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Sabancı Holding
Q3 2022 Financial Results
Webcast

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Speakers:

Orhun Köstem, CFO
Kerem Tezcan, IR Director

Mr. Kerem Tezcan, IR Director: Good afternoon everybody. Welcome to Sabancı Holding Q3 webcast. We have our CFO Orhun Köstem with us today and we will start with the presentation and Q3 major points. Before doing that, please refer to our disclaimer, as you can see on the screen. Now, I would like to hand over to Mr. Köstem for the introduction.

Mr. Orhun Köstem, CFO: Thank you, Kerem. Good morning. Good afternoon, everyone. We're quite happy to host this call to report another quarter of good, solid financial results as well as to report on our progress towards our strategic undertakings which we believe has also been successfully executed in the period. If you look at the backdrop of what has happening in the first nine months of the year, we're looking at the Turkish Lira depreciation of about ninety-six percent against the dollar, and about seventy-four percent against euro, and then the latest reading on inflation in the first nine months was about eighty three and a half percent, so I think it's worth mentioning and remembering those when we look at the financial results, which we believe is well above the expected thresholds. In this period, if you look at page three, we refer you to growth and earnings quality which I'm going to touch base in a second. We maintain the strength of our balance sheet. In fact, we continue to incrementally deliver in the period, and I'm going to show you the undertaking investments that we've been doing as we progress through our strategic transformation. Return on equity has tripled. It's a was about fifty-nine percent in the third quarter. Obviously, our banks' ROE has been up to over fifty percent quite seriously as well in the in the first nine months. Net Debt/EBITDA as I said fell below 1.0x. One area, as you remember, in the last two quarters that we were referring to, which was our operational cash flow now have obviously rebounded very strongly in this period. We are investing in renewable capacity in Turkey and outside of Turkey to further our climate technology strategic agenda as well as investing in disruptive emerging climate technologies.

In page four, when we say renewable energy investments in Turkey as you know, we have announced Enerjisa Üretim's thousand megawatt wind plant investments that are YEKA-2 tenders with the collaboration of Enercon. Outside of Turkey we have started our investments towards building a solar power plant in the U.S. as well as investing directly in certain startups. One is about the fusion technology and the other one about the drilling, technologies which we believe that are closest to getting commercialized in the near future. We further our initiatives investing in climate technologies, advanced material technologies and digital technologies.

We have left behind a very strong quarter that brought are nine month financial performance quite strongly. Our combined revenue grew by 175 percent , our combined EBITDA grew by 259 percent and our consolidated net income was up 321 percent. What we mean by quality grow up, pattern of growth where we grow revenue and profitability grows faster. Akbank has done very good job in this quarter as well. I'm sure you must follow the banking sector results are very good. On the non-bank side we are also quite happy with the performance of our businesses where the revenues in the first nine months were up by 178 percent EBITDA was up by 118 percent and the net income was up by over 200 percent so back to the point about cumulative inflation as well as the Turkish Lira devaluation we trust these are good results if you look at the existing working environment. The banks also again capital adequacy has further improved which will are quite happy with. It gives us not only confidence but we believe give us more flexibility to be more competitive in the market going forward. Now the return on equity is up in the period on the consolidated basis it was 41 percent if you look at the banks' return equity it was 55 and non-bank was 27.7, obviously a very good performance but we're still playing catch-up with the inflation so there's still room for us to further improve. If you look at our cash position it's it stands at 4.4 billion Turkish at the end of nine months which is down from 5.5 at the end of the first half of this period obviously worth to mention as our investments in the Climate Technologies in the periods the capital advances provided to Aksigorta to affect the subsequent capital increase which is probably due this period and then obviously our ongoing a buyback program. On the next you'll see our operational cash flow which obviously was a laggard in terms of performance in the first two quarters of the year but that was specifically due to increased working capital requirements of Enerjisa Enerji on the back of the price equalization mechanism that came with the lag now that's obviously behind us I hope and I trust you listen to our friends' webcast as well and they've done a great job in the period. Our operating cash flow has rebounded quite significantly now over above last year's full year levels and finally our net financial debt to non-bank EBITDA on a combined basis is down to 0.7 times.

I'll remind you that our group's midterm guidance on net debt to EBITDA is to maintain it at or below two times so we believe together with our cash at hand at the holding level gives us enough firepower to continue pursuing our strategic initiatives as well as defending ourselves successfully for any potential volatility going forward. If you look at certain details for this third quarter specifically the combined revenues of the group was up by 192 percent again I'm happy to say that the contribution of the energy business was quite strong we believe a portfolio is an important driver of the success of our business not only in the sense that we have a portfolio in distributions well as generation but also our generation portfolio is quite complementary between you know all the sources available in the market which allows us to do a good job on a sustainable basis. The retail growth pipeline growth in the period was also quite satisfactory like for like a basis obviously the critical point is that we've seen the customer growth to be relatively strong which obviously supports the topline growth of our retail businesses. Last but not least our industrials business obviously the demand was relatively stable so to say I mean if you remember our discussions earlier for our tire manufacturing businesses for example the OEside of that business was not growing the replacement part of the business is coming quite strong but in general has good you know demand and together with the favorable pricing we see strong topline growth in our industries business that assists our overall combined revenue growth in this quarter. If you look at EBITDA again I'm happy to say the EBITDA growth of 285 is of obviously faster than the topline growth in the quarter now obviously the banks now contribution becomes bigger. On the non-bank side I trust you would agree that you know between the energy prices and the raw material prices we believe our businesses are doing a great job in terms of growing it's absolute EBITDA and maintaining or minimizing any potential contraction and margin in this environment. Energy obviously again our energy business was quite instrumental in delivering strong EBITDA growth as I said in both of our businesses on distribution and generation did quite well in the period and regardless to say the demand for energy is high for this year specifically and therefore our businesses are on the profitability side doing quite well. The building materials again that we can't obviously help but note that the fuel prices have been skyrocketing for the building materials business and two things that we have been focusing on quite diligently, one was to ensure that we continue taking ourselves towards more alternative fuel usage we have brought it on average over 20 percent levels which is actually at par or even better than some of the EU benchmarks which were happy a bit but at the same time to ensure that we do a very disciplined opex management in the period so that we can maximize the leverage out of the topline growth that we see in these businesses which brought good EBITDA growth. On the industrials again we see strong EBITDA growth driven partly by the topline growth I have to say in these businesses obviously the fact that the parity euro dollar parity remains below one is not helpful and therefore my friends my colleagues have been able to mitigate this effect quite successfully this year something to think about for us next year obviously under prevailing conditions but nevertheless good strong EBITDA growth and contribution to the combined EBITDA of the group.

If you look at the net income, growth was over 350 percent. On the non-bank side also it was very strong at 230 percent, again the energy side we see the the good progress on the operating profit to flow through our bottom line was nicely if you look at our generation business Enerjisa Üretim obviously continue to deliver on the back of good financial profit and cash flow generation. Therefore our bottom line net income on the energy side has grown quite strong despite the fact that Enerjisa Enerji has been in the first two quarters of the year needed to incrementally fund it's growing working capital which we're happy to note that in the third quarter starting from the third quarter and given the changes in the recent amendments by the regulators has been more or less normalized for 2022. Now on the Industrials, you know apart from the fact that we have a discipline management of our financial expenses, there has been an extension of the tax incentives for Brisa so which normally should count for the first nine months flows into the third quarter that is about 60- 65 million TL impact so there is a jump but nevertheless good bottom line performance and on the building materials as well you know flowing through the operating profit we see strong net income performance hitting the bottom line therefore contributing very positively for the combined net profit of the business.

Now I will now hand over to Kerem which as always will take you through into certain details of our business units before we convene again for closing in questions thank you.

Mr. Kerem Tezcan, IR Director: Thank you, Orhun Bey.

Let me start with energy. We continue to benefit from having a portfolio in our energy business in terms of generation & energy trading and distribution & retail. In Q3 energy segment delivered a robust performance as EBITDA more than doubled thanks to the contribution from both businesses. Enerjisa Enerji recorded a strong performance as a distribution segment, EBITDA more than doubled compared to last year thanks to the higher financial income on higher inflation trend and change in financial asset model approach leading to a higher IRR. The strong growth in financial income with equivalent collection in higher national tariffs and hedge gains more than compensating for lower opex and capex performance due to the impact of higher commodity prices. As of nine months regulated asset base growth reached 68 percent mainly reflecting revaluation of opening balance with inflation. In the retail side of our energy business, gross profits more than tripled driven by volume growth impact of increasing procurement costs and inflation and base impact in liberalized segments. Higher gross profits in core business support EBIT despite higher opex spending as a result of high inflation. In the first half of 2022 the cash flow was negative due to the fact that continuing increase in electricity procurement prices were not supported by national tariff levels and the fact that any inflation assumptions incorporated to national tariff calculations were below realized inflation. The cash flow with 3Q recovered due to numerous measures introduced by the regulator to address the sustainability of the system. Financing costs increased on a year-on-year basis driven by both higher inflation higher financial debts and interest rates and increase in revaluation expenses of customer deposits due to elevated inflation.

Meanwhile, financing costs ease quarter on quarter basis as qudrant inflation increase decelerated and net debt declines. Thanks to strong operating performance the company's net income increased by 116 percent year on year more than offsetting higher financial expenses. Looking at the generation's performance Enerjisa Generations' revenue almost quadrupled driven by much higher spot electricity prices as well as weaker Turkish lira despite lower generational sales volume. Even though hybrid generation volume increased compared to last year total generation volume declined by eight percent year on year as a result of the efforts to optimize natural gas plants production to reach the highest profitability level as far as spark spreads are concerned. EBITDA is tripled as natural gas profitability increased on higher spark spreads due to higher market prices in addition to higher renewable volume in Q3. Moreover our team's ability on energy trade which led us to capture market opportunities and higher dispatch contribution supported EBITDA growth in the quarter. Despite increase at effective tax rates, net income registered solid returns compared to last year thanks to the robust EBITDA contribution and declining financial expenses. By the end of Q3 net debt declined 61 million euro indicating a net debt/EBITDA of 0.1 times The decline in indebtedness is an important development ahead of 1 000 megawatt wind investments as we have already announced in October.

Industrials' segments combined revenues increased by 144 percent year on year during Q3 thanks to flat volumes in both businesses and well-managed pricing specifically in the tire business. Although, tire business maintains its operating profitability segments EBITDA margin deteriorated by five percentage points due to declining EUR/USD parity and inflationary pressures in the tire enforcement business. Coming down to the bottom line net profit grew by 132 percent year on year thanks to EBITDA pass through declining net financial expenses and positive effect of tax incent incentives in tire businesses.

Moving on the building materials, segment displayed an impressive revenue growth of 186 percent year on year in the quarter thanks to the sales mix optimization driven by domestic markets. Also Cimsa Sabanci Cement BV's fx linked revenue contribution in segments results continuous at a material level. Despite negative impact of higher fuel, electricity, raw material and transportation costs, fuel mixed optimization that provided a better energy margin and better opex management led to tripling EBITDA resulting in 1.4 percentage points Improvement in EBITDA margin in Q3. It will also be important to point out that alternative fuel usage ratio improved even further to 25 percent from 16 percent compared to last year which is much higher than turkey's average of nine percent with the contribution of Çimsa's new investment at its Afyon plants. Finally the segments net income grew by 368 percent year on year on the back of solid operational profitability. Note that our net income figure exclude the proceeds from gray cement network optimization contributing around 900 million TL to the net income which we deem as non-recurring income.

On retail segments' combined revenues increased by 126 percent year on year thanks strong contribution from both electronics and food retail which was well above average inflation in Q3.

Like for like traffic in both businesses have shown double-digit imrpovement compared to last year when covid restrictions started to ease gradually. As impact of covid related restrictions disappeared from last year's base both companies recorded strong performances in food retail online sales and electronic retail GMV driven by marketplace investments. Solid topline growth managed to cover elevated operating expenses especially the minimum wage hike in July 2022 and operating profitability improved in both businesses. Segments' IFRS adjusted EBITDA increased by 136 percent year on year in 3Q and margin improvements and margins improved by 0.2 percentage points. Despite higher financial expenses segments' bottom line improved with positive contribution from both businesses.

Financial services segment had another quarter with robust top-line growth registered as 97 percent year on year driven by strong growth performance in all major life and non-life businesses. Segment's EBITDA increased by 40 percent driven by life and non-life businesses. In life business, thanks to the life protection volume growth and pension assets under management, EBITDA increased by 46 percent year on year. On the other hand, in non-life business, underwriting result was adversely affected driven by ongoing increase in inflation on claims costs, 2021 minimum wage increase of 50 percent, ultimate loss ratio upward revision which leads to additional reserve increase, the increase in the material damage coverage limit in motor line.
Consequently, combined ratio deteriorated to 134 percent in the quarter compared to 112 percent last year. However, increase in financial income offset the negative impact of underwriting result and EBITDA grew by 28 percent year on year. We would also like to point out that, with the contribution of increased financial income and improvement in MOD product's profitability, non-life business generated net income in 3Q.
Despite slight decline in non-life business' profitability, higher financial income on increased interest and FX rates in life business resulted in an impressive 76 percent year on year bottom-line growth in the segment.
Note that, with the new regulation published by the end of October, non-life companies are authorized to eliminate the impact of macroeconomic fluctuations in the calculation of the Unexpired Risk Reserve (URR). The positive impact of new regulation will be reflected in Q4 together with the affect of minimum wage increase scheduled by the end of the year.

On banking, despite all the volatility and challenging market conditions Akbank's strategic priorities have always remained intact. Akbank is one of the best-positioned banks in this environment with its robust capital – highest among peers, solid liquidity, highest level of efficiency and low operating cost base. Akbank's nine month net income was up more than 5 times year on year to 38 billion 2 hundred and 23 million TL. The Bank achieved an eye-cathing ROA of 5.6 percent ROE of 51.5 percent ROE for nine months.

Across the board fee performance, market share gains in SME & consumer banking, strategic securities positioning and stellar 1.7 million customer acquisition year to date contributed to solid core operating performance. The bank also further built capital during quarter, reaching a robust figure of 19.3 percent (excluding forbearances) with main contribution coming from internal capital generation. The sound solvency ratios will continue to provide the bank significant competitive advantage going forward.

This concludes the details of the segments. Now, I would like to hand over to Mr Köstem for closing remarks, thank you.

Again we're happy to close the third quarter of 2022 in a very good note obviously as a we're all aware there remains to be challenges for the year ahead however we're quite confident that we could also close the year with this good performance that we have seen throughout the nine months of 2022, so thank you for your attention and now we can move forward with questions.

Question: Have you done any inflation work on your consolidated ROE? What would be the real ROE stripping out the inflation?

Mr. Orhun Köstem, CFO: What we did obviously, we started looking at individual companies inflation adjusted the accounts starting from the first half of the year. The bank as you know they have been indicating that they're looking at a high single digit Roe on an inflation-adjusted basis which is great. We would be able to give you a more concrete guidance once we see the nine month inflation adjusted results for the whole group , I believe should be towards maybe on the back of this year but in any case on an even and inflationary just basis given the bank delivers quite nicely and I believe our energy businesses should do as well then we should be able to be at the good positive territory but bear with us a little while more please so that we can give you more concrete guidance.

Question: Are there any plan for the IPO of Energy generation unit?

Mr. Orhun Köstem, CFO: I'm aware in the past that there has been discussions of Enerjisa Üretim's IPO which at the time my understanding is that the business was not in necessarily a great shape or versus how the market was today if you're following up on our disclosure and if not I will be obviously happy to guide you to the fact that Enerjisa Üretim's performance very very satisfactory both companies but specifically Enerjisa Üretim. However it's quite questionable whether that's the right time to do an IPO going forward obviously we would need to align with our joint venture partners to see or weigh the benefits of such a transaction which could obviously be favorable in a number of ways but for the moment we don't have any concrete decision for that .

Question: What is the growth strategy in US and at what extend do you target to grow in U.S?

Mr. Orhun Köstem, CFO: Now obviously first of all as you know our stated purpose as we're seeing is to grow in three areas if you exclude the financial services of course one of them is climate technologies, material technologies and digital technologies. In material technologies we're looking at renewable energy generation capacity to grow in Turkey and outside Turkey when we look outside of Turkey we've seen that the biggest market globally for renewable capacity or renewable demand is China where we don't have any intention to do any business in the foreseeable future so the second largest market is U.S. which is attractive for us also in the fact that again I'm sure you must be following through our you know strategic dialogue that we're looking to improve our fx revenue streams we're looking to diversify our regulated base and also we want to make sure that sustainability is at the core of our decision making for capital allocation so this ticks all the boxes in that sense. If you look at U.S market though you know 100 gigawatts of renewable capacity is installed in the last three years only, there is serious push to you know continue increasing the renewable generation capacity in the US, if you follow the inflation reduction act it was an important facilitator to accelerate such investments and again if you look at the some stated commitments that the U.S companies have stated that they're going to source 80 percent of their consumption from renewable sources by 2045. That makes about four terawatt hours of energy you know that's mind-blowing so in that sense we've started with relatively small but we can quickly expand we've set to add some one gigawatt of capacity in our Turkish generation uh base which is obviously relatively sizable given the fact that we had already 3.6 so it gets us closer to five it's very sizable for turkey even if we build one gigawatt in the US to you know just for comparison purposes at the same period of time there would still be ample room for potential growth given the size of the demand is very high. We see Investments

Question: What shall we expect in VC investments?

Mr. Orhun Köstem, CFO: These are for us not only you know potential financial gains. U.S attracts some 60 percent of the global startup investments so we see a lot of good ideas in the disruptive emerging technologies in the US in our lines of work. We also look at these in the sense that because we directly invest in certain startups for Commonwealth for fusion and then Quaise for deep drilling technologies to see if going forward once they become commercialized as whether if we could actually integrate this into our businesses. Now that's a far outlook for the time being having said that the purpose of our investments as you may guess is not only for financial investment but we're looking to see ecosystem gains as well.

Question: How do you see the outlook for energy business for 4Q22 and 2023? Do you expect strong profitability to continue or normalize?

Mr. Orhun Köstem, CFO:

2022 first of all obviously has been a month so fast we haven't closed 2022 yet but so far has been a a very strong year in terms topline and profit growth now what drives it will be quite happy about the way that we manage our business we believe we're quite effective we have great capability our teams are great our balance sheet or resources are great platform on which we could build our business profitably, having said that it's also about the topline demand and needless to say that this year obviously the demand was very very high the spot prices remained very very high that's a bit driven by the general conjecture I mean we haven't planned for a Russia Ukraine event. We've seen that come back from the pandemic through the you know energy prices up which were even accelerated further with this unfortunately. All I can say is, I'm sorry I I wouldn't be able to give you a much definitive answer all I can say is both of our businesses are portfolio approach which allows us to capitalize fullest on any demand opportunity in 2023 as well and if it happens there's no reason why we shouldn't be able to maintain or even improve our strong profitability.

Question: What competitive advantage would Sabanci have in US renewable energy market? Is U.S market not competitive enough already, so that newcomers such as Sabanci can make good returns?

Mr.Orhun Köstem, CFO: I'm not sure at this point given the level of demand that we need to do anything very differently than the current players in the market. Obviously we have grown capability in the domestic market in Turkey setting up you know generation capacity and managing it very very effectively so obviously that's our competitive advantage but I'm not suggesting that to you that is going to you know take us to the pinnacle of the energy industry in the US that's not the point. The whole point is it's a very big market with great demand and more importantly given the incentives provided in the U.S market it gives us very good returns on our cost of capital so therefore that's an that's an important part of the equation and the other point as I try to underline as I was answering one other question was that it's the most liberated or most liberal let's market probably globally you know therefore it actually helps us in a great way to build generation capacity in a liberal market and therefore diversifying our portfolio in the way that we expect and at the same time as I said deliver good returns on capital so that's that's actually the whole so to say roadmap.

Question: Is U.S market not competitive enough already, what new comers such as Sabanci can make good returns?

Mr.Orhun Köstem: I'm not sure if it's not competitive enough I'm sure there are many incumbent players in the market who are competitive so it's not like we're eating easy bread we need to still work hard because in order to do that obviously as you might have realized we haven't started with acquiring business we started with building the business so that's our capability in that sense. However, what makes it work better for us are the incentives that are applicable to all by the way I have to tell you what at least allows even with our cost of capital which you may assume to be relatively higher than any potential you know U.S. corporation, allows us to generate decent returns on our cost of capital that's our viewpoint. The project that we look at I have to tell you initially and then some other party was awarded the tender and tried start the project and couldn't so it came back to us and now we're finishing it so it's a competitive advantage all I'm saying is we believe we know how to do a business or how to build generation capacity so we will put it into use as we build our base hopefully for renewable capacity in the U.S. We don't have any further questions you know on a late Friday afternoon thank you all for joining and I would like to once again hand over to your Orhun Köstem.

Mr.Orhun Köstem, CFO: Thank you everyone for joining. Kerem was telling me that the consensus estimate in Bloomberg for our net income for the full year we have reached it by this nine months so I'm happy with the performance that we have so far we are aware of the challenges going ahead we believe we have the capacity to manage our business very successfully in light of those challenges and looking forward to meet with you once again when we close the year to report back on our progress with that stay healthy and have a very good weekend, bye.