Company Name: Anadolu Efes
Company Ticker: AEFES TI
Date: 2019-05-09
Event Description: Q1 2019 Earnings Call

Market Cap: 10,450.66
Current PX: 17.65
YTD Change($): -2.95
YTD Change(%): -14.320

Bloomberg Estimates - EPS
Current Quarter: 0.100
Current Year: 1.002
Bloomberg Estimates - Sales
Current Quarter: 5064.000
Current Year: 22962.250

Q1 2019 Earnings Call

Company Participants

- Asli Kilic Demirel, Investor Relations
- Can Caka, Chief Executive Officer and Beer Group President
- Orhun Kiostem, Chief Financial Officer

Other Participants

- Unidentified Participant
- Hanzade Kilickiran, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to Anadolu Efes Beer Operations First Quarter 2019 Financial Results Conference Call and Webcast. Today's speakers will be Can Caka, Anadolu Efes' CEO and Beer Group President; Orhun Kostem, Anadolu Efes' CFO.

I'll now hand over to your host Ms. Asli Demirel. Madam, please go ahead.

Asli Kilic Demirel, Investor Relations

Hi, everyone. Welcome to Anadolu Efes' Beer Operations 2019 First Quarter Results Conference Call and Webcast. 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 Caka, Anadolu Efes' CEO. Sir?

Can Caka, Chief Executive Officer and Beer Group President

Thank you, Asli. Hi everybody. Good afternoon, and good morning to those in the U.S. Welcome to Anadolu Efes' first quarter results conference call. It has been almost two months since we announced our full year results and had a conference call and discussing our priorities and challenges ahead. Today, I'm very happy to say, we are on full track to deliver in line with our priorities.

Our diverse business profile delivered an overall robust performance by growing very strongly -- strong, both in revenue and profitable returns [ph]. At the same time, we were able to maintain consolidated EBITDA margin, despite a very high inflationary environment.

As some of you would recall, we were anticipating and communicating a record start to the year in Turkey, given the macro challenges, high inflation and weakening consumer confidence, which, coupled with the increased price points in this industry, obviously, as a result of the excise tax increases and cost pressures. We will discuss the performance throughout the presentation in more detail certainly. However, I can point out that these headwinds did not cause us to pause or reduce our investments in our brands and portfolio.

On the contrary, in line with our core strategy of building our brand portfolio, we increased our spending on certain existing brands besides expanding on our new brands as well. We preordered some direct marketing activities preseason, organized (inaudible) events to utilize new channels, and keep caps brewing passionately and responsibly throughout the quarter. Therefore, you will see a higher-margin expenses, especially in Turkey Beer, which we see as an essential spending trend [ph] sustainable strong brand portfolio and improve the relevance of our brands to our consumers.

For the quarter, better news came from really solid operational performance in international beer markets, mainly on the back of strong growth we achieved in Russia and Ukraine. I will give few comments on the highlights of the quarter, then I'll pass over to Orhun, who will cover the financials in more detail. At the end as usual, we will be ready for your questions as well.

Before proceeding, I wanted to draw your attention to the fact that when I'm comparing first quarter results with the same period of previous year, I will always refer to the pro forma figures. You would remember the business combination in Russia and Ukraine was realized back in April 1, 2018. Therefore, reported financials back in 2018 first quarter did only include Efes business. Pro forma financials for 2018 first quarter, however, includes the merge operation in Russia and Ukraine, as if it was operational since the start of 2018, therefore, including the results of the combined businesses since January 1, 2018, together with the impact of the net assets realization as a result of the business combination.

Also, to be able to provide you a better comparison, we are stripping off the IFRS 16 lease impact from 2019 first quarter numbers as well. Orhun will give you more color on that for sure.

Moving into the performance. We delivered 0.4% consolidated volume growth on a pro forma basis. This, as I mentioned earlier, was achieved by the strong performance of international beer operations, particularly Russia and Ukraine. Our international markets also performed in line with our expectations. The strong contribution by international beer offset the softer Turkey beer volumes and softer soft drink volumes throughout the quarter. I will discuss Turkey and international beer performances in more detail in the coming slides.

Our strong revenue growth -- strong revenue management capabilities yielded a strong solid revenue growth, significantly over the volume growth. This is assisted by positive mix impact, price increases as well as some [ph] translation impact.

We saw increases in input cost pricing, which will be mitigated by our strict expense management and synergies generated throughout the quarter. As a result, we managed to maintain an almost flattish EBITDA margin and achieving more than 21% growth on EBITDA level. We recorded a net loss of TRY171 million through the quarter. TRY74 million within this month is attributable to higher depreciation charges due to the revaluation of fixed assets in Russia and Ukraine, which were mostly one-off. Comparable net loss in the same period of 2018 was TRY187 million.

In this quarter, we continued to strengthen our market positions by performing ahead of the market in Ukraine and in Russia, bringing us head-to-head with the market leader in both markets. The time when we completed the merger, both in Russia and in Ukraine, our market share gap to the leader was around 4.4 percentage points. It is a great achievement that within a year following the merger, we managed to close the gap in both markets, and now we are head-to-head as of quarter one. We are working to convert our sustainable growth to sustainable leadership in these markets. In all other beer markets, we maintained undisputed leadership that we have.

On the next slides, I (inaudible) on the financial figures. Here, I want to highlight the growing importance of our International business. If you take international beer and international soft drinks, two-thirds of our revenue generation and half of EBITDA generation is coming from international markets as of the quarter. We discussed the portfolio nature. The international beer segment increased its proportion within the portfolio more than 10 percentage points in volume and EBITDA for this quarter.

As the international beer is getting its fair share now, the portfolio is getting more and more balanced in terms of geography and dependence, and Turkey is getting less and less. Obviously, the opportunity for us would be able to progress in international beer, having its fair share to profitability going forward.

Focusing on our Beer business. Full year total Beer volume growth was 5.5 percentage points, balancing the soft volumes in Turkey Beer as discussed, with a strong performance of International operations. 85% of our beer sales volume are generated in our international markets now. In Turkey, sales volume was down by 7% in the first quarter of the year. The price increases taken at the end of 2018 and at the beginning of the year as a result of the excise tax increases and cost pressures, deteriorating consumer confidence, which is linked to the macroeconomic conditions, obviously, and high inflation, and finally, unfavorable weather conditions through the quarter due to lower-than-average temperature, resulted in weaker demand in the seasonally low quarter.

We also had some destocking impact early in the quarter as well. Yet, as I mentioned at the beginning, we continued our focus on execution and increasing our contact with our consumers, and we see positive developments on the field. Current market dynamics was a holding factor, and it seems it will continue during May and June due to Ramadan impact and (inaudible) elections by the end of June. However, we are confident and optimistic that -- about our performance improving in the second half as a result of all these activities that I've mentioned, and potentially a strong tourism season.

On the International side, EBI had a strong start to the year by growing 8% year-on-year basis. Although all of our international beer operations performed in line with our expectations, growth was mainly driven by Russia. In Russia, the market grew by mid-single digits, and our performance was slightly above that, yielding market share gains. And also, secondly, Ukraine was also a strong contributor, where our operation significantly outperformed the low single-digit growth market -- low single-digit growth markets growing double digits.

As I mentioned earlier, we are now head-to-head with the market leader in both of these markets, and are working to convert our sustainable growth to the sustainable leadership in these markets. The outperformance of the market in Russia is closely connected with the larger cross brewing projects as well as our intense focus on brand expansions in our core brands, such as Bud 66 super premium brand launch.

The significant performance of the market in Ukraine was assisted by the relaunch of new products, such as Kozel (inaudible) from the former Efes portfolio. We also gained market shares in Kazakhstan and Moldova, expanding our leadership in both markets. In Georgia, the market share was under pressure, impacted with the weather and macroeconomic dynamics. In these markets as well, we have taken over ABI InBev's Premium portfolio, extending our portfolio in Premium segment. We have great execution on the field, having a proper placement of the portfolio.

Modern Trade is growing and creating a challenge on one side with additional cost, but also creating opportunities with wider shelf space, especially for us with a wider and Premium portfolio in these markets.

Before I leave the floor to Orhun, I want to say a few words on the soft drinks performance as well. I will not go into any detail, as you probably have listened the CCI results, conference call last week. Macro headwinds also had an impact on soft drink business, but also setting a very strong base in the first quarter, put additional pressure on sales volumes. 1.8% contraction in sales volume on a consolidated basis on the soft drink side was impacted by lower nonready-to-drink tea volume in Turkey, and lower sparkling volumes in Pakistan and in general, I would say.

Now I hand over to Orhun for financial overview.

Orhun Kiostem, Chief Financial Officer

Thank you, Can. Good morning and good afternoon, ladies and gentlemen. Before I start talking about the details of the numbers, I just want to give you a little bit of backdrop. Between the first quarter of 2018 and the first quarter of 2019, obviously, there has been significant structural changes to our business, as Can has explained. The merger in Russia and Ukraine has been completed. And then again, there were changes to IFRS on how we report. So today, actually we've tried to make sure that we give you a like-for-like view of our business performance that, obviously, is a little bit different than how we reported it.

Secondly, if you look at the -- we report in Turkish lira, so in that sense, if you look at how the impact of the exchange rate has worked, the Turkish lira has devalued against the U.S. dollar, on average, about 40.8% on an average basis or 42.5% on a period-end basis. So there has been a very sizable devaluation of Turkish lira, most of them on the first quarter of 2018. Euro -- against euro, Turkish lira also devalued around about 30%, both on average and period end. And if you look at the CPI, that has been 19.7% on a year-on-year basis, and Producer Price Index has been just under 30%, 29.6%. So with this backdrop, now I would like to move on to -- walk you through some of the details.

Again, if you take a 30,000-feet view, I believe we have delivered quite satisfactory results. Overall, if you get to the details of operations, they're of, obviously, different colors, which I'm going to underline. On a consolidated Anadolu Efes level -- like-for-like level, on top of that 0.4% volume change, the net sales revenue has increased about 28%. Given the currency effect, there is obviously, a translation impact going into that, but I can safely say, in all of our operations, on a constant-currency basis, we have overperformed above the volume performance. So that's one piece of top line improvement that we have seen. If you look at our Beer business, in total, over 5.5% volume growth, we've seen about 36% revenue growth in Turkish lira terms. So if you strip out the volume impact, the rest is almost half and half in terms of the translation impact and the real top line growth that we have achieved between pricing mix and portfolio management.

In Turkey, our volumes were down about 7%. Having said that, our net sales revenue per hectoliter was up by just under 30%, on a 29.5% level. Between March -- between the end of the first quarter 2018 and the first quarter of 2019, we had price increases in July, October and then in January. Plus we have, as Can was explaining, included new products into our portfolio that has increased the share of Premium overall. So that brought a very strong pricing performance. And therefore, with that, the Efes revenue in our Turkish Beer business was up by 21%. And if you come to EBI, Efes Beer International, on top of that 8%, 7.9% volume growth, we have seen about 41% revenue growth. Again, about, let's say, our real pricing growth in that is in low double digits, which primarily comes from good operations, good results coming from Russia, Ukraine and especially, Moldova, as we have indicated in our release.

If you look at the gross profit line, on a consolidated basis, we've seen about 110 basis points contraction. If you look at gross markets, obviously, there is a significant contraction in Turkey's gross profit margin. Otherwise the gross profit margins are either flat to slightly negative, which is normal given that this is the smallest quarter of the year, and then any volatility, especially in the raw material prices or FX has an amplified impact.

Now if you look at our total brewing business, we've seen about 190 basis points contraction in gross profit margin. It's primarily driven by, obviously, Turkey, where we've seen just under 500 basis points gross margin contraction. Now the gross profit on a per hectoliter basis actually grew by about 18%. Therefore, the total absolute gross profit growth was about 10%. However, if you take out the depreciation, the cost of sales in Turkey overall grew by 40% compared to the first quarter of last year. That's probably driven by the unit prices, which, let's say, increased to the tune of about 50% levels. And then the FX impacts on our cost base, even though we hedged, obviously, given the whopping 40-plus percent devaluation, even though we have been able to match that with our pricing. There was an impact in the quarter to our gross margin, and hence, the contraction.

Outside of Turkey, the gross margins were more or less stable, and we've seen about 10 basis points contraction in the first quarter, so pretty much in line. If you come to the EBITDA line, there's about 40 basis points contraction on a consolidated basis, which is, again, pretty much in line with -- as to how we were expecting to start the year. Across the Beer business, we've seen 100 basis points improvement in our EBITDA margin, and that's -- this time coming significantly from our businesses outside of Turkey, especially the performance in Russia and Ukraine, where the EBITDA has turned from a negative to our positive territory, made a significant margin expansion.

When we come to Turkey though, obviously, the margin contraction is amplified at the EBITDA level on top of the gross margin. That's primarily driven by the marketing expenses, again, what Can was mentioning in his commentary. This is in part driven by our portfolio management. Now we have a more premium brands that we would like to support, a, we are supporting our brands a touch higher than we have done compared to last year; and finally, we're getting ready to, hopefully, a very strong season, so we are frontloading our marketing expenses in this quarter.

And again, given the smaller size of the quarter, the small changes in absolute numbers make a big difference. But also, the satisfactory start altogether to the year in our business. And again, that's also reflected towards free cash flow. If you compare on a consolidated level in Anadolu Efes, our free cash flow was in minus territory, and nevertheless, we showed the improvements -- a slightly improvement versus last year. And if you look at the Beer Group, we've almost ended on a breakeven free cash flow level, which is actually quite good, given that this is a smaller season and normally, our free cash flow generation, it doesn't necessarily start until we get closer to the season. So that's, again, a good start to the year in that sense.

If you look at -- obviously, most of that on the Beer Group is coming from our businesses outside of Turkey to a greater extent. And as you see a breakdown, we have done a very good job about the contribution of working capital was to our overall free cash flow generation.

We talked about the FX volatility, and again, for the past few days as well, I'm sure you're following that there is also some more devaluation of Turkish lira against the dollar and euro. But if you look at our balance sheets through the net investment stage, if you look at from end of March of 2018, about 72% of our balance sheet is hedged. And if you look at the unhedged portion, actually, that's not coming from hard currency. Some of them are coming from non-Turkish local currency level. And from a consolidated Anadolu Efes level, that hedge is in place for that 58%. So we are pretty much managing that exposure.

And again, as we stated in our last call, as we reported our 2018 results, if you look at Turkey and Turkey's cost of goods sold and operating expenses, we hedged about 90% of our exposure there. So if you look at the structure of our P&L, any Turkish lira devaluation against the dollar especially can result in positive absolute Turkish lira numbers, whereas as we have hedged to a great extent our exposure in Turkey's cost and expense base.

Moving on. Despite this volatility in currency, our leverage numbers are quite satisfactory as well. Our net debt-to-EBITDA has moved about 0.2 times on Bear Group level, and only about a 0.1 times at consolidated level, which is good at the smallest quarter of the year. And again, we hold just under 70% of our cash in hard currency on the Beer Group side, as our debt is just over 80%, is in hard currency, basically. And if you look at our maturity schedule, our largest maturity comes through 2022, that's the Eurobond maturing, which on average makes about 2.6 years on the Beer Group side. On the Anadolu Efes side that's a bit longer, especially after CCI refinanced its Eurobond, now maturing in 2024.

So with that, I'll give the floor back to Can for his closing remarks.

Can Caka, Chief Executive Officer and Beer Group President

Thank you, Orhun. Since I took over as the CEO at the beginning of the year, we put forward couple of priorities, together with our expanded management team and our board. Certainly we focus, we try to focus on a limited number of -- and making for ISN, making sure that those are priorities for us. Therefore why we have identified four simple areas: the first one is the financial discipline, which is embedded in our DNA anyway. For many years we have been very prudent and conservative in managing our balance sheet, maximizing our free cash flow generation. This priority has proven its benefits in the past few years, and there were a lot of headwinds in our operating markets. This disciplined and conservative approach will continue, that is clear.

Nevertheless, we have also noted that we have had under investments in our brands, in our talent and in our digital infrastructure back in the last couple of years. So our priority will be on investing more in our people, nurturing talent, ensuring development of leaders for today and for the future of our business. Secondly, investing in our brands by providing choice, great taste, quality and innovation to the consumers, and at the same time, owning the beer culture, which would mean that creating much more touch points with our consumers would be critical going forward. And finally, developing the corporate wisdom, as we call it, to build the competitive advantage through a lean and efficient process management, and developing annoted skills, based on these simplified processes, will be the core strategy areas going forward.

We have already identified many key initiatives and started to implement them -- those already. We've seen positive developments in many areas already, and I'm confident this model will keep on delivering what we aim for. That concludes our presentation, and now, we are ready to take your questions. Thank you for listening to us.

Questions And Answers

Operator

We'll now start out question-and-answer session. (Operator Instructions) Our first question is from Parth Jhala [ph] from Goldman Sachs. Please go ahead.

Unidentified Participant

Hi. Good afternoon and congratulations on decent set of results in tough conditions. My first question is basically on balance sheet numbers. The slight increase in debt levels that we see, is that largely due to translation of the unhedged hard currency to Turkish lira? Or was there incremental debt taken up? Thank you.

Orhun Kiostem, Chief Financial Officer

Thank you. This is Orhun speaking. There actually is no incremental debt in that sense, it's primary attributable to how the currency has been moving. So that's why, as I've tried to explain, it's not necessarily out of our expectation. Basically, it's pretty much in line, given the volatility of the currency.

Unidentified Participant

Perfect. Thank you.

Operator

(Operator Instructions) We have a question from Hanzade Kilickiran from JPMorgan. Please go ahead.

Hanzade Kilickiran, Analyst

Hi. Thank you. My question is on Russian beer business. You had a very strong quarter in Russia, and I can see that Carlsberg was quite weak in terms of volume, they lost some sort of volume. And do you expect -- I meant, do you see any sort of strategic change in Carlsberg in terms of marketing after this weak market share performance as a kind of competition -- more competition on your side? Thank you.

Can Caka, Chief Executive Officer and Beer Group President

Well, thank you. I mean, it's very difficult to make any commentary on our competitors. So I'm sure they have already announced their plans, and they've commented on their performance. We are fully concentrated on what we are doing, and we have -- in our previous calls also, we have discussed the advantages that we have. We are pretty much concentrated on the Premium portfolio that we have. The leadership that we have in large cities like Moscow, those are key features for our business. We're trying to extend the cross brewing between our breweries, trying to expand also our core brands, especially in core main stream. So we are trying to benefit and build our business going forward on our strengths and regardless of what our competitors are achieving or doing on the ground. So we are very much focused on our own business and own advantages.

Hanzade Kilickiran, Analyst

And so you probably expect to gain more market share in the remainder of the year? (Multiple Speakers)

Can Caka, Chief Executive Officer and Beer Group President

Well, we're -- certainly, we have our initiatives. We believe those would work. We are -- I mean, that's all our target, we are trying to keep the growth sustainably going forward, that's the plan. Certainly, how the markets would evolve throughout the season with the help of -- I mean, we're still talking about this smallest part of the year. So the season would be much more important, and we'll see how it is developing, properly at the end of second quarter call, we will be much more comfortable in giving more details about that.

Hanzade Kilickiran, Analyst

Okay. Thank you very much.

Can Caka, Chief Executive Officer and Beer Group President

Thank you.

Operator

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

Can Caka, Chief Executive Officer and Beer Group President

Well, we thank you all for participation and interest in our business. Thank you very much. We look forward to talk to you and meet with you again in the coming months, and also after the second quarter results in our announcements. Thank you all.

Orhun Kiostem, Chief Financial Officer

Thank you.

Operator

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