Arçelik A.Ş. Full Year 2021 Financial Results Conference Call

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Conductors:

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&

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OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Maria your Chorus Call operator. Welcome and thank you for joining the Arçelik conference call and Live Webcast to present and discuss the Full Year 2021 Financial Results.

At this time, I would like to turn the conference over to Mr. Polat Şen, Chief Financial Officer, Mr. Özkan Çimen, Finance & Enterprise Risk Director & Mr. Öktem Söylemez, Senior Investor Relations Specialist.

Mr. Şen, you may now proceed.

ŞEN P: Thank you very much. Good morning and good afternoon, ladies and gentlemen. Welcome to our Fourth Quarter 2021 Results Webcast. I am here with Özkan and Öktem. First of all, I'd like to take the opportunity to thank all of our employees for their hard work and dedication in through this 2021. I'll start with the highlights of the fourth quarter.

Our consolidated net sales was 22.5 billion Turkish lira in this very, very challenging quarter, registering 69% year-on-year and 24% quarter-on-quarter growth, while the growth was 42% year-on-year organically. In Turkey, MDA6 market has experienced pull-forward demand, particularly in November and December with higher inflation expectations. As expected, the demand was contracted in European markets in fourth quarter on a yearly basis.

Our EBITDA margin was 9.4% in the last quarter of 2021, bringing the annual margin to 10.6% which is in line with our guidance of around 11%. In fourth quarter '21, there were 2 one-off items which will be discussed later. Excluding the impact of those one-off items, the EBITDA margin was 8.1% in fourth quarter and 10.1% in 2021.

Our OPEX to sales ratio in fourth quarter went up by 271 basis points to 23.8%, compared to the last quarter, while slightly improved on the yearly basis. On an annual basis, the ratio was improved by 169 basis points to 22.7% in 2021.

Networking capital to sales ratio was 26.3% in the last quarter, flattish compared to a quarter ago and in line with our guidance with no major deviation. The leverage was realized at 2.4 times in 2021. If the value of the shares bought back as of yearend was added back, it would have a 0.26 times positive impact on the leverage, and bring it to 2.14 times. Also adding 0.39 times positive impact of annualized EBITDA and cash contribution of our recent acquisitions, the leverage would go further down to 1.86, which is much more comparable to last year numbers.

In November, Arçelik's approach of placing sustainability at the center of its business has been awarded with 2 important initiatives. Arçelik has registered the highest score in Dow Jones Sustainability Index in its industry, and awarded His Royal Highness The Prince of Wales' Terra Carta Seal. Next slide, please.

Before going into operational and financial details, I'd like to open up the sustainability awards a little bit more. We are more than happy to increase our score by 7 points compared to 2020, and to achieve the highest scoring household durables company in Dow Jones Sustainability Index. Having the highest score in 3 years in a row as of 2021 was a powerful indicator of Arçelik's commitment to a sustainable future.

In November, Arçelik was one of the 45 companies across the world who has been awarded His Royal Highness The Prince of Wales Terra Carta Seal. Terra Carta Seal recognizes global companies which are driving innovation and demonstrating their commitment to and momentum towards the creation of genuine and sustainable markets. We are very proud to be the first and only company of our industry across the world, and to be the first and only company in Turkey which we received the Seal.

Our net sales on a consolidated basis increased by 69% year-on-year to 22.5 billion Turkish lira in fourth quarter '21, while the growth was 24% on quarter-on-quarter basis. The main drivers of the growth were Turkish lira depreciation on both quarter and annual-wise. Price increases on both quarter-on-quarter and year-on-year and inorganic growth volume also contributed to the growth. Organically, the growth was standing at 42% year-on-year.

Consolidated gross profit margin was 28.8% in fourth quarter, slightly better than on a quarterly basis, while significant rise in the raw material prices coupled with the Turkish lira depreciation was the main reason of 726 basis points contraction year-on-year. Additionally, normalized capacity utilization rate and strong US dollar against euro were also having negative impact on gross margin.

On the right hand side, you can see consolidated EBITDA margin. In the last quarter of 2021, EBITDA margin was 9.4%, down by

47 basis points quarter-on-quarter, including 129 basis points positive impact of one-off items in fourth quarter. On a yearly basis, despite having better OPEX to sales ratio, significantly increased raw material costs resulted in 513 basis points contraction in the EBITDA margin. Negative goodwill of Whirlpool Manisa plant acquisition and the sale of subsidiary was…were the main one-off items that created the positive impact of 129 basis points. Excluding this, EBITDA margin was 8.1% in the fourth quarter.

On the other hand, 271 basis points of deterioration in OPEX to sales was mainly due to higher guarantee, installation and transportation and advertising expenses. Let me move to the next slide please.

I'll continue with the domestic market, in fourth quarter, despite having a quite high base Turkish MDA6 market was down by…only by 1% in unit terms. Particularly starting from November, the market experienced pull forward demand with consumer's anticipation of further increasing prices. In November and December, the market was up by 7% and 8% respectively, which had limited the further contraction as previous quarters. Arçelik again outperformed the market and strengthened its market share.

Turkish MDA6 market was up by 9% year-on-year in 2021, while Arçelik grew by 15%. Pull forward demand also was experienced in the AC market. Market grew by 34% year-on-year in fourth quarter, while our AC sales have increased by 27%. TV market continued to shrink in the fourth quarter. Next slide, please.

Let me move onto the European market. In fourth quarter, the demand of the majority of the European countries were contracted on a yearly basis, mainly attributable to the strong base in 2020. In Western Europe, consumer demand was growing in France, Belgium, and Italy, while there was contraction in UK, Germany, and Spain in 2021 on a yearly basis.

In Eastern Europe, sellouts were quite strong despite the high base and up by mid to high single-digit 2021 year-on-year. A major market such as Russia, Poland, Ukraine, and Romania were contributing to that strong demand in Eastern Europe, each of them contributing at different degrees.

With our Beko brand, we have captured the market leadership position in France, in 2021, and strengthened our market leadership position in UK. In Eastern Europe, except for Poland, the demand in other major countries such as Russia, Romania, and Ukraine have contracted. On an annual basis, 2021 has been a year of growth for all these countries. Beko continued its leadership position in Poland, while Romanian Local Hero Arctic and Beko brands keep their first and second position in Romania. Next slide, please.

The share of European markets in our total sales was 45% in the fourth quarter of which 31% was coming from Western Europe and 14% from Eastern Europe. As demand was weaker in Western European countries on both quarterly and yearly basis in fourth quarter, Arçelik benefited from acquiring Whirlpool Manisa Factory. The additional units provided by that acquisition and the price increases were the main drivers of the revenue growth of around 1% quarter-on-quarter and 10% year-on-year euro terms.

With our Beko brand, we have captured the market leadership position in France in 2021, and strengthened our market leadership position in the UK. In the Eastern Europe, our revenue grown by…has grown by almost 5% on a quarterly basis and 3% on a yearly basis in the fourth quarter. Mainly thanks to the price increases. Beko continued its leadership position in Poland while our Romanian Local Hero Arctic brand is first and second position.

When I moved to Africa, Middle East, and APAC having a total of 8% share in our consolidated sales, Africa and Middle East region posted 14% quarterly and 2% yearly growth in the fourth quarter in euro terms, Defy net sales in South Africa and units sold increased by double-digit in fourth quarter '21. Thanks to the positive impact of Christmas and Black Friday. In '21, despite the challenging operating environment Defy was able to post double-digit revenue growth compared to 2020. As of '21, Defy strengthened its leadership position in South Africa with significant market share gain. In Egypt, net sales declined in fourth quarter on a quarterly basis almost 15% in euro terms, due to off season impact.

On the other hand, on a yearly basis, sales were up by 60%. Thanks to price increases together with higher Beko share in a growing market. Beko Egypt succeeded to increase its market share particularly in cooling and dishwasher categories and Beko became market leader in dishwasher category as of fourth quarter.

APAC sales continued to have larger share in our consolidated net sales with Arçelik Hitachi contribution. In the fourth quarter, Arçelik Hitachi net sales have increased by a high single-digit in euro terms generating 13% of our total sales.

Despite the challenging fourth quarter due to inflationary pressure together with the offseason impact. Our sales in Pakistan with Dawlance brand posted 21% growth in euro terms in fourth quarter year-on-year, bringing yearly growth to 65% in 2021. Thanks to both again the price increases and the growth in units that we have sold.

Singer in Bangladesh net sales was contracted in mid single-digit in Bangladesh taka terms, mainly due to the ongoing pandemic impact with the help of strong first and second quarter Singer closed '21…2021, with mid single-digit higher revenue on a yearly basis.

I'll continue with the raw material prices. In this quarter average metal price index was softened moderately compared to the previous quarter, mainly due to the increase in capacity usage in China.

On the contrary, as we mentioned in the previous quarters, the energy crisis that world has been facing with for a while coupled with the power cuts in China, within the scope of its 'blue sky' motto had a negative impact on, especially the plastic prices in the fourth quarter.

Now, I'm going to handover to Özkan Çimen to take you through the numbers. Then I'll take over again on the guidance side. Thank you.

ÇIMEN O: Thank you, Polat. I will continue with the sales bridge and growth slides. In Q4 Turkey sales grew by 48.4% year-on-year with the impact of price increases and the pull forward demand. International sales grew by 78% out of this growth 38.6% was coming from the acquisition. Again a similar ratio 37.9% was FX impact as a result of significant Turkish Lira depreciation in the last quarter and 1.1% was organic.

On the right-hand side, you can see our original sales breakdown. With the recent acquisitions, we have more diversified operating geographies. The share of Turkey in total sales has gone down by 4% to 31% in 2021 versus 2022.

So if you move to the next slide, Summary Financials. You can see the summary of our Q4 and full year 2021 financials. Figures include the impact of our acquisition, as mentioned in the beginning of our call today, recent acquisitions, price increases and Turkish Lira depreciation in Q4 resulted strong revenue growth of 69% on a yearly basis and 24% on a quarterly basis, excluding the contribution of acquisitions organic growth of 42% year-on-year. Following 28% year-on-year growth in 2022, Arçelik was able to register quite solid growth of 67% in 2021 and reached 68 billion Turkish Lira net sales.

Our consolidated gross margin was 28.8% in Q4, bringing 2021 gross margin to 30%, reflecting 375 basis points contraction on a yearly basis. This contraction was mainly as a result of the increase in the raw material prices. In Q4 EBITDA margin was contracted by 47 basis points, quarter-on-quarter to 9.4%, which is mainly due to a higher OPEX compared to Q3, excluding 129 basis points, positive impact of one-off items, the EBITDA margin was 8.1%. And we have 2 one-off items as Polat has mentioned. And the impact of those was 25 basis points of our subsidiary sales and 104 basis points was coming from negative goodwill of Whirlpool Manisa factory acquisition.

And despite having improved OPEX sales ratio in 2021 full year, the hit in the gross margin driven by higher raw material costs, reflected into an annual EBITDA margin as well. In 2021 EBITDA margin was decreased by 309 basis points to 10.6%. Excluding one-off impact EBITDA margin was 10.1% in 2021.

If you go to the net income line, which is 893 million in Q4, including a 292 million of one-off impact. Net profit margin was flattish compared to Q3 while down by 481 basis points year-on-year. As of 2021, we have recorded 3.3 billion net profits, which is 4.8% of our revenue and 13% higher than last year. Net profit contribution coming from our acquisitions were 302 million in Q4 and 357 million in full year.

Next slide, leverage slide and our gross debt slide. Our leverage was 2.4 times as of end of 2021. Despite cash out of acquisitions and recognizing on the 6 months of EBITDA and cash contribution from the acquired companies and buyback program, our leverage was still within healthy levels.

We have continued buyback in the last quarter of 2021 and our buyback at the year-end has reached around 5.4% of the total sales. When the total value of the shares record as of last year is deducted from net debt, the leverage will be down by 0.26 times, which takes us to 2.14 times. In addition to that annualized EBITDA on cash contribution of the acquisitions will have 0.29 times positive impact on leverage. Thus if we take into account of those calculations the leverage will be 1.86 times.

On the right-hand side, you can see our loan and bond portfolio, as of end of '21 we have 31 billion Turkish lira equivalent debt and 27% of that debt in Turkish Lira. We are financing our Turkish business working capital needs with Turkish Lira loans. As the new loans in Q4 are limited, therefore we have been able to maintain a flattish Turkish Lira effective interest rate around 18%.

As of end of 2021, we have 16 billion cash…Turkish Lira cash in our balance sheet. Well diversified between currencies and 17% of our total cash is in hard currency Turkish Lira share is 8% only.

Next slide is EBITDA margin and working capital sales ratio. As mentioned previously consolidated EBITDA margin was contracted on a quarterly basis, mainly due to higher OPEX sales ratio. CAPEX to sales ratio was flattish in 2021, having a low base in 2020 last year…the year before. The increase in net working capital resulted in negative free cash flow of 3 billion in 2020. So I will leave the word to Polat for the guidance.

ŞEN P: Thank you, Özkan. For 2022, we are expecting our Turkey revenues to be increased around 35% year-on-year Turkish lira terms, mainly driven by price increases and mix improvement. We do not really expect a market growth. So we have assumed a stagnant market, let me say. We expect our international revenues to be increased by 20% year-on-year in FX terms including the revenues from Arçelik Hitachi and Arçelik Manisa factory, thanks to price increases and mix improvement and better market conditions.

On a consolidated basis, we expect our revenues to be increased by more than 60% year-on-year in Turkish lira terms. In 2022, since near future holds a lot of uncertainties, we aim to sustain our EBITDA margin at 10.5%, around 10.5%, including the effects of the new acquisition. In terms of net working capital to sales, we aim to keep around 25% and which are believing is the healthy and sustainable levels for Arçelik. Our CAPEX guidance remains the same as last year at €220 million.

So I would like to hand over for Q&A. Thank you very much for listening to us.

Q&A

OPERATOR: The first question is from the line of Demirtas Cemal with ATA Invest. Please go ahead.

DEMIRTAS C: Thank you for the presentation. My first question is regarding your guidance. Roughly what was your current expectation or like assumption for this estimates, you know, for the consolidated revenue growth more than 60%? And the other question is about the margin pressure. Do you see further margin pressure in first quarter and any color on the demand side in the first quarter at least in January? Thank you.

ŞEN P: Okay. I will leave the currently assumption to Özkan. I will answer the second question that you have asked. The margin pressure, of course, it will continue. It seems like it will continue, but I have to say that with the price increase, especially at the end of December, I think that we have been able to overcome some of the margin issues that we have. And starting from January, out of Turkey, we have been increasing prices in almost all the market. So that is going to ease some of the margin pressure. So because almost all countries are experiencing inflationary problems and that kind of price increases in an inflationary environment is easier to pass on, I have to say. So that's why quarter one, we do not expect further contraction in the margin side, so it's not going to be there because in quarter four, it was a little bit unexpected actually, this currency depreciation. It came so quickly that in order for us to take action, it took time. That's why actually our fourth quarter margins even though it was a very turbulent quarter, especially in Turkey, I think that we have been able to keep the margin at a healthy level.

On the demand side in quarter one, yes, we do not see a big increase in demand. Actually, our expectation especially in the domestic market maybe in the first quarter a little bit contraction but it is still too early to say something. The January results are not so, let's say we don't see contraction in January results but in coming February and March, we really have to see what will happen but we do not really expect a huge contraction in the market in quarter one. That's what I can say in Turkey. Out of Turkey, the…our expectation for the markets is some, you know, single mid-to-low digit increases…low mid-digit increases in most of the markets that we are operating in Özkan…

ÇIMEN O: In our guidance calculation, so we have assumed the average freight to increase around 50%, so this year also we need to take into account that some of the countries that we operate, the margin in markets might have comparably lower weak currency compared to euro and dollar. Therefore, we assume at least 50%...close to 50% depreciation compared to average write off in 2020 for Turkish lira.

DEMIRTAS C: Okay, so we embed...So the FX against Turkish lira will appreciate by 50%, do you mean that?

ÇIMEN O: Average-to-average, yes that is the assumption we have.

DEMIRTAS C: Okay. That's good. And as a follow-up, regarding your depreciation, I see the increase in the depreciation expense in fourth quarter, if I am not mistaken. What was the reason for that?

ÇIMEN O: Actually, in terms of sales, there is no big increase but what I can say is in the last quarter, we had some capitalizations which impacted…which were in the balance sheet with a higher currency rate. So that increased the depreciation a little bit but as a percentage of sales, we don't have a big change.

DEMIRTAS C: Because I'm looking at the quarterly numbers in the first 3 quarters, you had around 1.2 billion Turkish lira, and I see more than 650 million Turkish lira, that's what I told maybe it's related to FX then?

ÇIMEN O: It's mostly related to the FX, because of the capitalization with the higher value of Turkish lira.

DEMIRTAS C: Thank you. And probably you mentioned about the domestic market. Do you mean that sell-in or sell-out rates that you mentioned about the you know, the contraction?

ÇIMEN O: Sell out.

DEMIRTAS C: Sell out.

ŞEN P: Sell in side it's not…it's still very, very strong actually.

DEMIRTAS C: And despite very significant increase last year, right. You know, as far as I remember, in the last year, in first…I think it was in first 2 months, it was more than 59%, and in January it was 59% and February it was 42% increase again when I look at my numbers. So despite a very strong base, it's a long season, though, you see some increase in sell out…sell-in, which means there is no inventory problem then. You know, do you have any idea about the inventory levels in this sector?

SÖYLEMEZ Ö: Hi, Cemal, it is Öktem speaking. In the first quarter of 2021, the market was up by almost 40%. And yes, you're right to say that, despite having a quite high base, we are now seeing the sell-in is quite strong in the month of January.

DEMIRTAS C: Thank you.

OPERATOR: The next question comes from the line of Kilickiran Hanzade with JP Morgan. Please go ahead.

HANZADE K: Thank you for the presentation. I have 3 questions. The first one is related to your margin guidance drivers. Maybe I can also combine this with my second question. You are looking for around only 35% year-on-year increase in Turkish, I mean, in Turkish revenues, and you don't expect any volume increase. I understand you are looking for a flat volume. And that price increase is supposed to be lower than the average inflation in Turkey. So I mean, Turkey seems to be under pressure of margin in 2022 with this price increases. Is it true? How am i interpreting your revenue guidance?

And second, I mean, you're already realized margin, excluding all these one-offs was around 10.1% for the full year and you are now guiding 10.5% roughly in 2022. So what could drive these margins up, I mean, this year, given that euro may be much weaker, and Turkish lira already depreciated? So I'm trying to understand why you have I mean, like a positive outlook for 2022. And is it possible for you to, I mean, help us to understand your loan rollover and average interest cost increase in 2022 on Turkish lira? Thank you.

ŞEN P: I'll answer the first and second one, Özkan will answer the third one. On the…yes, you're right first of all, we are not assuming any volume increase in 2022 compared to 2021 in the domestic market of Turkey. So when we look at 35%, of course, if the inflation is going to be higher that number may drive up, I think that there is a upside potential in terms of growth. But right now as we have done our price increases especially in 2021 the price increases came especially in the last quarter let me say. So that's why there's a unbalanced impact there. That's why we are guiding for 35% on the growth side. But as you rightly mentioned it's mainly coming from price increases and some mix improvement as well.

HANZADE K: Can I just confirm this? So you're planning to increase the prices at least in line with the inflation in 2022, I mean, average inflation not the year-end inflation?

ŞEN P: Actually, we have to really see…it's not the consumer price index that we are looking at as you understand. We have to check our costs, because even though there's inflation, if the material costs start to decrease at some point of time, I don't think that we will be need of increasing the prices as well. So we have to check all the factors carefully before we make an increase, we do not want to drive inflation.

HANZADE K: Alright, thank you.

ŞEN P: On the margin side. Yes, you're right without the one-off impact we are at 10.1%. And to be honest with you in this 10.1% Whirlpool and Arçelik-Hitachi let me say Arçelik-Manisa and Arçelik-Hitachi is only 6 months and their margins…average margins are lower than ours. But in 2022…and I have to say that when we are going to 10.1%, especially third and fourth quarters was the main factor actually our first half margins were very high. But I think that we have taken necessary measures especially beginning of the year we have been able to increase prices in almost all the countries that we have been operating in. In MENA markets, Europe and MENA markets we have been able to…from last year to this year, we have been able to increase almost 8%, let me say not 8% mid-to-high single-digit in those markets. Other than that, in South Africa, we have been increasing prices and we will keep on doing that in February in order to catch up the profitability and in order to catch up with the cost. So, in Turkey, we have done necessary adjustments in the prices as well. So, I think we are starting the years on a right foot, it's not like the beginning of quarter 4 for us, we think that we have taken necessary measures especially on the…both cost side and the price side, that's why we are aiming for 10.5%. And I have to say that, you know, without the Arçelik Hitachi and Arçelik Manisa, I think that would be…they are having a deteriorating affect of 0.5% when you compare our guidances in 2021 and 2020 as well, its 11% actually with the contribution of the new acquisitions, it's going to 10.5%.

HANZADE K: So, your margins without Hitachi and Whirlpool was around 11% in 2021?

ŞEN P: No, no, it's for 2022 I was talking about.

HANZADE K: Okay. Sorry..

ŞEN P: Has an effect of 4.5%...

HANZADE K: Okay, all right. Thanks very much. But, do you still see some margin expansion obviously I mean in 2022, so okay, so you are looking for some sort of easing on the input costs?

ŞEN P: Not easing, especially in the first and second quarter we are really expecting let's say relaxation on the input material costs, maybe starting from third quarters, that would be possible in some of the materials, but other than that, we do not expect this actually. Our main expectation is, why we are having a better margin is that we have taken all the necessary measures especially at the beginning of this year, and we think that is going to be helping us to achieve this margin.

HANZADE K: Okay. Thank you very much.

ÇIMEN O: If you look at our Turkish lira portfolio, loan portfolio for this coming…for this year 2022, we have a loan of 5 billion Turkish lira mostly starting from March and each quarter we have roughly similar amount of roll. If you look at the rates that's starting from December, there was a huge increase in the market where the rates were more than 30%, however, at that rates, we didn't have a big amount of loan needs, but starting from March we will face higher rates compared to our 2021 average of 18% that means it will affect us at 700 basis points minimum for the new loans and the total amount is as I said is 5 billion TL to be the impact.

HANZADE K: Thank you very much.

ÇIMEN O: This is not including the working capital needs for further growth.

HANZADE K: Additional loans, alright, okay, thank you very much. So, that means that there would be some EPS pressure in 2022 because of rising interests costs, right, on your projections probably?

ÇIMEN O: Yes, correct. And we are monitoring this very closely, to have a long-term bonds in our portfolio or a loan from a bank.

HANZADE K: Thank you very much, Özkan.

OPERATOR: We have a follow-up question from Mr. Demirtas Cemal with Ata Invest. Please go ahead.

DEMIRTAS C: Thank you. My question is about affective tax rates, did the currency change have some effects on the effective tax? I see the number below, its round 10% in full year. Do you expect this trend to continue, could we assume around 10% to 15% or any indication on the tax rate? Thank you.

ÇIMEN O: Right, Cemal, as you have said, the affect rate is around 10% and actually as you will recall this as rate has been declining because of the incentives coming from Turkey business mainly. It was related to CAPEX and R&D expenditure which reduced this effective tax rate, but as our business is growing with the other regions in world, so that the impact of Turkish business will be limited even though the tax rates goes down, so yes, we can expect a similar rate in 2022 as well.

DEMIRTAS C: Okay. Then it's like 10%, yes, no actually [technical difficulty] 10% or something minus 10%, I didn't get the….

ÇIMEN O: 10% is the average of 2021 so we can expect you know similar rates, but if this other business grows, so the contribution of our non-Turkey business is higher than 2021, basis, so this will increase our effective tax rates from10%.

DEMIRTAS C: Okay thank you.

OPERATOR: Ladies and gentlemen, there are no further questions at this time. I will now turn the conference over to Mr. Sen for any closing comments. Thank you.

ŞEN P: Right. Thank you very much for listening to us in our fourth quarter results. I hope it's going to be a better year in 2022. I wish health to everyone who is listening. Thank you very much.