Arçelik A.Ş. Third 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 Senior Lead

Conference Call Conducted by Chorus Call Hellas

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OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Konstantinos your Chorus Call operator. Welcome and thank you for joining the Arçelik conference call and Live Webcast to present and discuss the Third 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 Senior Lead.

Mr. Çimen you may now proceed.

ÇIMEN Ö: Good morning and good afternoon ladies and gentlemen. Welcome to our Third Quarter 2023 results webcast. Before starting the presentation, I would like to take this opportunity to thank our people for their relentless efforts in this challenging economic environment.

So, I would like to start with the highlights of the Third Quarter. Arçelik generated TRY58.2 billion revenue in the Third Quarter with a substantial annual revenue growth of 70%. In Turkey, the demand remained strong in both the wholesale and the retail markets across product groups. On the contrary, consumer demand in our major international markets continued to fall. Our consolidated EBITDA margin was 10.6% in the Third Quarter with a 190 basis points annual expansion.

Margin improvement was mainly backed by further decline in material costs and continuous strategic pricing, despite having 120 basis points higher OPEX to sales ratio. Our networking capital to sales ratio as of Third Quarter was 23.4%. Our leverage was 2.36x as of Third Quarter of 2023.

This quarter we have successfully issued a $400 million five-year Eurobonds with a yield of 8.5%. The books opened at an area of 8.75%, where we managed to squeeze it by 25 basis points during execution on the back of a 2x over subscription. Actually, this proved the strength of Arcelik's fundamentals and the investors' confidence on Arçelik.

If we move to the next slide, in the Third Quarter of this year, Arçelik delivered consolidated revenue of 58.2 billion with a 70% year-on-year increase. Solid growth in unit sales in Turkey, strategic pricing initiatives across regions, and further depreciated Turkish lira were key drivers behind this growth.

Our consolidated gross profit margin for the Third Quarter was 32.8%, which is up by almost 400 basis points, compared to the same period of last year. Margin improvement has been supported by strong unit growth in Turkey, further eased raw materials costs and favourable Eurodollar parity.

In the Third Quarter, we achieved a consolidated EBITDA margin of 10.6% with an annual expansion of 190 basis points. Despite having higher OPEX to sales ratio, significantly improved gross profitability has resulted in margin expansion.

If you move to the next slide to domestic markets, following the strong annual unit growth of 18% in the first six months of the year, Third Quarter has also been strong in terms of demand. MDA6, wholesale market grew by 30% in July-

August period on a cumulative basis, compared to a year ago. And Arçelik's units sold increased by 30% in the same period. Retail market was also strong in the same period with a growth at low 20s percentage.

Arçelik, as a group maintained a strong leadership position by far as of August, 2023. Sales in air conditioner market was significantly up by 334% in July-August period on a cumulative annual basis, while Arçelik outperformed the market with around 500% growth in the same period. The growth was mainly driven by pull-forward demand.

If you look at the TV market, it grew up by 19% in January-August period on a cumulative basis. And Arçelik's units increased by 16% in the same period. Revenues generated in Turkey in the Third Quarter was TRY22.4 billion, which is registering 121% yearly and 22% quarterly growth. Annual growth was mainly driven by strong unit growth in all major product groups and price increases. And the share of domestic market in total business was 38% in the Third Quarter.

If you move to the next slide to European market, having 39% share in total consolidated revenue in the Third Quarter, revenues generated from Europe were flattish in Euro terms compared to a year ago.

Following the first and second quarter, consumer demand in Western Europe continued to decline, however, at a slower pace. After a high single-digit percentage annual unit contraction experienced in the region in the first six months of 2023, consumer demand contracted by around midsingle-digit percentage year-on-year in July-August period on a cumulative basis.

Meanwhile, in Eastern Europe, which is driven mainly from strong Russian markets, consumer demand increased by around 10% in the same period. Demand remained negative in other major countries in Eastern Europe.

Having 23% share in total revenue in Third Quarter, Arçelik revenue in Western Europe were down by a low single-digit percentage in Euro terms, reflecting the overall demand contraction despite price increases. Having 16% share in total revenue, Arçelik revenues were up by a low single digit percentage on a yearly basis in Euro terms.

If you move to the next slide, Africa, Middle East and APAC, the revenues from Africa and Middle East region represents 9% of consolidated sales in the Third Quarter, grew by around 7% annually in Euro terms, thanks to strong performance of Middle East region. Following the decline in the consumer demand in the first and second quarter, consumer demand showed an improvement in the Third Quarter and stayed flattish compared to a year ago.

Defy’s net sales increased by around 4% in local currency. However, in Euro terms, revenues contracted at around low teen percentage, reflecting depreciation of the local currency. As of September, Defy maintained its strong leadership position.

If you look at Egypt, declining trend in white goods markets decelerated in July and August. However, Beko Egypt managed to deliver a solid revenue growth of 54% in Euro terms year-on-year, which is actually a result of increased white goods sales in a declining demand environment. And as a result, Beko brand increased its market share in both value and unit terms.

Revenues from APAC region, having 12% share in total revenue, were down by around 31% in Euro terms on a yearly basis in the Third Quarter. This contraction reflects the declining demand in the environment. In Pakistan, compared to a year ago, revenues grew by 16% in local terms in the Third Quarter. However, in Euro terms, net sales contracted by 17% as a result of depreciated rupee.

In Bangladesh, lower unit sold in major product groups resulted in around 35% revenue contraction in local currency in the Third Quarter and in Euro terms, revenue decreased by around 47% in the same period.

Let me look at the cost side. In the next slide I will talk about raw material prices. Metal raw material market prices have further been decreased during the Third Quarter on both quarterly and yearly basis, mainly as a result of declined global demand, increased policy rates and decreased energy and input costs. Global declining demand, eased energy and logistic costs have also resulted in lower plastic and raw material market prices during the quarter.

If you move to the next slide, sales bridge. In the Third Quarter, Turkey sales grew significantly by 121% on a yearly basis. International sales increased by 48%. Organically, international sales were down slightly by 1.3%

in the Third Quarter compared to a year ago. The contribution of FX conversion impact in the annual international growth was 44%, while inorganic revenue contribution was 5.8%.

On the right-hand side, you can see our regional sales breakdown. Turkey's share in total revenue was around 38% in the Third Quarter of 2023, while the share of Western Europe declined to 23% from 25%, compared to a year ago. The share of Eastern Europe was 16% in the quarter.

Now, I will leave the floor to Mine to talk about the summary of our financials.

YAZGAN M: Thank you very much, Özkan Bey. Good morning and good afternoon. Here is the summary of our Third Quarter financials with yearly and quarterly comparison given on a consolidated basis.

Arçelik consolidated net sales registered an annual growth of 70% in the third quarter. This growth was mainly attributable to solid Turkey performance. Turkish lira depreciation and strategic approach on pricing were other factors behind the revenue growth.

Arçelik delivered consolidated gross margin of 32.8% in the Third Quarter. Margin expansion of 398 basis points on a yearly basis was mainly attributable to declining material costs together with strategic pricing. Robust expansion in gross margin is reflected on consolidated EBITDA margin as well. Arcelik’s consolidated EBITDA margin for the Third

Quarter was 10.6%, marking an annual margin expansion of 190 basis points despite higher OPEX-to-sales ratio.

Arçelik posted net income of TRY1.1 billion in the Third Quarter. Net profit margin expanded by 52 basis points annually and realized at 2%. Despite having significantly better operating margins annually, ongoing higher financing costs continued to limit the further expansion in the net income margin.

If you move on to the next slide, our debt increased by TRY14.5 billion, compared to the last quarter, mainly due to working capital funding and Turkish lira depreciation. As of Third Quarter this year, our cash and cash equivalents increased by TRY11 billion, compared to the second quarter and reached at TRY39.6 billion in our balance sheet with well diversification between currencies.

11% of our total cash is USD denominated, where 54% is Euro and 17% Turkish lira. As a result, along with improved annualized EBITDA, our leverage was down to 2.36x at the end of Third Quarter, from 2.45x as of June.

On the right-hand side, you can see our loan and bond portfolio in detail. As of this quarter, we have TRY83.8 billion equivalent debt. Turkish lira share in total debt was 16% as of September. With the new issuance of $400 million Eurobonds, USD share in total debt increased to 17%, while Euro share was 56% as of Third Quarter.

If we move on to the next slide, on the upper left corner, you can see the bridge of EBITDA margin. Significant annual improvement in gross margin was the main driver of expanded EBITDA margin in this quarter.

On the lower left corner, you can see our CAPEX to sales ratio, which was 4% in the Third Quarter. On the upper right corner, net working capital to sales ratio is shown. The ratio was 23.4% as of Third Quarter this year, in line with our guidance.

Finally, on the lower right corner, due to high working capital and capital expenditures, we generated negative free cash flow of around TRY2.5 billion. We want to highlight that our Bangladesh, Egypt, Manisa investments are still underway and have not been contributing to sales and EBITDA yet.

I'll give the floor once more to Mr. Özkan Çimen to go through our guidance. Thank you.

ÇIMEN Ö : Thank you, Mine. Based on our most recent forecast, we have reviewed our guidance. Thanks mainly to the solid performance achieved in the nine months of the year in Turkey. We are upgrading our annual revenue growth guidance of Turkey from around 60% to around 75% this year. In the remainder of the year, we expect revenue growth to slow down due to high growth achieved in the first nine months of the year, negatively affected purchasing power by the high inflationary environment and also the increasing interest rates that is reflected on credit cards.

And due to persistent decline in demand across international markets so far this year, we are revising our existing between around 2% contraction and around 2% growth in international revenue growth guidance to around 4% contraction, which is in line with the first nine months performance.

We are keeping our EBITDA margin guidance at around 10.5% and net working capital to sales ratio guidance is below 25% and we are maintaining our CAPEX guidance of around EUR300 million.

So, this was the end of our presentation. Now we may have the questions.

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

DEMIRTAS C: Thank you for the presentation and congratulations for the operating performance side. My first question is about the top line growth. As far as I see, you increased to 75% but already in the first nine months the growth is much significant just average around maybe 90% or 94%.

So, what's your expectation for the fourth quarter? Do you expect any cooling? And related to the details of the Third Quarter, do you see major increase, not in the white goods or the consumer electronics, but the others, which might be related to AC. So, was extraordinarily high, maybe you can elaborate on that side for the fourth quarter. That's my first question.

The domestic side and the color maybe, you know, in the domestic market. And in the export side, you revised down your guidance in the volumes. What was the major driver behind that? I know you were cautious, but you're a little bit more cautious. You know, you have some indications for the rest of the year, what might be the driver behind that?

And the last question for now is, again, when I look at your EBITDA margin, it's good, 10.6, fine. And I see that the one-offs maybe can elevate the balance. And the other issue which I really want to understand going forward is the FX sides. And when I get into the details of the FX side, I see again similar FX costs in the Third Quarter, which is around TRY1.5 billion.

So, when I put all the FX costs together, and when I look at the currency movement, there was not major moves in the currency. So, I would like to understand that, maybe in association with that. So, for now, it's the three questions, maybe long questions for that, but domestic side, export side, and the FX side, because that might be critical for us to make the expectation for the following years.

When should we see some improvement in that front? Should we expect the interest rates to be cut or changes in the FX regulations? I know these are comprehensive questions, but maybe if you elaborate that will be very helpful. Thank you.

ÇIMEN Ö: Thank you Cemal Bey for the long questions. So, if I start with top line growth for Turkey, as you rightfully pointed out, that the growth in the first nine months is around 90%, which is a significant growth. However, we see in the market that there is some slowdown that is going to happen or has already started to happen. This is mainly as a result of the purchasing power impact in the households and the regulations that is trying to cool down the domestic demand which has some reflection on the interest rates as well as the credit card limitations.

So, considering all those, we are cautious of the last quarter in terms of quantity growth. And we expect that the growth pace will be different in the fourth quarter, which as a result, we will be reaching around 75% growth compared to 90% growth in the first nine months.

The other line you mentioned, there is a growth in the other line of revenue which is AC and partially solar panel related. The AC is mainly driving that impact. There is a huge growth of AC, which is coming from the campaigns and also the pull-forward demand. The base of the last year was low when we look at the AC, so this affected the total growth.

If you look at the international markets, as we have presented the decline in units is around 10% in some countries and in some countries, it is even higher. And in East Europe it's around 10% unit decline in year-to-date terms and in Western Europe, it's around 7%.

If you look at market-wise, Germany has the highest 12% decline. And similarly, the emerging markets, we see unit declines in the emerging markets. And therefore, we think that it will -- what we have seen in the first nine months is around 4% to 5% decline overall in Euro terms will be the same in the coming three months.

And of course, the environment that we are right now seeing the wars continue, there will be short-term impact either on the oil prices or on the raw material prices. But more importantly than that the higher interest rates might continue to cope with the high inflationary environment.

So all-in-all, we do not expect a short term recovery of that unit decline. Therefore, our expectation is to be similar to 5% unit decline in international, sorry, revenue decline in international markets.

You have touched based on the FX side and financing costs. In the last quarter, we have tried to explain this. It is not only FX position impact. I mean, even though the currencies do not fluctuate, we have an open position where we need to hedge and the hedging cost is similar to borrowing Turkish lira rate. Therefore, you see a higher FX net impact in our P&L, whereas considerably lower interest expense in our P&L.

As long as our position is similar and it will continue to be in the same level, And there won’t be -- if there is no interest decline in the market, which means hedging costs will still be high, this trend will continue. We see that the policy rate is being changed by the economy management and that also has an impact of short-term borrowing fluctuations, which we are also impacted with our hedging costs.

DEMIRTAS C: Thank you.

ÇIMEN Ö: Thank you.

OPERATOR: The next question is from the line of Kilickiran Hanzade with JPMorgan. Please go ahead.

KILICKIRAN H: Thank you very much for the presentation. I would like to ask about your working capital financing. How do you plan to finance this in 2024 if Turkish lira borrowing remains limited? Do you have enough cash or do you will you consider to borrow in hard currency next year as well?

And is it possible to share your target leverage with us for next year if possible, of course? And this is about for CMA review, is there a certain timetable for the review and do you expect this to be completed before the year end and what will happen if they block the UK merger? Thank you.

YAZGAN M: Thank you very much. I can take the first two questions, Hanzade. Well, Turkish lira loan is not still accessible for us because we are not maintaining the 5% ratio, which is necessary for Turkish lira utilization. But in the meantime, we observed that Capital Markets Board was quite flexible in terms of Turkish lira Bond issuance.

So now already we disclosed that in last week. We applied for Turkish lira Bond issuance and we are awaiting some good news hopefully from the Capital Markets Board.

But if not, well, we also have some other tools that we use internally with our dealers and with our subsidiary in Turkey, which we try to maintain some discounts to have access to Turkish lira, which is limited. But again, helps us to have an access to Turkish lira funding.

On the other hand, as the issues that Eurobond $400 million in September, now we do not see any issue in terms of liquidity. But as Özkan Bey rightly mentioned that when you use your hard currency, you utilize loans for Turkish lira needs. It brings as an open position as well. And the hedging costs are quite high in the market right now, which brings us financial costs that we do not want to bear.

So that's the only, available credit line as of today but we are focusing on some trade finance solutions like, Turkish lira LC discounts and supply chain discounts. So we are trying to manage our working capital need in Turkish lira to that extent.

KILICKIRAN H: Mine Yazgan, in that respect, could there be an option for you to cut for working capital further in 2024 in order to reduce the FX leverage risk?

YAZGAN M: Yes. The thing is that we are targeting a leverage level around 2x, but that might fluctuate temporarily from one quarter to the other, depending on a FX and a CAPEX cash out. But the target is to maintain the leverage around 2x.

KILICKIRAN H: Okay, thank you.

ÇIMEN Ö: I will take the question related to our transaction. As you know, we have applied for the regulatory processes for the European Union and the UK CMA. CMA announced Phase 2 investigation. Actually, this implies a prolongation of the process to obtain all necessary regulatory approvals.

The statutory deadline for the CMA decision is set as end of March 2024. But we are working continue to work probably with the CMA for an efficient process to accelerate the Phase 2 review period. And in the meantime, we expect the European Commission decision on its Phase 1 review of the transaction, which is due by 23rd of October.

So, we continue to work constructively with all the relevant regulators to obtain approval and we remain confident of the significant benefits that the transaction will deliver to the customers.

KILICKIRAN H: Okay. Thank you very much Özkan Bey. And can I ask a final question about the consumption trends, actually pricing. Can you continue to pricing the European markets after rising competition from the Chinese players?

ÇIMEN Ö: Actually, if you look at the markets, we see much more competition than ever which where all the competitors have promotional activities to increase their market share or sustain their market share. And what I can say is, it's not as easy as to increase your prices compared to six months ago. So that will be a risk that we need to manage going forward.

KILICKIRAN H: Thank you.

OPERATOR: The next question is from the line of Campos Gustavo with Jefferies. Please go ahead.

CAMPOS G: Hi, thank you very much for the presentation. Congrats on the operational results. If you wouldn't mind providing some color on -- more broadly speaking on how you're planning to refinance the short-term debt? As well as expectations on the reversal of working capital over the next few quarters. And if a slowdown in the market, which you alluded to, could improve that reversal? Thank you very much.

YAZGAN M: I can take the first part of the question regarding the short-term debt. Well, in September, we issued the Eurobond with five-years, so that's going to help us to maintain a more-longer tenured debt portfolio. And in addition to that, we are in close communication with a bunch of potential lenders to have long-term loans.

But as you already know, in the last year, it was quite difficult in the local markets to have foreign currency denominated debt with longer tenures because Turkey market is not available for longer tenures. That was the reason that we preferred, in some sense, we had to utilize short-term loans, but we were expecting to be able to issue a Eurobond with five-years, which we managed in September.

So now, we have a more balanced and have the balance sheets right now. And again, we are in communication with potential lenders to utilize longer tenure loans. So the aim is to replace the short-term loans with the longer ones, when the credit lines available.

CAMPOS G: Okay.

ÇIMEN Ö: Regarding net working capital, I can comment on that we will continue our net working capital improvements. So, we are focusing on our inventory levels to optimize the inventory days and also we are negotiating with supplier for a better payment terms, where we see some reflection on our results as a positive net working capital improvement.

On the other hand, we use factoring as a tool to optimize our financing costs, where we see advantage compared to short term borrowing. We are using factoring as a financing tool.

CAMPOS G: Great. Yes, thank you very much for the call, that was very helpful. If you wouldn’t mind, I'm seeing that there's about $1 billion due by the end of 2023. Has any progress been made so far on that $1 billion?

And as well as I was curious in, as you were potentially consulting with banks locally, what would be the rate and what is the loan market environment on that sense? Yes, thank you.

YAZGAN M: Thank you for the question. Part of the short term debt, you observe in the upcoming one-year is part of cash pool utilization. So, there's a continuous process there. So, we do not see a refinancing risk. So, it's part of our operating process.

But on the other side, we have, yes, some local banks or branches of the multinational banks that offers us short-term credit lines. What we observe is that now the foreign currency denominated loan market is much favourable compared to last year or even last quarter.

So, the banks have the appetite to offer the loans with better rates, compared to one-year ago. So, it changed from bank-to-bank, but of course, the rates that we receive as of today is not higher than our average borrowing rate. So, it seems that, it's going to be quite promising in terms of loan rates.

And on the other hand, as Arçelik, we are not utilizing Turkish lira denominated loans. We have many ample credit lines in the bank and now as banks are much eager to offer FX loans. So, we see quite a competition there because we have been experiencing flight a quality in the last quarter, so we do not have any concern to refinance the upcoming debt. Thank you.

CAMPOS G: All right. Thank you very much. Much appreciate.

OPERATOR: The next question is a follow-up question from the line of Demirtas Cemal with ATA Invest. Please go ahead. Mr. Demirtas, can you hear us?

DEMIRTAS C: Sorry. My question is about the currency side. We see that euro-dollar parity is around 1.06. How does that affect you so far? You have more countries you're focusing, but in the past, it was one of the critical issues for us to euro-dollar, but how does it impact you so far now?

And the other question is about the TL levels. And do you see any further pressure on the cost side because of the inflation for the rest of the year or for the following six months, if the euro-dollar TL or Euro-TL stands at current levels?

And in the past, there was some regulations related to exporters, like you, that was limiting the flexibility of the movement, you know, by keeping some money in Turkey and etcetera. Do you see any change on those, in terms of, more regional policies the government is seeking recently? How do you see the picture on that side?

You know that domestic, international markets may be a little bit slow related to their situation, but do you see the currency factor as a critical factor for now? That's my question. Thank you.

ÇIMEN Ö: Thank you, Cemal Bey. Euro-dollar parity, we are closely monitoring. If you look at our revenue composition and cost composition, our US dollar revenue is lower compared to our cost of US dollar. Therefore, euro-dollar parity is an important factor in our margin.

However, we are looking this closely to review our prices or optimize the US dollar negative impact with our cost improvement plans in the factories that we are doing constantly. But it's one of the key parameters that we are following closely.

If you ask about Turkish lira cost side, which is actually the result of inflationary environment in Turkey and given that exchange rate devaluation, Turkish lira devaluation, Euro to Dollar is not at the levels of the inflation currently. That is also putting some costs. So, we are compared to last year, our costs in Euro terms is higher because of that currency and inflation mismatch.

And however, what we are doing is, we are optimizing our OPEXes as well as logistic costs and all those cost improvements plans is limiting that big impact that we might see if there are no actions that we have taken.

And the regulatory environment for FX in Turkey is asking us to sell euro or dollar or the currency generated from exports to Turkish lira. That under requirement is 40% right now. Actually, this is also impacting our FX position. Therefore, our hedge costs increases while Turkish lira borrowing costs decreases.

And the other regulatory requirement is that, you have to use Turkish lira loan from a bank. You need to have FX in your balance sheet less than a threshold, which is 5% right now. And being an exporter and being an importer, we have to continue our exports, we need to pay our suppliers.

Therefore, we need to have some hard currency in our balance sheet. Therefore, we are not using Turkish lira loans from the banks because of that regulation.

DEMIRTAS C: Thank you, Özkan Bey.

OPERATOR: There are no further audio questions at this time. We will now move to our webcast question. And the first webcast question comes from Kayahan Demirak and I quote.

KAYAHAN D: Thanks for the presentation. Do you see any signs of demand recovery for the next year in international markets, which will be cycling a relatively low base particularly in Europe? Thank you.

ÇIMEN Ö: Thank you for the question. Actually, we haven't started to see the pace of decline to be better compared to previous months. And I think in the short term, given the fluctuating environment, it will take some time to see that improvement in the markets. Therefore, our short-term expectation in the Europe market is a similar quantity decline compared to the previous year.

And the other impact is the inflationary environment needs to be taken into consideration by the economy management of the countries and central banks especially. They are using the interest rates to cope with inflation and even the high rate of interest and even the mortgage that the consumers spent is also impacting the demand to our customers.

Therefore, we are a little bit cautious on the short term, but yet we haven't seen any improvements. However, we expect that some recovery might happen after Q1 or in Q2, next year.

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

ÇIMEN Ö: I would like to thank you all for attending our Q3 results webcast and I hope to see you in our next quarter meeting.