Company Name: Anadolu Efes Biracilik Ve Malt Sanayii AS

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Y 2019 Earnings Call

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Company Participants

- Asli Demirel, Investor Relations
- Can Caka, Chief Executive Officer & Beer Group President
- N. Orhun Kostem, Chief Financial Officer

Other Participants

- Ece Mandaci, Analyst
- Nikolay Kovalev, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to Anadolu Efes Q4 2019 Financial Results Conference Call and Webcast. Our presenter today, Mr. Can Caka; the CEO and Mr. Orhun Kostem, the CFO. I now hand over to the Investor Relations Manager, Ms. Asli Demirel. Please go ahead.

Asli Demirel {BIO 19904189 <GO>}

Thank you. Hi everyone, welcome to Anadolu Efes Beer Operations 2019 Fourth 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 {BIO 16475025 <GO>}

Thank you, Asli. Hi everybody. Good afternoon and good morning to those in the US. Welcome to Anadolu Efes full year 2019 results conference call. Obviously this is a very difficult time to have a conference call and talk about the performance of our company. We are very sorry about what's happening in Syria, and we hope that our soldiers who were in Syria to ensure settlement of the citizens. And today it's heartbreaking refugee ladies, rest in peace forever.

Obviously, we do not know what's happening, and we will not be able to comment on anything for the time being. I'm sure you all share the sorrow that we have an excuse us, if

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we sound a little bit dull through the conference call. We thought of cancelling the call, yet we decided to at least have the opportunity to review the numbers in a solemn way.

In short, our business delivered a very solid set of results through the year, where we were able to grow our EBITDA ahead of our revenues and revenue ahead of our volumes. Our magic formula worked through the year, we were able to record all-time low working capital, which enabled us to generate a very strong free cash flow, which is also obviously supported with the improved operational profitability.

Our net income was also at historically high levels. Furthermore, our board of directors had supported our proposal to share it with our stakeholders. Therefore, yesterday we announced also a dividend proposal amounting over a TRY1 billion. Winning with our brands and our portfolio, was our number one priority at the beginning of the year. And I think, we started to reap the benefits of this across all operations.

We managed to become the leaders of the operations, leaders in Russia and Ukraine, with deep focus on our brands and portfolio through the year. And we also enjoyed high margins in these operations, benefited from the better operating leverage and synergies of the merger. Furthermore, we were able to expand our leadership by increasing market share in Moldova and Georgia.

In 2019, people and talent has been the core of our focus and it will continue to be so in the coming years. We are building a cultural change in our operations, where the organization become leaner with an open communication and focusing on winning culture, capability development within the organization and developing our talents were key for us. And I can say that we are on a good track on these fronts. We also do our roadmap for digitalization and taken an important step in this regard. We vision Efes becoming a digital company within the next two years. We have taken important steps in this regard and we are about to kick a project to update our core Enterprise Resource Management systems and gather all mobile and digital efforts under seven different programs to lead all these efforts in one direction.

Our final area of focus for us is our relentless efforts to optimize our business, by lowering our cost, by lowering our spending and CapEx. These efforts are coordinated on the zero based spending and we are extending our efforts to different expense categories and to our international operations as well.

Now, I will be sharing a few comments on our performance, focusing more on beer operations, obviously. Then I'll pass over to Orhun who will give much more insights on the financials. Then I'll be back with our priorities for 2020 and for future guidance. During the fourth, we delivered 2.4% volume growth on a consolidated basis.

This was as a result of very strong volume performance, especially in our Russian and Ukrainian Beer businesses. Turkey Soft Drinks also contributed to our volumes in the quarter. Our revenue significantly outperformed our volumes, driven by price increases, made in all business lines. We also benefited from the favorable mix. Our EBITDA margin expanded over 200 basis points. Thanks to the performance of international beer operations, as well as the Turkish soft drink operations. We recorded over a TRY1 billion net

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income in 2019, mainly attributable to the improvement in operational profitability. Now with this, it was also boosted by one-off gains like the sale of our Istanbul Brewery land plot. We recorded a very strong free cash flow in 2019.

I would once again like to underline that this was a result of significant improvement in working capital across all business lines. As a result, our net debt to EBITDA ratio decreased to 1 times, as of the end of the year. I have already gone through the financials. But what I would like to draw your attention on this slide is the growing share of our international business, within the total portfolio. We are benefiting from the diversification of our business and geography and our portfolio is getting more balanced. As is shown in the figures, the dependence on Turkey is getting less and the share of international business is increasing.

Now, one-third of our consolidated operational profitability is generated by our international beer operations. Regarding our beer business, the volume growth was almost 5% in the last quarter and 6% on a full year basis. The volume growth was nourished by the solid performance of Russia and Ukraine. But our strategy of revitalizing our core brands also contributed to these brands in every other international operation. You can also see the breakdown of our beer volumes on country basis where 85% of our beer volumes were generated in our international markets.

Specifically in Turkey sales volume was under pressure in the last quarter of the year, just like the previous quarters. The macroeconomic environment as well as the deteriorating consumer confidence have pressurized the whole FMCG sectors throughout the year. Beer market was down by mid-single digit in -- for the year, negatively affected by the high price environment on top of the macroeconomic and the low consumer confidence issues. In such a challenging environment, in-line with our commitment to drive value growth, we were able to expand our premium category. We never gave up investing in our brands and even increased our spending on marketing in order to strengthen our touch with the consumers.

On the international beer side, we had a robust performance this quarter as well as -- were the volume increased 7%. The Russian market started the year very strong as you would recall, however, the amount become tougher in the second half, partly due to the high comparables coming from 2018 season. The market closed the year with flat volumes, where we were able to outperform the market with high single-digit volume growth. We've managed to become the leader in the market in the second year of the joint venture, second year of the merger. I'm pretty content with the performance of the operations, where we were also very successful in achieving the synergy targets.

Ukraine market was also flat on a year-on-year basis, but our significant outperformance was assisted by the launch of products such as Kozel, Beily Medved, Stary Melnik iz Bochonka coming from the former Efes operations portfolio. In Kazakhstan, Moldova and Georgia, our leadership were maintained. In Moldova and Georgia revitalizing our core brands paid-off [ph] yielding additional market share gains, especially in the second half. And in Kazakhstan, we see our competitor discounting heavily and gaining certain market share in modern trade especially. However, I'm very confident with health hold and standing of our brand portfolio. We have also started to launch AB InBev brands in all of our international operations, extending our portfolio on the premium segments, in-line with our commitment

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to premiumization. Before I leave the floor to Orhun, I want to touch based on the soft drinks performance as well. Consolidated sales volume was up by 1% in the period, being negatively impacted by the headwinds in international operations, Turkey and Central Asia, CIS delivered very successful results where we were able to mitigate lower volumes in Pakistan. Macro headwinds had significant impact on Pakistan and Middle East volumes during the year.

Now, I hand over to Orhun for financial review.

N. Orhun Kostem

Thank you, Can. Good morning and good afternoon everyone. Obviously, we're quite happy to be able to report a very strong set of numbers for 2019 for Anadolu Efes. And we're happy that our growth algorithm holds strong top-line growth and margin expansion. And this year, obviously there are a few other items that I want to point you out about our performance. First of all, obviously, we're quite happy how our international beer business is doing. On one side, and this was an important year as the merger -- our operations in Russia and Ukraine were concluded. It was quite important that we had a seamless integration process, which was in place and also we have been able to deliver a strong set of results from the joint venture. Both top-line growth and bottom line margin expansion.

In other markets of operation outside of Turkey, we still see above average margins, a healthy growth and healthy balance sheet and cash flow generation. So overall, as you see the international beer revenues grew by about 32%, over an 8% volume growth, whereas [ph] EBITDA was a whopping 84% -- approximately 84% growth. And that the margin expansion there were of 450 basis points. Obviously made up for the contraction in Turkey. Again it was a challenging year in Turkey where we've seen the top-line contracting. We have been able to reduce the gross profit margin contraction about 120 basis points. And as far as the marketing and sales expenses are concerned, as we have been communicating throughout the year. We have -- in this year, we have stepped up our marketing expenses and investments in the market. And hence, we have seen in a contracting market and a contracting top-line, our EBITDA margins contracting as well. However, together with the strong performance of the International Beer Group overall has performed quite well. And over, just under 6% volume growth, we've seen revenues up by 30% and 50 plus percent EBITDA margin growth, with a margin expansion of 230 basis points. So that's, and -- translating into Anadolu Efes obviously together with CCS performance, we have been able to expand our margins to 120 basis points, over a net sales growth of about 22%.

That's pretty much the P&L. And if we get to the details of the EBITDA in the next page, obviously the volumes in the international brewing business. If you look at the Beer Group EBITDA has been an important driver of our profitability this year. We've -- as I said, we've continued to invest in sales and marketing. That's true for Turkish business, also would be true for our international businesses. But obviously we have been able to maintain our G&A expenses and we have seen about TRY172 million of conversion coming into our EBITDA this year.

And these numbers as you see that ends up with a TRL1.768 billion, also includes IFRS 16 -- impact of the IFRS 16 that's fully impactful in 2019. Now if you turn to the cash generation that's obviously we have seen in Anadolu Efes a very strong cash generation of TRY2.3

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billion. And in the beer side and the beer grew TRY1.3 billion and obviously on top of the EBITDA, what was quite important to see this year was how we have been able to manage the working capital. The working capital as a percent of revenue, on the Beer Group side is on the negative territory. That's primarily owing to our businesses in Russia and Ukraine. Having said that, without those businesses we have been able to half the core working capital, as a percent of revenue in all new business. In Turkey, for example, we have been able to convert the cash cycle to the negative territory, about minus 15 days. So that was a very important performance and what is quite important also is that our gains that we have reached in the inventory days and etcetera are coming from certain initiatives of which we will continue to see the impact going into 2020.

And then, if you look at the CapEx in '19 versus '18, it was pretty much at comparable levels, 9.2% in 2019 versus 9.4% in 2018. So that was quite comparable.

Also in 2019, obviously we've to say, there has been a number of our sales of the idle assets that we have done. The biggest one of which was the land of our old Istanbul brewery, basically that also added back to the free cash flow generation this year. But overall, I think it's important to note that we have a very strong free cash flow generation. And I'm happy to say, if you exclude the land sales, which could be -- which is obviously a one-off for 2019 all the gains that we have achieved under core working capital, we would be able to continue maintaining and building on in the coming years.

If you look at the balance sheet piece, which obviously is quite important given how the currency can move and today's [ph] an example of that. As you know, on one hand, we continue to have a 57% of our debt hedged through the net investment hedge and cross-currency swaps. in Anadolu Efes, that corresponds to about 69% of our debt on the beer side. And the remaining unhedged portion, the majority is in local currencies, and Turkish lira that we believe doesn't create much volatility going forward.

What, we don't talk about here is obviously the risk management that we do to manage our P&L. You will remember that in 2019, we have hedged about 90% of the FX exposure of our Turkey P&L based corresponding to COGS, OpEx and interest. We already hedged 86% -- sorry of that exposure for 2020. And in addition, we've already completed just under 90% of our barley purchases for 2020. So we are pretty much ready for the season.

On the commodity side, as you know, we have actively also looking to manage the risk coming from especially aluminum that's impacting the cans. Starting from 2019,we started to hedge financially and that's about 60% of Turkey's exposure and about 40% of Kazakhstan's exposure. But if any of you are following the markets, obviously the aluminum prices are getting softer and softer and currently we are enjoying the supply prices. And we are looking to continue fixing prices, potentially on a longer-term because in the shorter-term, we would very much like to continue enjoying this pricing environment.

In the next page, and as a result, if you look at our, P&L cash flow and balance sheet have done. Obviously our net debt to EBITDA was at one times in Anadolu Efes and 0.9 times at the Beer Group. So we are, let's say -- we are at the lower end of our policy level, which we said that we intend to keep between one-time to 2 times. We hold a majority of our cash in hard currency. In fact, obviously, we also can now receive dividends coming from the international brewing business that's driven by generation of free cash flow in each of our

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international brewing businesses, which is good news versus 4% of that is in our hard currency in on the Beer Group side that's as of end of 2019.

And therefore, as you see in the next page, about $115 million of worth of debt maturing in 2020. In fact, we already paid down a little over $40 million of that exposure. So we're going to run a very continue to run a very healthy balance sheet into 2020 as well. Obviously, the majority of our debt exposure is due 2022 that's owing to the Eurobond, that's maturing by the time. And therefore we would be between now and then considering how to manage that liability. And obviously, it gives me obviously great pleasure to say we will see how we can make our two investment grade ratings work in identifying and evaluating the alternatives to do that.

And on the next page. In a nutshell, if you look at our financial priorities as we said the funding plan for 2020 is on track. And we would -- obviously would like to maintain our leverage between one times to two times and that's the -- leverage ratios that you should be following. And in fact, we are quite comfortable with the maturity of the debt in 2020. We are managing actively the FX and commodity exposure, and we will continue driving down working capital requirement as we have done so in 2019 that we will continue. The zero-based spending, we are expanding the base between 2019 and 2020, not in terms of categories, but also we have expanded and managing it in other countries out of Turkey as well.

Our joint venture already has that -- obviously ability and capability. And you should expect us to continue focusing on our balance sheet held and free cash flow generation, with very strong financial discipline in 2020. With that I'll hand it back to Can.

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Can Caka {BIO 16475025 <GO>}

Thank you, Orhun. You would remember at the beginning of the last year, we set our priorities mainly focusing on people, on our brands and corporate wisdom as we define the excellence in operations, the infrastructure and the digitalization and vision. And obviously, on the funding layer, it's always the financial discipline for us. So when we look at these priorities, starting with the brands, I mean, these priorities will continue for 2020, as well and we will be focusing on our core brands. And on the other hand, we will continue to provide different choices with great taste and quality to our consumers.

We are committed to grow in value terms through premiumization and by expanding our portfolio as well. Obviously, we will never ever sacrifice the quality, that's number one priority. And in order to create a lean and efficient process management, we are well aware of the importance of the improvement in corporate wisdom. And I was mentioning before our priority will be on investing more in people. We believe in the potential of our people, we know how important it's to nurture the talent for the future of the corporate.

No need to say, as noted, financial discipline has been one of our priorities, part of our DNA and proven by our solid financial performance we'll be -- continued to be prudent on CapEx spending, balance sheet management and free cash flow generation. Before going into our guidance, I would like to also comment on another side issue on the outbreak of Coronavirus. Unfortunately the globe is facing a very, very important health issue as well and we are currently assessing the development -- following the development of the virus outbreak and it seems the challenges are expected to continue for a while. The virus -- Coronavirus will negatively impacted our business in China, as we are one of the -- China is one of our major export markets, especially from Russia. However, we would like to underline the fact that the export business has limited share, within our total sales volume. We'll continue to observe the progress of the outbreak and we will revisit our 2020 expectation in due course if necessary.

I guess, now we are ready to take your questions. Thank you for listening.

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Questions And Answers

Operator

(Operator Instructions). We already have a question from Nikolay Kovalev, from VTB Capital. Please go ahead, sir.

Q - Nikolay Kovalev {BIO 19173928 <GO>}

Yes, hello. I have two questions on your Russian operations. First is on the price competition, given that you now at the first part in the country. Do you see that the next rival is trying to gain market share back due to the aggressive pricing policy. And my second question is on your international profitability. You guide for the improving EBITDA margin from already quite challenging level. So I was wondering, are you keeping intact our synergies estimate? Or you see some upside risk, and also what share is attributable to 2020 out of your total synergies expectation from the merger. Thanks.

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A - Can Caka {BIO 16475025 <GO>}

Yeah. I mean, specifically for Russia. Let me take the first question and for the synergies I'm sure Orhun would help. I mean for Russia, specifically I mean significant part of the business is going through Modern Trade. There is always kind of a, let's say continuous relationship and continuous promotions through this channel to our consumers. So there is the fact that price discounts and promotions continue in the market and we'll always beat that.

When we look at our portfolio and when we look at our business, certainly, we see our business very well balanced between different segments and we have a strong lead on the premium side of the portfolio that is helping us. In that perspective, we have a strong position in the major cities in Russia. Higher market share than our average market share. Those are contributing to the current trend of our business. And in that perspective, when we look at the -- let's say our brand's positioning of our portfolio positioning within different segments, we see that we have with respect to the pricing we have very healthy, very reasonable position of our brands within every other segment.

So in that perspective, our business or the merge business was a little bit under-indexed in terms of traditional trade and in terms of core in the past because of various reasons and the combination actually had helped us in terms of developing our businesses, in these channels and segments, driving out the synergies, driving out the utilizing the infrastructure that we have and benefiting based on all those with the strength that we have.

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So in that perspective, yes the business continues on a well track and I believe this is a big [ph]. We are very happy with the performance, we are very happy with our brands and portfolio standing. We are very happy with the execution on the ground. So it is not as simply as a price competition in Russia. It is about the brand portfolio, it's about reaching out to consumers and creating the relevance with the brand portfolio, with the brands that are winning. So in that perspective, we are very happy with what we have today.

Orhun, would you like to comment on?

A - N. Orhun Kostem

Sure. And as you will remember our guidance for the synergies was somewhere between $80 million to $100 million and that had a three-year outlook. So, two years behind us and we are ahead of our expected progress in terms of delivering synergies. So that's good.

If we continue doing so, potentially we could end-up at the higher end of the range in terms of synergy deliveries, which is also good. But I wouldn't say in 2020 the majority of that margin improvement is going to come through synergies. Now, we are happy in the first two-years of the JV that we have been able to build top-line momentum, by leveraging the synergies that we extract out of our base. And obviously going forward we would very much like to see how we can further extract cost and expense out of our base, but the majority of synergies are behind us. So the expected margin expansion again, as Can was explaining is going to come from our scale, our top-line, our portfolio and our revenue growth management and any initiative that we're going to take from this point forward, not because of synergies, but obviously that's how we would very much like to work taking cost and expenses out of our base.

Q - Nikolay Kovalev {BIO 19173928 <GO>}

Well, that's very clear. Thank you very much.

A - Can Caka {BIO 16475025 <GO>}

Thank you.

Operator

Our next question comes from Ece Mandaci from Unlu & Co. Please go ahead.

Q - Ece Mandaci {BIO 16138484 <GO>}

Hello. I have a follow-up question about the EBITDA margin progression going forward in International operations. In 2019, we have seen significant improvement in your EBITDA margin and previously you were guiding some figures like 17% medium-term -- in the short term, 20% in the long-run. Do you still maintain these EBITDA margin guidance, since you have a slight strategic change with higher volume growth in the market and market leadership position. Could you please elaborate on your strategy going forward in the market overall. Thank you very much.

A - N. Orhun Kostem

I mean strategically obviously if Can wants to add he would. Having said that, margin-wise, I mean -- in general, what we have been saying was that obviously the margin base of our international business can continue improving. And the reason we were saying that was if you look at the operations that is today forms the JV. The EBITDA margin is coming from single-digit and now obviously its grown into a healthy double-digit territory and we would very much like that to continue.

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And that should at least if you take the joint venture, come closer to the average of what we delivered in our Beer Group because that's currently behind. On the other hand, if you look at our businesses outside of Turkey and outside of the joint venture, these are already businesses that deliver healthy EBITDA margin that are over let's say 20% levels and we would very much like to maintain that. Now these are obviously -- we always plan towards margin expansion. But given the size and scale of the business, the biggest driver there obviously would be the joint venture. But again, when we were having this discussion at the time, the understanding was the same because we were -- we wanted to make sure that we were building momentum into our business.

In the joint venture, 2019 was very critical, given that this was the year where the integration was going to be completed. And we would very much like to ensure that our portfolio continues to work and it can work to our favor. Now, given the scale. So, there has not been a change of strategy there.

Q - Ece Mandaci {BIO 16138484 <GO>}

Thank you very much.

A - N. Orhun Kostem

Thank you.

Operator

(Operator Instructions). Well, it seems that we have no further question for the moment. So I give back the floor to the Company.

A - Can Caka {BIO 16475025 <GO>}

Thank you all for participating to the call. Hope to see you on the next one.

A - N. Orhun Kostem

Thank you very much. Bye, bye.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you all for your participation, you may now disconnect.

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