Company Name: Anadolu Efes
Company Ticker: AEFES TI
Date: 2016-11-04
Event Description: Q3 2016 Earnings Call

Market Cap: 10,882.89
Current PX: 18.38
YTD Change($): -.51
YTD Change(%): -2.700

Bloomberg Estimates - EPS
Current Quarter: -0.094
Current Year: 0.663
Bloomberg Estimates - Sales
Current Quarter: 2025.000
Current Year: 10616.091

Q3 2016 Earnings Call

Company Participants

- Asl■ K■l■ç Demirel
- Robin Michael Goetzsche
- Onur Çevikel

Other Participants

- Tristan Van Strien
- Anirudh Patwari
- Sanjeet Aujla
- Walid Bellaha

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, welcome to Anadolu Efes Beer Operations Third Quarter 2016 Results Conference Call. Today's speakers will be Mr. Robin Goetzsche, CEO and Mr. Onur Çevikel, CFO.

I will now hand over to your host, Ms. Asl■ Demirel. Ma'am, please go ahead.

Asl■ K■l■ç Demirel

Hi, everyone. Welcome to Anadolu Efes Beer Operations 2016 third 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. Robin Goetzsche, Anadolu Efes Beer Group President and CEO. Sir?

Robin Michael Goetzsche

Thank you very much and good afternoon or good day to all. Clearly, a day of turmoil again in the market, so an interesting time to be presenting our results. Pretty much in line with our expectations and in fact, what we've spoken to you about before, but I'll take you through some of the key highlights. If we look at the volume of the group, we're up low single digits and kind of positive for us in terms of that. Particularly noteworthy for us is that the quarter three volumes for both Turkey and Russia much improved and also our volume for our soft drink business up just under 2%.

Revenue is really only pretty flat in terms of the reflection against volume, I think driven by a couple of issues. The first is obviously we generally price in local currencies and well, we've had price increases, we've had to manage that.

But I think in particular, obviously we've had some devaluation of the operating currencies outside of Turkey against the Turkish lira. Our margin is slightly down, really driven by the impact of raw material process, as well as the forex pressures I've spoken about and some costs that we certainly continue to manage. But very strong improvement in net profit, so well up for the nine months.

And as we have reported to you on all of our previous calls, a big focus on free cash flow and a very positive improvement for the nine months in our free cash flow. And, of course, very important in terms of managing our balance sheet is that our net debt to EBITDA ratio now at 1.8 times.

If we look at it in summary, at a graphical level, you can see that the soft drink business is around three-quarters of our business, down at about 70% of our net sales revenue and about just under two-thirds of our EBITDA. So the beer business is obviously contributing at an EBITDA level.

If I look just at the soft drink business first, clearly, being driven particularly by a very good performance in Pakistan, but I think positive to report that the Turkish volume growth is there as well, bearing in mind the significant issues we have faced as a country over this last year.

Central Asia also performing well and some growth in North Iraq and good momentum in Jordan, of course, quite a small base. So generally, Middle East volume is positive. I won't dwell on the soft drink business much.

If we go on to the beer business, beer business volumes overall down just over 5% but the highlight for us has been the performance of the Russian beer market. So the Russian beer market has been impacted less by the economic issues and, of course, a more stable currency this year, impacting the economic conditions and pretty good summer season for us.

Turkey, within the context of the difficult environment we're operating in, is hanging in there. I think because we have the index on tourism, we felt some of that impact, particularly the impact of both Russian tourists due to the sanctions which thankfully now have been addressed and also obviously the impact particularly on the German tourist trade driven by the unfortunate tourist activity earlier in the year.

This is also [ph] flying (4:49) through to consumer confidence. And as you well know, we absorbed a fairly high excise tax increase at the beginning of the year. And then just a final comment on Turkey is that before we look a little bit more detail is, of course, we are managing our stock levels to help us with our working capital management and that has some impact on our sales.

If we look at Turkey in particular, as we said, I think a better third quarter. We're very comfortable with our sales execution. We've had a significant investment in coolers and have continued to drive improved sales performance, particularly in terms of sales, loyalty programs into our tri-channels. We've also had some really good launches of new products and new variance, particularly the Efes Pastörsüz unpasteurized variant which has gone very well.

And the team have done a very good job at managing both the cost base but also the working capital and free cash flow and hence, this positions us well for the last quarter and also going into 2017.

Looking at the international operations, very good positive performance for us both driven by price increases, but also strong positive brand mix improvements. So the margin is up well with teams all again, all over the country is managing OpEx very tightly, better and improved efficiencies. And while we've seen some impact on gross margins driven by COGs and certainly fallen through to the bottom line in terms positive OpEx management and we continue to focus heavily on free cash flow.

Just to mention the Russian market. The Russian market declined certainly by less than we expected for the year, driven by the better economic performance. And for us, we've seen gains in market share and again for us positive in the sense that it's both in the premium and upper mainstream area, which certainly bodes well for us as we see some restrictions on PET coming in from January.

Our continued strategic focus continues on our brands, on our execution, on making sure we continue to drive efficiency both in terms of cost and productivity and making sure that we engage at all level with our key stake holders.

What I'll do is hand over to Onur to take us through some more detail on the financials.

Onur Çevikel

Thank you very much, Robin. Good morning and good afternoon, ladies and gentlemen. Welcome to the nine months financial results conference call of Anadolu Efes. Thank you all very much for joining the call today. I'll briefly take you through our financial results for the first nine months of 2016.

I'll start with our Anadolu Efes consolidated results. As discussed by Robin, our volumes, they're up by almost 1% reaching up to 70.4 million hectoliters in the first nine months of 2016. Our revenues were recorded as TRY 8,265 million, flattish compared with last year with the same period. Consolidated EBITDA was recorded as TRY 1,548 million, 2.4% lower than the same period of previous year.

Our profitability has been impacted by high raw material prices, as well as a fixed base cost and also by increased fixed cost due to lower volumes in Turkey. But still, despite all these, we were able to manage our EBITDA margin to be at 18.7%, only 48 basis points lower than previous year, and mostly in line with our guidance. On the other front, our net income has reached to TRY 364 million, which represents a very significant improvement versus last year's loss of TRY 179 million.

To continue with our Beer segment, domestic volume performance in Turkey improved compared to the first two quarters. Volumes were 4.6 million hectoliters in the first nine months of 2016 with a decline of 10.8% compared with the same period of 2015.

Our revenues performed better than our volumes and reached to TRY 1,108 million. Our revenues grew by 2.6% in the third quarter of 2016. Our EBITDA revenue called it to be TRY 318.5 million for the first nine months of 2016, 16% lower than the same period of the previous year.

Our profitability, as discussed, was under pressure due to higher fixed cost as a result of lower volumes, higher raw material costs due to FX, the main reasons for the pressure in profitability. Our EBITDA margin was 28.7%, 367 basis points lower than the same period of previous year. On other side, our net income improved significantly and was recorded as TRY 86.8 million.

Talking about out international beer operations. Our volumes were 11 million hectoliters in the first nine months, [indiscernible] (10:41) decline of 3%. As well mentioned by Robin, the minor decline than our expectations at the beginning of the year is mostly attributable to our performance in Asia.

Our revenues were $497.9 million with a decline of 18.4%. However, this decline is mostly attributable to the devaluation and fixed impact. Our analysis show that on a constant currency basis, our performance on revenue would show a growth.

Our EBITDA was recorded at $90 million, with an EBITDA BNRI margin of 18.1% which shows a moderate 39 basis points improvement.

Finally, in our Beer Group consolidated numbers, the volumes were 15.7 million hectoliters, with a 5.4% decline, whereas our revenues were TRY 2,590 million with a 7.8% decline.

EBITDA BNRI was TRY 551.1 million with a decline of 13.3% in the first nine months of 2016. Our EBITDA margin was recorded to be 21.3% with a 133 basis points decline in the overall consolidated Beer Group numbers.

Net income has recorded to be TRY 217.3 million, showing a significant improvement again as the previous segments that we have spoken compared to the previous year.

Talking about the free cash flow. As you all well know, free cash flow is one of our major priorities both in Anadolu Efes and as well in the Beer Group. First nine months, we were able to generate a strong free cash flow of TRY 173.1 million and we are very and particularly happy with this strong free cash flow generation.

Talking a bit about balance sheet items. We have – as also discussed by Robin, our net debt-to-EBITDA ratio of 1.8 times both in our Beer segment as well as Anadolu Efes consolidated numbers, which is very healthy level at these volatile times.

Our net debt on beer side was $386 million and on Anadolu Efes consolidated, our net debt was $1,053 million both of which declined compared with the same period of the previous year. Our debt repayment profile is highly favorable with an average maturity of 4.6 years on Anadolu Efes and on beer side and 3.3 years on Anadolu Efes consolidated level.

Finally, talking about our free cash flow generation Anadolu Efes consolidated numbers, as you can see in the slide number 20. Our free cash flow in Anadolu Efes have reached to TRY 723.2 million, which is contributed by both segments, Beer and Soft Drinks.

We are particularly happy, with our free cash flow generation, backed up by moderate CapEx and better working capital management as we have been discussing by the beginning of the year and couple of years for now.

And finally, talking a bit about our financial priorities. Yet, they haven't changed much until our last conference call. So our still priority will be sustaining the consolidated cash flows and our focus areas will be the working capital optimization as well as an optimized CapEx policy, and sticking to tight balance sheet management.

Efficiency improvements and savings and OpEx management will be continue to be our priority, as well as deleveraging and managing the impact of, especially, operational FX volatility in the operations. And finally, we still continue our commitment to our investment grade ratings.

This basically concludes my presentation. I will hand over the floor back to Robin for his final conclusions.

Robin Michael Goetzsche

Thank you, Onur. Just before I kind of sum up, I think it's important that when we go to Q&A, I'm sure I'll get asked about the impact of the closing of the Anheuser-Busch InBev, SABMiller deal. As you are aware, SABMiller was a 24% shareholder of Anadolu Efes and that now has transferred to Anheuser-Busch InBev, ABI. And ABI have indicated to us, in fact, confirmed to us that they will continue to be our shareholder, so there's no impact there. Certainly for us, in our growing concerns is business as usual, so we continue with our businesses as usual.

And, yes, over time, we will engage with them as partners around any future value enhancing opportunities that do exist, and I guess that will happen in the next – and coming months. So that's just broadly what I thought preempt just to discuss this. So, yes, ABI will continue to be our partner and shareholder.

In terms of the kind of rest of the year and going into 2017, certainly our portfolios are looking strong. We've done a lot of work around our brands, and the positioning of the brands also the right SKUs, so cutting out unprofitable SKUs and in the right places, launching new SKUs particularly things like multipacks and so on.

Execution, critical for us in our market, so the sales service model as well as the route to market models in all of the businesses continue to be under scrutiny and get refund. As we've indicated in the past, we will focus on getting quality market shares. So it's really around making sure we're driving the value for our businesses. And I think in terms of Onur's feedback, just to reinforce, certainly free cash flow critical for us on an ongoing basis, both CapEx having strong scrutiny as well as working capital.

And the soft drink businesses continued to look to improving both revenue and margin and at the same time focusing on the sales side of the business. In particular, as we know, the soft drink businesses are very key in terms of how we execute.

So with that, as background I think I'll just ask Onur to take us through the forward-looking view for the rest of the year.

Onur Çevikel

Well, thank you, Robin. As far as our 2016 outlook is concerned, we don't have any changes on this. So we basically reiterate our 2016 outlook that we had done in our midyear call. And there's no change in our 2016 outlook and we reiterate our guidance that has been provided in the last conference call and in our last announcement.

Robin Michael Goetzsche

Right. So then, let's open up to questions.

Asl■ K■l■ç Demirel

Yeah.

Q&A

Operator

Thank you. [Operator Instructions] Our first question comes from Tristan Van Strien from Deutsche Bank. Please go ahead.

<Q - Tristan Van Strien>: Hi, Robin, Onur and [ph] Altu■ (19:18). I've got three questions if I may. Just, Robin, on the first one, just a follow-up on your ABI statement. Obviously, they're partner and shareholder, but there – in the market also a competitor. So how does that work, like, if you could just give some color on that?

And the second question which is a bit related. As you got Miller Genuine Draft in your portfolios both in Turkey and Russia. Now that Miller – Molson Coors is owning those brands, how does that work? I mean, have you guys come to an agreement with them [ph] or a risk (19:50) you may lose those brands?

And the third – if you could give more color on your working capital opportunity, I mean, obviously, looks like Turkey is the drag, especially if you benchmark it internationally. Why is Turkey such a drag comparatively? What are the opportunities there to improve the working capital that you have?

<A - Robin Michael Goetzsche>: Okay. Hello, Tristan. I'll answer the first two and I'll ask Onur to comment on the working capital. In terms of ABI being a competitor, clearly at a optical point of view, it's really Russia, of course. And at this stage, we continue to compete as competitors in Russia. So, similar to any other deals that you've seen, we continue to compete there, and hence, in terms of information sharing, et cetera. Those aspects would be tightly governed around that until and when and if there's any change in that.

So, yes, we do compete. Our main impact really is Russia. The others, they have a small kind of import market in some of the areas but nothing big at all. And in Turkey, we, in fact, represent [ph] best (21:06) brand in any case.

In terms of MGD, yes, we've had a very good and positive interactions with Molson Coors and continue with that relationship. We value the MGD brand very highly in our system, and agreement with them is that we will continue with the MGD brand and continue to represent it.

I think worth making the point, I mean as a business, not just Anadolu Efes, but more broadly the Anadolu Group, we're very strong partnership driven cultures and organization. We have lots of partners including the Coca-Cola Company, McDonald's, and, of ,course a number of beer companies, and had a very good relationship with SABMiller, and we'd certainly continue to maintain that relationship with our new beer franchise or partners.

On working capital, let me ask Onur just to cover that.

<A - Onur Çevikel>: Yeah, for sure, and hi, Tristan. Thank you very much for the nice questions. Well, on the working capital requirement management, as we have been talking about that in the last two years, three years, we have been working in that and as you well pointed out, working capital requirement has its own peculiarities and changes when you compare it with different operations.

So that's why, we are taking each country separately and making sure that we manage our working capital requirement according to the needs and requirements of the market that we operate. Basically, working capital requirement is made of three items, basically, which are receivable, stocks and payables. And these may differ due to the peculiarities that exist in the market that we operate.

That's why we tackle this question more than a consolidated level and also we tackle it with each individual country operation. And each year, we have been reaching out to a better number on the working capital requirement as measured by the [ph] slow (23:22) working capital requirement ratio to the net sales. And if you look each country, we do see some improvement in each country in this parameter. Even in some countries, we can reach negative working capital requirement, which you well know that it's not that easy to reach. But as I said, the different peculiarities, different markets, that's why in some markets, the working capital requirement is higher. In some markets, the working capital requirements are lower.

Just to give you an example, an idea of what I'm meaning. Taxes, for example, differ. So in countries where we have higher excise taxes, the working capital requirement on receivables increases, and that's part of the case that we see in Turkey.

I don't want to get into too much detail on that, but that's how [ph] the efforts to (24:28) the working capital requirement.

<Q - Tristan Van Strien>: Thank you, guys. That's very clear.

Operator

Our next question comes from Anirudh Patwari from Goldman Sachs. Please go ahead.

<Q - Anirudh Patwari>: Hi. Thank you for the call. It's Anirudh Patwari from Goldman Sachs. I have three questions if I may, mainly on Russia. Can you please throw some light on the pricing trend in Russia? Basically, how much have you increased in this quarter and how's the competitor doing?

Second, if you could share some details about the market share in Russia for this quarter, as well as vis-à-vis the last quarter?

And finally, we saw a strong growth in the Russian market in this quarter. So I'm trying to understand how much of that is a function of lower comps and how much is coming from the increased demand in Russia. So basically, I'm trying to see if it's fair to assume that the Russian market is at an inflection point. Thank you.

<A - Robin Michael Goetzsche>: Thank you very much. As you well know, in the Russian market, when we had the very big devaluation of the ruble, clearly what happened was that it was very difficult for the market to price at that level. So it's kind of being a catch-up, I guess, over the period. You would have seen sort of for us, our increase this year was around sort of between 5% and 6%, and that's not different from much of the market. And so, still probably lagging inflation a little bit and I guess that to some extent has driven some of the growth just in terms of affordability.

I think the other point to make on pricing is that the market continues to kind of see growth in the modern trade outlets at the expense of traditional trade outlets. And that does two things. One is it does actually drop price down because they are obviously very, very price competitive. But it does put pressure generally on the suppliers. But hopefully, to counter that, we see volume flow through. So certainly, I think still a tough market from a pricing point of view and we're not seeing the industry being able to recoup all of the impact of, for example, exchange rate and so on.

For us, we've been very fortunate that we've done a very good job or our teams have done a very good job on obviously hedging ourselves at an operational level, and that's helped us manage our margins and our costs. And we have seen some good market share growth in our business which is obviously showing in our numbers, so positive growth for us in market share.

And on the growth, I think probably two points. I think, generally driven by the pricing, so I think the pricing helps. I think, the economy is not seeing the same kind of inflation levels that we are seeing in past periods. And I think the other interesting thing is very strong growth in the local, smaller brewers. As you know, there are over about a thousand brewers in the country and you certainly are seeing growth in what we call draught in off-trade, so very much local brewers in local cities selling draught in off-trade. So that segment is showing significant growth, mainly driven by very, very strong pricing. So, selling product quite inexpensively actually.

So kind of a mixed bag, as I said, and I think from our point of view, very positive in terms of mix into upper mainstream, in particular, which is a segment that we focused on this year to see growth. We are, as you know, strong in premium and we kind of [indiscernible] (28:24) at our sort of wait for what we call lower mainstream, mainly in the PET category.

But our focus has been that we call upper mainstream which are really the big local Russian brands, in our case, brands like Zolotaya Bochka and Stary Melnik, and we've seen our fair share gain in terms of market share there.

Thank you.

<Q - Anirudh Patwari>: Thanks.

Operator

We have no further questions at this time. [Operator Instructions] Our next question comes from Sanjeet Aujla from Credit Suisse. Please go ahead.

<Q - Sanjeet Aujla>: Hi, Robin, Onur. Just picking up the point on draught and off-trade and the growth that you've seen in the Russian market there. What share of that segment do you have and what investments are you making to try and capture your fair share of growth there? Thanks.

<A - Robin Michael Goetzsche>: It's quite difficult for me to comment on that because one of the things is obviously the market is measured in a number of ways. Clearly, most of the brewers use Nielsen and Nielsen doesn't cover a lot of that. So very difficult for me to give you an accurate number.

It also differs very much city by city. So, again, depending on which city you're in. I think the big thing with draught in off-trade is – the main thing is that everyone has to watch always and particularly, the sort of main big brewers watches its profitability. So, again, you don't want to be playing in market where you're not making any money. So, generally, it's kind of very local, but as I said to you, there is growth in that market, driven really, generally, by pricing.

I think one of the impacts that it'll have over time is the new [indiscernible] (30:30) system, where obviously the authorities are tracking much better. And without being explicit, I think that would enhance tax collection going forward.

<Q - Sanjeet Aujla>: Okay. Thanks.

Operator

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

<Q - Walid Bellaha>: Hi. Good afternoon. Thank you very much for your presentation. I just have the one question. With the lira being very volatile these days, could you just remind us of the hedging policy that you have on your operations, how much of your cost in – FX cost in Turkey are hedged?

<A - Onur Çevikel>: Well, actually – thank you very much, first of all, for the question. Basically, what we do on our hedging policy is to make sure that we observe the market very closely, and to make sure that we hedge the operational part and short-term operational part of our operations, particularly both in Turkey and in Russia.

Until the end of 2016, most of our exposure on the operations both on the cost side as well as on the OpEx side is hedged, and a part of 2017 is also hedged right now. But I am not able to give you any numbers until we give the guidance for 2017.

<Q - Walid Bellaha>: Thank you.

Operator

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

Robin Michael Goetzsche

Okay. Thank you very much, everyone. Let's look forward to the last quarter. Obviously, quite a low one for us in terms of going into winter in our markets. But clearly interesting times in the markets and I look forward to engaging with you with our full year results in the next couple of months.

So, thank you for your time and your effort and wishing you a good weekend wherever you are. Thank you. Cheers.

Onur Çevikel

Thank you very much for joining us today.

Operator

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