Arçelik A.Ş. First Quarter 2022 Financial Results Conference Call

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&

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Conference Call Conducted by Chorus Call Hellas

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OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Jason your Chorus Call operator. Welcome and thank you for joining the Arçelik conference call and Live Webcast to present and discuss the First Quarter 2022 Financial Results.

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

Mr. Çimen, you may now proceed.

ÇIMEN O: Good morning, and good afternoon, ladies and gentlemen. Welcome to Our Q1 2022 Results Webcast. I'm here with Öktem Söylemez, our Senior Investor Relations Specialist.

I will start with the highlights of the first quarter. Our consolidated net sales were 28.2 billion in this quarter, registering 117% growth on a yearly basis and 25% growth on a quarterly basis. Excluding revenues of the acquired companies on a like-for-like basis, organic growth was 84% on a yearly basis.

In Turkey and Eastern Europe, consumer demand was quite strong in the first 2 months mainly due to the expectation of further rising of product prices due to inflation. And in Western Europe, consumer demands were weak due to a high base effect. And as expected, sell-in were contracted in Turkey in the first 2 months of the year.

Our EBITDA margin was 10.6% in the first quarter of the year, reflecting 127 basis points expansion on a quarterly basis mainly due to price increases and lower OPEX sales ratio. On the contrary, on a yearly basis, our EBITDA margin was down by 393 basis points as a result of significantly increased material costs and cycling high rate.

When we look at the OPEX to sales ratio in the first quarter, it improved by 108 basis points to 22.7%, while it was stable on a yearly basis. Our net working capital to sales ratio increased 27.7% in the first quarter compared to 26.3% at year-end last year. It's mainly due to higher receivable days in Turkish operations and higher inventories, which is the result of increased material costs despite those are offset with the improvement in payable days.

The leverage increased to 2.81 in the first quarter of the year from 2.40 at the end of last year mainly due to increased working capital requirements of our emerging market operations, the dividend payment that we made this quarter, shares bought back continuity, and partially, the ratio is impacted negatively because of the currency translation. So, when we exclude the share buyback and the annualized EBITDA cash contribution of our recent acquisition, the leverage would go down to 2.24 times.

If we move to the next slide. Our net sales on a consolidated basis increased by more than double year-on-year to 28.2 billion in the first quarter. This substantial revenue growth came mainly due to the price increases across regions, Turkish lira depreciation and inorganic revenue contribution.

Excluding the contribution of acquisitions, yearly revenue growth was still strong at 84%. On a quarterly basis, again price increases and Turkish lira depreciation were the main drivers of 25% revenue growth.

Consolidated gross profit margin was 30.8% in the first quarter, which is reflecting 208 basis point improvement compared to previous quarter through price increases and higher capital utilization, although material costs overall continued to increase. And on the contrary, last year Q1 was above average levels, where we have utilized long-term purchase contracts, coupled with price increases and again, higher capacity utilization and depreciating against the US dollar resulted in 368 basis points lower gross margin on a yearly basis.

In the first quarter, EBITDA margin was 10.6%, up by 257 basis points compared to previous quarter, like-for-like basis. Despite the decline in volumes, the margin expansion was achieved mainly through price increases, particularly the one that we had done in the late December, which was most effective in the first quarter and improved OPEX sales ratio. On a yearly basis, EBITDA margin was down by 393 basis points, which is actually coming from the gross margin impact that I mentioned.

If we move to the domestic market slide, in the first 2 months of the year, the Turkish MDA6 market was down 11% on a yearly basis, and Arçelik units were down by 12%. Despite declining selling units, sellouts were quite strong in the same period mainly as a result of continuous expectation of further hikes in product prices. The continuing high inflation in Turkey is impacting the affordability and changing the customers' shopping priorities. And moreover, increasing energy prices and supply chain problems may impact the demand negatively in Turkish MDA6 wholesale and retail markets.

AC market was up by 26% on a yearly basis, and Arçelik AC sales increased by 14%. Television TV sellouts were down by 13%, while Arçelik sold 6% higher compared to last year. Revenue from domestic markets was considerably higher on both quarterly and yearly basis, delivering 79% yearly and 42% quarterly growth. Domestic revenues reached 8.4 billion in the first quarter. And with the geographical expansion, the share of our domestic revenue has continued to decline, so we have 30% in the first quarter, from 36% a year ago.

If you move to the European market in the next slide, the share of Europe in total revenue was 38%, which is down by almost 5% versus a year ago as a result of higher growth in the other regions, especially in APAC and Middle East. In Western Europe, consumer demand has declined in the first 2 months of this year by low to mid-single digits, the contraction in the majority of the countries due to high base effect. And Germany was cycling a low base, which posted close to double-digit growth on a yearly basis.

Despite lower units, the market grew in value terms mainly as a result of increases of prices and leaning towards premium segments having 27% share in total revenue, Arçelik's sales were up by 8% in euro terms. And in Eastern Europe, consumer demand grew more than 25% in the first 2 months of the year, and this is excluding Ukraine's figures. Growth was mainly attributable to pull-forward demand in Russia due to the depreciation of ruble. And the market also grew in value terms both in unit growth and price increases having 11% share in total revenue, Arçelik's sales were up by 11% in euro terms.

If you look…move to the Arçelik results in Africa and Middle East, APAC, in the next slide, and having a total of 11% share in our consolidated sales, Africa and Middle East region posted around 48% quarterly and around 59% yearly growth in Q1 in euro terms. This strong revenue growth is mainly driven by significantly higher Middle East revenues.

Defy in South Africa. Units sold in the domestic market contracted on both quarterly and yearly basis mainly due to some logistic problems in the country and the high base of the same year of last year. Defy posted mid- to high single-digit revenue growth in euro terms in the first quarter of the year on a yearly basis mainly due to the price increases.

In Egypt, sales more than doubled both quarterly and yearly. And we have 155% higher year-on-year and 175% quarterly revenue growth in euro terms in the first quarter. APAC sales having 19% share in total revenue grew by 136% in euro terms and in the first quarter versus a year ago, because of the contribution of the Arçelik-Hitachi business. And in Pakistan, together with price increases, sales increased by around 23% in euro terms, and the local currency growth was 28%. Bangladesh sales growth was lower compared to the other regions, with 3.8% in the local currency.

If you go to the next slide, which is about raw material prices. In this quarter, average metal and plastic prices in the market have increased mainly as a result of the conflict and war between Russia and Ukraine, which also triggered the increasing energy prices, which also impacts the plastic prices and all the other raw material prices.

Metal prices have gone up particularly starting from late February. And we have made some contracts, therefore we were not that affected in the first quarter from the recent cost inflation as a result of the Ukraine and Russia conflict. And additionally, with the metal raw front, we executed second quarter's purchases just before the war started, therefore the material cost impact in the coming quarter will be limited. However, after that, we will start to feel the negative impact of all the material increases in our costs.

For plastic raw materials, energy, oil and natural gas are the main inputs of plastic raw material production. Ongoing rise of energy price is further accelerated by the Russia Ukraine war. As oil prices jump, we do not expect the prices to go down as quickly as they went up. And the contract is on a monthly basis, therefore, in the second quarter and afterwards, we will start to feel the pressure here.

If you go to the sales bridge slide, in Q1, Turkish sales grew by 78.8% year-on-year organically, and international sales grew by 180…138.5%. And out of this growth, 5.6% was organic, 81% was the FX impact and 53%...51% is coming from the acquisitions. And on the right-hand side, you can see our regional sales breakdown. And with the recent acquisition of Arçelik-Hitachi and the Manisa factory, the share of Turkey in total sales has gone down by 6% quarter-on-quarter.

So if you move to the next slide, which is the summary of financials. I mentioned that the revenue is 28.1 billion TL. Cost inflation was quite obvious in the first quarter of this year when we compare to a year ago. Together with lower capacity utilization and Turkish lira depreciation, our gross margin was narrowed down to 30.8%, registering a 368 basis point contraction on a yearly basis. So I need to underline that the last year's quarter performance was well above the average of…in terms of gross margin.

In Q1, consolidated EBITDA margin was 10.6%, contracted by 393 basis points on a yearly basis. We have been able to keep the OPEX sales ratio at 22.7%. And despite stable OPEX sales ratio on a yearly basis, the EBITDA margin declining in the first quarter was a reflection of the cost inflation and high base of the first quarter of last year. Compared to previous quarter, on a comparable basis, EBITDA margin was expanded by 257 basis points mainly driven by a 111 basis point improvement in OPEX sales ratio and prices increase.

Net income before minority share was 1.224 billion in Q1, with a net profit margin of 4.3% and which is 168 basis points better versus a quarter ago and on a comparable basis 413 basis points lower on a yearly basis mainly due to higher interest costs, coupled with the gross margin impact.

So if you move to the next slide. Our net debt has increased by around 6 billion TL, mainly due to share buyback, which we continued in this quarter as well; dividend payments again in the last month of this quarter; working capital funding of our emerging market operations increased; and negative currency translation impact, all had an effect on our net debt level. In the first quarter of the year, a total of 1 billion cash out for the shares buyback and additionally, 1.3 billion for net dividend payments and the remainder is coming from the working capital fund of Turkey, Pakistan, South Africa and Bangladesh operations, and Turkish lira depreciation.

As a result of the increases in net debt, our leverage was increased by 0.42 times to 2.81 times as of first quarter. On the right-hand side, you can see our loan and bond portfolio. As of March, we have 37.6 billion equivalent debts, and 9% of the total portfolio is in Turkish lira. And the average Turkish lira interest rate was 19.2%, which is up by 150 basis points compared to last year-end.

And we have lower interest rates in our portfolio, in Turkish lira, and we expect our Turkish lira effective interest rate to increase as we rolled off interest loans with the new borrowing rates, which is higher than the current rates. As of March, we have 16.7 billion TL cash in our balance sheet, which is well diversified between currencies around 66% of our total cash is in hard currency.

If you move to the next slide, we can see the net working capital sales ratio here and the EBITDA margin. And consolidated EBITDA margin was contracted on a yearly basis, as I explained. CAPEX sales ratio is 2.7%, which is flattish compared to last year's same quarter. Net working capital sales ratio increased to 27.7% as of March from 26.3% mainly due to increased receivable days in Turkish operations and temporary increase in other items. Increase in inventories was mainly attributable to the increase in material costs and unit contraction in some of the markets. But the negative impact of inventories was well balanced with our improvement in payable days. We have delivered negative free cash flow of 1.8 billion TL and which is mainly coming from the working capital requirement.

And the final slide is related to our guidance. We have made adjustments on our revenue guidance while keeping all other items unchanged. Based on our most recent forecasts, we increased our Turkey sales growth expectations from 35% to 60% in Turkish lira terms. Our international sales growth expectation increased from 20% to 25% in euro terms. And our consolidated sales growth expectation is to adjust 60% to more than 80% in Turkish lira. And this change mainly reflect price increases that we have already done so far due to rising costs.

Okay. So now, I have completed my presentation here. So we can have your questions.

Q&A

OPERATOR: Our first question comes from Cemal Demirtas from ATA Invest. Please go ahead.

DEMIRTAS C: Thank you for the presentation and congratulations for the results. My first question is about the domestic side, I see that you are increasing your guidance. And we, again, we see significant growth in the first quarter. Could you give us some, at least, indication about the volume trends, how was the volume trends and pricing trends in domestic market and also in the international side? And I see the inorganic growth impact, it looks like it's lower based on the FX currency translate into dollars. Did you see any seasonality in the inorganic growth side in the first quarter? That's my first question?

And the other question is about the indications for the second quarter in terms of at least the margin trends so far. How does it go in the domestic and international side? Thank you.

ÇIMEN O: Thank you, Cemal. When we look at the Turkey domestic performance, we have increased the sales prices last days of December of last year, which has a positive impact in the first quarter, and we also continued to adjust our prices in the first quarter as well. So that impacted the total growth of Turkey business because the price increases were higher than that we were planning to do, because of the increasing cost of material impacts. So therefore, we need to adjust our Turkey revenue guidance, reflecting the impact of those price increases.

When we look at the quantity side of our business, so we started to feel that there's a contraction compared to last year and the sell-outs...both in sell-ins and sell-outs. The reason mainly, there's a high base impact, and also, the increasing prices are also impacting the demand side, therefore we are cautious about the Turkish market, while considering further price increases because we are monitoring the sell-outs very closely. So we feel that the cost pressure it continues till the end of this year, there will be a contraction...a further contraction, in the...which is reflecting through the quantities.

And you asked the growth in international markets. The international FX impact was around 81%, so if you exclude the acquisition and the FX impact, it is 5% growth. And we have seen growth in many...in all of the markets, but the growth has slowed down. And when we look at the competition, everybody was trying to increase the sales prices to reflect the cost to the customers. However, we see that the competition is also selective of making those price increases to sustain their...to sustain the demand and to continue of the growth. Therefore, as I said, similar comments to the Turkey market, as long as the cost pressure is there and the competition is hesitating to reflect the prices to keep their market share, there will be some pressures on the margin or if we increase the prices further, there will be a possibility of contraction of those markets, which is to reflect to the quantities.

DEMIRTAS C: And the colours in, you know, April/May. Do you see any...the restocking or destocking in the markets...in domestic markets?

ÇIMEN O: In domestic markets, we are closely monitoring the inventory levels. We see...we haven't seen a major increase in the inventory levels, but there are some categories...product categories which have higher inventory levels. So we are careful on those. But there is no major increase in the inventory levels as of today.

DEMIRTAS C: Okay. And the last question is about maybe… asset sales financials. I see some PP&E sales loss from those sales, around 22 million TL. And I see a loss from Voltbek. How should we think for the following quarters? And what was the reason behind that loss for the asset sales? And again, the Voltbek side, you recorded losses, could we expect that figure to turn to positive in the following quarters or in the following years? Thank you.

ÇIMEN O: Cemal, I couldn't hear the first part of your question. Could you please repeat?

DEMIRTAS C: The first question is, we see some loss...it's not that significant, but still higher compared to previous years, 22 million TL loss from sales of assets, expenses from investment besides 21%. What was that asset sale? And the other question is, from the associates...income associates, we see 50 million TL loss in the Voltbek, possibly due to currency changes. But I wonder how could that be in the following quarters. At some point, do we expect that figure...that loss from associates figure to turn to positive? Thank you.

ÇIMEN O: Yes. Let me start with the Voltbek. It is actually...since it's a joint venture we are reflecting the performance of that 50% of that performance to our P&L. And in the first quarter, the price increases were not in place. Therefore, the loss coming from the Voltbek business was higher, but this will be compensated with the price increase we have already done in the market. So, the coming period quarter will be better in terms of results. And for the asset sales of 22 million TL, let me get back with that after the call with the details.

DEMIRTAS C: Thank you. Thank you very much.

OPERATOR: Our next question comes from Hanzade Kilickiran from JP Morgan. Please go ahead.

HANZADE K: Thank you very much. Özkan, I have 3 questions. The first one is on margins, and the second is also related to this. How much margin headwind do you expect from raw material contract renewals for the second half of the year, I think you already renewed the second quarter but not the third and the fourth quarter?

And the second question is, what is the timetable for this renewable for the second half? And the third question is, how much increase do you expect in interest cost this year due to rollover of Turkish lira loans, I mean, what is the current interest rate that you are accepting on Turkish lira loans? Thank you.

ÇIMEN O: Thank you. And in terms of raw materials, we have contracts for 3 months, as long as, we can do that, especially for the metal part, and plastic parts, as I said, is a monthly...renewable monthly contracts with the suppliers. So that means we have some room of risk management when it comes to metals, but plastics, we are open to fluctuations each and every month. And when we look at the coming months, we can say that in terms of metal prices, we have not been that impacted of the huge increase after the Russian and Ukraine crisis. So, we will benefit some margin there.

However, as you know, our purchases do not directly reflect to the cost of goods sold because of the inventory and production process. So, there's a time lag there. And we have already started to feel the last year's pricing, cost increases in our P&L and we will benefit the contracts of metal this quarter. However, the plastic price increases will be impacting us every month, and we're trying to balance it with price increases, but every day it's getting to...it's getting difficult to reflect to the prices all the material costs. And not only the material costs, but we have the energy cost increase as well. So, we are trying to balance it, and I can say that we will be able to keep our EBITDA margin at the level of 10.5% as in our guidance, carefully reflecting to the sales prices, as long as, we can do, and partially managing it with alternative suppliers and long-term contracts as long as we can do.

And in terms of interest costs, the current interest rate for Turkish lira borrowing is around 23% to 24%. But as you can see, our balance of portfolio is around 19%. So that means we will be...that the overall interest rates will be increasing as we reroll the...with new loans, and the total amount is around 5 billion TL to be rolled.

HANZADE K: Thank you, Özkan.

OPERATOR: Our next question is a follow-up from Cemal Demirtas from ATA Invest. Please go ahead.

DEMIRTAS C: Özkan, again I have a question in some details in the other operating expenses activities, its credit finance charges from trading activities. I see a significant jump in the first quarter, around 241 million TL versus 55 million TL in the fourth quarter, and that's a significant jump in that figure. I don't see any big deterioration in financial expenses, and I don't see any...I see some improvement in the FX position, like the FX gains, around 60 million. But I wonder what was that...what was the factor behind that credit finance charges, the increase in the first quarter is significant compared to previous quarter.

ÇIMEN O: We are using the benefit of discounting and have...we are comparing it with the financing costs. And in case we see an opportunity, we are discounting the receivables partially, and some of the dealers prefer to pay in advance. So, this is more related to that part.

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. Özkan Çimen for any closing comments. Thank you.

ÇIMEN O: So, I would like to thank everyone, especially our colleagues, to drive the Q1 performance in this very volatile environment. So, thank you, everyone, for joining our call.