Arçelik A.Ş. First Quarter 2023 Financial Results
Conference Call

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Conductors:

Mr. Özkan Çimen, Chief Financial Officer
Ms. Mine Şule Yazgan, Finance & Enterprise Risk Executive Director
Mr. Öktem Söylemez, Investor Relations Lead

Conference Call Conducted by Chorus Call Hellas

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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 First Quarter 2023 Financial Results.

At this time, I would like to turn the conference over to Mr. Özkan ÇİMEN, Chief Financial Officer, Mrs. Mine Şule Yazgan, Finance & Enterprise Risk Executive Director and Mr. Öktem Söylemez, Investor Relations Lead

Mr. Çimen you may now proceed.

ÇIMEN Ö: Good morning, good afternoon, Ladies and Gentlemen. Welcome to our First Quarter Results Webcast. The month of February saw a devastating earthquake in southern Turkey which has left us all feeling deeply saddened. I would like to offer my condolences to all those who have been impacted by this tragedy.

The last few quarters have presented a challenging operating environment and recently obstacles have continued to persist around the world. I want to express management's gratitude to our employees for their dedication and adaptability in contributing to Arcelik's growth story.

Here are the highlights of the First Quarter. Arcelik recorded TL39.9 billion revenue in the First Quarter, posting 42% annual growth. On an organic basis, the revenue growth was 36% year-on-year. In the first two months of this year, MDA6 market in Turkey showed 13% increase in unit terms compared to previous year. This was primarily driven by the low base effect.

On the contrary, consumer demand decreased by a higher single-digit percentage during the same period due to the negative impact of the earthquake. The demand for MDA6 products had been in a declining trend over the past few quarters in international markets and this pattern continued in 2023 so far.

Opex-to-Sales ratio were 24.4% in the First Quarter. Yearly increase of 171 basis points and quarterly increase of 222 basis points, was mainly attributable to higher administrative expenses. 210 basis points of the quarterly gross margin expansion has been neutralized by the increase in Opex/sales. Thus, consolidated EBITDA margin increased by 11 basis points in the First Quarter compared to previous quarter and realized at 9.3%. On an annual basis, EBITDA margin was down by 137 basis points.

Net Working Capital-to-sales ratio increased to 22.7% as of First Quarter mainly thanks to increase of our receivables. Our leverage was 0.32x higher compared to last year end due to increase in funding needs and as well as the FX conversion impact.

If we move on to the next slide, in the First Quarter of this year, Arcelik reported consolidated revenue of TL39.9 billion, which is representing 42% year-on-year increase. The growth was supported by several factors which includes price increases, depreciation of Turkish Lira and slight increase in white goods sales in Turkey and also the inorganic revenue generated by recent acquisitions. Organic revenue growth was 36% compared to a year ago.

Our consolidated gross profit margin for the First Quarter was up by significantly 210 basis points, mainly attributable to shrinkage in material costs, favorable Euro-dollar parity. And on a yearly basis, the expansion in the gross margin was 28 basis points. The positive impacts of price increases and declining raw material costs were largely diminished by lower capacity utilization and depreciated Euro-dollar parity on a yearly basis.

Consolidated EBITDA margin for the First Quarter was 9.3%, registering 11 basis points quarterly expansion, 155 basis points yearly and 188 basis points quarterly increase in expenses were limiting factor behind the further expansion of EBITDA margin in the First Quarter. On a yearly basis, EBITDA margin was down by 137 basis points.

If we move to the next slide, domestic market. Cycling a low base effect, Turkish MDA6 market grew by 13% on a yearly basis in the first two months of the year. Our sell-in units grew by 7% in the same period compared to a year ago. And sell-outs were down by high single digit percentage in the first two months of the year compared to a year ago. We remained our strong leadership position by far as of February 2023.

Sales in air-conditioner market was down by 3% in First Quarter on a yearly basis, while our units were contracted by 17% in the same period. Cycling a low base, TV market grew by 18% in January and February on a cumulative basis and our units increased by 6% in the same period. Domestic revenue in the First Quarter was TL15 billion, which registered 79% yearly and 20% quarterly growth. Annual growth was mainly driven by price increases and slight increase in white goods unit sales. The share of domestic market in total business was 38% in Q1.

If we continue with the European market, having a 38% share in total consolidated revenue in the First Quarter, the revenue generated from Europe was up by 9% in Euro terms compared to a year ago mainly to price increases and inorganic revenue contribution. On an organic basis, the revenue growth was around 1%.

And the ongoing macroeconomic and political challenges remained in Europe, which impacted the demand in the first two months of this year. Consumer demand was contracted by a high single digit percent in Western Europe compared to a year ago. Germany, Great Britain, France, the three biggest markets across Europe were the ones that the MDA6 demand contracted the most in Western Europe.

If you look at the Eastern Europe, white goods market contracted significantly by around 20% in the first two months of this year compared to a year ago. And despite the price increases across the industry, both Western and Eastern Europe market have been contracted in value terms by low single digit percent and mid-teens percent respectively.

Having 23% share in total revenue, Arcelik's revenue were down by mid-single digit in Euro terms, reflecting the overall demand contraction. And having 15% share in total revenue, Arcelik's sales were up by 41% on a yearly basis in Euro terms, thanks to unit growth and price increases and also inorganic revenue contribution. On an organic basis, annual revenue growth was 16% in the First Quarter. In total Europe, Arcelik posted around 9% annual revenue growth in Euro terms in Q1.

If you move to the next slide, Africa and Middle East and APAC, the revenues from Africa and Middle East region accounts around 9% of consolidated sales in Q1, declined by around 14% annually in Euro terms, mainly as a result of low sales in MENA. The ongoing macro challenges in South Africa also resulted in a significant decrease in consumer demand in the first two months of this year, cumulative basis compared to a year ago.

The company Defy revenue were down by 4% in local currency, due to lower units sold, which was partially offset by price increases. And in Euro terms, annual revenue contraction was around mid-teens percent, reflecting the depreciation of local currency against Euro.

As of February, Defy maintained its strong leadership position. In Egypt, white goods market in the first two months of this year remained flat, compared to a year ago. Despite cycling a strong base, Beko Egypt's revenue increased by 74% on a yearly basis in Q1, in local currency. But when we look at Euro terms, it's down by 1%. During January-February this year, Beko increased its market share in Egypt in unit terms, compared to the same period of last year.

Revenues from APAC region having 14% share in total revenue were down by 18% in Euro terms on a yearly basis in the First Quarter. This contraction was mainly as a result of lower contribution of Arcelik-Hitachi business due to declining demand environment.

In Pakistan, due to deteriorated purchasing power of consumers and recently imposed import constraints on raw materials, revenue were contracted by around 32% in Euro terms on a yearly basis in the First Quarter. And in local terms, the contraction was around 7% in the same period.

In Bangladesh, revenues declined by 4% in local currency in the First Quarter, and macroeconomic headwinds and early monsoon negatively impacted the market in Bangladesh, and continuous depreciation of local currency led to 19% annual revenue contraction in Euro terms in Q1.

Next slide, we would like to touch on raw material prices. Material, raw material market prices rose quarterly due to expectation of a better demand outlook, resulting from the global easing of recessionary concerns and the lifting of COVID restrictions in China. In Turkey, metal raw material prices saw a notable increase, mainly due to implementation of tax increases on steel products and also a sudden surge in demand and a decreasing supply following the earthquake.

Compared to a year ago, metal raw material prices contracted substantially thanks to a decline in demand. In the First Quarter of this year, plastic raw material prices remained steady in comparison to the previous quarter. However, they contracted considerably when compared to the prices from a year ago. This was due to decreased demand and lower energy and logistic costs. And we want to highlight that through strict, proactive, and effective cost management in a timely manner, Arcelik costs have been low compared to market levels.

Next slide, sales bridge slide. In Q1, Turkey sales grew significantly by 79.3% organically on a yearly basis, as a result of price increases and slightly improved white goods unit sales. Our international sales increased by 25.7%. Organically, international sales were down slightly by 4.2% in the First Quarter of this year compared to a year ago. The contribution of FX conversion impact in the annual international growth was 24.6%, while inorganic revenue contribution was 5.3%.

On the right-hand side, you can see our original sales breakdown. Turkey's share in total revenue is 38% in the First Quarter. Western Europe declined to 23% from 27%. And Eastern share has increased to 15% from 11%.

I will leave the floor to Mine for a financial summary.

YAZGAN M: Thank you very much, Özkan Bey. Good afternoon and good morning. Here is the summary of our First Quarter financials with yearly and quarterly comparison given on a consolidated basis. Consolidated net sales grew by 42% on a yearly basis in the First Quarter, despite weakening demand environment. Together with slightly increased white goods sales in Turkey, Turkish Lira depreciation and our pricing initiatives were among the key factors, pillars of the growth.

Organically, revenue growth was 36%. On a quarterly basis, Arcelik's consolidated revenues increased by 2%. The consolidated gross margin was 31.1% in the First Quarter of 2023, increased by 28 basis points on a yearly and 210 basis points on a quarterly basis. The improvement in the gross margin was mainly attributable to lower raw material costs.

Higher G&A expenses increased Opex/sales ratio, which then have pressured our EBITDA margin in the First Quarter of this year. Consolidated EBITDA margin was realized at 9.3%, down by 137 basis points compared to a year ago. Arcelik posted Net Income of TL1.159 million in the First Quarter of 2023. Net profit margin was suffered by 144 basis points compared to a year ago and realized at 2.9%. The contraction mainly reflects the decrease in operating margins and higher financing costs.

We can move on to the next slide. Our net debt was increased by TL5.7 billion, compared to 2022 year-end mainly due to increased working capital funding. As of 2022 year-end, we have TL29.3 billion equivalent cash in our balance sheet with well diversification between currencies. 49% of our total cash is USD denominated, 30% is Euro denominated. Turkish Lira share was 6%. As a result, our leverage was up by 0.32x compared to 2022 year-end. That includes 0.20x of FX conversion impact.

On the right-hand side, you can see our loan and bonds' portfolio. As of First Quarter '23, we have TL57.9 billion equivalent debt. 18% of total portfolio is in Turkish Lira terms while Euro and USD share was 50% and 21% respectively. Our Turkish Lira effective interest rate was 24.2% as of First Quarter.

If you move on to the next slide, on the upper left corner, you can see the bridge of EBITDA margin. Despite slightly improved gross margin, higher Opex sales ratio driven mainly by higher G&A expenses has resulted in annual contraction in consolidated EBITDA margin.

On the lower left corner, you can see our Capex sales ratio. Capex sales was 3.9% in the First Quarter. On the upper right corner, Net working capital sales ratio has been shown. The ratio was increased to 22.7% as of First Quarter '23 from 21% at year-end mainly due to higher receivables. Finally, on the lower right corner, due to increased working capital requirements, we generated negative pre-cash flow of around TL3.2 billion.

I leave the floor to Mr. Özkan Çimen once more.

ÇIMEN Ö:: Thank you, Mine. For the guidance, we are keeping our guidance as we have announced in the beginning of this year. The revenue of Turkey is around 45% growth. International growth is around 6% in FX terms and EBITDA margin will be around 10% and working capital sales ratio will improve around 24% and Capex is expected to be EUR300 million.

So, this was the end of our presentations. Now, we can go to the Q&A session.

OPERATOR: The first question is from the line of Zaczkiewicz, Daniel with Barclays. Please go ahead.

ZACZKIEWICZ D: Hello. Thanks very much for the call. So, I just wanted to ask about your recent Eurobond maturity that you repaid. Was this repaid just using cash or did you access any bank financing? And at some stage, would you like to replace this Eurobond in your capital structure? Thanks.

ÇIMEN Ö: Thank you for your question. The Eurobond maturity was at the beginning of April, and we paid it partially with the cash in our hand as well as we had some short-term FX loans from the market. The window to reissue the Eurobond was not available. Therefore, we are following right now in the short-term or mid-term to have that option again. But right now, it is partially financed with short-term loans.

ZACZKIEWICZ D: Okay. Thanks very much. And maybe just a question on market conditions. So, in Europe, things have been relatively weak. When do you think, in terms of volumes, when do you think things might improve? And then also, on your EBITDA margins, when are you expecting some improvement there? Thanks.

ÇIMEN Ö: Thank you. Ongoing macroeconomic and political challenges is continuing to impact consumers' lives in Europe, which is actually impacting the demand. So, we have weak demands in key countries. Demand is also impacted by high inflation and interest rate environment. And also, the consumer confidence and purchasing power is also impacted.

The key markets, Germany, Great Britain and France, were the ones mostly impacted. And we have a contraction, we have seen contraction in those markets. And for the coming periods, we expect demand for appliances for the rest of the year to be stable. We do not expect growth, actually. And also, it is not possible to estimate the outlook due to uncertainties. However, if inflationary pressures are reduced with central bank interest policies, and raw material prices easing might lead to demand stabilization, mainly in core markets in Europe.

And then we look at the cost side, we have started to see the benefits from lower raw material costs, and especially freight costs, which are going back to pre-COVID levels. But on the other hand, it is still the energy prices and also labor inflation is still an important cost element. We are working on cost efficiency projects to improve our mix, along with strategic pricing.

And also, we are focusing to lower our fixed costs to create efficiency. And we have seen the partial results in March, where we have higher EBITDA margins compared to January and February. And we expect that trend to continue in the coming months. And therefore, we are not changing our 10% EBITDA margin guidance.

ZACZKIEWICZ D: Thanks very much.

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

DEMIRTAS C: Thank you for the presentation and fair results. My first question is about the pricing environment, especially in the Asian markets. Do you see additional competition from the China side, maybe due to lower freight costs? I would like to understand that. Apart from low demand, do you see any increase in supply from the competitors? That's my first question.

The second question is about the financing items below the operating line. Again, for this quarter, I see higher credit finance charges from trading activities. I look all together, the financial expenses and net assets together, and I still see that figures high when we include them into financial expenses, similar to the Fourth Quarter. Then, do you think we should see some decline in that side, the FX cost and the working capital financing side? That's my second question. Thank you.

ÇIMEN Ö: Thank you, Cemal Bey. Competition is actually tough. Everyone is trying to capture or preserve the market share. Especially in core markets, where the demand is declining, the price levels are a significant factor for consumers to decide on which brand to acquire. And we see almost in all markets, all the competitors acting on pricing promotions on some categories, selected categories, or even all categories.

And Chinese are also active. In Asian markets where they are close, they have more dominance, of course. That pricing environment is not only in Asia but impacting all over the world. So, what we are doing is we are trying to improve our mix, try to reposition our product portfolio so that we have a better range and better competitive pricing, and providing better products to the consumers with increasing features. Therefore, that's our aim to improve our market share or at least preserve market share with a better margin.

Regarding the financing expenses, since the beginning of the second half of last year, the interest rates all over the world is increasing. And this is impacting our financing costs, not only in Turkey, but also in Europe, where we have some loans. And also, in other countries like Bangladesh, Pakistan, where we are having loans, the cost of borrowing has increased. So that impacted our financing expenses for the interest line. And on the other hand, we are factoring costs, which is also increasing with the increasing interest rates. Therefore, you see a higher credit price financing charge in our P&L.

On the other hand, hedging costs increased dramatically compared to last year in Turkey, where we needed to balance our open FX position. Nowadays, it is 40% or 45% to hedge it. Therefore, our hedging cost is also another element of our financing item, which has increased dramatically. On all these together, impacting the total financing costs, shall we expect an easiness in the market? Actually, with the increasing trend of interest rates, it's unlikely to see it in the short term.

But what we can improve? We can improve our working capital, which we are working constantly. As a percentage of sales, we are improving it. We are working on our inventory and receivable levels to optimize. We will see some benefit of that. But on the other hand, there will be negative impact coming from the interest rates.

DEMIRTAS C: Thank you. As a short question regarding the taxes, effective taxes, you recorded again, tax income. I would like to understand maybe some details on that. Did you have additional asset revaluation or any incentives in that number? And another question related to this factor regarding the new implementations after earthquakes. The tax authority asked to pay 10% from the tax incentives, the investment incentives the companies are having. In this quarter, did you record any one-off costs related to those taxes on previously earned incentives in this quarter? Thank you.

ÇIMEN Ö: Deferred tax income is mainly driven from the asset of Arcelik Turkey entity. We are continuing our investment and the investment incentives is creating tax assets. Therefore, the positive amount that we see in our P&L coming from the deferred tax asset is mainly attributable to that investment in Turkey and also partially valuation of those assets in Turkey.

Right now, we are working on the amount of tax to be paid based on the recent regulation announced. We do not foresee a major impact in our financials for the tax coming from the earthquake regulation. It will be around TL100 million levels.

DEMIRTAS C: Thank you. You did not record in the First Quarter. Possibly, you might record in the second, which is not a very significant number?

ÇIMEN Ö: Yes, it is not a significant number. It will be offset with the tax asset as well. Therefore, it will be neutral. We can say it will be neutral.

DEMIRTAS C: Thank you.

OPERATOR: The next question is from our webcast participant, Max Nekrasov with Citi. And he asks, what were the key drivers of c.90% year-over-year increase in G&A expenses in 1Q '23?

ÇIMEN Ö: Actually, first of all, as we are in the inflationary environment, that inflationary environment requires an increase in the labor side. In the First Quarter, we have increased in all the countries that we operate the salary levels. And also, the inflationary impact affected most of the fixed costs, which are linked to consumer index. Those have also increased.

And on the other hand, we have some one-off costs in our SG&A, mainly attributable to the project that we are working on right now for the partnership with Whirlpool. There are some consultancy legal costs. And also, in relation to earthquake, there were some grants which might be classified as a one-off cost. Those impacted around 0.4% to sales our SG&A. The main impact is coming from the inflationary adjustments that we need to make, either through contract regulations or, as I said, the labor cost increase.

OPERATOR: Thank you. The next question comes from the line of Luiz Gomes Antonio with Ninety One. Please go ahead.

LUIZ A: Hi there. Thank you for your time. I just wanted to ask you regarding your refinancing of the remaining loans that you have due this year from your debt maturity chart. You have 62% of your debt due this year, a third of which is the bond that you said you just repaid. I just wanted you to outline what you have to pay, what's going to remain short-term, and you're going to roll, and so forth?

ÇIMEN Ö: Okay. Mine, would you like to take this question?

YAZGAN M: Yes, sure. Thank you for the question. After we repaid the bond, now we have a relatively smaller size falling into the first following year. So, we may tell that 54% of the remaining debt will be following in the next one year, considering the remaining part of our loan portfolio after repaying 500 million euro bonds.

LUIZ A: Do you intend to repay it, or are you just going to roll it?

YAZGAN M: The bond matured in April, and we repaid the bond. But the upcoming maturities, most probably, most of them are available to be rolled over. So, we're going to assess when the maturities come one-by-one, if the market allows us to roll for further maturities or remain as short-term loans.

LUIZ A: Okay. Thank you.

YAZGAN M: You're welcome.

OPERATOR: The next question comes from the line of Lanka Sashank with Bank of America Merrill Lynch. Please go ahead.

LANKA S: Yes. Thank you for the presentation and the opportunity to ask questions. I have two questions, if I may. The first one is related to your hedging policy towards raw materials. I think the consensual view is with China reopening, there could be an increase in plastics and metal prices towards the later part of the year. So, just wondering how you're positioning for this potential raw material price increase, given in the last two quarters, you've seen prices come off a bit, which has obviously benefited you? That's the first question.

And the second question is, can you provide us an update on the transaction that was announced, the Whirlpool European business? Where are we right now? I think the guidance given was the second half for closure. So, I would appreciate any color. Thank you.

ÇIMEN Ö: Thank you for your questions. Regarding the hedging of raw materials, actually, we do not do financing hedging because it is more costly than hedging with your own resources. What I mean by our own resources is either we have contract terms with the suppliers from one to three months or we have inventory in hand to use as part of a hedging policy.

So, considering the expectations in the market, our purchasing team closely monitors the best options, either making long-term contracts or short-term contracts or increasing the inventory levels as a hedging policy.

For the Whirlpool potential deal, we have announced it mid-January. Right now, we are in the process of getting the approvals from the authorities and we are answering and responding to the authorities' questions. We expect the process to be completed second half of the year, close to the end of the year. But right now, there is nothing that we can share because the process is still going on with the authorities.

LANKA S: Thank you.

OPERATOR: We have a follow-up question from the line of Demirtas Cemal with ATA Invest. Please go ahead.

DEMIRTAS C: Thank you again. My question is again about the domestic demand side. Domestic market has been strong in main consumption sites in autos and white goods, electronics, all together. For the rest of the year, what's your base case scenario? And could we assume that domestic sales were more profitable compared to international revenues? Could you give us some color on that? How do you see, at least as a color, the Second and Third Quarter? Do you see any change in the domestic demand side? Thank you.

ÇIMEN Ö: Thank you, Cemal Bey. The first two months, there was a decline in the market. But also, at the same time, we were able to reprice our products. As a quantity change, we expect the year to be almost flat in terms of quantities. But the second half of the year, actually, we are a little bit cautious on what will be the demand side because of the macroeconomic environment that we are facing right now.

As you said, Turkey's domestic market is more profitable. And normally, the levels of Turkey should be around 25% to 30%, whereas in this quarter, it was 38% because of the strong performance of Turkey. But we do not expect that percentage to be at the same level the second half of the year.

So that means share of Turkey will be lower, quantity increase will be even zero as flat. And that will definitely impact the total margin because Turkey is more profitable compared to other sites. However, we are also improving our mix in the other markets that we operate. And that will be a balancing factor, even though Turkey's sales are back to 25% to 30% level.

DEMIRTAS C: And one last question about the currency impact. Now in Turkey, it's one of the head of the election. That's one of the key questions. How would Turkish companies be impacted from any Turkish Lira devaluation? How is your exposure?

I see from the presentation, but how do you just see that picture? Because you are international, you have been competitive international player. But recently, the cost base is increasing because of inflation for most of the exports oriented, like the strong export oriented companies we have been pursuing.

What's your perception about that? Do you see, what should be the net effect of any the TL depreciation on your financials or on the operations overall? And related to that, do you see some normalization in Bangladesh or Egypt regarding the devaluation in those countries?

As I understand, there was some devaluation in those countries. Do you think there will be any recovery in those markets in the rest of the year, maybe in Third or Fourth Quarter? Thank you.

ÇIMEN Ö: Thank you, Cemal Bey. As you said, we are operating in different markets where FX regulations in some period of time is creating obstacles to run your business. However, we are trying to mitigate those as much as we can do with the instruments available in the market.

For Turkey, we have been trying to hedge our position as much as we can do. But right now, the regulations or the policies do not allow us to fully hedge ourselves. So that means we have some open position in Turkey, which is around EUR150 million. If the rates were at a different level, being an exporter, we would have benefited higher gross profit. That would actually balance the currency risk that we are holding right now.

So, in terms of a devaluation, which might happen in Turkey, there will be a FX loss in the financing line. But also at the same time, being an exporter, we would have higher sales coming from a higher FX rate that will partially balance that FX loss. But right now, we are experiencing a higher Turkish Lira interest cost in our financing line. But the FX rates are stable. Therefore, we are not benefiting that margin impact. On the other hand, Euro denominated production cost is getting costly compared to one year ago or two years ago. That is something that we need to manage.

Regarding Bangladesh and Egypt, in Egypt, there are the regulations of restricting import payments. Therefore, the companies importing and selling in the market, the operations are impacted, sales are impacted. But we are trying to solve this with extended payment terms to Arcelik so that our company in Egypt continues its operations. There is the expected depreciation of local currency around 20% to 30%, which we are trying to balance with pricing.

Bangladesh has a similar case. The import payments are restricted. That is impacting our quantity of production because of raw material availability. But we are trying to solve this with discussions with the authorities as well as the banks. And we are trying to continue our operations with minimum interruption.

DEMIRTAS C: Thank you, Özkan.

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

ÇIMEN Ö: I would like to thank you all for participating in our earnings calls. We hope to see you in the next call. Thank you.