ANADOLU EFES

CONFERENCE CALL TO DISCUSS ANADOLU EFES Q3 2021 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 2021 Financial Results Conference Call and Webcast. My name is Aslı Demirel and I am the Head of Investor Relations 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 and 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 question, 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, Asli. Good afternoon to all. We've been continuously talking about the COVID for the last couple of quarters. However, I mean obviously this summer we have seen across the board eased restrictions and increased mobility and that helped us throughout the quarter and we managed to deliver another strong volume performance in the most biggest quarter for our business.

We had remarkable performances in both segments and volumes at Beer Group operations where we have recorded solid growth, while soft drink business also continued its strong volume growth momentum that was both domestically and internationally. And on the Beer Group side, the volume growth was mainly supported by the growth from the international segment. July specifically was an exceptional month for us and we have in Russia recorded one of the highest ever monthly sales. And similarly, on the soft drinks, we have seen historical numbers for Turkish domestic operations. And with the increased mobility, we have also seen increased number of COVID cases afterwards so that had impacted for the second half of the quarter in all respect.

So, thanks to our almost 24% increase in terms of revenue per hectoliter on a consolidated basis, we had also added on top of the volume growth, and we had very solid revenue growth. And the value of focus obviously that has been improving with the price increases, which were implemented through the year and our deep focus on profitable revenue growth management initiatives yielded this very strong growth on our revenue on top of the volume growth.

On the other hand, the challenges continue. Obviously, the rising commodity and raw material prices starting from this quarter, we have seen the impact effect on our financials and thanks to hedges in place, the impact has been limited, but the current levels of commodities and raw materials unfortunately keeps us awake for the next year, especially. We already started to fix some of our exposure for next year and Gökçe will take you through this in his part.

On top of that, we have started to implement price increases in all of our operations, especially on the Beer Group offer during the Q4 in order to mitigate such impacts and also being ready for next year's planning and implementations in order to ensure there is a smooth transition for the new price levels to cover these cost pressures.

And in order to overcome these pressures on the gross profitability, we also had continued our tight OpEx management, especially on our international operations despite cycling already a very low level. You would remember last year through the peak of the pandemic we were discussing about various type of OpEx management and this is becoming a kind of the continuing trend for us. Specifically, on Turkey, we continued to invest in marketing in terms of our relaunch of our flagship brand that has a slight impact, but still we continue to be very cautious on our OpEx management here in Turkey as well.

And that in result helped us in generation of quite high free cash flow through the quarter as well, and predominantly due to the international beer operations and CCI we have an outstanding performance on both in terms of the working capital and also prudent CapEx management that supported the free cash flow generation. This solid performance in free cash flow generation will persist for the year-end, however, the current core working levels are expected to be normalized slightly in the last quarter of the year. Therefore, you will see some normalization in this strong free cash flow generation for the rest of the year in line with our guidance.

Going on to the next slide, as you can see on this slide, we already had a sound performance in the first half, especially on the Beer Group and Anadolu Efes level where all metrics were above last year and in the third quarter, we managed to keep the same pace, except with the impact of the commodity price that I mentioned a little bit earlier and that had an increase impact on the gross profitability, which filtered through the EBITDA performance.

And the Group free cash flow was slightly below last year as well in the third quarter, Beer Group free cash flow generation, however as you see for the first nine months, we are strongly ahead of last year and this is mainly pacing of our working capital with respect to different quarters and also a low CapEx base. And consolidated sales volumes were up by 9% and reached to 36 million hectoliters in the third quarter, and similarly, for the Beer Group, volume was 4% higher, reaching 11 million hectoliters.

Revenues grew by 35% and if we exclude the impact of the FX translation, the increase was still strong around 22% leading our top-line close to TRY12 billion, backed by the price increases, premiumization and proactive revenue growth management actions, contribution of the Beer Group reached to 42% with TRY5 billion contribution and a 33% growth. And consolidated EBITDA was 13% above last year, again close to 4 percentage points decline in margins mainly driven by the decline on the gross profitability level.

All in all, I mean we have seen, as I mentioned, certain challenges. We are seeing increased number of COVID cases, but still, that is putting slightly pressure on the mobility and that is, especially for Turkey reflecting into lower tourism activity. And also, specifically in Turkey wild forest fires in some provinces and flown in the northern part of the country during early August again put pressure in Turkish business and the commodity price increases we are seeing the impacts. However despite all these challenges, we are seeing a very strong performance with 39% revenue growth and 32% profitability growth with almost 50% free cash flow generation.

More details on the Beer Group front and as noted, very good volumes continued, it's a growing trend and increased by 4.4% in the third quarter of the year and international beer operations volume were even higher, expanded by more than 6% supported by our performance specifically in Russia and Georgia, to some extent. Russia, the remarkable performance despite the high base of last year and there was not tourism outside of the country. And in July due to the extraordinary high temperature recorded in the country our volumes, as I mentioned, have hit its record levels.

And we are keeping our focus on our premiumization strategy focusing on the growth of our premium and super-premium brands, such as mainly, BUD and Stella, Hoegaarden and we saw the strongest growth through this quarter. And non-alcoholic beer is also another focus area for us and we have seen more than 40% growth compared to last year and we see specifically for the non-alcoholic beer we also benefited from the online delivery services. We are also increasing our partnership with some brands in order to increase the penetration of our non-alcoholic offerings and we had also further compressions with the on-trade chains and those are all contributing back to our business and we are growing non-alcoholic beverages. And also, we have adjacencies to beer, that we are growing in those categories as well.

Specifically for international operations, where we have posted a decline specifically in Ukraine, mainly driven by the higher price increases versus the competition. Our volumes also affected by the unfavorable weather conditions in the country. However, similar to Russia, regarding some international pressures we are trying to develop our brand portfolio by adding different alternatives including non-beer adjacencies, our premiumization focus and adding new flavors, and so forth and growing our business case. However, as I mentioned, higher than pricing higher or pricing higher than competition and with discounting competition impacted our volume specifically.

Our volumes in Kazakhstan and Moldova were up by mid-single digits and in Georgia specifically we grew more than almost 30%. We managed to improve our volumes in all these countries with new product developments, relaunches of mainstream brands and increasing our focus on execution and increasing our touch points with our consumers, our route to market.

We also observed a solid increase in our on-trade volumes in Turkey, right after the release of the restrictions starting from July onwards. However, as I mentioned, August was impacted with the sad events in Turkey forest fires and then lower tourism and so and so forth starting from the second half of the year. So despite the quarter especially the beginning of the quarter was strong, we have seen, let's say, slower volumes in the second quarter of the second half of the quarter. Therefore, our volumes were down by around 5% versus last year.

Another area we are focusing is our craftsmanship culture, we have been as I tried to mention about different countries, we're trying to expand our offerings and reach our consumers with the flavored BAs, with different specialty beers with seasonal beers and also the most recent example is our gluten-free beer offering in Turkey. So all these new offerings are adding to our portfolio, adding to our volumes, adding to our profitability. So in that perspective, we have taken the innovative leadership in every other country, expanding our portfolio nicely and profitably.

As usual, a couple of words on the soft drinks, which is growing fantastically as a result similarly, eased restrictions and increased mobility helped our business segment and CCI's consolidated sales volume extended very strongly and grew by more than 11%. And here in Turkey, volume growth was around 15% as a result of the focus on segmented market campaigns, tactical promotions obviously and seasonal offerings on the soft drink segment as well, and the high penetration on the e-commerce, which is growing fast in Turkey, especially its helping.

And more important, the sparkling beverages recorded a growth by around 30%, and Coco-Cola brand itself growing over 13%, still category increased by 21% especially supported by strong ice tea and energy drinks performances, water category was up by 18%, especially thanks to increased share of the small packs.

International operations grew by 9% specifically Pakistan despite the price increases during the quarter. We have seen the volume performance of around 8% and continued with the growth on top of the pricing, increases with better execution and increased penetration. CIS grew by more than around 20% in the third quarter. All CIS markets on the soft drink side also delivered double-digit and high single-digit volume growth except for Turkmenistan and Middle East where we have seen a decline at 5%, cycling a high base of last year.

And going to the last page, basically, we discussed around the performance in the prior pages. This is kind of let's say summary. But let me touch base with the bottom-line we haven't discussed. We recorded a net income around TRY556 million in third quarter bringing our net Income level to almost TRY1.3 billion range.

The year-on-year financial expenses were higher this year and there was a one-off negative impact coming from CCI regarding non-cash provision for spare part amortization, was hitting the bottom-line. However, thanks to the higher operational profitability as well as gains from again the sale of land at the CCI level, our net income increased more than 20%. Similarly, for the free cash flow generation, we have recorded more than or almost TRY4.3 billion cash generation in the first nine months, that is TRY1.4 billion higher than what we have generated throughout the first nine months of last year. And that increase was supported equally by both beer and soft drink segments. As I mentioned that would partly be normalized then through the third quarter, but again that's a very strong performance.

Now, I will hand over to Gökçe for the details on our performance. Thank you.

Gökçe Yanaşmayan:

Thank you, Can. Good morning and good afternoon, everyone. I'm going to take you through the financial results. Actually, I'm quite happy that we are reporting another successful quarter. If we start with beer business, this is the third quarter in a row in 2021 Beer Group reports growth in volume and in both top and bottom-line, and as Can was also saying earlier, we are seeing strong volume growth in our international beer business, especially remarkable volume performance in Russia and Georgia in third quarter versus last year.

Beer Group sales revenue was again substantially ahead of volume and grew by 32.5% in third quarter versus last year and on a constant currency basis increased by almost 17%.

Besides growth in volume, price increases across the board and favorable product mix supported solidly our top-line. As a result, Beer Group's sales revenue in 9M2021 reached TRY12 billion with a year-on-year increase of 31.3%.

The pressure on the gross profit in third quarter due to raw material and commodity price increases has started to impact Beer Group EBITDA and margins too. The good news though, despite cost pressure, EBITDA grew by 5.1% in third quarter, thanks to successful revenue growth management, as well as savings in especially international operations OpEx. Beer Group cash flow was almost parallel to last year's high base and in nine months, free cash flow reached TRY1.5 billion, significantly above last year.

I'm going to give more details on EBITDA and free cash flow in the following slide. When we come to Anadolu Efes' consolidated financials, CCI continues to contribute significantly to bottom-line and top-line performance in third quarter too, and consequently, consolidated net sales revenue was up by 34.9% in third quarter, and by 39.4% in nine months and consolidated EBITDA grew by 12.8% and by 32.3%, respectively, in third quarter and in nine months, while free cash generation is well above last year and reached TRY4.2 billion.

I believe EBITDA and free cash flow bridges on Slide 11 make it easier to show impacts that I was talking about on our Beer Group results for third quarter. So, if I summarize again, what you see in the EBITDA bridge is, a strong revenue management, resulted by a combination of factors like volume growth, price increases, and favorable product mix, and also, a very successful OpEx management we see, as increase in OpEx is notably lower compared to revenue growth. And worth mentioning here that these comes over a very low OpEx levels of 2020.

So the main challenge actually is cost of sales growing ahead of revenues, and again, to remind this is due to rising commodity and raw material prices. I'm going to show you in a while the details of commodity hedges which has helped us to partially limit the impact.

And the other line that you see in EBITDA bridge mainly refers to currency translation. All in all, we achieved to grow last year's high base EBITDA in third quarter.

Free cash flow, like EBITDA, had a high base in 2020 as a result of significant improvements in working capital as well as very prudent CapEx spending. In 2021 though, in line with our planning, we spend more CapEx which naturally has a negative impact on our free cash flow. However, strict working capital management, specifically in Russia, continues to contribute positively. As an additional note, I have to say that, cash cycle days in all operating countries improved versus last year and working capital to sales ratio is at record low levels across the board. In addition to working capital changes, incremental EBITDA generated is also positively impacting. Overall, we are successfully landing close to high level of last year and generated TRY435 million in third quarter.

Now if you look at the balance sheet on the Beer Group side, we are at 1.7x net debt to EBITDA and Anadolu Efes at 0.8x multiple. So we are looking at a very healthy set of numbers. You may remember from our previous call or announcements, we have issued a new bond of $500 million to refinance our existing bond maturing in November 2022. With this extension of our existing Eurobond maturity for another seven years, our average debt maturity now is 4.1 years and Eurobond remains as the only FX debt exposure in our balance sheet.

When it comes to cash, our policy is to hold the majority of our cash in hard currencies, and consequently, as of end of September, we hold above 80% of our cash in hard currency. And when it comes to risk management, from commodity hedging point of view, we are hedged by 100% for aluminum for 2021. However, we've gone intentionally a bit slower for 2022 hedging as commodity prices were hitting record high levels for the last 10 years or so. Currently, we are close to 30% for next year. PET, again, hedged 100% for 2021, 76% for 2022. And last but not least, from FX hedging point of view, I would say that we have hedged currently almost 50% of our exposure of 2022 in Turkey.

So this concludes my presentation. I will give word back to Can and thank you.

Can Çaka

Thank you, Gökçe. With respect to year-end estimates for our outlook we are revising our guidance for Anadolu Efes, obviously that has been upon the upgrade in the soft drinks, given the strong business momentum year-to-date and also due to inclusion of Uzbekistan the soft drink's consolidated results will be affected by a couple of percentage points at volume and revenue levels, while there would be a slight dilution on EBITDA margin.

We made no changes in our Beer Group expectations, especially on the top-line. However, we are a bit cautious on meeting our profitability margin guidance considering the upward price trends in the global commodity markets and raw material prices together, with the higher inflationary environment we see. As I've tried to explain, we are trying to mitigate all these by earlier price increases through the quarter and also the impacts of, and accordingly, we now expect our consolidated volumes to grow by mid- to-high single digits and revenues to grow by high teens to low teens in the FX-neutral basis. We still expect to deliver strong free cash flow, yet we expect some normalization compared to the fantastic nine months' numbers that I would say.

So this concludes our presentation and we'll be very happy to answer your questions, if there would be any. As Aslı mentioned, you can write down your questions. And thank you all for participating to the conference call.

Aslı Demirel:

We have already two questions at the moment. Let me read both of them. How much of the negative TRY532 million in cost of sales was related to raw material increases? And the second one is, have you increased prices in Russia during the third quarter, if so, how much?

Gökçe Yanaşmayan:

Maybe I can start with the cost part. Almost two-third of our increase we can say that it is attributable to the raw material increases.

Can Çaka:

We have already made a price increase in August in Russia, and as I mentioned that, in all operations we have started to have price increases in September, October and November in different cases in Russia specifically after the price increase at the beginning of January now, in August, we have increased, it is nothing more than 5% price in Russia.

Aslı Demirel:

There is another question from Hanzade. Thank you for the presentation. I have three questions. How much margin headwind do you expect in Q4 and 2022 from rising commodity and raw material prices? The second one is after strong cash generation from working capital, do you still see room to generate cash flow from working capital in 2022? Can you please comment around recent demand trends, particularly in Russia?

Can Çaka:

Gökçe would you –

Gökçe Yanaşmayan:

Yeah. I can start with that, well, in Q4 we expect similar or slightly better to Q3 maybe. With the price increases that we are putting in place, our expectation would be slightly better, but similar to Q3 margins.

Aslı Demirel:

The second one was related to cash generation. After strong cash generation from working capital, do you still see room to generate cash from working capital?

Can Çaka:

Yeah, well, I mean, specifically for the beer operations, let's say obviously, we have reduced our working capital significantly so throughout last year and this year we have generated cash from our working capital. That's a very valid observation, that at these levels, it would be much difficult to raise further cash.

But please keep in mind that now our working capital is negative. So as our balance sheet expands, the working capital will still be, because it's on the negative territory it will be positively impacting the free cash flow generation as it expands. With respect to the demand side, we are seeing similar trends in every other market, so it's shortly.

Aslı Demirel:

(Operator Instructions). Yes. We have one more. Do you have an estimate of what the negative effect from raw material increases will be in 2022? More specifically, how much will COGS per hectoliter increase?

Can Çaka:

Well, let me jump in, Gökçe. I mean obviously, when you look at the major raw materials, the barley, malts, packaging, they make two-quarters of our total costs and also on the overheads we have energy and so and so forth. So they are linked to global prices, they are linked to commodity prices. So we are all seeing significant increases there. So in that perspective, our teams are working in terms of they are planning for next year.

Obviously, there are two ways to mitigate this, one is pricing, and the second, further OpEx management and reducing our operating expense as a percentage of our revenues. So this is how to mitigate. So our, let's say, purpose is to mitigate almost and again this is work in progress and in the meantime also, we see different fluctuations in the commodity prices.

We will be in a better position at the beginning of the year to give more clarity on this, but again our willingness, our aspiration is to cover all the impact on our performance.

Aslı Demirel:

(Operator Instructions). We have one more. Do you plan to take more increases in Russia after the August one in coming months to cover cost inflation?

Can Çaka:

Well, basically, let me reflect for all countries. Obviously, at the beginning of the year, we were depending on the further development and additional, because we haven't taken all the price that is required to cover the tax and cost changes or reflections for 2022. So, in that perspective, we would and we are planning that our plans for 2022 would cover additional price increases by the beginning of the year.

Specifically for Russia, let's be honest here. It is a very competitive market. We have seen a very high pressure in terms of competition, in terms of promotions and discounts as we have discussed in the last couple of quarters. So, in that perspective, although we are the market leader, we cannot just simply disregard the rest of the market. We have taken a strong price increase as I've noted earlier, at the beginning of August, and we need to make sure that our competitors are rationally following our price increases in that perspective.

We are monitoring that very closely, we have seen the competition increasing prices but unfortunately, that is not in the magnitude that we have. So, in that perspective, further price increases would require such gap to be closed. However given I'm sure all the players would be quite rational in terms of keeping the revenue for our business and in that perspective with the condition that the gap on pricing is closed, we would be considering further price increases.

Aslı Demirel:

There are actually, no more questions at the moment. So we can conclude I guess.

Can Çaka:

Thank you, Asli. Thank you, all for joining. Hope to see you at the end of the year.

Gökçe Yanaşmayan:

Thank you.

Aslı Demirel:

Thank you for joining.