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Sabancı Holding
Q1 2023 Financial Results
Webcast

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Speakers:
Orhun Köstem, CFO
Kerem Tezcan, IR Director

Mr.Kerem Tezcan, IR Director: Good afternoon, good morning everyone. Welcome to Sabancı Holdings' first quarter webcast. Please refer to our to our disclaimer before we move on to presentation. I have our Group CFO, Orhun Köstem with me today. Orhun Bey floor is yours.

Mr.Orhun Köstem, CFO: Thank your Kerem. Again good morning and good afternoon everyone, wherever you are. Welcome to our first quarter results webcast, we're very happy to be here. When we announced our annual results we had at the time referenced to the earthquake given that happened back in February the 6th having said that this is the first time that we can quantify some of the impact that actually we can show and talk about. If we look at the general highlights, first of all we believe we have reasonably good start to the year and potentially more opportunities in the rest of the year. We've seen our top Line growing by 76 percent, combined EBITDA by 27 percent and our consolidated net income by 18 percent. We're happy that we have been able to deliver an ROE of 35 percent, obviously that's higher than what we have achieved at the same time same quarter in 2022.

We believe we still maintain a very healthy balance sheet at 0.4 times net debt/EBITDA at the end of the period, we have a across the group a long FX position of 318 million dollars and the holding only cash position at the end of the first quarter was 338 million dollars. We believe depending on the outlook and expectations for rest of this dynamic 2023, we believe it will allow us to be more defensive or offensive as the case may be as the year falls ahead of us. One very important a message and I hope that you have been able to follow that in addition to our 2050 carbon zero commitment we have just announced our interim objectives. We have committed now to reduce our scope one and two emissions by 42 percent across the board by 2030. These are actually without any carbon credits to be more specific. We are obviously working with the Science Based Target initiative and our group companies defining the scope 3 coverage is now seven. We are continuously supporting our objective statement as a group and in that we expect by the third quarter of 23 we would be able to cover about 60 percent of all ours scope 1 and 2 emissions under Science Based Targets initiative. That's an important milestone we believe in our journey.

Our net asset value has grown by 54 percent on a year-on-year basis at the end of this first quarter. As you know our net asset value discount is down to 26 and have improved from about 34 percent compared to a year ago and I believe this adds quite well to our overall value proposition in Sabancı Holding market capitalization.

Moving into the financials, I would like to draw your attention to a little bit about background, what's happening on this year. Between 2021 and 2022 where the commodity and the energy prices have been relatively higher which was quite remarkable in the first quarter of 2022 obviously owing to the fact that this was at the start of the Russian adversary against Ukraine as well. We are seeing at the first quarter easing on both fronts both in commodity and energy indexes. It's a debate in rest of the year how China will grow and how the demand for both commodities and energy will shape but that has been the environment in the first quarter globally. If you look at something more specific to Turkey, given the relatively higher inflation that you see on the top left corner the consumer price index was 72 percent across 2022 and it now came down a little bit about 50 percent in the first quarter of 2023. Nevertheless, the minimum wage increase was quite a significant to see. On an index about 100 basis points between the first quarter of 2022 to first quarter of 2023 and if you've seen how it has developed between the years of course there was a massive increase starting from 2022. What that means is obviously in terms of our businesses it impacts the operating expenses in some of the other businesses like insurance it potentially impacts the minimum capital requirements. It is an important element to follow. On the bottom right you see how the FX basket has been moving 73 percent in 2022 and then starting from a 79 percent in the first quarter of 2022 and now about 34 percent in the firstquarter of 2023. There was a slowdown in the basket devaluation which obviously has implications on our bottom line especially when you compared it to the first quarter of 2022.

On the combine net revenue side we grew our net revenues by 76 percent of course Akbank’s net revenue have grown in excess of 100 percent and then the non-bank businesses revenues have grown by 62 percent. If you look at the combined EBITDA an overall 27 percent growth, slowdown coming from the bank which has grown by 31 percent but also from non-bank businesses where the growth was about 20 percent. I'm going to walk you a little bit detail about the breakdown of the contribution of different segments of our business into EBITDA, I think we can say that we're happy that we still have a diversified portfolio of businesses where one part of the business had a slow start to the year which is compensated by some other part of our business . If you look at the net income the overall net income growth was 18 percent. On the bank side this was a 40 percent, on the non-bank side there is actually you see like for like contraction of 15 percent. Two things we're going to address going forward. One, something that our colleagues on the bank side must have been referring to as to their CPI link portfolio where the inflation assumption makes a difference about 800 million TL so from their assumption which is 35 to let's say 45 which was more or less the case, the difference in this quarter would have been an incremental 2 billion Turkish Lira which is an opportunity for rest of the year if you feel that the inflation would be more towards fortyish than thirtyish . Moreover as I said if you look at the devaluation in the first quarter of 2022 which was 79 percent of course we see an incremental 400 million TL give or take that we have recorded in the first quarter of 2022 which is not the case in the first quarter of 2023 because the devaluation has slowed down. If there's anyone obviously that has viewpoint that there could be more Turkish Lira devaluation for the rest of the year, of course we should keep that in mind again as a potential opportunity for our bottom line.

If you look at first of all to return on equity on the non-bank business you know it is pretty flat our overall ROE has grown with some contraction on the banking side. Our operational cash flow was continued to be quite healthy. You remember this time around last year we were discussing uncertainty on the working capital of Enerjisa Energy business due to the price equalization mechanism, as this has been resolved toward the back end of 2022 we see a very serious swing of our operating operational cash flow in our businesses. Please bear in mind this comes at a time when the working capital performance of some of our businesses were far from perfect that's primarily attributable to the impact of the earthquake. Some of our businesses like Brisa have already extended their receivables from their business partners like distributors in the period to ensure that they can support. Similar for businesses like Temsa bus business who had to shut down for a period given their facilities are in Adana. Although we didn't have any issues physically of course there has been some impact that flowed into this first quarter so therefore we're quite happy that we have been able to deliver this quite strong turn around in the operating cash flow. Again that's now significantly supported by our energy businesses.

Our holding only net cash position is about 6.5 billion TL slightly less than the same quarter of last year which was at 7.7 billion TL at the end of the first quarter. Our net debt/EBITDA stands at 0.4 times. For me this is quite remarkable because as we've discussed across 2022 the amount of investment that we put into our business, acquisition of businesses or etc. I'm quite happy that we're able to maintain a very healthy cash and balance sheet position as I said which we hope will enable us to play both offense and defense based on how the rest of the year will develop.

If we get to a breakdown of the businesses or the contribution of the business segments to the financial performance, the overall 76 percent growth of our top line the biggest contributor is the bank followed by the energy business. We have now separated the digital as you see that's just for the reminders, we have now established a separate digital business unit folded Teknosa underneath that. For those of you who we have discussed for most of last year in 2022 that Teknosa is transforming itself to marketplace which we launched in February of 2022. As long as we're successful in continuing doing that and so far we have done so. We see Teknosa as a digital business and part of our digital initiative. The businesses that we acquired under the digital, cyber security business is doing quite well, the digital marketing business had a relatively slow start to the year that's owing to the impact of the earthquake and the impact of the earthquake on the general marketing budgets which again is an area that we expect to be normalized in the course of rest of the year. Otherwise the growth of this business is quite satisfactory for us. The Industrials was also an important contributor to our topline as well as the building materials and financial services. On the other now there is a retail business , again a very healthy topline growth that we've seen in the first quarter.

When we get to the EBIDTA, growth of the energy segment was at about 13 percent We're happy that we have both generation and distribution businesses together something that we have repeatedly told you over time the benefit of the portfolio, given that the electricity prices are relatively lower the electricity demand is relatively lower versus last year and then we're going through lower hydrology period. Generations start to the year was slower than the distribution but overall we're happy with the contribution and we believe there are more opportunities as we go in in rest of the year. The Industrials' contribution was much less, that's owing to a general market outlook because obviously at the start of the year as the expectation on the economies was relatively bleak especially re-changing part of our business not the original equipment but the replacement part of tire business globally was relatively slow which obviously had the impact on the industrial in general side. It is expected to normalize hopefully in the next half of the year. We're quite happy that the building materials' contribution was very strong. Together if you look at these two businesses we had a satisfactory contribution to our EBITDA base and the financial services basically coming after that.

If you look at the net income. Apart from the banking contribution, the contribution of the energy segment was much better than the EBITDA with a 49 percent growth year on year. Between the building material and Industrial there's a balance. Although of course the contribution remained limited given the industrial segments contribution was under a negative territory. As you see in the other piece there's about 850 million TL swing. Majority of that is owing to the fact that as I told you the FX gains which were there in the first quarter of 2022 with a 79 percent devaluation of the basket which was not to the same tune inthe first quarter of 2023 and that's how the net income has unfold between the first quarters.

If we move to the performance of our stock price as we said our net asset value has grown by 54 percent in dollar basis and 8 percentage points contraction of our discount rate. Since the starting from the third quarter of 2022 our discount has more or less stabilized around mid-20ish levels. That's obviously quite low when you compare to the averages of the last three, five and ten years. If you look at the contribution of the net asset value again here you see the way that we strategically describe to you the Banking and Financial Services together and then the Advanced Material Technologies which is mainly today's building materials and Industrials contribution together. The energy and climate technology's piece is relatively understated given at the back of this presentation in the appendix you're going to see the breakdown of our net asset value where we refer to the unlisted Enerjisa Üretim generation piece by the book value and that's actually represents its contribution basically and then the rest as you see. Hopefully going forward more balanced between the Energy and the Advanced Material Technologies and hopefully with the growth of the Digital Technologies across our net asset value breakdown. If you look in the course of last 12 months even though our share has comfortably over performed BIST 30 index we believe that our P/E multiples potentially could point to more value generation going forward. So with that I'll pause and leave the ground Kerem, who's going to walk you through some details of our business segments.

Mr.Kerem Tezcan, IR Director: Thank you, Orhun Bey. Let me start with the Energy segment as always. We continue to benefit from our diversified business in energy in terms of generation and distribution. In Q1, energy segment delivered a robust performance despite the Earthquake in the eastern part of Turkey, which affected more than 10 cities at which both of our energy businesses operate.
As for the generation business; Enerjisa Generation's revenue growth remained limited at 15% year on year due to low demand, decline in electricity prices and low hydro generation due to drought conditions in Türkiye. On natural gas, EBITDA remained below last year due to lower prices, lower demand and lower dispatch contribution. On renewables, EBITDA performance remained in-line with last year as lower generation volume offset by higher dispatch contribution and FX linked feed in tariff revenue. On coal, EBITDA performance was strong thanks to higher dark spread driven by higher market prices and high generation volume on strong availability.
Net debt/EBITDA further dropped to 0.6 times in Q1. In addition to strong EBITDA performance, lower financial expenses and lower effective tax rate resulted in a %48 year on year growth in net income compared to last year.

With regards to Enerjisa Enerji; despite the impact of earthquake, Q1 Operational Earnings increased by 41% to 3.8 billion TL . On distribution business, positive impact of financial income driven by high inflation was neutralized with negative efficiency & quality impact, mainly due to earthquake related operational expenses. The contribution of the Retail and Customer Solutions business unit in operational earnings slightly increased to 21% in Q1 from 20% last year same period. Costumer solution business gross profit resulted below prior year due to the shift of projects to subsequent months because of earthquake focus.The regulated segment's gross profit increased by 50% mainly due to the increasing energy prices. Meanwhile, liberalized gross profit increased due to increasing energy prices and a low comparison base.

Below operational earnings line, financial net expenses decreased due to lower average debt and decrease in financing cost.

For the Industrials segment, combined revenue growth remained at 43% year on year in Q1, due to weakening demand in tire reinforcement market despite strong local demand in tire business. Moreover, stronger TL and last year's high base have played an important role in slower momentum in revenue growth in tire reinforcement business. Segment's EBITDA margin deteriorated due to high base impact. Moreover, in Q1, COGS to sales ratio of tire reinforcement business was negatively affected from high-priced inventories and rising share of personnel expenses due to wage inflation, which remined above USD/TRY depreciation. Coming down to the bottom line, net profit declined by 19%, led by higher net financial expenses due to increasing debt position related with financing of Microtex acquisition. Net Debt/EBITDA for both businesses remained above last year. In tire business, higher dividend payments and capex spending are the major drivers of this increase. In tire reinforcement business, Microtex financing is the major reason for the elevation in debt. Yet it is important to note that net debt level of tire reinforcement business is still in line with global peer averages.

Moving on to the Building Materials, despite sluggish global demand, segment's topline grew by 90% as local demand remained strong. EBITDA growth and margin improved in Q1 driven by sales mix that is dominated by the domestic market, better energy margin and fuel mix optimization. Segment's net income grew by almost five folds compared to last year thanks to strong EBITDA pass through and relatively lower financial expenses as segment's net debt continued to decline.

Our Digital Segment's topline grew by 117% with a higher contribution from electronics retail business on basket size and customer traffic growth, driven especially by higher demand in telecom sales.

Our new digital marketing and cyber security companies also contributed strongly to the topline growth of the segment. Worth to mention one that we have successfully completed the acquisition of SEM and Radiflow back in Q2 last year, which was an important step for strengthening our presence in digital business.

In addition to physical store sales growth on higher basket size, e-commerce sales positively contributed to the segment's topline growth driven by more than tripling gross merchandise value owing to the marketplace investment in February last year. Segment's EBITDA margin deteriorated in Q1 led by adverse impact of sales mix in electronic retails and high fixed cost to sales ratio in new digital marketing and cyber security companies due to ongoing integration process. Higher financial expenses pressured net income growth.

Financial services segment had another quarter with robust performance as top-line growth reached 112% y/y driven by life and non-life businesses.Segment's EBITDA more than tripled with the contribution from both businesses.

In life business, number one market position maintained in all of its product range. While technical income before general expenses was as strong as top-line growth, EBITDA growth remained limited at %27 due to wage inflation. Asset under management reached TL 8.7 billion up by %102 y-o-y, and average annualized yield stood at %24. Net income remained below previous year due to limited financial income contribution on lower CPI linker income and lower interest income.

In non-life business, top-line growth reached %108 compared to last year and selective growth approach in non-motor and health prevailed in order to improve the combined ratio. EBITDA growth remained strong growth thanks to improved motor segment loss ratio that declined to 112% from 164%. Expense ratio increased from 11% to 15% on wage inflation.

On retail, segment's revenues increased by 105% y/y, which was well above the average inflation driven by like for like basket growth despite 5 stores closures at the earthquake region. Operating profitability deteriorated compared to last year led by elevated operating expenses, especially driven by cumulative minimum wage hikes in the past twelve months. High financial expenses continued to push net income down to negative territory

On banking, Akbank is one of the best-positioned banks with its superior capital and liquidity buffers, agile balance sheet management with the lowest TL interest rate risk among peers, prudent risk management and solid efficiency. Its cutting-edge infrastructure, sophisticated digital capabilities and competitive product offerings gives the Bank superior ability to focus on future while dealing with the daily challanges and volatility.

In 1Q23, the Bank reached a solid 3.6% RoA and 27.9% RoE, while maintaining a low leverage of 8.2x. Buffers remain for both ROA and ROE, as the Bank used 35% for CPI-linker valuation vs YE expectation of 45%. Had the Bank used 45%, reported ROA and ROE would have been notably higher at 4.2% and 32.9%, respectively. Akbank proactively complies with regulations while focusing on maturity mismatch. As a result, TL deposit to total deposit ratio reached 60% as of February 2023, meanwhile fixed rate bonds for CBRT pledge is limited at TL 30 billion as of April 2023, which is only 2% of its total assets. Outstanding momentum in customer acquisition accelerated further during first quarter, as Akbank gained 730k new customers, on top 2.3 million gained last year. This customer acquisition, has resulted in record high market share gains across the board, in consumer loans, broad-based deposit base, and demand deposits. Robust x-sell ratio along with sizeable customer acquisition led to across the board fee performance in 1Q23 as well. The bank keeps its leading position in capital with a robust figure of 18.6% which will continue to provide the bank significant competitive advantage going forward.

This concludes our segments financials. We can move with Q&A. Please use Zoom's Q&A section for your questions.

Question: What is driving below inflation growth in the energy and industrials businesses in Q1?

Mr.Orhun Köstem, CFO: Thank you. Kerem also explained a little bit on the energy side on the generation side especially. The electricity prices have been lower the first quarter there have been reductions in electricity prices I’m sure you must have noticed which impacts our generation business negatively, impacts the distribution business positivel. More importantly the hydrology has generally been lower this year compared to last year which I believe is something we're going to see for the rest of the year as well so basically it was more about the spark and dark spread which was relatively stronger. Going forward hopefully is a opportunity for rest of the year between the energy demand and electricity prices especially for the generation business. On the Industrials again as I said it's more about a general global market outlook also true for the Turkish market where we see a slower demand pickup in the replacement business and then that is you know met by a stronger demand in the original equipment business but obviously if you look at the automotive industry which actually is relatively stronger compared to last year tire replacement business potentially in the rest of the year could pick up but that's a time lag issue you know we don't see that in the first quarter which resulted in a relatively slower growth for the Industrials section.

Question: Do you think to exit CarrefourSA operations in line with your investment strategy which focuses on lower regulation, more Fx revenue?

Mr.Orhun Köstem, CFO: Well I think if you look at the food retail of Carrefoursa business obviously that business has somewhat improved its financial performance over the course of 2022 and actually continued to do so in the first quarter of 2023. If you look at our general you know strategic outlay where we say, we specifically would like to invest going forward on Energy and Climate Technologies, Advanced Material Technologies as well as Digital Technologies obviously we will need to see how Carrefoursa may fit into that strategic framework or otherwise you know back to your point could be a divestment opportunity for us.

Question: NAV discount is around 26% now. What is your next target over the medium term and what drivers should help you get there?

Mr.Orhun Köstem, CFO: Thank you. Over the top of mind target is difficult. Having said when some of the investments that we're making today like are expanding our footprint in Renewables in the U.S as well as in Turkey the higher contribution of the of the digital business basically or any new initiatives in the overall Advanced Material part of our business which is either the building materials or the Industrials of today segments I think we hope to see a potential value proposition. It's a matter where we can see the discount taking place I'm sure you must see that if you measure our discount to the listed assets its almost at par today I think I'm looking at yesterday's closing about one to two percent difference. I'm not suggesting that's a target all I'm saying is obviously there should be more for us to lower that discount going forward given the value proposal of our businesses.

Mr.Kerem Tezcan, IR Director: It seems like there are no further questions. Orhun Bey floor is yours for the final remarks.

Mr.Orhun Köstem, CFO: For the closing, let me reitirate our mid-term guidance. In addition to everything that you heard we also have integrated our 2030 score one and two emission reduction objectives into those which we'd be more than happy to follow up. The reason why we can reiterate our guidance is on the last page that you see at the start of this year what we see a solid set of results in a relatively uncertain environment I believe we have a great portfolio of businesses and balance sheet which is robust. In general if you see any macrovolatility in the rest of the year like for exampl,e potential devaluation or etc. I believe in our non-bank businesses we look at a very robust piece. We measure that even though we can build another 10 percent devaluation of the basket into our macro set as a stress scenario, we still see almost no change in our top line or our bottom lines on the non bank side. My friends in Akbank have already explained in their webcast earlier the bank's position vis a vis with an interest rate differential but overall I think it's a very solid portfolio for performance. There are pockets in the first quarter that we have highlighted to you which we believe could in the rest ofthe year turn into opportunities for growth and profit delivery. We're quite happy with our cash flow generation and our ROE contribution. Net asset value growth was strong we should but still we believe the valuations have potential in Turkey not only for our business, many other prominent Turkish businesses this could be said and we have a healthy balance sheet and a strong liquidity which will enable us to work both ways in rest of the year for both investments on an offensive side or a cash flow management on the defensive side and so we're able to play the game in every way.

Many thanks for joining us today. Looking forward to share our results with you for the next quarter and share with you a good delivery of performance again by for the time being.