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Sabancı Holding
Q2 2023 Financial Results
Webcast

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Speakers:
Cenk Alper, CEO
Orhun Köstem, CFO
Kerem Tezcan, IR Director

Mr.Kerem Tezcan, IR Director: Hello, everyone. Welcome to Sabancı Holdings' second quarter webcast. Please refer to our to our disclaimer before we begin our presentation. Today, I have our Group CEO, Cenk Alper and Group CFO, Orhun Köstem with me. I know would like to leave the floor to our CEO for opening remarks. Orhun Bey and I will be talking about financial performance more in detail in the remainder of the call. Cenk Bey..

Mr.Cenk Alper, CEO: Thank you, Kerem. Hello everyone, welcome to our second quarter webcast. I'm Cenk Alper, Sabancı Holding CEO.

I'll start by talking about the major events that affected our Group in the first six months of the year. Orhun and Kerem will provide more details on our financial performance.

The first half of the year was exceptionally challenging resulting from the devastating earthquake, high volatility in local macro environment together with uncertainties around elections as well as difficulties in the global markets due to the recession in major economies. Although eased in the beginning of the second half, global recessionary environment in the first half had made a slight impact on the volume performance of our export-oriented portfolio companies such as cement, tire, composite, and tire reinforcement businesses. Yet, those companies benefited from robust demand in the domestic market and offset the slowdown in the export markets and maintained their earnings growth momentum.

In terms of local macro environment, high inflation continues to affect our businesses especially on the wages as well as sharp price increases on local materials and services. In addition to inflationary pressures, demand volatility in different businesses was another important fact that was experienced in the first six months. Moreover, rapid changes in regulations had a major effect on our group companies. Yet, we managed to act proactively and in an agile manner to better position our Group against such challenges owing to our close monitoring of the regulatory landscape. Thanks to these efforts, we managed to sustain our profitability to further maximize shareholder value.

All these macro challenges that I mentioned got even more stretched up until May as the country was under the influence of long-awaited elections. We, as a Group, continued to remain cautious in this extremely volatile period but sticked to our investment plans and capital allocation strategies that we have been addressing since mid-2021, which we define as the “new economy”. We have reviewed multiple options and investment opportunities both in Türkiye and abroad that fit our capital allocation criteria to continue to deliver on our Group purpose that we have been highlighting at the very beginning of our strategy house; We unite Türkiye and the World for a sustainable life with leading enterprises.

In this volatile and challenging local and global macroeconomic backdrop, I’m happy to see that we have managed to improve our numbers at every level and even performed better than last year’s numbers, which was a period that had marked by hyperinflation. Our earnings quality prevailed in the first six months as our 50% year over year net income growth comfortably exceeded 42% EBITDA growth in the same period. Our operational cash flow surged 8 times compared to previous year. Our ROE in the first six months reached 38%, driven by both bank and non-bank businesses.

The group’s balance sheet remained strong, and our favorable FX position benefits any currency volatility and reinforces our healthy balance sheet, as evidenced at the of first half. Our liquidity, especially at the Holding level, continued to be solid even after adjusting for the dividend payment, which has more than doubled compared to a year ago.

I’m confident that we will continue to reap the benefits of having a diversified portfolio of companies that is enabling solid and sustainable financial performance despite local and global economic volatility. This, I believe, will continue to be a major competitive advantage for Sabancı Holding.

Aside from strong financial performance, we continue to bank on building an ecosystem within Sabancı Group. In addition to investments in core and new businesses, we are also aiming to sustain our “building a sustainable ecosystem” theme with our venture capital investments as well. In that respect, Sabancı Ventures has completed two new deals in first half of the year, including first APAC-based investment in a green hydrogen equipment company and reached a total of 9 investments and a total investment amount of ten million dollars. These are all separate from our other venture investments in energy and climate technologies.

Corporate venture capital investments are an essential component of our growth strategy as well as an instrumental tool to foster innovation and create value in our existing businesses as it helps us build synergies and commercial collaborations across Sabancı Group. We are also increasing our global footprint with 4 of our last 5 investments being headquartered abroad.

While concentrating on strategic priorities and financial performance, we also kept our focus on ESG, as it is an integral part of Group's strategy. We have been prioritizing Sustainability in all our investments not only for the future of Sabanci Holding but also for the future of the world.

Let me talk about our successful implementation and execution on our ESG principles.

With the aim of being pioneer in "sustainability as a business" we continue to accelerate our investments in the areas that support the United Nations Sustainable Development Goals. With our projects and new-economy oriented businesses, we aim to reach net-zero emissions by 2050 as our ultimate target.

- In that respect we have already defined our interim Scope 1 and Scope 2 emission reduction targets in line with the Science-Based Targets initiative, a major step toward our Net Zero goal. According to these science based targets, we will be decreasing our Scope 1 and 2 GHG emissions by 42% as of 2030 with 2021 base year.

- As of 31 December 2022, we have already reduced our Scope 1 and Scope 2 emissions by 11% compared to 2021 with Group efforts and sustainability-dedicated projects. Specifically, our building materials and energy group companies played a vital role in reducing Scope 1 and 2 emissions. We aim to attain a 15% reduction no later than end-2025.

  Let me give you some additional facts and figures about our ESG performance:

- We reduced our energy consumption by 12%.

- We increased our renewable electricity consumption 3.3 times compared to 2021. On the other hand, we produced %31 more renewable electricity in 2022.

- We reduced our water consumption by 9% compared to 2021.

- and we increased our water recycling rate from 23% to 31%.

- So to sum up, 2022 has marked the reversal of a business as usual trend, in which companies are expected to increase their footprint while growing their businesses. This was not the case at Sabancı in 2022.

- Moving forward in the next 4 years, energy continues to be the major driver of our low carbon growth strategy as 1 out of every 3 wind and solar power plant investments in Turkey will be made by Sabancı Group. This also means adding 10% in Turkey's existing installed wind power capacity.

- Through our business strategy and ESG integration into our capital allocation decisions, we manage our new investments on the axis of sustainability-related areas. In this regard, we project our CapEx and OpEx in the activities associated with the United Nations Sustainable Development Goals to reach 5 billion dollars among 2022-2027 year-end.

I tried to give you a color on our investments, financial performance and ESG initiatives. Now, let me hand it over to Orhun to speak on our financial performance more in detail. Orhun...

Mr. Orhun Köstem, CFO: Thank you, Cenk. Hi everyone, good morning and good afternoon wherever you are, this is Orhun Köstem speaking. I'm happy to report we had a great a set of results at the end of the first half 2023. I'm sure you must have seen that our second quarter results have been much better than what we have reported on the first quarter and I would be more than happy to touch base some of the details around that.

I won't go into detail in this page (Q2 2023 Earnings Presentation, p.3) except for the fact that we're looking at in summary, NAV growth of 43% , NAV discount of about 29% and our non-bank capex to sales ratio have been gradually improving and this has come to 8.6% from 7.4% compared to the first half of 2022.

On the next page (p.5) as far as the macro backdrop is concerned before we move into the details of the financials, we're looking at a relatively better environment when it comes to commodity and energy prices compared to last year when we take reference of Bloomberg indexes we've seen and easing on the cost of commodities and energy in general. In Turkey obviously one of the things that we have been following and I'm sure you must be looking at is how the minimum wage has been increasing with a recent increase after the reporting date of our first half results but obviously from the first half of 2022 to first half of 2023 if you take the end of 2021 as an index we're looking at about 280 compared to 100 index at the end of 2021. The Consumer Price Index at the end of June has been recorded at 38% that's roughly half of what it was a year back, still high but nevertheless came down. If you look at the FX basket how it changed in the first six months its 36%, pretty much in line with the top-line inflation. Going forward we still look at a lot of volatilities and again I'm sure you must have noted in the month of July the inflation has started to pick up again. In this macro backdrop and a relatively still volatile environment, I'm happy to say that we have grown our top-line by 59 %, our EBITDA by 42% and our net income by about 50%. I'm also quite happy to say that our net income growth has been contributed both by the bank and the non-bank businesses. I'm going to talk about the bank later when I talk about the details in the quarter but as you see the return profile of the bank is normalizing as is in the general banking sector whereas I'm pretty sure you must see that akbank did announce a great set of results compared to its peers and the sector in general. However, I would also like to draw your attention to the fact that in the non-bank business we have been able to deliver what we call a quality growth what we mean by that is as the top-line grows in this case by 44% we've seen our bottom line growing faster by about 51% which suggests a more profitable growth on a year-on-year basis. This is also reflected in our return metrics if you look at our return on equity we're quite happy with the trends where we've seen. The basis increased by 33.6 to 37.8 at the end of the six months in 2023 so about 420 basis point improvement. In non-bank case there's a 60 basis point improvement where the bank's return metrics are, as I said normalizing. It was quite interesting again on the non-bank side if you only look at the second quarter, non-bank businesses have delivered a return on Equity to about 48% compared to 30% in the second quarter of 2022. That base have been gradually improving. We have seen a whopping eight times growth in our operating cash flow to 16.6 billion Turkish lira from a three billion Turkish Lira back in 2022 but in all fairness if you have listened to us last year as well actually the 2 billion TL was out of ordinary, the base of 2022, this was driven by the fact that the price equalization mechanism for our retail electricity business have only normalized towards the end of 2022 and actually created this anomaly within the period. So, strong operating cash flow generation we were quite happy with eight times is great but again you need to be careful about the base of last year in that sense. Nevertheless, if you look at our balance sheet details we still held about 4.5 billion Turkish Liras of net cash, roughly about 176 million USD. That is Holding-solo cash we're having. Our net debt/EBITDA it's come down from 1.3 times to 0.5 times compared to end of the first six months of 2022. It is more or less at the same level when you compare it with the end of 2022. In the meantime, as I said let me underline again we continue our investments and our capex to yourevenues on our non-bank businesses have grown from 7.4% this is 2022 to 8.6 percent which is the first half of 2023. In spite of the fact that we continue growing our capex as we have communicated we still manage a fairly healthy balance sheet and we still believe we have enough ammunition to continue investing for growth.

If you look at the second quarter results. First of all if you look at our second quarter revenue growth has been 45%, that is a 75% growth on the bank side and 30% growth on the on our non-bank businesses. On the bank side, in this period obviously the fundamental banking returns were positive from trading income to to portfolio returns etc. However, what I would like to draw your attention specifically is how the digital customer acquisition has been moving forward in the bank.

You remember last year we've reported that the bank has acquired some 2.3 million new customers digitally on top of that it has grown another 1.3 million customers so within a one and a half years these have grown by a whopping 42%. That growth results in market share expansion, cross-sell opportunities and obviously a very healthy and strong contribution to the performance of our bank which we're happy with. On the non-bank side as I said the revenue growth was 30% you're going to see this is actually mostly driven by the fact that in our energy generation business this year, the business is mainly driven by renewable energy generation contribution together with hydros where you're going to see what I mean in the next few pages where we have a very strong profit generation however the top-line growth has been somewhat subdued in this quarter due to the mix especially coming from generation reasons. Having said that, we're quite happy of how our building materials businesses top-line is growing, how are digital segment or financial segment has been growing all of which are contributing to our overall non-bank top-line growth.

If you get to the EBITDA, we see a 51% growth of EBITDA in the quarter, faster than our revenue growth. On the bank side this is a 44% growth on the non-bank businesses this is 69% growth. Again, EBITDA growth has more than doubled compared to the top-line growth as I said the profitability corrects itself. On the energy side , now this time in generation the share of the renewables have been increasing which is making us happy with positive margin and profit contribution. Hydrology in the second quarter after april became much better than what the outlook was in the first quarter. Therefore, heading for the profitability despite the fact that the electricity prices are low and the output of our natural gas plants in Bandırma have been limited due to two stoppages of generation in the period. Other than that if you look at our building materials business the EBITDA growth has been 99&, digital side 71%, financial services EBITDA has been growing quite significantly but again we remember the base last year was low especially for our non-life insurance business, this year obviously it's premium generation of our insurance businesses as well as the EBITDA contribution has been much better.

If we get to the net income for the quarter, here the growth is 73%, again much faster than how the top-line has been growing. Banks' net income growth in the quarter was about 55% whereas the non-bank businesses net income growth if we exclude of course one of items in the period is a 108% percent. The energy business contributes the fastest 137% growth, building materials 174% growth and financial services over 300% growth and the industriuals business net income is not growing in this quarter, it was not growing in the first quarter either you remember that was due to the fact that, Kordsa's global footprint and global markets there's a very serious demand and price competition, a) because of the economies either slowing down or contracting, impacting the overall demand and secondly of course given China has slowed down considerably there is now a lot of Chinese products in the market which creates a lot of pricing tension. You see a descent cash flow from Kordsa and you results pretty much in line with our plans for the year. However, compared to last year we see some slowing down in the overall industrials. Although, Brisa's business continued to be doing quite well.

With that I'll move on to the next page(p.13) and talk about our NAV growth which was at 43% on USD basis compared to the same quarter of last year. Again compared to the same quarter of last year we have some 6% reduction in our NAV discount. If you look at the last three to five year averages obviously we're looking at 40-42% so we have now stabilized our NAV discount in a much healthier level. If you look at the contribution to our NAV, there you see on the graph on the right hand side of this page(p.13) obviously it seems that the Banking and Financial Services has the highest contribution with some 36% followed by our materials businesses mostly industrial and building materials, is 29% and then followed by energy which is 22%. If you turn to the next page(p.14) you see pretty much the same breakdown on your pie chart on the left hand side. However, as I'm sure you must have all noted and seen and if you haven't noted and seen we must have reached out to you and told you that given our initiative around merging our subsidiary Exsa with Sabancı Holding A.Ş. to simplify our structure basically so there is much clarity on businesses like Sabancı-Skoda joint venture that produces electric buses which we're hopefully going to have a direct ownership now and not through Exsa.

Through that process we have by regulation we have had to produce an independent valuation report which was produced by EY at the time and if you look at some of the valuations for our non-listed companies in particular Enerjisa Üretim. On the right hand side of this page (p.14) you see a much more balanced breakdown of NAV where the energy businesses now account for about 40% Banking and Financial Services 27% Advanced Materials Technologies 21% and digital is up-and-coming, it's quite small we started last year as you've seen the top-line has been growing quite satisfactory however its still coming off a small base. Even though NAV growth was quite nice and we have been able to grow and still over the BIST30 in the last 12 months or if you look at since the start of the year we're pretty much in line or maybe slightly above BIST 30. This is hardly reflected on our price earnings ratios especially if you compare to our historical levels there is slight improvement. However it seems there is much much more opportunity for us to move forward. Now with that I will leave the floor to Kerem so that he could take us through the details of our business segments and then I'll talk about our midterm guidance again, thank you.

Mr.Kerem Tezcan, IR Director: Thank you, Orhun Bey. Let's start segment discussion with energy. As for the generation business, as a result of lower spot prices and lower natural gas volume due to stoppages in natural gas plants, revenues dropped by 55% compared to last year. Despite low natural gas profitability because of procduction stoppages and low spot prices, EBITDA was up by 65% compared to last year with positive contribution from renewable assets thanks to higher water inflow, higher dark spreads at coal plant and positive asset light contribution on higher trading activities of Enerjisa Commodities. In addition to positive EBITDA performance, higher FX income supported the bottom-line and net income more than doubled in Q2.

With regards to Enerjisa Enerji; Operational Earnings improvement driven mainly by strong growth from our distribution business as well as retail and customer solutions segments. Distribution business generated growth, both from its return on assets and investment activities as financial income increased on the back of higher inflation and investments as well as the IFRIC, financial income calculation methodology change, which has incorporated in Q3 last year. Further on, please note that the negative impact stemming from the 780 million OPEX costs booked in Q1 related to the earthquake, have now been classified as pass through non-controllable opex. CAPEX increased massively on higher inflation as well as the low activity level at the first half of 22. In retail segment, gross profit margin recovered on the back of higher energy costs and increased cost coverage for higher inflation and doubtful receivables. Our Customer Solutions' operational earnings increased significantly driven by new solar power projects, where we install solar panels on our customers' facilities, providing them with access to green energy as well as positive impact from FX gains.

The bank ended the quarter with a record 20 point 3 billion net income, up an eye-catching 90% QoQ, resulting in solid 5.8% return on assets and 50.3% return on equity. Buffers remain for both ROA and ROE, as the bank used 40% for its CPI-linker valuation. Akbank added a solid 1.3m net active customers year to date. This is on top of the net 2.3 million acquired last year, taking its active customer base to 12 million, up by 42% in the last one and a half years. This customer acquisition has resulted in record high market share gains across the board, in consumer loans, broad-based deposit base, and demand deposits. More importantly, customer acquisition continued with higher cross-sell ratios.

All these led to fee income market share among private banks to surge by 250 bps in first half of 2023 according to the BRSA monthly data. Also worth to underline that, while growing due to prudent risk management, the probability of default of the portfolio did not increase. With the agility in balance sheet management, timely hedges and strong customer related business, Akbank once again leveraged its exquisite treasury management, further boosting net income. Akbank proactively complies with regulations while focusing on maturity mismatch. In addition to these, the bank keeps its leading position in capital with a robust figure of 17.1 % which will continue to provide the bank significant competitive advantage going forward. Please keep in mind that with the July Tier 2 issuance, capital adequancy ratio would even be higher at 17.8%.

Financial services segment had another quarter with robust performance as top-line growth reached 94% y/y driven by life and non-life businesses. Segment’s EBITDA more than tripled with the contribution from both businesses. In the life business, EBITDA was up by 10% y/y thanks to the growth in pension assets under management, higher profitability in Return of premium products driven by TL depreciation and positive impact of cumulative life profitability. Net income has more than doubled thanks to higher technical profitability as well as strong financial income owing to favorable interest rate environment and higher FX gains on weak TL.

In non-life business, despite the company’s conservative approach in Motor Third Party Liability, top-line growth reached 96% compared to last year thanks to favorable trends in non-motor segment. Underlying net income performance remained somewhat under pressure because of additional provision related to the Constitutional Court decision on Motor Third Party Liability and impact of minimum wage increase on technical provisions. Despite weakness in underlying net income, EBITDA performance significantly improved compared to last year thanks to weak TL and profitable trading transactions during the second quarter. Because of a strong EBITDA pass through, net income sharply recovered from a loss from last year.

Moving on to the Building Materials, segment’s topline increased by 45% as local demand especially in Marmara region remained strong. This strong topline growth has achieved by focusing on sales mix optimization despite lower volumes compared to last year due to sale of Çimsa’s Kayseri and Niğde plants on July 2022 as a part of its network optimization strategy. In addition to better sales mix, higher energy margin and fuel mix optimization led to solid EBITDA growth and margin. The alternative fuel usage in both companies is standing at 25%, which is well above Turkey's 10% average. The segment's net income almost tripled compared to last year thanks to the positive impact of declining net financial debt level and higher FX income.

For the industrials segment, combined revenue growth remained at 21% year on year in Q2, due to the continuing weakness in the global tire reinforcement market leading to a lower sales volume. Yet, this weakness offset by strong demand in the tire business driven by Original Equipment market. Although, EBITDA growth of tire business remained strong in the quarter owing to favorable pricing and sales mix, industrial segment's EBITDA margin deteriorated due to the weakness in tire reinforcement business on high-priced raw material inventories. Net profit declined by 16%, led by higher net financial expenses due to increasing debt position related with financing of Microtex acquisition and increase in financing cost.

Our Digital Segment's topline more than doubled with a higher contribution from the electronics retail business driven especially by strong demand and market share gains. In addition to physical store sales, which are the major driver of basket growth, e-commerce sales positively contributed to the segment's topline growth as gross merchandise value almost tripled. Our new digital marketing and cyber security companies also contributed strongly to the topline growth on higher sales in cloud technology and architecture services in SabancıDx and higher sales in advanced analytics and product business line in Opportune, formerly known as SEM. Segment's EBITDA has almost doubled thanks to strong topline growth despite higher fixed cost to sales ratio due to ongoing integration process in new digital marketing and cyber security companies and adverse impact of minimum wage hike in electronics retail business. Higher FX losses and higher financial expenses because of higher borrowing cost pressured net income growth.

On retail, segment's revenues increased by 87% y/y, remaining well above the average inflation driven by higher average basket size and organic growth in physical stores . While EBITDA growth remained 60% y/y, EBITDA margin declined 100 bps due to negative impact of minimum wage increase. The adverse impact of high financials expenses continued to affect bottom line growth.

Now I would like to leave the floor to our CFO, Orhun Bey to speak about our guidance.

Mr.Orhun Köstem, CFO: Thank you, Kerem. As you remember our mid-term guidance is to grow our top-line 8% better than the top-line CPI, our EBITDA to be 10% better than top-line CPI. Just to give a brief color of this, we have looked at the past two years after we announced our mid-term guidance. We've seen that our combined net sales are grown 23% and 49% above the top-line CPI. Our EBITDA has grown 36% and 100% above top-line CPI for the past 2 years. We are comfortably head of our mid-term guidance but obviously we are going through quite volatile periods moved in to hyperinflation and then expect that to potentially come down in the coming years, we will continue looking at our mid-term guidance going forward. For the time being it is maintained.

You will also remember we had one addition to this where we added our 2030 guidelines on sustainability where we said we're looking 42% reduction in Scope 1 and Scope 2 emissions by 2030.

Questions:

- Do you think >40% EBITDA margin in energy generation business is sustainable in the remainder of the year?
- What is the general guidance shared by Industrial companies for the rest of the year?
- Do you see any scope for higher dividend income from non-bank companies in 2024?
- Shall we expect to see an improvement in dividend payout ratios? If so, which company would you particularly mention?

Mr. Orhun Köstem, CFO: Let me take this over, this is Orhun speaking many thanks for the questions. For the generation business we're looking at reasonably a good hydrology for the remainder of the year a there is no difference in terms of the pricing metrics for pricing dynamics in the market. Yes there is no reason why we should think of a much lower EBITDA margin for rest of the year what we have done so far as I said was a relatively lower contribution from dark and spark spreads and that was met in general by renewable and hydrology and again our trading business in general provided you know positive outcome. As long as these conditions continue yes you shouldn't expect any serious changes there.

For the industrial companies obviously we're not looking at here I haven't seen their guidances per se. For us, as we discussed Brisa's holding on to their profits and their cash flows maybe not growing significantly year-on-year compared to last year but nevertheless we believe so far they have done a good job basically given the conditions so more or less let's say flatish given the relatively difficult circumstances. I would say the same for Kordsa as well again as I said we're not looking at a year of growth for our industrial businesses having said that we're looking at holding on to profits basically. We are expecting to see good cash flow performance in general which we feel to be quite important in a year like this where we demand pressure in the market.

Going forward, yes higher dividend income could be. In my mind these are two different questions the dividend payout ratios could change but more importantly some of our dividend contributors have been changing what I mean is Enerjisa Üretim for example has been a quite strong dividend contributor over the past two years, distributing something to the tune of 150 million dollars basically. So the answer in general is yes in my mind not because there will be major changes in dividend payout ratios but the absolute profit growth of the non-bank businesses can continue to perform quite well especially the energy business has the dividend and potential to match our bank business which has been as you know the largest dividend contributor historically.

Mr. Kerem Tezcan, IR Director: Thanks all for joining our webcast. Hope to see you next quarter earnings. Thank you.

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

Mr. Cenk Alper, CEO: Thank you very much for participating our webcast.