Transcription for ŞIŞECAM A.Ş

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Corporate Participants

Görkem Elverici
Şişecam – CFO

Operator
Ladies and gentlemen, welcome to Şişecam 2018 Year-End Consolidated Financial Results audio webcast call. I will now hand over to Görkem Elverici, CFO, and Başak Öğe, Investor Relations Director. Sir, you may begin.

Görkem Elverici
Good afternoon ladies and gentlemen. I would like to welcome you to our webcast today where we will be talking about our 2018 year-end results and key developments that have had impacts on our operations.

At the end of the presentation, we will be happy to take your questions. I would like to remind you that our presentation and the Q&A session may contain some forward-looking statements and our assumptions are based on the current environment and may be subject to change.

On page number two, a very quick look at the economic and political landscape is presented to your attention. I do not want to take your time about the macro and political events, but overall 2018 has ended with a global downturn and the outlook for 2019 is that growth expectations have been marked down in many economies, signalling a cautious stance also for the next year. As for Turkey, while we were benefitting from weak TL, macro pictures in the domestic as well as in the global markets make us adopt a prudent approach.

Moving on to slide three, I would like to give you a brief update on the global and the Turkish glass industries. Globally, a growth of 5-6% per annum is sustained. 73% of total glass production capacity in Turkey belongs to Şişecam. In 2018, Turkey's glass exports volume increased by 20% on an annual basis, while glass imports volume decreased by 13% mainly due to weak TL. Construction industry contracted by 5.3% in the third quarter of the year and 1-2% contraction is expected for the overall year. While there is not yet a clear impact on the domestic market for construction material, there is the risk of around 5% to 10% shrinkage in 2019. Exports in automotive industry contracted by 1% while production decreased by 8.6 in 2018. In the white goods industry, exports continued to increase by 7% while production remained flat year-on-year.

As for tourism, Turkey's revenues grew by 12.3% in 2018, while the number of tourists recorded in this year grew by 18.1%.

Before moving on to the financial results, I would like to talk about the major developments that took place in our group in the second half of 2018 on pages four and five. As we have mentioned in our half-year results' webcast, in July, Trakya Cam acquired Sangalli Manfredonia for approximately €16 million. It is our Group's second flat glass production facility in Italy with an annual capacity of around 190,000 tons including the laminated, coating and satin lines. With this acquisition, we are now one of the top two largest flat glass producers in Italy. We also acquired the remaining 50% stake in HNG India and became its sole owner. Starting from August, BOTAS, national gas distributor of Turkey announced three consecutive tariff hikes for industrial use and two major tariff increases for electricity production. The increases were followed by a price discount for electricity producers in November. Although the price hikes were above the market's expectations, on the consolidated basis, the effect was mostly netted off with the cost control initiatives that were taken and also due to pricing actions in various businesses of Şişecam.

In the second half of 2018, both S&P and Moody's downgraded our long-term issuer rating with a negative outlook after lowering the sovereign's long-term credit rating due to extreme volatility of the Turkish lira during the summer months. Currently, we are rated as BB+ by Fitch and Ba2 by Moody's.

In September, operations of Cam Elyaf Sanayii, our old glass fibre production company were terminated as its last furnace completed its useful life, and since January 2019, Şişecam Elyaf Sanayii's new glass fibre production facility investment in Balikesir with 70,000 tons per year capacity is fully operational.

Anadolu Cam ignited its fourth furnace with 150,000 tons per year production capacity in Eskişehir plant by the end of July. With the completion of this investment, glass-packaging group's installed capacity in Turkey increased by 14% to 1.2 million tons per year. Two months later, Anadolu Cam announced its fourth furnace investment with 80,000 tons per year capacity in its Mersin plant. Expected CapEx is around $18 million.

In January 2019, Trakya Cam Sanayii and Anadolu Cam Sanayii's collective bargaining agreement with Petrol-İş has ended. New bargainings are currently taking place.

Now, we can move on to the financial and operational overview section. On slide six, you will see the snapshot of our financial results. 2018 was another year of progress with improvements in sales, EBITDA margin, earnings, and return on equity. We ended the year with TL 15.6 billion top line with 37% year-on-year growth and TL 4.9 billion EBITDA. As we benefitted from the depreciation of TL against hard currencies, EBITDA grew by 57% year-on-year. Had no FX translation gain on our fixed income instruments, and other adjustments being included into our financials, EBITDA margin level would have been at 26%. Net profit came in at TL 3.4 billion. After minority interests, it is at TL 2.3 billion, which grew by 90% year-on-year, that was more than the improvement in EBITDA. The main drivers behind the increase in earnings was strong operational results, combined with the FX translation gain on our fixed income instruments and lower effective tax rate as a result of reduced tax payables after receiving incentives for largescale investments made in 2018. Net profit margin of our company increased from 15% to 22%. Earnings per share increased to TL 1 from 55kr in 2018 as ROE rose to 20% from 13% in 2017. Free cash flow in 2018 decreased compared to last year, but we will discuss it further on the upcoming pages.

On slide seven, we can see the historic evolution of our topline and EBITDA performance. In five years' time, growth in EBITDA was more than our revenues as a result of favourable business mix, timely acquisitions, and initiatives taken to sustain operational excellence. EBITDA margin levels were kept at or above sustainable level of 20% in line with our strategy, thank to robust operational performance across all divisions.

Moving on to page eight, highest contribution to Şişecam's top line continues to be from flat glass business on the back of strong contribution coming from operations in Europe, encapsulation and auto glass unit and positive pricing impact in Turkey operations. Topline performance of chemicals was also strong thanks to positive currency impact, steady volume with slightly higher pricing in soda, strong pricing in chromium chemicals and higher revenue generation from electricity business. Strong ruble against TL, solid demand growth in Russia, favourable demand and pricing conditions in Turkey uplifted glass packaging top line performance. Increase in hard currency denominated sales and improved pricing environment supported glassware division's topline with 65% share of international revenues in 2018.

On slide nine, flat glass segment's EBITDA contribution decreased from 39% to 37%. Chemicals' contribution increased from 29% to 31% and glassware share's from 10% to 11%, while glass packaging segment's share remained flat at 19%.

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On slide 10, TL 737 million negative free cash flow was generated in 2018 mainly due to change in net working capital, increasing CapEx and dividend payments. The main reason behind the increase in change in net working capital was the increase in inventory costs, which reflects the increase in production costs due to the depreciation of TL against hard currencies and increase in energy prices. Please also consider our DIO were longer than DPO and DSO in 2018, as we see the impact of currency fluctuations on inventory costs were more than payables and receivables. Increase in our costs was mostly netted off with the pricing actions together with cost control initiatives taken throughout the year, as you may see from sustained EBITDA margin levels. Operating cash flow continued to be strong, roughly, at TL 2.5 billion.

Turning to the next slide, CapEx increased to TL 2.2 billion. Major CapEx items were fibre glass investment in chemicals, furnace investments in Turkey in glass packaging, cold repair, and new line investments in flat glass. Apart from CapEx, we paid $85 million for the acquisition of the remaining 50% of HNG's share in India and took over the excess of Manfredonia in Italy for an amount of approximately €16 million. Şişecam is not a highly levered company despite the robust investments undertaken historically. In this year, thanks to the continued strong EBITDA generation, our EBITDA to CapEx ratio came in at 2.2.

On slide 12, we can see the evolution of the production in the course of the year. In 2018, 3% growth in glass production was realised, driven by incorporation of Indian operations, capacity increasing-initiatives in Yenişehir plant of Anadolu Cam. 73,000 tons of capacity in Bulgarian plant of Trakya Cam was inactive for the last four months of 2018 due to the cold repair undertaken. On soda ash side, improved capacity utilisation levels resulted in 1% growth in production. Please note that in glass while 57% of the production is realised in Turkey, remaining 43% is produced in the plants outside of Turkey. In soda, 60% of the production is realised in Turkey and the remaining 40% is produced in the plants outside of Turkey.

On slide 13, looking at the ratios, we continued to sustain the low and conservative net debt to EBITDA and net debt to equity levels, 0.46 and 0.13

respectively. Still, we have a huge headroom in terms of covenants in our loan agreements and the existing Eurobond. Our gross debt in hard currency is 75% of total, while 46% of the loan has a maturity of less than one year, the rest is mostly maturing in a one to five-year timeline. As for the interest rate structure, the portion of fixed rate liabilities is at 62%. We continuously review our funding and maturity profile. We are considering opportunities to access the US$ international bond markets in 144A/RegS format over the course of 2019 to raise general corporate funding and/or potentially, partially refinance our $500 million Eurobond maturity due in May 2020. We have already obtained the relevant CMB authorisations back in 2018 to allow us to complete a benchmark-sized issuance.

Moving onto slide 14, we are seeing that Şişecam's strong cash performance continued in this period as well. Cash in hand decreased to TL 3.2 billion from TL 3.4 billion mainly due to cash payments regarding acquisitions. More than 87% of all cash and cash equivalents is in hard currencies, including $500 million Eurobond investments, allowing us to benefit from a positive carry, by hedging interest rates on our outstanding Eurobond. As mentioned in our previous calls, this strong cash position gives us the flexibility of proceeding first in case of a viable M&A opportunity, while we also continuously seek better ways to optimise our already strong balance sheet management.

On slide 15, you can see that we continued to have a long FX position for $452 million at a consolidated level. We have long positions in both euros and dollars. I would like to remind you that we do not use derivatives, but in the past we had some very limited interest rate swaps and cross-currency swaps for hedging purposes, especially for operational reasons. We will continue to use the hedging transactions if needed, but our enlarged operations and geographies continue to provide opportunities for hedging within our own balance sheet.

Now, I would like to walk you through each division in this last section of our presentation.

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On page 17, starting with flat glass, Trakya Cam delivered strong yearend results with TL 5.9 billion top line performance that grew by 36% year-on-year with a strong EBITDA margin of 25%. As you may recall, we finalised negotiations with HNG at the end of first half of 2018 and became the sole owner of the Indian plant and started to incorporate into our financials starting from third quarter. Topline contribution of this line was 5% and had a dilutive impact on EBITDA by 100 bps in the first year of the acquisition. Investment in India will allow us to grow and improve the profitability levels in the region, which promises a high quality long-term profit growth for construction and automotive industries. Share of international sales reached 59% in 2018.

Sales from European operations increased by 44% year-on-year in TL terms primarily driven by strong sales volume in Italian plant and higher contribution from auto glass and encapsulation business in Europe thanks to a better project mix.

On top of the operational performance in the region, weaker TL was also supportive. Sales from all operating regions in volume terms increased by 1% year-on-year after inclusion of Indian operations. Had it not been included, total volume would decrease by 3% year-on-year primarily driven by decrease in production units in Bulgarian plant due to cold repair, which started in September.

Excluding India, share of sales from domestic operations in total volume has not changed significantly, which was at 56% in 2018 versus 55 in 2017. In the second half, our focus in domestic operation was also shifted towards increasing export concentration, 14% of sales volume from Turkey operations was generated from export markets. Increased production process capabilities of auto glass in Turkey, simplified sales mix and encapsulation unit and improved capacity utilisation rate in Romania uplifted the overall auto glass units' performance, which exhibited a higher margin expansion than flat glass unit.

Product price increases for all these glass products in domestic market throughout the year was also supportive for margin improvement of Trakya Cam, despite the rising raw material and energy costs.

In 2018, excluding payments for acquisitions in India and Italy, €64 million was made, majority of it attributed to new coated line investment in Turkey and cold repairs in Bulgaria. We will add a new float line in Turkey most probably within 2020 amid upcoming cold repairs.

On page 18, in glassware segment, 29% year-on-year topline growth was recorded in 2018 with an 18% EBITDA margin, mainly driven by pricing actions taken across Turkey and favourable currency conditions in international markets. Our gross profit margin increased to 37% in 2018 compared to the prior year's level of 34%. Our efforts to reduce production costs, to drive growth and expand margins continued throughout the year. We implemented consecutive price hikes in Turkey, restructured our pricing strategy on project basis and improved our capacity utilisation rate.

In addition to that, we simplified our SKU units compared to last year and increased our EBITDA margin from 15 to 18%. Share of our international sales was at 65%, thereby, allowing us benefitting from local currency depreciation in 2018. Our intention to list Paşabahçe, if market conditions for both the glassware industry as well as the equity capital markets are favourable, we aim to find the right window of opportunity in the coming future.

Moving onto glass packaging on page 19. 2018 was the third consecutive year in which we recorded a double-digit topline growth and for the period between 2015 and 2018, compounding average growth rate of our revenues, namely 28%, was higher than Turkish lira depreciation against euro and the hard currency basket. Having increased to TL 3.2 billion, our consolidated revenues were 34% higher year-on-year on the back of average unit price increase in all operating regions, namely 20% in Turkey, 5% in ruble terms in Russia, and rising consolidated sales volume by 6% and growing share of exports in our regional revenue portfolios.

On top of the operational performance, 22% appreciation of ruble on average against TL led to translation gains on the consolidation phase. Last year, glass packaging demand grew by 4% in our domestic market while our sales contracted by 2% in volume terms. But please recall that the implementation of product price increases in the beginning of the year had resulted in recording orders brought forward in the last quarter of 2017, and this move enabled us to mitigate seasonal nature of our business and which ended up in an increase on our average capacity utilization rate. Meanwhile, sales from non-Turkey operations grew by 9% in volume terms on a year-on-year basis with the support of World Cup event and good weather conditions, especially on the beer and beverage markets in addition to portfolio strategies targeting seasonality balancing.

Once again, we were able to beat the demand growth in Russia and continued to increase our market share. Turkey and non-Turkey operations' export volume performances were also very strong with 33% and 20% respective increases on a year-on-year basis. Consequently, having grown by 47%, our international sales accounted for 55% of the consolidated revenues. Despite the rise in raw material and energy costs, glass packaging Turkey unit's gross profit margin expanded by 80 basis points, while non-Turkey operations experienced a larger and a more substantial margin expansion, bringing the regional profitability to 32% level.

On the consolidated basis, Anadolu Cam recorded a 47% increase in gross profit and recorded 30% of margin. OpEx to sales ratio was maintained at mid-17% levels, which is parallel to 2017 year-end level. Our adjusted EBITDA margin went up by 140 basis points to 24%, the highest level seen in the last 7 years.

In 2018, through new furnace and development investments, we added 180,000 tons to our operating capacity in the local market, and on the consolidated basis, our total production capacity increased by 8% to 2.5 million tons per annum. We continue to make strategic investments focusing on both maintaining our market leader position and expanding our export capability by adding a fourth furnace to our Mersin Plant. We plan to have this investment online in the second half of this year.

Moving on to Page 20. With the flagship company of our chemicals division, we registered an impressive performance. While the topline grew by 40% on a year-on-year basis, we ended the year with an EBITDA margin adjusted to one-off gains of 33%. Profitability was around 350 basis points higher than the level recorded in the previous year, highest margin attained in the last decade. Our outstanding performance was indeed a result of better business landscapes for both soda ash and chromium chemicals markets. Although sales volume growth stayed at low single-digits rates for the two segments of operations, chromium chemicals and soda ash average unit prices grew by 12% and 2%, respectively in US$ terms. Annual average Turkish lira depreciation of 35% against the hard currency basket has also played an important role in our profitability increase.

In 2018, we maintained our advantageous position against local currency depreciation by generating 86% of revenues in hard currencies, while 41% of the costs were denominated in TL. As you all know, we experienced beyond expectations tariff hikes for our natural gas purchase in 2018. To give you an idea on how steep the tariff increases were, I'm sure it will be enough to say that we started 2018 with a 13% rise in per unit natural gas price compared to January 2017 tariff for the first quarter of this year. On the other hand, today per unit tariff level is 94% higher than January 2018 pricing. In 2018, our COGS to sales ratio came down by 350 basis points and our gross profit margin increased to 38%. OpEx to sales ratio declined slightly below 15% level. Demand for soda ash continued to be strong, and the market is still tight on the back of temporary capacity closures in Chinese market, summing up to 2.5 million tons to 3 million tons level.

In the chromium chemicals segment, pricing environment was robust since the second half of 2017, thanks to more room created for us to display our price-setting power with the capacity closure of Lanxess. OXYVIT, our vitamin K3 and sodium metabisulphite production unit, maintained its high gross profit margin at levels parallel to chromium chemicals segment per se. Throughout the year, we made TRY 822 million of CapEx. TRY 602 million out of the total was in relation with Şişecam Elyaf investment, which is already online with commercial production and sales, while the rest was dedicated to operational efficiency and modernization projects.

Coming to the end of the presentation, I would like to draw your attention to a few key takeaways. The historic evolution of our financial results drove inference for our continuous focus on operational excellence and a favourable business mix, as we have above industrial levels profitability compared to our global peers, having a continuous focus on M&A opportunities on a selective basis. While both organic and inorganic expansion continued, we have not compromised our profitability, which should give you further comfort given our aspirations to be among the top three players globally.

Coming to the end of the presentation, now I will be happy to take your questions.

Question and Answer Session

Operator
Our first question comes from Akif Dasiran from TEB Investment.

Akif Dasiran
I have two questions. First of all, on the glassware segment, there was a provision in the fourth quarter. Can you elaborate on this and on the amount and also the structure? Is it related with the retail operations or not? And second question is related with the flat glass operations. There's an amazing increase in the export sales. Do you expect this export sales increase to continue in 2019? Is it related to strategic actions taken in Italy? Or is it related more or less with the TL depreciation? Please also elaborate on the glass packaging segment's rise of exports.

Görkem Elverici
On your question regarding the glassware segment, it is in relation with annual provisions required to be set aside on an annual basis, so there is nothing specific, and if you would like to have additional information on that, we will be very happy to provide you further details for sure.

Coming to the exports for Anadolu Cam, the company's exports, both from Turkey and Russia, is one of its main strategies that the glass packaging is going after to take advantage of currency devaluations on one side, but also used as a risk management tool that the glass packaging has been experiencing especially starting from the Russian crisis back in 2014. Unlike the other business segments, Anadolu Cam is mainly keeping the needs of OEM business and creating connections for the export business that takes around four to six quarters. Therefore, keeping the share of exports at increased levels is important especially when there are hold-downs in the local markets as it is right now in Turkey and also to some extent in Russia.

The glass packaging business' strategy is to have its exports arms up and ready, to bring its share at least up to 15% of the overall portfolio. So taking the TL devaluation as an advantage, for sure, Anadolu Cam has increased its export business this year to around 170,000 tons and targets to take the volume beyond 200,000 tons, which will be for sure very much dependent on also the currency fluctuations and the profitability margins generated from domestic and export markets.

Flat glass segment exports are also supported by the TL depreciation. Trakya Cam is very strong, one of the market leaders in the Eastern European part, especially in the surrounding region of Turkey, including the Balkans and and in Eastern Europe, even in Central Europe. There was an extreme demand coming from those markets, but due to the incredibly high volume of demand in the local market, we were not able to fulfil the export markets' We have utilized the opportunity of being able to dedicate some of our production to the export markets, we are using this as a tool for any upcoming wind that might occur in the local construction business starting from 2019 in Turkey.

Operator
Our next question comes from Ömer Ömerbas from Ak Invest.

Ömer Ömerbas
Görkem, I just wanted to learn about your plans regarding India. Do you have a plan to increase the flat glass capacity there or just maybe add any other glass operations? My second question would be a follow-up to the exports of Trakya Cam from Turkey. I was just thinking that some of the exports were to supply the volume loss resulting from the cold repair in Bulgaria. So when the Bulgaria cold repair is completed and the plant is again operational, would there be some kind of a pressure on the capacity utilization of Turkey because even though the construction demand was kind of depressed, you still managed to generate a high capacity utilization rate in Turkey and in Trakya Cam. I was just wondering the outlook there, and whether you have a B plan, or not.

Görkem Elverici
Thank you. Starting with India, especially for flat glass, we became the JV partner back in 2013, and when we penetrate markets, for sure, our long-term intention is to grow our market's presence and strengthen our position in the market. But mainly due to the issues we have faced with our JV partner especially on the financial side, we have been unable to function with further investments, that was one of the main reasons why we made the acquisition of the rest of the shares. As we have not yet announced I am not able to provide a timeline for when the upcoming investments can take place. But I can clearly state that Trakya Cam has long-term intention to continuously strengthen its position in the Indian flat glass market and even expand further in the coming future if the market conditions prove to be sustainable and profitable for the auto glass business in the coming future, for the export markets of Trakya Cam.

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Trakya Cam is using the exports business to some extent to utilize the already existing opportunity in the markets right now, and the portfolio built, especially for the plant in Italy, in order to offer the full range of product portfolio in the surrounding regions. This is also supported by Bulgarian operations but Turkey is providing a differentiated segment of product for exports. The other reason is that against the risk of a contraction in the construction industry starting from 2019. Trakya Cam management is taking all the necessary actions in order to get the export markets ready, so that the operations can be started by avoiding a dilution risk in the margins.

[No further questions]

Görkem Elverici

Thank you very much. I would like to thank everyone for their participation to our webcast, and we will be able to reach you all in half-year results in 2019 and hopefully with even better and stronger results. Thank you.

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