Webcast Transcript

TÜRKİYE ŞİŞE VE CAM FABRİKALARI A.Ş.

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Corporate Participant

Görkem Elverici

Şişecam – CFO

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Operator

Ladies and gentlemen, welcome to the Şişecam 2020 First Half Consolidated Financial Results. I'll now hand over the call to Mr. Görkem Elverici, CFO. Sir, please go ahead.

Görkem Elverici

Thank you. Good afternoon, ladies and gentlemen. Welcome to the review of our first half earnings results. I hope everyone is safe and well in this extraordinary time.

Moving to slide two, where we will present the agenda, I will cover financial and operational performance of Şişecam together with the earnings performance of each segment and geography. Secondly, I will focus on the impact of COVID-19 on our operations and our mitigating actions as well as the potential opportunities we have identified in the post-COVID world. I will continue with our cash position and the capital allocation and will conclude by running through our merger process and One Şişecam project 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.

Moving onto the next slide. We started the year with a solid performance as our portfolio worked well in the first quarter with 18% revenue growth year-on-year, and made up TL 4.6 billion revenue with 32% gross margin and 25% EBITDA margin after adjustment. Net income after minority interest was TL 433 million with 9% margin. Glass packaging operations generated strong sales volumes with positive pricing and product mix and remained resilient through the COVID-19 outbreak. The pandemic began to affect all business operations from mid-March, excluding chemicals. In that segment, weaker TL, higher sales volume of soda ash and glass fiber supported chemicals operations, while chromium demand decreased due to extremely weak business activity in China. Lower gas prices in our Bulgarian plant, better product mix in Russia and Turkey and depreciation of TL supported glassware operations. Flat glass operations in Turkey were relatively strong in the first quarter, while revenue and profitability in Europe came down due to the continued downward trend in flat glass prices and lower architectural glass sales volume, together with the decrease in encapsulation revenue.

We started the second quarter by further prioritizing the aim to manage our operations in all operating regions and business segments successfully in these difficult times we have been through with global lockdowns, slowdown in many industries, deteriorated motivation of consumption, supply chain interruptions and enforced less working hours. Moving into the second quarter, April and early days of May were particularly challenging for flat glass and glassware operations and resulted in a total production level of below breakeven sales. We experienced significant decreases in capacity utilization rates and, therefore, negative profitability margins.

As keeping furnaces active has to be the main target in flat glass operations, we rearranged our production shifts, decreased our daily production units, used more recycled glass in production processes and undertook cold repairs in two lines of Turkey in Yenişehir facility. The automotive industry was hit hardest by the demand collapse and OEM shutdowns. In turn, we made planned downtimes to manage the inventory levels for our auto glass operations. Household consumption decreased dramatically at significant end markets of glassware operations, thus capacity and inventory optimization measures were also taken for this segment through production stoppages.

Moving onto slide four. As you may see from the monthly figures exhibited on this slide, our diversified portfolio proved its resilience in April and May with relatively strong performance, as seen in glass packaging and chemicals segments. Despite the negative impact of Ramadan and quarantine measures, positive pricing in our sales mix in all geographies together with resilient demand, mainly in domestic market and export markets of Turkey and backed our profitability levels. Russia, on the other hand, was relatively weak in terms of sales volume. After the completion of the cold repair in Pokrov plant, we started to closely monitor the market conditions and align our planning accordingly. Moreover, favorable currency environment was supportive for export margins, as we continue to build on our global footprint. Weak soda ash demand from flat glass producers was partially offset by incremental demand coming from glass packaging and detergent production industries while TL depreciation was again supportive for profitability in the Chemicals segment. Slowdown in global economic activity together with below 50% capacity utilization rate in leather tanning industry and production stoppages in auto industry acted as the main contributors to low sales volumes of chromium chemicals' products, which have given recovery signals starting May

From June, we have begun to see a strong recovery in Turkey, revival of our operations in Europe with an upward pricing trend and tight control on our Russian and Indian operations. We are also confident on pent-up demand playing out in the upcoming quarters for flat glass operations. Auto glass has already started to return as we expect positive impact of the recovery in this industry will increase by the pent-up demand.

With the improvement in HoReCa channel, we expect increased population mobility and re-openings in many economies of developed and developing markets to support performance in glassware and glass packaging operations, while chemicals will preserve its balanced composition. Underpinning our increasing confidence in the operating environment, Şişecam revenue has begun to tick up on a monthly basis from June and points out an expectation of recovery within the second half.

To summarize, in the first half, we recorded TL 8.8 billion revenue with 3% increase year-on-year while gross profit margin was at 29%, which decreased by more than 300 basis points year-on-year, while TL depreciation brought us some leverage. EBITDA after adjustments came in at TL 1.9 billion with a margin of 21%, that was narrowed by more than 200 basis points. Having the precautionary approach, TL 25 million provision expense was recorded in relation to Competition Board's investigation on flat glass business.

Net income after minority interest recorded at TL 518 million with a margin of 6%. We are comfortable with our results in this challenging quarter as June figures give us confidence in the second half outlook.

EBITDA margin came down to 11% in May after weak performance within the first two months of the second quarter compared to 25% of the first quarter level. Albeit, we started to record better sales after re-openings in mid-May, our capacity optimization measures for flat glass, auto glass and glassware segments that were planned in the early days of April and taking place starting mid-April brought down capacity utilization rates and deteriorated our profitability by fixed cost deleveraging of these segments and continued throughout May.

Operational performance in June drove recovery from 11% to 20% by the end of the month. We believe we may end the year with a higher topline figure year-on-year with a limited contraction in profitability levels. However, we preserve our cautious stance amid this volatile environment. We will continue to tightly monitor our discretionary expenses and reduce non-essential parts as much as possible to cope with these extremely hard times successfully.

Moving onto the next slide. Pandemic-related impacts and the required actions varied across our operating regions, and we closely monitored the needs of our regional businesses and responded rapidly. Russian operations were affected from coronavirus later than Turkey and Europe, and it was a challenging quarter for India due to strict lockdown measures in the region with disruptions to many aspects of our operations. As mentioned earlier, we took necessary measures in order to optimize our capacities and inventories in each region for the most affected business segments, and put forth extra effort on the distribution of our products in each region and in the export markets. Share of international revenues was at 59% in this half. No dramatic change was recorded compared to last year.

Moving onto page six. We have entered this crisis with a strong liquidity position and we distributed a total of TL 469 million dividend, paid off having matured $300 million worth Eurobond on 9th of May and did not use any emergency loans during this time. We ended the half in a net debt position of $819 million, made up of cash and cash equivalents of $1.7 billion, including financial investments portfolio amounting to $493 million, which are all held to maturity. 80% of this portfolio will mature in 2021 and 2022, and we will reconsider whether to reinvest in or not upon the market conditions. Outstanding debt was $2.5 billion with a term structure of 27% short, 73% of long, and 70% of fixed and 30% of variable interest rate structure.

85% of the cash and cash equivalents is in hard currency. We were short in TL during these times to preserve our long position in hard currencies and be able to fund Turkey operations. Şişecam's net long FX position amounted to $778 million after $300 million Eurobond payment that matured on 9th of May. Fitch Ratings has also affirmed the credit rating of Şişecam as BB and Its outlook as stable on July 2nd, 2020.

Moving onto slide seven. We reviewed and reduced the non-committed CapEx and spent €87 million in the first half; significantly lower than planned at the beginning of the year, which consisted of cold repairs and ongoing new line investments. We continue to have the flexibility to meet the crucial investment needs of our business and return cash to shareholders.

Our cash conversion cycle increased by 20 days quarter-on-quarter as we extended some payment terms in a controlled manner for strategic customers and initiated a supplier financing program. Please note, we have not experienced any material bad debt during this period. Negative free cash flow was recorded at TL 1.3 billion, mainly due to lower cash flows from operating activities.

Moving onto the next slide, we provide you some commentary on COVID-19. We implemented all possible measures to help protect the health of our business partners, customers, suppliers, and most importantly, our employees. Our Emergency Coordination Committee, chaired by Şişecam's CEO, quickly put a Pandemic Action Plan into place. We introduced a minimum workforce protocol to allow full social distancing in all our workplaces. We have switched to remote work practices and have planned annual leaves. We also introduced short-time work by ensuring to continue to have job security at those facilities most affected by the pandemic.

Our Procurement Presidency also quickly established the risk committee to monitor supply chain activities with sales and operations planning, critical procurement needs such as supply of critical raw materials, control of supplier status, and adopted emergency plans accordingly. This committee identified suppliers who are in financial distress or have funding problems and introduced a financing program in order to increase collaboration and support financially distressed suppliers. We, therefore, reached through this crisis with limited impact on supply chain and procurement processes.

Independent from this situation and an important part of our digitalization strategy, we see supplier financing program having a vital role in increasing cooperation with our suppliers and identifying opportunities to expand those relationships globally. Due to the shrinking demand in connection with global lockdowns and supply chain interruption, we optimized and adjusted our production and inventories quickly, mainly for flat glass, glassware, chromium chemicals and glass fiber operations of which key end markets of construction, automotive, leather, and metal plating and tourism that were hit hardest by this pandemic.

Our diversified portfolio continues to underpin our long-term growth strategy as glass packaging and chemicals operations exhibit resilience during this pandemic. They experienced continued demand in connection with food, mineral water, and pharmaceutical industries, and soda ash from glass packaging, chemicals and detergent manufacturers. A lean structure will enable us to increase cost awareness further, strictly monitor working capital needs by having a dynamic approach in these times of uncertainty.

Moving onto page nine. Following the COVID-19 outbreak, European Commission has agreed on a major recovery plan in relation with the environment on the center stage. As the importance of clean energy is getting higher, we are aiming to increase our presence by focusing more on solar panels in our flat glass operations in this sector. Considering disruptions of cross-border trade relations, we believe that Turkey would be a great alternative for exports to Europe and USA. Similar geographical advantages remain on the agenda for our different business operations. In line with the just-in-time production for auto glass in replacement market, nearby geographies are gaining further importance.

For glass packaging, recyclable healthy products and sustainable product supply are among the hot topics of the pandemic period. Trade wars between USA and China and regionalization in Europe could be in favor of our glass packaging exports. Similar to other segments, in soda ash, the group could possess its geographical advantage for accessing the Mediterranean Basin, Europe, Middle East and North Africa, and may increase its footprint.

Moving onto page 10, we would like to talk a little bit about V-Block technology. We are also aware of the importance of the glass industry, which increases day-by-day and has the ability to create sustainable solutions for the most critical global issues, such as the environment, climate, energy and healthcare. As part of our One Şişecam project, we continue to focus on renovating our competencies and prioritizing product development to achieve alignment with the digitally transforming world and changing customer need.

In response to the pandemic, we developed V-Block technology in a record time of two months, thanks to the 45-year R&D experience of Şişecam Group. This technology neutralizes viruses and bacteria on glass surfaces with a special chemical formula and hot coating method and provides 24/7 hygiene, which will initially be applied on glassware products. Patent processes for the formula and the application of the Antimicrobial V-Block Technology have been initiated. Following the completion of the necessary permissions, initial production is planned by the end of August, and it will be initially offered in Turkey and then to the rest of the world.

Moving onto page 11, on 27 May 2020, the first trade finance transaction on the Marco Polo block chain network in Turkey was made by Şişecam with İs Bank, Kuraray Europe GmbH and Commerzbank. We continue to innovate and use all the digitally available solutions to provide the best service and experience to our entire ecosystem including our customers and suppliers. We also established and started to operate a “Digital Fraud Detection and Control System” for payments made through banks. We are the first company using this system in Turkey. This initiative will help reach our goal of “End-to-end Digital Treasury Management”. Through this system, suppliers around the globe will be able to access any financing opportunities linked to their sales to Şişecam by means of a single global platform.

Lastly, our Sisecam Investor Relations application will provide our investors and stakeholders a toolkit to examine earnings results and reports as well as corporate governance and ESG materials. With this application, we hope your journey of Şişecam will be much easier. This will also be improved by offline access and push-up notifications.

Moving onto the next slide and coming to the end of the presentation. The final thing I would like to talk about is our One Şişecam project. We aim to merge Şişecam with four listed subsidiaries: Trakya Cam, Anadolu Cam, Soda Sanayii and Denizli Cam as well as Pasabahçe, which is not listed. The intention of this merger is to simplify the structure of Şişecam, which will help to consolidate its position as a global player in the glass manufacturing sector and drive further growth.

Moving onto page 13This is what Şişecam’s operations look like. The four main business areas we are in: Flat Glass, Glassware, Glass Packaging and Chemicals.

Across these 4 main business segments, we operate 43 production facilities, which are located in 14 different countries. Behind this, the corporate structure of the Group is currently very complex with 68 separate companies operating in 18 different countries. You can find a full breakdown in the appendix.

Under the current structure, operating and management principle of the groups are silo-based. Trakya Cam, Soda Sanayi, Anadolu Cam, Denizli Cam and Paşabahçe, each have separate managements under group structure and Şişecam has been acting as the final decision-maker.

The process of simplifying this structure has already begun, with Treasury and Corporate Finance, Investor Relations, Tax, Strategy, Human Resources now centralized for Sisecam Group while IT and R&D have always been centralized within the current structure for a long time. Centralization of the procurement function has already begun back in 2017. However, there is much more simplification that can take place to make Şişecam Group a leaner and more efficient operation to compete better on the global stage.

As the next phase in the simplification strategy, in January, we started the process of merging Şişecam with Trakya Cam, Anadolu Cam, Soda Sanayii, Denizli Cam and Paşabahçe

Through the merger, we aim to:

- create a single stock, with a higher free float and increased depth, which will have greater appeal to local and international investors
- positively impact Şişecam's valuation and create long-term, sustainable value growth for investors
- optimize operating costs, unlock synergies between business units, and centralize revenue generation leading to higher operating profit.

In terms of cost optimization, this will come through the centralization of Supply Chains at Phase I. We have plans to continue evaluating centralization of core operations to attain future synergies. The merger will also result in improved corporate governance and a more centralized key decision-making process. All these efficiencies will result in increased revenue generation, leading to higher operating profit.

Moving onto slide 15. This slide sets out the timeline of the merger, which already begun back in January. Last week, we received approval for this merger from the Turkish Capital Markets Board. We would like to thank all public authorities, mainly in particular to Capital Markets Board, CRA and Borsa Istanbul for their cooperation in each step of this exemplary high-volume merger transaction.

The next stage is the extraordinary general meetings, which will take place between 26th and 28th August for Şişecam and the four listed subsidiaries. If we get shareholder approval at the EGMs, we expect to complete the merger within September.

Moving onto slide 16. Prior to the merger process, we had already taken a number of important steps towards simplifying our structure. Firstly, the elimination of cross ownerships and the merger of same-segment production facilities operating in the same territory under one legal entity. This includes the merger of glass packaging operating facilities in Russia and Turkey and the merger of flat glass production facilities in Turkey.

The critical next steps of our transformation to One Şişecam include digitalization and bringing in operational excellence, by which we mean bringing in standardized and lean manufacturing processes. Digital transformation process, which has begun in 2018, will bring improvements in efficiency and communications. It will enable us to execute best practices and procedures faster and more efficiently. In this project, we are collaborating with PwC alongside SAP and McKinsey is supporting the PMO. Once the process is finalized, Şişecam will have all necessary means to employ AI analytics, advanced technologies on top of the cloud-based systems and big data handling skills, and further improve our agility and flexibility.

Moving onto page 17. To give you an example of how we have been simplifying the structure, I would like to talk through the centralization of procurement, which began back in 2017 and was a key milestone in this process. This initiative had begun internally at Şişecam and then developed further in cooperation with A.T. Kearney consultants. The outcome has been the successful integration of this function, which has proved our ability to benefit from other potential synergies across the business. In the first year of its implementation, when the centralization process was applied only to domestic procurement in Turkey, the Group saved 11% of the total value of contract-based purchases.

Since 2018, following the inclusion of all local and international procurement operations in this new structure, annual savings reached a yearly 4-5% run rate on supplier contracts. The contribution of savings on direct purchases account for roughly 55% of the total, while automotive and logistics' aggregate was around 35 to 40%, with the rest on savings in investments and indirect purchases.

The success of our centralized procurement is illustrated by this slide. You can see how our profitability has evolved in the last 4 years: the period in which we started recording the benefits of the centralization of Procurement.

For us to have a more comparable view of gross profitability, we have excluded the impact of local currency depreciation in order to show organic revenue and our profitability trend. Consecutive natural gas tariff hikes in 2018 and 2019 in Turkey had also 4%-5% dilutive impact on gross profitability

The graph shows that Şişecam Group increased its profitability [on the gross level adjusted to TRY depreciation and natural gas tariff hikes] from 30% to +35% since 2016, as a result of topline growth and higher operational efficiencies. Savings attained through the centralization of Procurement function has also contributed to our profitability

Moving on to the next slide, I will address our 'Operational Excellence' program, which has an important role in Şişecam's evolution. Since its foundation, Şişecam has continuously enlarged its scale of operations in highly competitive markets by adding sub-segments to its core business scope of glass production, by tapping international markets with exports and by adding new geographies to its operating territories, while we have earned the identity of a growing industrial company with a lean management. Being in the dominant position in all operating segments to date in Turkey, our Group has limited potential for growth in the domestic market. Moreover, we face fierce competition, higher operational complexity and more complex customer expectations in our international operations.

Therefore, we must rely on Şişecam's operational excellence to continue to grow higher revenue, profitability and return on invested capital with the competitive cost advantage. Our operational excellence priorities are, maximizing efficiency and effectiveness in all our operations, keeping a low-cost structure to manage financial resources, maintaining customer satisfaction with improved services in order to have sustainable customer loyalty and to establish long-term and strategic collaboration with all our stakeholders, primarily our suppliers.

Moving onto slide 20. Şişecam is already on the path to operational excellence with the projects we have completed in the last five years, and we continued the evolution of this process. Our operational excellence program is implemented in four phases:

- Process management will ensure that our processes and business practices maximize value creation and synergies
- Lean management will be the key to continuous improvement through agile and proactive management
- Structural and digital transformations will ensure the elimination of inefficiencies and will enable us to create strategic advantages through continuous improvement in operational performance
- Business perfection is the final step to make Şişecam best in the class

Moving onto last slide. The first phase of One Şişecam transformation will focus on the restructure to a unified organization. Operational excellence has already been the strategic focus of the company, and we plan to roll this out across the new business structure, including putting in place technological developments and digitalization initiatives through the value chain. We are working to unlock further synergies in order to boost the Group's revenue generation in the second and third phases.

We forecast that the centralization of supply chains will have a run rate of at least 200-300 basis points on EBITDA profitability, starting from two to three years after the merger. Centralization of supply chains will allow us to optimize production planning and logistics, which will contribute three fourths of the cost improvement at Phase I. The remaining one fourth is expected to come from the improvement of demand planning through centralization of supply chains. With this process optimization, Sisecam will be able attain its operational targets without needing to increase managerial-level headcount.

Now coming to the end of the presentation, I will be happy to take your questions.

Q&A

Operator

[Operator instructions]

Our first question comes from Daniel Zaczkiewicz, Barclays

Daniel Zaczkiewicz

Just got a question on CapEx reduction and the 70% of this was achieved in the first half. So what are the projects that have been canceled or delayed to achieve this? And should we expect to catch up in CapEx in the second half of 2020? Or is there some element of this CapEx drop that will be permanent?

Görkem Elverici

So in the first half, we roughly spent around $100 million in CapEx, and you may understand our position that during the pandemic, we decided to delay any projects, which are not aligned with already existing furnace building projects and cold repairs that will keep up our capacity as it is. And they are coupled with the operational excellence programs that we are running to improve the capacity utilization and the returns generated from these furnaces. So any projects, apart from this, have been delayed, and we are waiting for the market conditions to become much more clear to decide whether to delay or totally cancel, which we don't expect to happen. But we are also cautious on this side for the CapEx that we already planned at the beginning of the year.

For the second half, we expect roughly $150-$200 million of CapEx spending. But with this, I would like to remind that this is based on the assumption we are making from what is visible as of now. If there's a second episode or any other catastrophic thing happening that is affecting our geographies or the global macroeconomic outlook, for sure, we will reconsider our CapEx plan and make the necessary adjustments immediately.

Other Question: Ece Mandacı, Unlu

Ece Mandacı, Unlu

Thank you for the presentation

In your results release, it was stated that as of June, contraction in sales volumes had been lower than previous months. How is the outlook for July? Are there any visibility for recovery? What are the sustainable figures for net working capital and Capex going forward and your expectations for those in the second half?

Görkem Elverici

Thank you for your question

As of June, we have started to see recovery signals in all segments. The effect of pandemic on glass packaging and chemicals was very limited. Chemicals' business dynamics are very dependent on other business segments, but it has already managed to have alternatives compensating the loss coming from contraction in flat glass segment.

We also had alternatives for flat glass and glassware. We are now in a condition to send our products to Península Ibérica and USA where we had limited sales in the past.

Chemicals and glass packaging, with their strong operational performance, have always these B plans. We have the position to react fast in case we have negativity in any product or geography for those segments.

For July, I cannot provide you a detailed information, but there are developments supporting second half would be in a better position if recovery which was seen in June continues in the same manner or even better in the upcoming months.

For net working capital, it is obvious that our net working capital requirement increased within this period and we can say that it was intentionally. We will continue to have the responsibility to sustain our operations without interruption and support our suppliers and customers, which have strategic position in our supply chain in order to make them get through from this crisis with less damage. Thus, we will continue to have the opportunities coming from our cash position and leverage potential on our liabilities and design this process not to have additional financial burden.

We pay attention to control the increase in net working capital to keep it very limited and without resulting in additional financial cost on our numbers by considering the transfer pricing and other regulatory obligations. As you would appreciate, we have been through the greatest crisis in the world history.

I would like to emphasize that, sustainability of our operations and supporting our strategic customers and suppliers to make their operations up and running after the pandemic have the same priority level for us. As previously mentioned, we also decreased our Capex significantly within this period

We have decided to delay discretionary capex until the situation having clarity after getting over the pandemic at least for us. We also continue to invest for continuity of our operations and in operational excellence to increase efficiency and sustain our operations as strong balance sheet makes this possible.

We have roughly $100 million of Capex in the first half. For the second half, we expect roughly $150-$200 million of CapEx spending. Please do not consider any of these as final decisions, considering the extraordinary circumstances we are currently experiencing. If there is a second episode or any other catastrophic thing happening that is affecting our geographies or the global macroeconomic outlook, for sure, we will reconsider our CapEx plan and make the necessary adjustments immediately. I hope I was able to answer your questions.

Operator

[Operator instructions]

We have no other questions. Dear speaker, back to you for the conclusion.

Görkem Elverici

I would like to thank everyone for their participation, and I would like to remind that for both the merger process and anything affecting our operations, we will continue to inform our investors, analysts, and all the ecosystem with all the necessary tools. I would like to thank, again, for the participation for today.