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Sabancı Holding Q3 2021 Financial Results Conference Call & Webcast

November 5th, 2021 17:00 TR Time

Speakers:
Orhun Köstem, CFO
Kerem Tezcan, IR Director

Moderator

Welcome to the Sabancı Holding third quarter 2021 consolidated financial results conference call and webcast. Thank you very much for standing by. There will be a Q&A session following the presentation by the speakers. If you would like to ask a question, please press star five on your telephone keypad and if you'd like to participate in our written Q&A, just type your question into the ask a question text area and then click the submit button. Before the presentation, we would like to inform you that the information that will be shared today is based on the actual results and company judgement. Sabancı Holding does not accept any liability for the information or content discussed. This event will be recorded and published in an audio visual and written form on Sabanci Holding Investor Relations Website in order to inform interested parties. So please be informed that while you take the floor you give explicit consent to Sabancı Holding to process your voice and speech as well. With that, I will now hand you over to your host Mr. Orhun Köstem, Sabancı Holding CFO and Mr. Kerem Tezcan, Sabancı Holding IR Director.

Gentlemen, the floor is yours.

Mr.Orhun Köstem-The CFO:

Thank you. Good morning. Good afternoon everyone wherever you are. Welcome to Sabancı Holding's third quarter results webcast. I am happy today to be able to share with you another successful quarter that we left behind us. Our success in this quarter, driven by improved contribution from our bank obviously as well as solid performance in our non-bank businesses. In the third quarter we've seen a solid demand environment that positively impacted some of our business units and operational efficiencies across the board, which is partly offset the increasing trend in input costs. And obviously we had a quite important growth in Turkey that has been there in the period. We benefited having complementary businesses, not as a holding group portfolio but also within business units. And in this quarter, our energy generation business is a good example of that, which you're going to hear a little bit more detail later. But of course our generation portfolio was quite resilient, generating strong topline growth and profit growth despite this massive drop that was impactful especially the third quarter of the year. Now, the demand growth in our local businesses and our global market, obviously, was also benefiting from last year's low base and as well as we made use of the challenges in the global supply chain based on our existing geographical footprint, which reaches a wider coverage and proven to be a competitive advantage for us.

Our operating cash flow was solid in the first nine months, and obviously lead to continued deleveraging of our balance sheet and our net debt to EBITDA is at 1.4 times compared to 1.5 times at the end of 2020. Our consolidated return on equity was up to 17.5% in the first nine months that follows our midterm guidance and obviously benefiting the sharp increase that is coming on return of equity of the bank in the period.

You have also heard in the meantime that there has been changes to the ownership of our insurance companies, a new partnership with Ageas and then after which we started to fully consolidate both of our businesses with Ageas having being a shareholder in both Aksigorta and AgeSA. And this full consolidation started from July first this year. This had a positive 1.4 billion TL one-off impact on our third quarter consolidated net income. However, as we have our discussion today, you will not be hearing about this one-off bottom line impact. Just to remind ourselves because these were announced earlier, but in the third quarter we also completed the restructuring of our white cement business outside of Turkey and finalize the acquisition of the Bunol plant in Spain. This, we believe is an important milestone for our building materials business, in which we believe we will create an efficient and strong platform abroad in order to position ourselves as a leader in the global white cement business. Moreover, again, you heard but ourselves, together with Philip Morris International have started the process of transferring all of the shares that we hold in Philip Morris Turkey, which is about 25% of that business. And again, then Philip Morris International, therefore applied to the competition authority, which was on October 6 of this year for approval of that shared transfer process, which were valued at roughly 2.9 billion TL. This price obviously will be subject to certain, you know, adjustments at the end of this year. You will hear once obviously we close this transaction hopefully, which is expected to be in the last quarter of 2021, pending relevant permissions and approvals as customary.

Last but not least, obviously one, still, you know, big unknown is how the pandemic will take shape in the months and quarters to come. And we have, we believe we have done to the best of our ability to roll out at least vaccination across our group. And I'm happy to say that the average vaccination ratio stands at 98% in Sabancı Group, as a whole.

Now, on the next page, if you look at the, on a top line basis, first of all, you know, financial performance in the period, obviously you see a 33% growth of revenues, 38% growth of EBITDA and 45% growth of consolidated net income, which is obviously a very good performance that makes us happy. As we discussed, the revenue growth, obviously comes from strong demand growth, both local and international, which benefited the EBITDA performance, which furthermore accelerated through operational efficiencies, higher capacity utilization, and thereby ending up in a higher margin, and consolidated net income was higher. As we said, we continue deleveraging our balance sheet, which obviously helps us lower our financial expenses and together with good, cash flow generation obviously, let us drive much stronger bottom line. This again, we will talk about later comes through a number of challenges, including the drought in Turkey, you know, rising input material costs, etc. So we can say; we're quite happy with the performance and obviously need to underline the fact that our bank's performance in the third quarter was much better, obviously supporting the overall performance of our business. We talked about cash flow and then obviously our operating cash flow for our nonbank business was up by 17%, which is great, it comes on top of a 28% CAGR growth over the past five years. So, we continue with the strong momentum, that we see, and therefore, as we said, we've continuously and gradually lower our Net Debt to EBITDA, deleveraging our balance sheet. In fact, our total non-bank combined liquidity, excluding financial services and tobacco business stands just under 10 billion TL at 9.6. And additionally, in our insurance business there is additional 5 billion TL. So that's a very strong position to be in.

If you look at return on equity, obviously, it follows this good performance. Our non-bank return on equity was 17.5%, which is great. The return on equity isdriven by improvement in, both bank and non-bank businesses, but obviously, the change in the bank business was much sharper. And then, our cash position at the holding entity stands at 1.9 billion TL, whereas some 63% was in FX at the end of September. If we talk today, I think it's more like 75-76%, so pretty much in line, continues with the trend that you that you are accustomed to. If you look at, the break it down into the quarter, if you look at the third quarter per say, again, just to underline, bank's performance in the third quarter was remarkable. I am sure you must have heard from them earlier, they have announced our results. Outside of our banking business obviously, the combined revenue of the non-bank business was, up by 40% over a combined revenue of 43% including the bank. The energy business was an important driver. You are going to hear more about that later in the presentation, but the pricing there supports this strong topline performance. On the industrials, we see good demands, generates higher volumes, generates higher share of market for us. And obviously a relatively weaker TL compared to last year drives better revenue growth in terms of the export businesses and on the building materials of domestic demand was strong to support and contribute to the combined revenue growth of the business. If you look at the EBITDA, there is a strong growth of EBITDA, 46% in a combined, all businesses basis, 16% on a non-bank basis. Again, as we discussed at the end of the second quarter, now obviously on our generation business, the mix is different. There's less hydro and less wind per say and then there's higher natural gas, which results in very strong absolute profit growth, but relatively lower margin growth. So therefore, that is why you see, energy business contribution coming from there resulting in slight contraction in margin. Together with the higher inflation, obviously our EBITDA in the distribution business has done quite well. We look at a remarkable performance. On the industrial side, the good let us say top-line growth flew through the profit growth basically, which we have obviously amplified with better operational excellence. And on the building materials piece, there's a higher fuel mix this year compared to last year which is standard about I think 15% at least 2.5% increase compared to the mix last year. And if you look across the past three years, obviously that trend continues which Kerem will underline. This is important for us, because the input costs, there is obviously increasing and the alternative fuel is a very good way for us to mitigate such input cost inflation.

If you come to the net income line on a combined basis, the net income was up by 40%. If you exclude the bank, actually there is a slight reduction in net income. That's not necessarily operational, that's owing to, let's say, relatively stronger Turkish Lira in the quarter, which you may assume has rectified itself, since then, given how the Turkish Lira has moved. Excluding which actually the next income growth would be at 14% if you only took an operational bottom line performance. There as well the industrials and the energy businesses were strong contributors to the bottom line performance. Now, with this, I will ask Kerem to walk us through the business segments.

Mr.Kerem Tezcan, The Investor Relations Director

Thank you. To deep dive into segments, let us start with energy.

In Q3, energy segment delivered strong EBITDA performance and annual growth reached 14% y/y despite continuous weakness in hydrology in generation and lower liberalized profit in retail.

On Enerjisa Enerji, the company's EBITDA growth remained resilient with positive contribution from distribution business

In distribution segment, despite lower theft detection performance mainly due to high base in Q3 2020 as field activities accelerated following the lockdown in Q2, EBITDA increased by 3% y/y in Q3 on higher financial income driven by higher long-term inflation assumptions and Regulated Asset Base.

As of September, RAB growth reached 14% y/y on faster pace on capex spending in line with our communication in previous quarters and higher long-term inflation.

Meanwhile in the retail side of our energy business performed lower but was overall resilient despite the high base and the impact of increase in procurement cost. Liberalized gross profit declined due to lower margins as a result of increasing procurement costs, strong base impact and change in product mix. Note that a part of negative impact offset by higher liberalized sales volume and higher regulated gross profit. Moreover, higher customer solutions and decline in doubtful provisions supported EBITDA growth in Q3.

The company's net income declined 9% y/y due to higher financial expenses driven by increase in the cost of CPI-linked financial instruments.

Looking at generation's performance, electricity demand increased by 6,3% y/y in Q3 as a result of high industrial and touristic demand and peaking temperatures in July and August. Average market prices increased by 77% in Q3 y/y due to higher demand, lower hydrology and increasing global commodity prices.

Enerjisa Generation's revenue increased by an impressive 59% y/y thanks to much higher spot electricity prices on a y/y basis. On a separate note, higher power purchasing agreement prices in lignite plants and better operational performance continued to support top-line growth.

Despite lower hydro generation due to extreme drought conditions and lower wind generation in Q3, EBITDA increased by 41% y/y thanks to higher spreads in natural gas plants and lignite plants with increasing market prices.

Net income registered a remarkable growth of 60% y/y due to strong EBITDA pass-through and relatively slower pace in increase in financial expenses offsetting negative impact of marked to market of hedging contracts.

On the industrials segment, combined revenues increased by 57% y/y driven by volume growth thanks to not only strong demand but also higher market share in both businesses. Specific to tire business, we opted to focus on local market in Q3 and we remain agile to provide more supply to the export markets in the coming quarters.

Profitability remained resilient through operational excellence and volume growth despite the cost pressures in freight expenses and commodity prices. The negative impact of higher raw material prices offset by well-managed hedging strategy in tire business.

The strong operational performance pass-through and declining financial expenses as a result of lower debt level supported the segment's bottom line.

Please note that, our tire reinforcement business maintained its operational performance target for the year- end despite the negative impact of ongoing force majeure by nylon manufacturers in the world and the fire that occurred in the nylon production line in Indonesia in the last week of August.

Moving on to the Building Materials, most important highlight of the quarter was the completion of the acquisition of Bunol plant in Spain, which is an important milestone for our building materials business to create an efficient and strong platform abroad, which would pave the way for Sabancı Group to position itself as the leader in the global white cement trade. Becoming operational back in early July, CSC BV (Cimsa Sabancı Cement BV) not only runs Sabancı Group's overseas white cement businesses in Spain, US, Italy and Germany, but also started to contribute to segment's financial performance. Following the ramp-up period, CSC BV is expected to become a key driver in segment's financial and strategic value creation.

Continuing with financials, segment's revenue growth registered as 79% y/y in the quarter on strong domestic demand and new synergies created by CSC BV as well as positive contribution of weak TL on exports. As cost side pressures started to escalate in the quarter, topline pass-through on operational profitability remained rather limited, while fuel mix optimization, better energy margin, and operational efficiency helped EBITDA growth to remain in green territory, while YTD EBITDA growth reached 70% y/y.

Bottom-line, however, slid down by 4% y/y on the back of higher financing expenses, driven by higher interest rates. However, YTD net income grew by 240% on an annual basis. Looking forward, trends in fuel & electricity and freight costs as well as supply/demand and capacity dynamics in the sector should be monitored closely.

On retail, segment's combined revenue increased by 18% y/y thanks to improvement in basket size both in electronics retail as well as food retail, bringing total top line growth to 24% in the first nine months of the year which is well above inflation.

Meanwhile, e-commerce sales growth continued its high pace trajectory, reaching 7,2% of total sales revenues in Q3 2021 compared to 5,7% last year. Comparing to the pre-pandemic period in Q3 2019, the e-commerce sales of our retail companies nearly quadrupled.

Solid top line growth and relatively limited impact from elevated operating expenses translated into double-digit operating profitability as IFRS-adjusted EBITDA increased by 20% y/y in Q3 2020. Yet, the adverse impact of high financials expenses continued to affect bottom line of the segment in Q3, mostly driven by food retail.

Moving on to Financial Services, segment's topline growth registered as 26% y/y driven by strong growth performance in both life and non-life businesses.

In non-life business, underwriting result was adversely affected by the decreasing positive impact of lock-down coupled with the increase in FX driven claim costs in motor segment and big claims in non-motor segment. Combined ratio reached 112% in Q3 compared to 104% same period last year. In life business, on the other hand, total technical income increased by 15% y/y, driven by the growth in life protection volumes and assets under management in the pension business.

Recovery of financial income on the back of the increase in interest and FX rates continued in the quarter. Yet, segment's bottom-line remained almost unchanged compared to one year ago as life business' performance managed to offset the deterioration in non-life business' bottom-line, driven by lower technical profitability on higher claims.

To remind, we have 1.4 bn TL one-off impact in our insurance companies due to consolidation methodology change, however this one time positive impact is eliminated in the financial numbers on this slide.

On banking, despite the challenging environment, along higher global inflation as well as the negative impact of ongoing pandemic, Akbank's positioning enables the bank to leverage its strength while carrying priorities for improving profitability. Robust TL loan growth, strategic securities positioning as well as across the board stronger than guided fee income growth were supportive factors for solid core operating performance. Its net cost of credit evolution has fared much better than guided thanks to strong risk discipline through the cycle. As a result, it reached 14.9% ROE, 1.8% ROA and 8.4x leverage, already delivering its mid-teens FY ROE guidance.

So this is the details of the segments, we can go to Q&A now.

First question comes from Umut Ozturk, from Oyak Securities. Thank you for the presentation. How would you evaluate the possible impact of the recent significant increase in energy and natural gas prices on your businesses?

Mr.Orhun Köstem-The CFO:

Thank you, Umut Bey, thank you very much. Obviously, energy segment in general has been quite volatile globally as well, not only in Turkey. Obviously, the market prices, the input prices have been changing. Now I believe so far we have been able to, let's say, successfully deliver on our expected performance between our diversified portfolio of generation, our, let's say, alligned balance sheet between revenue growth versus exposure, our hedging, let's say, initiatives that has been in place, our sourcing abilities in terms of both access to raw materials or our trading capabilities and all of which obviously comes to where we are today. Again we have been able to successfully deliver on that. Now, obviously going forward if you take a longer term for next year, I believe this year, looking from today, we see no reason why we should not be able to deliver in line with our guidance. Having said that next year, obviously as in globally there are, let's say some challenges building up and obviously we will be making sure that we leverage our abilities to mitigate such challenges. Asked the same question when we discuss about next year and obviously we'll be happy to continue discussing that.

Moderator

Thank you speakers. All right, as you may have gathered, ladies and gentlemen, we are into the audio question section. If you would like to ask a question, please press star five on your telephone keypad and just remind if you want to participate in the written Q&A, just type your question into the ask a question text area and then click the submit button. With that. I hand you back to our speakers.

Mr.Kerem Tezcan, The Investor Relations Director:

Thank you. The next questions come from Pınar. What are the plans for deploying cash generated by the PhilSA sale?

Mr.Orhun Köstem-The CFO:

Pınar Hanım merhaba. Thank you for the question. Now obviously, let me tell you in a nutshell, there are four pillars of how we would like to deploy our capital. Obviously one of them is to ensure that we continue investing on our core businesses. One of them is obviously making sure that we grow our business by expanding into adjacent businesses and new businesses. Thirdly we want to continue generating an above average shareholder return that includes of course dividend distributions and then potentially other instruments like buybacks which I know has been in discussion for a very long time, which again is a good I think could be a good value driver for the business going forward. Finally of course making sure that we maintain our Net Debt to EBITDA at or below two times going forward. So depending on the chronological order and you could expect to hear from us based on these elements, as how we are going to deploy the cash that we're going to receive once those that transaction is closed.

Mr.Kerem Tezcan, The Investor Relations Director:

We have another question for Vittorio from Helikon Investments. Are you speeding up increase your CAPEX in electricity generation renewables given the current positive environment?

Mr.Orhun Köstem-The CFO:

I mean obviously, we already have discussed the expansion strategies on the renewables or expansion, opportunities on the renewable base, which has been a CAPEX plan. Yes. I mean, look could be, if you look at the general environment and our generation business as you rightly put, we believe we are at an opportunistic place with our portfolio, our trading abilities etc. Maybe we will be keeping a close eye on additional opportunities that we can see because as I am sure, you know, as you heard the state and many times that we would very much like to continue expanding our renewable generation base and would capitalize on the opportunities as they come our way. We have the means to do that, not only, you know, our capabilities, but also obviously financially, we are also able to deal with that.

Mr.Kerem Tezcan, The Investor Relations Director:

The next questions come from Muharrem, Kona Capital. What would be the dividend income growth this year?

Mr.Orhun Köstem-The CFO:

Muharrem Bey merhaba. I mean I cannot give you a guidance for the full year obviously. However, what I can say is, you know how our dividend policy goes. We say it's not changed obviously. Then you see how our bottom line is improving. So I'm sure you can have an estimation from there as indicated earlier.

Mr.Kerem Tezcan, The Investor Relations Director:

Thank you for the presentation and the opportunity to ask questions. Congratulations on executing the PHILSA sale, are there are any other businesses that you may to look divest a stake, which you think is non-core to your strategy? Also any update on share buy-backs given some of your peers have become active in Turkey on it?

Mr.Orhun Köstem-The CFO:

Thank you Sashank. Now, let me start with the second one. Again, it was part of the answer to an earlier question. Look, technically I will not be able to say whether or not we can do a buyback. Obviously, I am sure you are not expecting that. All I can say as I wanted to underline earlier, it's been part of our capital allocation, it is part of our capital allocation strategy and we see potential value creation doing so given where the stock trades today. But I can't say anything more than that. And again, other businesses could be in the meantime, of course, what we didn't put here is there are some assets that has been also in the third quarter, actually that we've sold under the building materials business, which was part of the network optimization in Turkey, which is again, and expecting a clearance from the competition authority. These are relatively small, but I believe should give you an indication to obviously going forward if you feel that any of the businesses was not necessarily perform or industry wise, we feel that's not a fitting to our overall purpose and portfolio going forward. Yes. And if it in the case of this building materials business, if it doesn't fit for some reason from an operational point of view, obviously we will be and quite willing to liquidate those assets and see how we can invest those.

Moderator:

All right, gentlemen, I don't see any more written questions. So let me just quickly remind everybody. If you would like to ask a question, the written Q&A, please just type your question into the ask a question text area and then click submit, we will leave it for a minute, another minute or so, but it appears that those are the written questions, speakers.

Mr.Kerem Tezcan, The Investor Relations Director:

We do not have any further questions.

Moderator:

All right, thank you. Thank you very much gentleman. That is Mr. Orhun Köstem, Sabancı Holding CFO and Mr. Kerem Tezcan, Sabancı Holding IR Director. Thank you very much, gentlemen. If you would like to conclude, please.

Mr.Orhun Köstem-The CFO:

Thank you. Again, thanks for everyone for joining. I hope what you have left since we started this conversation to remember for the third quarter, this here is a obviously we continue with our remarkable financial performance and quite poised to meet our guidance for the year despite the challenges. There has been some portfolio moments in the period, some of which were in the pipeline for a bit of time. We are happy to be able to close them and move on and obviously going forward, quite keen to continue adding value to our portfolio by such movements as and when we feel these are opportunities for us. Finally, we are quite happy that we find ourselves healthy and hopefully do the same at the end of the next quarter after hopefully another successful period. Thank you very much for today and have a very good weekend.

Operator:

Thank you very much, gentlemen, thanks for the presentation. And ladies and gentlemen that now concludes today's webcast call. Well, thank you again for your participation. You may now disconnect.