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Sabancı Holding Q4 2020 Financial Results Conference Call & Webcast

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Speakers:
Barış Oran, CFO
Kerem Tezcan, IR Director

Moderator

Welcome to Sabancı Holding 2020 Q4 Consolidated Financial results Webcast and Conference Call. Thank you very much for standing by everyone. There will be a Q and A session following the presentation by Mr. Oran. If you would like to ask a question, please press Star five on your telephone keypad and to participate in our written Q and A. Just have your question into the Ask a Question text area and click the submit button. Very simple. Before we start 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. Sabanci Holding does not accept any liability on the information or content discussed. Hold on, hand you over to Mr Baris Oran, CFO of Sabanci Holding all yours. Mr Oran,

Mr. Oran

Thank you good afternoon. Our 2020 operational performance was strong across the board, owing to resilient and non-cyclical business model despite extremely challenging and volatile conditions especially in the markets, demand and supply chain. We kept our balance sheet strong with roughly 90 billion TL of liquidity and further improved operating cash flows and debt profile of the group. This solid performance has led to a record high non-bank ROE of 17% in 2020.
As Covid 19 pandemic continues to be a major part of our lives, we continue to keep an alert level at the highest degree to preserve the safety and well-being of our employees, their families and our customers. We are cautiously following health and economic development to rapidly adjust ourselves to potential changes in conditions both on the ground and abroad.
Let me share the overall conditions in the first two months of the year: Effects of the pandemic started to ease and impact on our business is marginal. We are expecting stronger momentum in the economy with the increasing vaccine rollouts despite major normalization efforts. The solid momentum in Q4 and early indication in the first couple of months, is leading to an expansion in the economy in Turkey. The recovery of the U. S and European Union markets has also started and Asia Pacific markets are solidly back.
Our earnings quality improved further in 2020 despite challenging operating environment, bringing non-bank operating cash flow to 11 billion TL , a massive three times growth compared to 2015. The solid cash generation allowed us to improve our debt profile. Our net debt to EBITDA decline further to 1.5 times by the end of 2020 compared to 1.8 by the end of September. Our combined non-bank sales increased about 20% and improved, especially in local markets.

Demand in the local market and profitability of the exports has led to a growth in our non-bank EBITDA of 21%. Our non-bank bottom line growth reached an impressive 48% as lower financial expenses and long FX position add to our EBITDA growth.
In Q4, domestic demand was vibrant and continue to be supportive for our locally exposed businesses. Momentum in international markets fared better than Q3 and we have benefited from an overall operational diversification. Yet international economy was still unable due to regional differences because of the pandemic. Asia Pacific is still heading the economic recovery from a global perspective from what we can see from our businesses.
Operational performance of the final quarter was as strong as Q3 when economic activity was it is highest level. Non-bank combined revenue growth has remained strong at about 23% leading to a double-digit headline revenue expansion. Coupled with strong operating performance, we continue to benefit from lower financial expenses in Q4 which results 29% net income growth.
The solid upward trend in our non-bank returns in the first nine months of the year has accelerated even further in Q4 and non-bank's ROE reached 17%, the highest level since 2014. Sabanci Holding standalone net cash position remains at 1.1 billion TL, which is almost fully exposed to compose of hard currencies. Our total non-bank combined liquidity, excluding financial services in tobacco, is standing around 9 billion TL , while the funds at our insurance companies are about 4.3 billion TL . We remained resilient against effects of volatility and we have a long position of $155 million at the consolidated level.

Mr. Tezcan

Let us go into details. Our total comparable combined revenues were up by 15% year on year in Q4. In terms of combined revenue breakdown, excluding the bank, comparable combined revenues grew by 23%. Major contributors are energy, retail and industrial segments. Non-bank combined EBITDA growth was 30% driven by energy, retail and building material segments on a comparable basis. Industrials segments contributed substantially to EBITDA growth on relatively better mobility in Q4 following a weak performance in the first nine months of the year. Total comparable consolidated net income registered 29% growth in Q4 with the contribution of strong operational performance and well managed financing activities. Non-bank net income increased by 15% driven by building materials, industrials and retail segments.
To deep dive into segments performance, let's start with energy. In Q4 20, Energy segment delivered robust performance despite Covid 19 crisis. Enerjisa Energy's EBITDA performance remained solid, driven by continuing strength in the retail business in Q4. Meanwhile, the distribution segments financial income growth was soft in Q4 due to lower nominal return rate compared to last year, given the decreasing WACC as well as lower growth in regulatory asset base. Change in the fair value of financial assets driven by differences in interpretation of the methodology on treatment of the scrap sales and connection fees with the regulator and due to non-recurring expenses related to previous years. The latter is mostly related to tax correction, which has disclosed with forth regulatory period announcements. Therefore, the company's Q4 performance has impacted with these retrospective adjustments related to previous periods.
The parameters of the new regulated appearance has also announced. The new regulatory framework is overall supportive for growth in physical network, encouraging increase in service level through improved quality mechanisms and rewarding, corporate governance and transparency. Increasing initial capex allowance provides predictability and higher initial capex will be one of the key drivers of the future growth.
Looking at generation segment’s performance, electricity demand continued to recover and increased by 4.6% year on year in Q4. Energy generation's revenues were up by 53% year over year, driven by higher volumes, especially in natural gas plants on increasing spark spreads, positive impact of FX linked renewable sales prices and power purchasing agreement in lignite fans and higher trading volume. Generation's 20% year on year EBITDA growth supported by higher spark spreads and higher volume growth. EBITDA margin affected from change in sales

mix. Net income increased by 69% owing to increasing EBITDA contribution despite higher net financial expense.

Generation also managed to reduce its net debt to €493 million or 1.6 times net debt to EBITDA as of end of December. It is worth mentioning that Enerjisa Generation is planning to distribute its first dividends from 2020 earnings.

Going forward, hydrology, natural gas tariffs, electricity demands and spot prices will be the main factors to watch for Enerjisa generation. We will be tracking inflation and interest rate trends for Enerjisa Energy.

Financial services segment had another quarter with robust top line growth with high technical profit and stronger ROE. On the non-life business, premium production increased by 27% in Q4, driven by strong performance in motor and non-motor businesses. On the life and pension business, total protection premiums were in line with the same period of last year as pandemic ratelated slowdown in credit-linked products is compensated by non-credit linked life protection, underpinning diverse business models. Increase in fund management income on higher pension volume and increase in net earned premiums on life protection made up 75% of technical income growth. On the non-life side, despite the improvement in net earned premiums and higher underwriting results in Q4, thanks to lockdowns and low claim frequency, lower financial income contribution to EBITDA has decreased by 13% compared to the same period of last year. Both businesses has a sizable flood and expanded their assets under management to sustain solid profitability going forwards.

Moving on to building materials, based on the sector data, Turkish domestic cement demand was up by 23% year over year by the end of November. As recovery continued in the local market in the final quarter of the year, our domestic sales volume increased by 13% in Q4. Moreover, export volume growth reached 7% year over year despite last year's high base, bringing the total sales volume growth 11% for Q4. The recovery in total sales volume and higher export prices on TL depreciation has led to the 39% year on year increase in the top line. Higher profitability in exports and white cement, driven by price increases, led to a 5pp year on year EBITDA margin improvement in Q4 offsetting higher petr-coke prices. Lower financing expenses driven by refinancing activities in Q2 add on to strong operational performance and in result bottom line significantly improved.

On retail segment, revenues increased by 39% year on year despite the weekend lockdowns started back in November. While shift towards bulk shopping behaviors supported food retails top line growth, new normal of home office and home schooling fostered the discretionary buying and contributed to electronic retail's top line performance. The major change in customers' behavior towards online shopping due to lockdowns served a significant growth in e-commerce sales. Throughout 2020, e-commerce sales of our retail companies quadrupled year on year and e-commerce sales share in their combined revenues tripled compared to a year ago and reached 9%. We also have a limited impact of elevated operating expenses, solid top line growth translated into impressive improvement in the operating profitability as IFRS adjusted EBITA more than doubled compared to last year. Bottom line benefits from effective financing management as both companies enjoyed lower interest rates despite marginal increase in their debt levels.

For industrials, demand recovery driven by solid volume growth in both tire and tire reinforcement businesses, together with sustained pricing discipline in Brisa translated into 27% year on year top line growth on a comparable basis. Yet with weak demand, in aviation sector continued to drag the composites business down. While high volume in capacity utilization supported Kordsa's EBITDA growth in the quarter with the improvement in contribution margins and effective OPEX management, Brisa also managed to deliver strong EBITA growth. As a result, segment's operating profitability increased by 50% year on year on a comparable basis. Industrial segments net income surged by higher than 121% year on year on a comparable basis with the pass through impact of strong EBITDA.

On banking, despite the challenging environment along with rising funding costs Akbank successfully managed to preserve solid core operating performance during the quarter with a continued balanced asset and liability management without changing risk metrics. Growth, proactive securities positioning, low maturity mismatch as well as CPI linkers, which work as hedge were supportive factors for core operating performance. Thanks to proactive and prudent IFRS 9 implementation, cost of credit has been improving since it had peaked in Q2. This improvement is a harbinger for gradual normalization in CoC for 2021. It's robust capital remains a source of strength with significant buffers remains as a major source of strength and supportive for growth in 2021. Akbank's financial strength and operational resilience remained intact in 2020 and its positioning will enable the bank to leverage its strength while carrying priorities for improving profitability this year. I will now leave the floor to Baris for further comments and closing remarks.

Mr. Oran

Thank you. We have literally experienced two halves or you can say four seasons in 2020. In Q2, we delivered solid results despite the global GDP contraction, thanks to our non-cyclical and resilient business mix. Our operating performance has improved sharply in the second half of the year thanks to our business model, which has successfully captured the rebooting of the economies all over the world, especially locally.
As we have mentioned in the beginning of the call, we have shown a solid performance in an unprecedented year in 2020, thanks to our business mix, which has limited exposure to covid or lockdown related industries such as travel, leisure or eat out. We have not only strengthen in our balance sheet by keeping our liquidity strong to stay resilient against demand volatility, but also we have stretched ourselves to improve our cost productivity further, sustained higher earnings quality and in return further reduced our debt level.
As promised, we have revealed our mid-term targets by the end of November'20 by stressing three pillars of our strategy. Let me briefly remind you what those are:
We will increase our growth through renewables, material technologies and digital.
We will continue to keep our high performance through right capital allocation, and
We will maintain our strong long term focus on sustainability.
Our midterm guidance for 2021 to 2025 period which fully overlaps with the major players of our strategy is as you would recall;
We will grow faster both in terms of revenue and EBITDA by improving our profitability.
We are targeting to increase share of the new economy and FX revenues in the groups combined revenue by keeping robust balance sheet and high liquidity with an unchanged debt profile.
We will update our dividends parallel to increasing ROE, and
We're targeting at least one notch upgrade if not more, in MSCI ESG index.
Finally, we will keep our alert level at the highest degree to adjust our business against potential effects of pandemic. This ends our presentation today. Now, I would like to turn it off to the operators. We will be happy to answer any questions you may have.

Moderator

Right. Thank you very much for that presentation, gentlemen. Also with Mr Barış Oran, the CFO of Sabancı Holding. Okay, Ladies, gentlemen, we'll now start our question and answer session. First, the audio questions and then the written questions. If you'd like to ask an audio question Very simple. Just press star five on your telephone keypad. You could do that right now on. If you want to participate in our written Q and A, which is coming up later, just type your question into the ask a question text area and then click the submit button. You can begin doing that now too. But first, the audio questions star five on your telephone keypad and we'll cross to you to give you an opportunity to ask your question. And you could do that. Now, now is the time.

Moderator

So just a reminder. If you want to ask your audio question. Now is the time. Just press star five and your telephone keypad and for the written Q and A. Just enter your question into the ask a question text area and click Submit. Thank you.

Moderator

Right. I believe you have a question from Hanzade Kılıçkıran from JP Morgan. Please go ahead. Thank you.

Hanzade Kılıçkıran (JP Morgan)

Thank you. Barış Bey, I have a question on your short-term guidance for 2021. Is it possible to share it for the non-bank from a top line growth perspective and the profitable to give the expected recovery in the platform sectors in 2020? And can you share the expected dividends in flow? I mean your expectations for the dividend inflow given the BRSA is now allowing banks to pay some sort of dividends like 10% this year.

Mr Oran

Thank you. As far as the short term guidance on the non-bank side, we did not provide a short term guidance on the top line and the profitability. But I can tell you, from what we see, we see a robust year across all segments today. And I don't have any reason for that to change anytime soon unless we have a global macro shock that we cannot foresee right now. So we will continue to grow both on the top line side and the operating profitability side throughout the year on the non bank side. On the dividend inflow, this has been a very remarkable year for us. This is the first year we're getting dividends from energy generation business. That's a milestone for our organization. And also there has been a number of dividend announcements from our companies. There has been some non-public information that I cannot share with you. But I can tell you that the dividend inflow that we will get from our companies is, increasing massively would be much, much higher from the year before. On top of that, we will also discuss it with our board and we will take it to our General Assembly, as far as our dividend proposal is concerned. Then it will be in line with our guidance. As we said in our guidance that we would like to continue paying sustainable dividends at a growing pace in line with our resources as well as the profitability of the enterprise. As you will recall last year in the in the middle of the pandemic, we did not cut our dividends, we kept it resilient and sustainable, and we will continue to pay dividends. I believe this is our 20th year of consecutive dividend payments that we have in our group, and there is no reason to, turn it down at this moment. So, looking into 2021 solid growth both on profitability and EBITDA and we anticipate the dividend inflow to increase massively. I'm talking about beyond solid, massively increasing dividend inflow and in line with our guidance, we would expect that some of that dividend to be shared with our shareholders. But that's subject to board approval and general assembly approval and includes some non-public information that I cannot dive into today.

Hanzade Kılıçkıran

Thank you Barış Bey. What is driving this massive increasing dividend flow? Is it the Enerjisa ,driving it? Because I think Enerjisa announced the dividend.

Mr. Oran

It is our energy businesses. The fact that...

Hanzade Kılıçkıran

The distribution business, right? Not the generation business?

Mr. Oran

Both of the businesses, both distribution and generation businesses.

Hanzade Kılıçkıran

I think you mentioned during the presentation that generation business will be ready to pay a dividend by 2022.

Mr. Oran

No, we will pay dividends in 2021 from 2020 earnings.

Hanzade Kılıçkıran

All right, okay, thank you very much.

Mr. Oran

So that's the first time dividend payment after many years of sizeable operating turn around and efficiency measures, we're glad to see that energy generation will be able to pay dividends and share the value creation with its shareholders. So that will be on top of the dividend flow we get from our other listed enterprises, and we are quite happy the fact that BRSA has lifted the limitations on banks dividend distribution. However, all of these are subject to General Assembly approval.

Hanzade Kılıçkıran

Okay, thank you very much, Barış Bey.

Moderator

All right. Thank you for that. Thank you. Right. So we just got a few more moments. If you would like to give in your audio question, otherwise we will get to the written questions. So there it is. If you would like to ask a question, audio question, now is the time. Just press start five and your telephone keypad. We will give you a few moments for that, and then we will get to the written Q and A.

Mr. Oran

All right. We have some written questions. We can take them if that is okay. Kerem would you like to go over the written questions quickly?

Mr. Tezcan

Sure. The first question comes from Cenk Orçan from HSBC. Can you please elaborate on latest developments at Temsa and Sabancı’s trends in EVs and EV infrastructure, and also an update on energy generation companies prospective listing?

Mr. Oran

Okay, let's go one by one. First, on Enerjisa generations’ listing, first thing we were putting for the listing was to be able to provide a lower leverage. The second was to make sure we have a growth pipeline. We do have a very sizeable over 500 megawatts of big pipeline for further growth as well as, making sure we can pay dividends. We have achieved all of those and at this moment, our priority would be to make sure we get the dividends and to make sure this company is ready to be listed. Now, when it's going to be listed, it will be up to market conditions as well as our discussions with our partner in line with our strategic interests. That's what we will take it to our discussion. But today we are quite happy with the leverage level, the growth pipeline and as well as the dividend paying capacity of the enterprise.
Other question was on the EV side on Temsa and Sabancı plans on infrastructure. We are working to be a supplier of the electric vehicles on the tire sites. That is a national project in Turkey, and we haven't received the results of the bidding yet, so that will be one of the elements we can discuss here. Also, we have charging stations, and also the grid size and the effectiveness of the grid will be sizably impacted by the EV vehicles, electric vehicles. As if you put a couple of charging stations in the middle of a residential area and if you don't adjust the grid accordingly, you may take the entire grid down. So we're working, with the ministry and actually waiting for their updated plans to make sure we can go ahead with further charging stations. Furthermore, as you know, we're in the electric bus business in our bus company and already started shipping some electric buses to different markets. And once the pandemic is over, we think that business is going to accelerate. So that's on the EV side. We have a very sizeable exposure to the most modern energy in the world – electricity, and we think the demand for electricity both for the distribution and generation will continue to improve in this country.

Mr. Tezcan

We have another question from Karim Sawabini from Moon Capital. What is the significance of the swap in ownership, just announced in your subsidiary Avivasa? Where do you expect leverage to end in the energy generation business in 2021? Third question - do you have further intentions to streamline your asset portfolio? Could you give some color? And fourth question - what are some areas of new investments?

Mr. Oran

Let's go one by one. the announcement of Ageas taking shares of Aviva in Avivasa, has been something that we quite like. As you know, Aviva has announced the fact that they are going to exit from certain markets and refocus in some of their, what they call it the core markets. And with Ageas we have a very, very solid working relationship. We have worked quite well in our enterprises, and this joining of forces in Avivasa is is going to help us to cross sell certain products, also to export certain synergies between the businesses. That's gonna be the impact on the business in the medium term, and that we're quite excited about this. In the past, there were some restrictions, as these are two separate companies with two different partnerships and we were not able to capture enough cross sale opportunities and we will be able to capture some of that and some of the cost synergies in the near future.

As far as the leverage of our energy business is concerned, these companies will continue to deliver, especially on the generation side. Depending on when we start the wind farm investment, I expect that, the leverage to continue to go down in 2021, and I expect, you've seen the Enerjisa energies earnings announcement, there's a sizable operating cash flow expectation there, so it should also reduce the leverage debt/EBITDA basis. And on top of that, they will continue to Enerjisa energy and will continue to invest while reducing leverage on that organization. So, that is gonna continue to go down. As far as investments are concerned, we are having some measurements for that 500 megawatts wind farm that we have in the western side of Turkey. So on some permitting, we're just trying to get it started as soon as possible and get it operational, frankly. But that will take some time, we want to invest right, as far as the asset changes in our asset mix. Today it would be premature for me to talk about it and to comment on rumours of M & A in our enterprise. So I would prefer to keep silent on that one.
And potential areas for new investments on composites is one. We will continue to invest in material technology beyond composites. Number three, we would like to get closer to our customers in our cement business. There is a massive opportunity to get a better, better part of the value chain if you have permanent establishments in the markets that we sell to. Remember, we sell quite a lot to Europe and the US, and we would like to get closer to our customers there. So that's another area that we will be looking into. And then digital technology would be number four as far as potential areas of investment for capital location. We will continue to invest in renewable expansion in energy generation. And we will continue to expand in the grid, investing in the grid in Enerjisa energy. But those do not require any capital infusion from the parent side. They are very well sustained enterprises.

Mr. Tezcan

We have another question. We have a new question from Ilya from East Capital. Dear Sabancı team, congratulations with great results for the challenging year. Could you please share your view on the discount to NAV that the stock is currently trading at? And do you consider special actions to decreasing it, including buy back? Do you think it is reasonable to expect the IPO of the Enerjisa Generation already in 2021 or it is more feasible in 2022? Thank you a lot and congrats one more time.

Mr. Oran

Thank you, Ilya. Thanks a lot. It has been a very interesting year, and, I am very very happy with the results we got. Let me talk about the discount to NAV. Of course, this is not something we like. However, we think some of that hefty discount is driven by the fact that, Turkish equity markets are not in favorite quite a lot with the international investors as it used to be. And also when banking ROE's improved through 2021, we should have a better NAV, appreciation of the entire Sabancı Group. So some of that will be taken care of by the markets themselves. As far as potential actions are concerned, we would need to have further cash infusion through different means at the group level to take some further drastic actions. Today, we do not have that very very sizeable level of cash build up at the holdco beyond a couple of billion TL, to create a sizable action that will change that pictures quite drastically. On the IPO question, I think it will be quite speculative to comment on this as far as timeline. In fact, some of the regulators are actually prohibiting us from giving a timeline. I can just tell you this company is in good shape. And when I look for a company ready for an IPO, those are dividend paying growth and low net debt/EBITDA. A very, very sizeable renewable generation, I think this company fits into that profile. However, the timing is too early to comment on that. I would not want to comment on it.

Mr. Tezcan

We have a new question from Vittorio from Helicon Investments. Hi, could you consider higher dividends or a share buyback considering the high discount to NAV both historically and compared to peers? Thanks.

Mr. Oran

As we discussed, unless we have a very drastic change in our operating mix and operating performance, which I don't foresee today, there is no intention to lower dividend. That's what I can say as far as how high it can go or the percentage it's gonna go, whether it's going to stay the same, that's gonna be our boards require, resolution, that's gonna go to General Assembly. It is a management proposal. We intend to stick to the guidance we have provided in November as far as dividends are concerned. So consistently growing dividends and sharing the wealth created at this group with our shareholders. That is what I can say. As far as buybacks are concerned on the cash level at the hold-co is currently too low to start a buyback program, and if we can have a cash infusion into the hold-co, then management would take it to the board to discuss it with our board and see if we can take action on it. But as of today, the cash level at the holding company - we don't have any debt but the cash level at holding company - we would like to keep cash a little bit higher than the current level before we can start thinking about a sharp share buyback.
We do not like the discount. We do not like the multiples, but we're trying to change them with growing faster and creating further cash inflow into our organization and show better profitability and ROE. Our ROE has improved quite drastically throughout the couple of years. And I assume that with guidance for all the banks in the country as well as AKBANK's guidance, we should have an uptick, next couple of years in line with our guidance we provided in November.

Mr. Tezcan

We have no more written questions.

Mr. Oran

Operator, if there are verbal questions on the phone line, we can take that.

Moderator

Gentlemen, no, we have no more audio questions. So if you would like to conclude, that would be fantastic. Thank you.

Mr. Oran

Thank you. Thank you very much. Thank you for joining our call this evening. We appreciate your continued interest in Sabancı Holding. It's a good operating environment we currently have, and we’ll see further recovery as immunization globally takes hold. And we're hoping that the recovery in the Asian markets will go into European Union as well as US. And the local conditions here in Turkey are quite robust today. So we hope to give you better news in the next couple of quarters and keep in touch. Thank you very much and have a great day.