first one that we got is, have you progressed on your JV acquisition in Russia, can you outline anything on the transaction? Furthermore, have you considered the sanctions risk associated with this?

Can Çaka:

Thank you. The transaction is progressing, probably on a slower rate than what we initially foreseen, but it is progressing. We have very good, let's say, discussions with our partner and shareholders. So in that perspective and given the current challenges and given the, let's say, issues in Russia and in moving parts, I would say that's a very cautious, very, let's say, prudent progress. So in that perspective, we expect it to continue to progress in this manner.

And frankly speaking, I think there were also questions about the potential timing, so on and so forth. We expect to see some sort of, let's say, clarification on the terms of the deal in the coming periods. Then we will have the regulatory approval process.

So I mean even if we go as fast as we can, I think this would only be realized, finalized, completed, whatever the verb is, by mid-year or in the second quarter next year. So, there would be certain time required for the regulatory approvals in both countries. Having said and for us to complete the transaction documents as well.

Having said that, as partners and as we are fully committed to the business and concentrated on the performance, making sure that the business, especially in Russia, progresses as we outlined, as we put targets for the management and also resuming and strengthening our operations in Ukraine. Again those are the main targets.

From the compliance risk point of view, obviously, we are constantly reviewing that. That's obviously something we have to be very careful. For the time being, neither in Türkiye nor in any other country, there weren't any sanctions against with respect to our business, let's say, our industry. And other than that obviously, we are following all the developments. That is what we can say for the time being.

Aslı Demirel:

Thank you. The next question is, could you please disclose contribution of Russia and Ukraine to the Beer EBITDA in 3Q? Could you specify the amount of cash that was in Russia and Ukraine as of 3Q? Both S&P and Fitch are worried about potential deal to acquire ABI's stake in Russia and might downgrade the ratings if they see increase in leverage. Could you please comment on this issue? How and if do you plan to approach the transaction in credit neutral way?

Gökçe Yanaşmayan:

Well, let me start with the first question. Russia and Ukraine contributes around 60% to 70% of our Beer Group EBITDA and cash-wise we can say that close to 40% of our cash basically is in Ukraine and Russia, again in Beer Group, and it's less than 20% when it comes to Anadolu Efes consolidated. And about the deal potential, deal acquisition, obviously I can't give flavor that much now, but we know our long-term commitment of leverage targets between 1x to 2x, so we will try to stick to those targets.

Aslı Demirel:

Thank you. Could you please comment on your ability to stream dividends from Russia?

Can Çaka:

Yes.

Gökçe Yanaşmayan:

Well, I mean again, we are taking actions with this direction to this year. So for the time being, as Can said, yes, actually we don't see a negative thing there. So, we are taking ownership and we are expecting to stream the dividends.

Aslı Demirel:

Okay. Do you expect a positive impact of pricing to play in 2023 and margins to normalize or do you see market scale will give opportunity to price further with no major interruption in volumes?

Can Çaka:

That's a very good question. Obviously, let us be very transparent here as well. Challenges are continuing despite, as I mentioned, aluminum, maybe some other commodities are below their peaks of last year and our hedges for 2023 are below what we have this year. So in that perspective, there would be some relaxation. But again, energy prices are high, grain prices are high, so from input cost point of view, from the raw material cost point of view, we still see the pressure. And obviously, that requires given the again inflationary environment continues almost everywhere in the globe. And this would require all the industries to take pricing. And again that is expected to have impact on the consumer demand to a certain point. And we see, as the prices moved higher and higher, that impact on the consumer demand. That's why 2023 would be as challenging as 2022. So in that perspective, we are making our plans in considering the current inflationary environment will continue. It would be a tough and challenging year from the consumer demand point of view. But again, we have lots of very strong portfolio.

You would remember, for the last couple of years, I'm talking about various our investments into people, our investments into our brands, into our digital platform, so on and so forth. So all these investments, all this preparation has created much stronger business profile as of today from the, let's say, management capability point of view, from the portfolio point of view, from the way we understand our consumers and the way how we can react.

The challenges will continue and our responsibility is to continue to our superior performance. That's what I can say today. But having a good, let's say, proper and realistic rational understanding of those challenges, as a management team we are preparing ourselves and I'm sure, as we delivered throughout the last couple of years despite all challenges, we'll continue to deliver.

Aslı Demirel:

Thank you, Can bey. We have a couple of more but almost the same questions, therefore I'm not reading them.

Can Çaka:

Thank you.

Aslı Demirel:

And other than that, we have no further questions actually, so...

Gökçe Yanaşmayan:

Good. Thank you, Aslı.

Aslı Demirel:

Okay, this concludes our conference call. Thank you for your participation.

Can Çaka:

Thank you all for your participation. Thank you.

Gökçe Yanaşmayan:

Thank you.