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Sabancı Holding
Q1 2024 Financial Results
Webcast

June 6th, 2024 17:30 TR Time

Speakers:
Orhun Köstem, CFO
Kerem Tezcan, IR Director

Mr.Kerem Tezcan, IR Director: Good afternoon, good morning everyone. Welcome to Sabancı Holding's first quarter earnings call. Please refer to our disclaimer before we start. We are together with our group CFO Orhun Köstem today to run through Q1 financials in detail. Orhun Bey, floor is yours.

Mr. Orhun Köstem, CFO: Thank you Kerem. Good morning, good afternoon, everyone. We're really happy to be with you again in one of our quarterly calls. And of course, this one, our first quarter, is the smallest quarter, it's about give or take 20% of our annual revenue. However, at this time it has become quite an important one. Given the fact that we will walk you through our inflation accounted numbers and also the quarter that we're comparing it to, the 1st quarter of 2023, was impacted by the massive earthquake which has certain implications on the base. So, that's how I'll try to walk you through our results for the quarter. First of all, I think it's fair to say that we have continued a progressing of our strategic agenda. Our solar project in Texas, Cutlass II, has come on stream with 272 MW of capacity. In fact, we were together with Kerem there last week. It's a massive project when you go and see it and quite spectacular. The second one Oriana, you remember the construction continues at the moment and we have also secured the funding of this. So, hopefully by the time that we report to you the first quarter results next year we then would be talking about our up and running half a gigawatt of capacity in the US. Çimsa, on the other hand has completed its calcium aluminate capacity expansion obviously which makes Çimsa the third largest capacity globally, that's quite important. And of course, in this period quite recently we have separated our materials business basically to Material Technologies and Mobility Solutions which we believe captures better our focus on these each different segment. On the other hand, our progress on ESG also continues. Now something which you haven't probably seen in the Press yet but Sabancı Holding yesterday has received an outstanding achievement for sustainability in the EFQM Global Awards which makes us very proud. I'm pretty sure you're going to hear more about that but that's a very serious achievement. And we're actually as you see here moving forward to implement a framework about circular economy basically that would be underway and of course we've launched the Sustainability Academy. Financials, I'm going to walk you through certain details but after implementation of the inflation accounting Sabancı Holding has a very healthy financial position. We have doubled our cash available; we have upped our Capex/Sales progressing towards our target of 14%, our Net debt/ EBITDA is just under 1x, our Consolidated ROE is just under 6% but there's more detail to that and I'm going to tell a little bit more about this and we still have a long FX position of 324 million dollars. In the next page, I'm going to show you the backdrop from a micro point of view what's taking place. On one hand the energy and commodity prices have continued to be favourable, especially in comparison to 2021-2022-2023 and that period so it's important especially in a year when the pricing ability due to hopefully decreasing inflation will be challenging this is an important driver for protecting and leveraging our margins. I'm needless to say the wage increase in general follows faster than the inflation and it's not only for us but I'm pretty sure you must be hearing from all the Turkish corporates that has an impact on everyone's financial performance. The Consumer Price Index has at the end of the 1st quarter was 68% actually it is a bit of an acceleration compared to the 1st quarter of 2023, whereas the year-on-year change of the basket FX was 65%, so pretty much in line with the CPI specific to this period.

Now moving forward, this is for you, so to say, 30,000 feet of what our financials look like. Of course, on a combined basis, our revenues were up in real terms by 6%. Our EBITDA was down by 17%, and it seems that our net loss has increased compared to the 1st quarter of 2023. In fact, since you know, the bank still makes a majority, especially of our consolidated results. It's important to note that for financial institutions, of course, the impact of inflation accounting results in a monetary loss. And what you see in Sabancı Holding's consolidated P&L as a monetary loss is a majority of that comes from the bank. And nevertheless, if we move on to the non-bank side, there are certain businesses there like our insurance business, and Enerjisa Enerji, we still post a monetary loss basically. If we start from the revenue piece, here on the non-bank side, where there is a 15% contraction. This is mainly the biggest drivers of that are coming from our energy businesses. I'm sure you must have listened to what Enerjisa Enerji had to say earlier. I think this is a relatively slow start to the year, but no change as to our expectations for the rest of the year. In fact, the customer solution side of the business, in addition to distribution, is picking up quite nicely. And that's a very good indication, not only for the rest of the year, but going forward as well. And Enerjisa Üretim, the energy prices are low compared to the 1st quarter of last year. Nevertheless, as you must have heard from us in general, the EBITDA generation of Enerjisa Üretim there are two important contributors to that. One of them is trading, and the other one is the generation asset-based EBITDA. And the generation-based EBITDA for a year normally should be about 500 million dollars. And this year is no different, basically. On a year on year, there could be changes to the hydrology wind or sun, or etc. But that's a rule of thumb for you. And we don't feel 2024 should be a different year basically. In fact, we expect the generation asset-based EBITDA to go in dollar terms whereas the trading income is decreasing. In the past two years, as there has been very serious volatility on the energy prices which were quite high. Of course, that contribution was quite high, I think at best we have last year made in excess of 100 million dollars. This year probably we should be able to make maybe about a quarter of that. So, the fundamentals of the business is intact you know, whatever we can guide you to. However, the trading business is coming back, which is OK for us because it's not a revenue objective driven business and it's a capital return business for us and we're happy with what we're seeing so far in the business. And other than that, of course you must have also heard the building materials business where the pricing is a challenge, both domestic and international. So that's why I've tried to indicate the energy and fuel prices in general in this quarter and the rest of the year is important. Nevertheless, you see our EBITDA performance is in fact better than our top line. So, we're posting an EBITDA margin improvement in this first quarter compared to the first quarter of last year on our non-bank business. When we get to the net loss, for the non-bank business, I will take you to the next slide which I hope should explain it a little bit better. If we look at our return on equity numbers on the left-hand side graph, you see our return on equity on an annualized basis for 2022-2023 and the first quarter of 2024. And these are, of course all inflation adjusted. The consolidated ROE moves from 19.8% to 7% on a year-on-year basis and then 5.9%, whereas the non-bank ROE moves from a massive 24.7% to 11.2% and then to 9.4% now. The graph in the middle shows you the same ROE inflation adjusted basis with certain items that are non-recurring. For example, in 2022 you will remember the disposal of the tobacco business and the capital gains that we have received from that, or the sale of Kayseri and Niğde facilities in our building materials business. So, if we exclude some of these big one-off items, then actually you see that our ROE has been moving from a high single digit to low double digit on an annualized basis, which is again quite in line with our expectations. For 2023, you see there is an uptick and that's mainly because of the incremental taxes that's attributable to the earthquake, which again is quite difficult to guide on an ongoing basis. In addition, as you've seen in my first graph, our capital expenditure is increasing, however, our Net debt/EBITDA is not. We're still under 1x, so our balance sheet continues to be quite healthy. And speaking of the balance sheet in the next slide you see whole cash that we hold at the holding have actually more than doubled compared to the first quarter of 2023. Which sounds quite nice, but under inflationary accounting, unless we make use of that, it penalizes us in our bottom line because it creates a monetary loss. And the 68% inflation and that limits, of course, the monetary gain in general that we should generate in our non-bank business. So going forward you should expect that of course to be converted into investment to be made good use of that. Now operational cash flow as you see the contraction. Which is more to do with the first quarter of 2023, again if you remember at the time of the earthquake, mostly some of the expenses were postponed, some receivables were extended, especially for our Enerjisa distribution business, which create a massive working capital change. So therefore, with the exception of which we don't see that to be a change quieter than normal. Now, this year, the free cash flow on an annualized basis may not be as high as the previous years because as you look at the next graph, our Capex/Sales has been increasing from 8% in the at the end of the first quarter of 2023 to about 11.3% at the end of first quarter of 2024, which is pretty much in line with our long term guidance of 14% Capex/Sales of our non-bank business. But hence has an impact, we will have an impact on our cash flow in general for 2024. But also that together with the increasing interest rates obviously explains you the drop in the ROE on a year on year basis, which I believe is

more reasonable to expect in this period where we are investing basically, but still healthy and in line with our expectations.
Now if you move forward, our NAV has grown by about 28% in dollar terms, and the discount to NAV has moved from 52% to 43%. Now if you look from a good side, obviously on the right hand that the banks contribution to NAV has accelerated and in general in this period the banking industry, the valuations or the market capitalizations have moved and of course our NAV has benefited that basically. But then it's followed by material, mobility as well as energy and climate businesses. Now the catch here is I think it's good that the banks market cap is improving, increasing, it adds on to our NAV and more importantly, I think our Enerjisa Üretim business value has been creeping into our NAV more in terms of its potential fair value versus its cost, which used to be our historical way of reporting. Now, this all adds very nicely on our NAV, but of course also increases the potential to increase the discount and of course between the NAV growth and the discount. It then becomes our job to make sure that we catch up with that increase in the NAV every time it expands. And as some of you may know and as we have discussed in the past, our long-term incentive actually describes this or one hand to grow the NAV and on the other hand, to make sure that the market performance better in comparison to BIST 30 basically. And the way to grow the NAV, if you look at the next page, obviously, we would very much like to be able to see a balanced contribution from our business units to the NAV and the banks and financial services still has a high share, but as you know, the share of the energy and climate technologies have grown quite significantly. However, going forward, we could argue the materials and mobility solutions piece as well as the digital has to catch up so that we could achieve our three-to-five-year target of having a more balanced NAV contribution and that's our aim to achieve going forward. Now here, I would hand over to Kerem to walk us through the details of the segments, the financial details of the segments. Following of course, we would be happy to close and receive any questions that you may have.

Mr.Kerem Tezcan, IR Director: Thank you Orhun Bey. Let me first start with the bank and before I start, please note that banking figures are based on BRSA financials as banks are exempt from inflation accounting for this year.

Akbank's robust expertise in flexible balance sheet management, including quick adaptiveness in navigating the tight regulatory environment as well as sustained excellence in fee performance continued to be supportive factors for its profitability. Regardless of the sector wide challenges especially in margin evolution, Akbank started the year as projected with 25% ROE and 2.7% return on assets. Akbank's strong momentum in expanding the customer footprint persists. The Bank added 600k new customers in Q1, reaching 13.7mn in total active customer base, with cumulative increase of 5.2mn since end of 2021, solidifying its recuring revenues and the footprint for long-term success in evolving markets. In addition to these; the bank keeps its leading position in capital with a robust 17% capital adequacy ratio which will continue to provide the bank significant competitive advantage going forward.

Continuing with our largest non-bank segment, in generation, revenues dropped by 48% year on year on lower electricity prices and lower natural gas volumes compared to last year. The decline in EBITDA was related to lower dispatch contribution and higher operating expenses. However, EBITDA generation from renewables assets remained solid, mainly supported by high hydro generation thanks to favorable weather conditions. The contribution from Enerjisa Commodities softened due to the limited profitable opportunities because of lesser volatility and liquidity in the market. With regards to Enerjisa Enerji, operational earnings in distribution and retail business increased by 45% year on year, mostly driven by higher financial income and Capex reimbursements, as well as the recovery of efficiency and quality related earnings. Customer solutions segment’s operational earnings has significantly improved compared to last year primarily due to solar panel projects. Yet, the retail segment’s operational earnings declined by 48% year on year due to lower sourcing costs both in the regulated and in the liberalized segment. As we mentioned in the headline of this page our energy segment has initiated a new capex cycle. The segment’s total Capex/Sales ratio surged 9% compared to last year and reached to 21% in Q1. As a result, the segment's net income declined mainly due to increased financing costs and the negative impact of inflation accounting on deferred tax assets.

On Building Materials segment, top line declined by 8% year on year. Even though domestic volume growth remained solid, price adjustments failed to cope with inflation. Despite the positive contribution from lower electricity prices, higher fuel and labor costs had an adverse effect on EBITDA. Segment's net income dropped by 80% compared to last year mainly due to EBITDA pass through.

Industrials segment revenues dropped by 3% year on year in Q1 due to price competition and lower volume in tire reinforcement business. However, segment’s EBITDA was up by 19% year on year thanks to improving profitability in tire business and solid performance in our bus business, which we started to consolidate following the Exsa merger at the beginning of the year. Lastly, net income increased by 67% in the first quarter as the negative impact of higher financial expenses were offset by the positive contribution from deferred tax liabilities, based on inflationary accounting.

Financial services segment’s inflation-adjusted top line growth was 15%, driven by both life and non-life businesses. In the life business, Agesa became the leader company and ranked as number one in Turkish market in terms of Private Pension asset under management as of January 2024. Agesa also maintained its number one position in terms of gross written premiums in life and personal accident. Despite the growth in pension business, strong contribution from increasing volume of high-margin credit-linked and standalone life products, EBITDA was negatively impacted by higher personnel expenses, the impact of the valuation of Deferred Acquisition Costs and Deferred Income Reserves, which are indexed to minimum wage increase and the increase in commissions paid on premiums Net income was negatively affected by sizeable monetary assets and net cash position. In the non-life business, despite the lower Motor Third Party Liability premiums, revenues increased by 11% year on year, thanks to favorable trends in health and non-motor segments. Despite the growth achieved in the non-motor segment, EBITDA was 52% below last year due to a higher loss ratio and rising share of reinsurance premiums after the earthquake. The segment’s bottom line was affected negatively after adjusted with inflation as insurance companies’ balance sheet is highly dependent on monetary assets.
Digital Segment’s topline increased 27% year on year, with a higher contribution from the electronics retail business thanks to its omnichannel strength, wide product range,

new customers, and value-added services. E-commerce sales performance also remained solid as Gross Merchandise Value (GMV) was up by 35% in real terms to TL 3 billion in the first quarter of 2024. EBITDA increased by 26% year on year, thanks to strong top-line growth in the electronics retail business. The segment's net income was negatively affected by higher financing costs on higher interest rates compared to last year.
And finally in the retail segment, top line increased by 5% year on year thanks to the growth in alternative channels. Disciplined cost management resulted in a major recovery in EBITDA margin, despite the negative impact of the minimum wage hike by the beginning of 2024. However, net income was affected negatively by higher financing costs. So, this concludes our segment information as well.

Mr. Orhun Köstem, CFO: Thank you Kerem, yes as a wrap up again in the first quarter of 2024 we continue with our strategic growth agenda we continue with our progress on the ESG front in fact we have so to say shifting gears and we continue holding a healthy financial position, and we're quite excited about the rest of 2024. With that we would leave the floor for any questions, thank you.

Mr.Kerem Tezcan, IR Director: Thank you Orhun Bey. Please type your questions to the Q&A section of the Zoom.
We have a question from Umut. Thank you for the presentation. How do you see the output for energy generation? Given the current the goal level of energy prices? Do you expect an increase in tariffs? And the second question on the energy segment I presume you expect strong EBITDA generation from energy generation in the rest of the year. How comfortable are you at the prices will increase to achieve the targets?

Mr. Orhun Köstem, CFO: Thank you again, these are two quite similar questions. So just wanted to make sure that we could address them at once. If you look at the electricity prices in Turkey, for the past 2 years, especially in 2022, after the Russian invasion of Ukraine, we have seen electricity prices to reach as high as $120, and this was obviously not necessarily quite sustainable. On a normal basis if we project over a very long term, we should expect the prices to be at around $80, you know, that's as a rule of thumb on a year-on-year basis. And today we're more like, you know, 60s. So, and I don't think this is also sustainable. Having said that, you know it's quite difficult to crystal ball what could be the prices, energy prices for the rest of the year, we are aware, and we make our plans with the expectation that, given the program to reduce the inflation. Obviously, such elements would be probably considered quite carefully by the Government. However, as I tried to say earlier, normally we should expect our generation assets to post an EBITDA closer to 500 million dollars. But obviously for this year the trading income is going to be reduced quite significantly. Which, again, is okay, because we could guide you and we could tell you, what our generation assets could produce as EBITDA, the trading contribution is dependent on the market volatility. And again, it's a capital allocation and a return on capital issue for us. So, we would be quite happy to have a reduced income on years like this. That doesn't unfortunately answer your question, because again, as I said, it's difficult to guess what it could be. But all I say is we expect to deliver quite close to normal EBITDA bandwidth in terms of the output of our generation assets.

Mr.Kerem Tezcan, IR Director: Okay, another question. When should we expect Enerjisa IPO to take place? What is the timeline on this project?

Mr. Orhun Köstem, CFO: Thank you. I think if we have that much of a clear timeline, probably you would hear. For the time being though I can say again we feel that the business is in great shape. As shareholders, we will need to align obviously going forward and I believe it's more than how the business takes shapes is more about how the markets could take shape and I'm not going to speculate about the potential valuation of Enerjisa Üretim. I'm pretty sure you must follow, as I was trying to say how it now contributes to our NAV compared to what it used to be a few years back. We would very much like to, you know, if we do something at the best possible market and conditions. And then we'll see when that happens. So, it's more like an issue of getting ready and capitalizing on the market conditions, but there's no specific announced timetable for that yet.

Mr.Kerem Tezcan, IR Director: Second question is on US investments. How much Capex is allocated for the solar investments in the US? How much EBITDA may generate once it is fully operational and is this going to be a fully consolidated?

Mr. Orhun Köstem, CFO: Thank you Hanzade, first of all let me start with the easier one yes, it's going to be fully consolidated because as you know Sabancı Climate Technologies which is a parent company of Sabancı Renewables that runs these businesses in the US is a wholly owned subsidiary of Sabancı Holding so that's a full consolidation. Now how much capex is allocated, I'll tell you how it works. If you take Cutlass where the generation capacity is about 272 MW, I think the overall Capex was around 350-360 million give or take. And when we started the project, we started assuming that capex amount roughly 1/3 equal instalments would be shared by capital, debt and Tax Equity. But when we finalize the project, it was more like 50% was Tax Equity, debt and capital was a quarter each. So therefore, our estimate for the amount of capital we use going forward is a little bit conservative when you look at how we can achieve. So, for the time being you could assume we spend about $120 million to own a generation asset of you know 272 MW. Here in terms of the EBITDA contribution, I think if you look at the full scope of our EBITDA these in the first instance at least the projects that we plan to own and operate they contribute a size as maybe 15% more all of which obviously this time would be FX. But the real returns there would be also as we can expand our base that's for you, our initial phase up to let's say one gigawatt which can increase our overall EBITDA from the generation business by another 15% and if you take the expansion of Enerjisa Üretim capacity increase in Turkey that's another 20%. So we expect a of course hopefully very reasonable uptick in our EBITDA coming from our generation businesses, Turkey and outside of Turkey.

Mr.Kerem Tezcan, IR Director: Third question is on banking industry, what would be the normalized ROE once inflation stabilized below 25%?

Mr. Orhun Köstem, CFO: That's a difficult one I have to tell you. I mean and I'm pretty sure our colleagues at the bank would be much comfortable answering that. All I can say if you follow what Akbank had to say, last year and before that when they started inflation accounting that they were looking at I think at least high single digit ROEs or low of double-digit ROEs, which could be some guidance Hanzade but I believe that's a very good question to be discuss with our colleagues at the bank. If you look on a consolidated basis as I said for Sabancı Holding and I can tell you that over a longer term basically we could argue that as I said without any one-offs or non-recurring items, we should expect our consolidated ROE to be low double digit to high single digit. The non-bank business does something quite similar to this currently and you know we don't expect to see anything lower than this when we project this ahead.

Mr.Kerem Tezcan, IR Director: Thank you, Orhun Bey. If you have any further questions, please type on the Q&A section of the Zoom, thank you. Once again if you have any question please type to the Q&A section of the Zoom. It seems we have no further questions thank you so much for participating and hope to see you in the next quarter.

Mr. Orhun Köstem, CFO: Thank you very much bye bye for now.