Transcription for ŞIŞECAM A.Ş

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Corporate Participants

Görkem Elverici
Şişecam – CFO

Presentation

Operator
Ladies and gentlemen, welcome to Şişecam First Half 2018 Financial Results audio webcast call. I now hand over to Görkem Elverici, CFO; and Başak Öge, Investor Relations Director. Sir, please go ahead.

Görkem Elverici
Thank you. Good afternoon, ladies and gentlemen. I would like to welcome you to our webcast today where we will be talking about our half-year results and key developments that have had impacts on our operations. Today, I am together with Ms Basak Oge, our Investor Relations Director. 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. Before talking about financial performance in the first half, I would like to walk you through the economic and political landscape as well as industry developments here briefly that had significant impact on our operations.

Moving to slide one. I do not want to take your time about the macro and political events, but overall, we are benefiting from the solid economic growth in EU zone. As for Turkey, while weak TL is helping us, we are cautious about the growth rates going forward.

Moving on to page two. I would like to give you a brief update of the global as well as Turkish glass industries. Globally, a growth of 5% to 6% per annum is sustained. 77% of total glass production capacity in Turkey belongs to Şişecam. In the first 5 months, Turkey's glass exports volume decreased by 10% year-on-year while glass imports volume increased by 19%. Construction industry grew by 7% in first quarter of this year as government incentives towards the industry is less than market growth. Exports in automotive industry contracted by 4%, while production decreased by 3% in the first half. Exports in white goods continued to increase while production increased by 2% year-on-year. As for tourism, Turkey's revenues grew by 31% year-on-year in the first half as number of tourists recorded the same growth rates in the first 5 months.

Before moving on to the financial results, I'd like to talk about the developments that took place in our group in the first half of 2018 on page three, as we have had a quite busy half year. We announced an investment for an additional float line in Polatli to meet the demand in Turkey and surrounding regions in the wake of upcoming cold repairs, which will be operational most probably in 2020. The acquisition of Sangalli Manfredonia in Italy was completed in June for an amount of EUR 15.7 million, and it will be the second production facility in flat glass in Italy with an annual capacity of 190,000 tons, including the laminated, coating and satin lines. With this acquisition, we have become one of the top two largest flat glass producers in Italy. Here, we also acquired the remaining 50% stake in HNG, thus, wholly owning the company in India. An important development has been on the energy prices. BOTAS, the natural gas distributor, announced two consecutive price hike in tariffs throughout the first half of year, and although the total hike has been above our expectations, we are confident that we will be able to retain the current margin levels throughout 2018.

Şişecam distributed TRY 300 million dividend in May, and a total of TRY 775 million cash dividend distribution was made, including our group companies. Also last week, Anadolu Cam completed its fourth furnace investment in Eskisehir plant. Fitch Ratings reaffirmed our rating as BB+, changing our outlook from stable to negative following the downgrade of the sovereign. We are one of the two companies in the local market that can hold onto its ratings.

Now we can move on to the financial and operational overview section. On slide four, let's have a look at our financial performance in the first half compared to the half of the last year. Our company posted strong results in the first half as top line growth came in at 24%, which is significantly above the last 5 years' average of 12% as a result of very strong operations of the divisions. On the profitability side, excluding one-offs, EBITDA margin reached 25% and EBITDA grew by 26% year-on-year. On the bottom line, again, when adjusted for one-offs, 108% increase in net income after non-controlling interest reflects stunning operating performance of divisions as well as translation gain of our financial instruments, leading to a significant improvement on return on equity from 12% to 18%. We reported negative free cash flow at around TRY 1 billion as a result of higher capex, including the acquisition and dividend payment in the reporting period together with the translation effects. Capex-to-sales ratio increased to 18% from prior year level of 7%.

On slide five, we can see the historic evolution of our top line growth steadily increasing and EBITDA margins levels that were kept at or above sustainable level of 20%, in line with our strategy, thanks to robust operational performance across all divisions.

Moving on to page six, highest contribution to Şişecam top line continues to be from flat glass business on the back of strong pricing and demand environment, improved product mix and higher contributions of auto and encapsulation businesses. We have witnessed strong top line growth in glass packaging and chemicals too. While the pricing environment and demands have been favourable for both glass packaging and soda ash, chromium chemicals market also faced a robust growth, backed by higher sales volumes and pricing levels in hard currency. Increase in hard currency denominated sales and better product mix also supported glassware division's top line.

On slide seven, flat glass segment's EBITDA contribution increased from 36% to 38%; chemicals contribution increased from 29% to 31%; and glassware's share from 10% to 12%, driven by better operational performance of the division, while glass packaging segment's share remained at 19%.

On slide eight, I would like to talk about free cash flow generation. As I mentioned on the previous slides, roughly TRY 1 billion negative free cash flow was generated in the first half mainly due to increasing capex and dividend payment. However, operating cash flow continued to be strong at roughly around TRY 795 million.

Turning to the next slide, capex recorded at TRY 1.2 billion, including advanced payments made related to capital expenditures. We paid $85 million for the acquisition of the remaining 50% of HNG's share in India and took over the assets of Manfredonia in Italy for an amount of €15.7 million. TRY 100 million was spent for fiberglass investment, while TRY 114 million capex was related to furnace investment of Anadolu Cam in Turkey. $10 million was also paid for Pearl's asset takeover in Egypt within this half. Şişecam is not a high leverage company despite the robust investment undertaken historically. In the first half of this year, thanks to continued strong EBITDA generation, our EBITDA-to-Capex ratio came in at 1.84.

On slide 10, we can see the evolution of the production within the course of the years. In the first half, 3% growth in glass production was realized, driven by capacity increase in Yenisehir plant of Anadolu Cam. On soda ash side, improved capacity utilization levels resulted in 2% growth in production. Please note that in glass, while 55% of production is realized in Turkey, the remaining 45% is produced in the plants outside of Turkey, and in soda, 60% of the production is realized in Turkey and remaining 40% is produced in the plants outside of Turkey.

On slide 11, looking at the ratios, we continued to sustain the low and conservative net debt to EBITDA and net debt to equity levels, 0.5 and 0.12, 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 73% of total. While 42% of the loan has a maturity of less than 1 year, the rest is mostly maturing in a 1 to 5 years' time line. As for the interest rate structure, the portion of fixed-rate liabilities is standing at 63%.

Moving on to slide 12, we are seeing that Şişecam's strong cash performance continued in this period as well. Cash on hand decreased to TRY 2.9 billion from TRY 3.4 billion, mainly due to cash payments regarding acquisitions. More than 86% of all cash and cash equivalent is in hard currencies, including $500 million Eurobond investment. In September 2016, we started investing in USD-denominated Eurobonds as we are hedging the interest rate of our outstanding Eurobond, allowing us to benefit from a positive carry. As mentioned in our previous calls, this strong cash position gives us the flexibility of receiving cash in case of a viable M&A opportunity, while we also continuously seek better ways to optimize our already strong balance sheet management.

On slide 13, you can see that we continued to have a long FX position for $476 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.

On page 15, starting with flat glass, Trakya Cam delivered strong half-year result with 25% year-on-year top line growth with a strong EBITDA margin of 25%. With timely acquisitions in international markets, share of international sales reached 55% in the first half, while weaker Turkish lira continued to support our sales. Excluding currency impact, Trakya Cam organically grew by 13% year-on-year in the first half through a favourable product mix and pricing in European flat glass market, higher contribution from encapsulation and auto glass businesses and also solid demand and pricing in domestic market. Strong rouble and improved product mix supported our Russian operations, while demand in the region stayed muted in the first

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half of the year. Our Turkey operations, representing 50% of the total revenues, including exports from Turkey, grew by 19% year-on-year. Demand in Turkey was comparatively high for the last two years, while import volumes decreased year-by-year as a result of weaker Turkish lira and antidumping measures taken.

As we are running at full capacity in Turkey, we have experienced a significant increase in profitability levels in the Turkish operations on the back of price hike announcement despite cost-push inflation in the region caused by natural gas price hike and weaker Turkish lira. It is noteworthy to mention that 11% price hike made in April had a partial impact in the first half results, which will be more visible in the second half. We will add a new float line in Turkey in order to meet the demand in the country, and we will be meeting our market position and upcoming cold repairs. New line will become online most probably within 2020. Turnaround in auto glass units, which has been led by efficiency initiatives and better product mix back in 2017, takes root and demonstrates higher operational leverage in 2018 as favourable €/TRY levels continue to support euro-linked auto glass sales in the domestic market.

Encapsulation business demonstrated better profitability levels in 2018, driven by restructuring efforts and improved price-cost spreads. European margins maintained its prior year levels through flat glass price hikes, cost of product mix effect and better performance in encapsulation business despite upward trend in energy prices. Increasing trend in glass consumption continued in Europe as regional capacity decreased due to competitor's cold repair in the first half. We have acquired a second production facility in Italy and become one of Italy's two largest flat glass producers. The new line will be in cold repair and is expected to be operational within the second half of 2019. We also finalized negotiations with HNG to acquire its shares in the Indian plant, which will allow us to grow in the region, signalling promising future growth prospects for construction and automotive industry. Excluding payments for acquisitions in India and Italy, $40 million capex was made in first half, 23% was attributed to maintenance. It is noteworthy to mention that our 220k tons of capacity in our Bulgarian facility will be in cold repair starting September.

Moving on to page 16, in glassware segment, 13% year-on-year top line growth was recorded within the first half with an 18% EBITDA margin, mainly driven by price increases in all operating regions. Starting 2018, glassware segment has taken initiatives to reduce SKUs in its product portfolio by simplifying it with high-margin units. Our gross profit margin increased to 38% in the first half compared to the prior year's level of 35%. Execution on cost reduction initiatives and realigning business to focus on profitable product mix, lifted up operating income as EBITDA margin increased from 14% to 18%, owing to price hikes and enhanced product mix. Improved utilization levels in Russian operations also contributed positively to margin performance. Our efforts to penetrate into the potential markets continued throughout the year without compromising on the profitability and the share of our international sales was at 64%, thereby allowing the division benefiting from local currency depreciation in the first half of this year.

Our Egyptian facility has been operational starting 2018 and will play a key role for us to penetrate into export markets. It is also noteworthy to mention that there were revisions on useful life estimates of tangible fixed assets and its classification of employee termination benefits in glassware to reflect the actual conditions in the first half. These changes had a lowering impact on cost of the goods sold. Our intention to list Paşabahçe continues, and if market conditions for both glassware industry as well as the equity capital markets are favourable, we aim to find the right window of opportunity.

Moving on to glass packaging on page 17, we sustained the double-digit top line growth trend in the first half of 2018. Our consolidated revenues, recorded at TRY 1.4 billion, were 19% higher year-on-year on the back of average unit price increases in all operating regions and growth in consolidated sales volume. While we increased our annual average per ton prices in Turkey by 12% to 13% in the very beginning of this year, price hikes from Russian operations were implemented as usual at the end of first quarter of 2018 by 4% on average in ruble terms. Volume-wise sales performance of the domestic operations was limited, especially in the first 3 months of the year, due to brought-forward orders recorded in the last quarter of 2017 as the group decided to carry the pricing negotiations of the year ahead of that period. After having experienced a 23% decline in its domestic sales in Q1, Anadolu Cam was able to lower year-on-year volume contraction to 9% in the first half of 2018. Meanwhile, international sales volume grew by 10%, thanks to the beer and beverage market supported by the World Cup event held in Russia and the good weather conditions, portfolio strategies targeting seasonality, balancing and the growing demand for exports from both Turkey and Russia. As a result, we experienced a 2% growth in our consolidated sales volume year-on-year.

On top of the operational performance, 10% average appreciation of ruble against Turkish lira led to translation gains in the consolidation phase. With the combination of growing share of exports from Turkey and strong performance in other operating territories, international sales accounts for 56% of the consolidated revenues, up from 51% last year in the same period. Thanks to capacity utilization rates of 98% in Turkey and 97% in Russia and proper mix of SKU combinations but also the rising share of high value added products in the sales mix, our COGS-to-sales ratio came down by approximately 350 basis points and our gross profit margin increased to 30%. OpEx-to-sales ratio was maintained at 18%, parallel to the 2017 year-end level. Consequently, Anadolu Cam reported a 24% adjusted EBITDA margin. Within the period, we continued our fourth furnace investment in Eskisehir plant with 150,000 tons annual production capacity and the furnace is online since last week. Meanwhile, the furnace located in Yenişehir plant underwent a cold repair process between February and April, and at the end, the furnace production capacity increased by 30,000 tons per annum.

To sum up, our domestic production capacity increased by 18% to 1.2 million tons per annum compared to 2017 year-end. In other words, we continued to invest in maintaining our market leader position by adding local capacity in pursuit of meeting our clients' growing needs parallel to the rise in glass packaging markets.

Moving on to page 18, our chemicals division continued to operate with an eye-catching performance. While the top line grew by 25% year-on-year, our chemicals operations ended the first six months of this year with an EBITDA margin adjusted to one-off gains of 32%, which is 200 basis points higher than the profitability recorded in the first half of 2017. Sales volume growth of 3% in soda ash and 2% in chromium chemicals, coupled with respective average per unit price increases of 6% and 14% on a year-on-year basis, were the main contributors to the top line performance. Our revenues were also positively affected by the depreciation of Turkish lira against hard currencies, namely by – 12% against dollars and by 26% against euro on average. Share of non-group sales in our revenues has been rising with larger amounts of the output channelled to overseas markets in Şişecam glass companies first started to procure a portion of their domestic soda needs from the local natural soda ash producer back in 2017. International sales have reached 89% versus 83% in the first half of 2017.

Our ability to meet the steam needs through the utilization of both the coal-fired boiler and the co-generation system at the same time, continued to generate savings in per unit soda ash cost and in turn, to mitigate the negative impact of rising natural gas and raw material prices on its financial performance. In addition to that, capacity utilization rates reaching 100% levels in chromium chemical segment provide us further cost efficiency. Even though natural gas tariffs were raised twice within the first six months of this year, our cost-to-sales ratio came down by 100 basis points, and our gross profit margin increased to 37%.

OpEx-to-sales ratio was maintained at 16%, parallel to the level recorded last year in the same period. Demand for soda ash continued to be strong and the market was tight to some extent, where the recent capacity additions to the local natural soda ash producer was easily absorbed by higher soda ash needs of the end markets while around 1.5 million tons of production capacity went temporarily out of the market due to environmental checks and further implementation of the new production standards in China.

In the chromium chemical segment, pricing environments continued to be robust since the capacity closure of Lanxess back in the last quarter of 2017. OXYVIT, our Vitamin K3 and sodium metabisulphite production unit consolidated under the chromium chemicals segment, maintained its high gross margins and in turn, increased our consolidated profitability by 60 basis points on the gross level. Within the reporting period, Soda Sanayii made TRY 227 million TL Capex, out of which TRY 100 million was in relation with the ongoing glass fiber investment and the rest dedicated to operational efficiency and modernization investment.

Coming to the end of our presentation, I would like to draw your attention to a few key takeaways. As I am sure you will all agree with me, our results have proved our efforts on our key focus points that were part of the strategy that I mentioned in the previous calls. We have increased our top line and profitability levels with a continuous focus on operational excellence, leading to smart cost management. We have above-industry profitability levels, compared to our global peers, and we have a continuous focus on M&A opportunities on a selective basis. While both organic and inorganic expansion continued, we have not sacrificed from our profitability, which should give you further comfort given our aspirations to be among the top three players globally.

And now I will be happy to take your questions.

Question and Answer Session

Operator
Our first question comes from Ömer Ömerbas, AK Investment.

Ömer Ömerbas
I have two questions. First, on Anadolu Cam, you seem to be reaching full capacity utilization in Russia. So how do you see the output there for the next 1 to 2 years? Will there be a plan now to increase the capacity? And the second question will be on Trakya Cam. As far as I can see, the demand trends in the local market have been fairly good through the first half. How do you see the outlook from this point on in the face of the – like expected slowdown both in macro terms and maybe more details in the construction sector?

Görkem Elverici
Thank you, Ömer, for the questions. So for the first one, Anadolu Cam in Russia looking at the markets and the trend, it seems like there might be some needs going forward. But considering the things that have happened, especially in the last 5 years, in Russia, we're a little bit cautious but carefully investigating the opportunities, not only for greenfield investments , but also on the M&A side. The first half of the year was also supported by the World Cup event, and we would like to see this strong demand continue moving forward. Additionally, we would like to see how the markets and the competitors react, and also, we are looking for both M&A and possible greenfield opportunities. But considering the available capacities in Russia, possible M&A can be more likely in the upcoming years.

As for the construction industry, although we are very cautious about the local market conditions, carefully trying to observe what might be coming, especially in the upcoming quarters in the industry, at least leading KPIs, give us some comfort that demand will continue, and considering that we have availability of exports markets not only to Europe but also to the surrounding region with our production capacity, especially from Mersin, we decided to continue with the investment which might even be considered as a little bit late for Trakya Cam. But as we have already seen the demand and the KPIs, while being comfortable for some extent, we have the flexibility of switching to exports for any possible decrease in sales in Turkey.

Operator
Our next question comes from Evrim Dairecioglu, Yapi Kredi Asset Management.

Evrim Dairecioglu
Good afternoon, in relation to the news around the 9% hike in natural gas prices, do you expect further increases in natural gas prices? And is there a certain rule on the price hikes for the natural gas to be generally observed that the hikes are on a quarterly basis?

Görkem Elverici
Thanks for the questions. So I should admit that we don't know anything more than you know, especially how it is regulated. So we all know that for electricity price is a little different than it is for the natural gas prices. They only promise for the next month. So if you're asking whether we are expecting, there might be some further hikes. So as all the market analysts are expecting, we cannot say "No, it cannot happen." Rather, our focus is on how to get prepared

and react to a possible hike and what impact it will have on our EBITDA generation. So there are some markets like the flat glass market, you can react immediately, and in the OEM business, they are either in the formulation or bound to some negotiations that you make. So for us, it can happen anytime and we are getting prepared for additional price hikes, and considering that we have experienced natural gas price hike of appr. 50% in 1 year, back in 2012, we are prepared for the worst, and you know that roughly 10% increase in natural gas price is translating into 60 to 70 bps in our EBITDA. Our leading position in the market, gives us some headroom for some additional improvements to be made, especially in our prices. So for sure, we will react in different segments, in line with their natural positions in their respective industries.

Evrim Dairecioglu
Additionally considering current energy prices and currency levels, can you please share any price hike level for natural gas for the remainder of the year?

Görkem Elverici
Well, I believe that making a comment on our side is not that fair. There are industry experts who are better equipped or informed than we are but I should add that we check with different sources for all sorts of expectations in the market. But the initial levels were told to be roughly around 30%. We are always a little bit too conservative, especially for the cost increases when we are doing our budgeting. So we will react accordingly this time also.

Operator
Our following question comes from Akif Dasiran, BNP Paribas.

Akif Dasiran
I have two questions, please. First of all, my first question is related with your exports, especially for the glass-packaging segment. It seems that it's reached around 20% of your sales in terms of exports from Turkey or Russia, and it's quite high, in my view, for the glass packaging segment. So can you elaborate on these exports? Which countries, which markets are exporting mostly? And should we expect upcoming investments in these markets going forward? And my second question will be regarding your glassware business. There is a healthy growth this quarter. But most probably, it's coming from the FX side, I believe. What is your

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view going forward? When should we expect volume growth in glassware business in the medium term?

Görkem Elverici

Thank you for your questions. So starting with glass packaging, we were already announcing for so long that we have a real dedication for improving our exports portfolio. So as of now, I can say that we don't have a specific target for initiating some additional production capacities only to be directed to exports from Turkey. But having a widespread foot in the exports market, it's giving us flexibility to switch between the local and exports markets, depending on the market conditions. So this, I believe, gives us, to some extent, relief about if the demand in local market do not grow as much as we are expecting in the coming quarters or even diminishing to some extent, we always have our foot already existing in the export markets that we can increase or direct some most of the production capacities over there because we need to consider that it's an OEM business. So it's not like that overnight, you can decide to export and you have the necessary buyers waiting for you like it is in the flat glass business. So you need to have all the trial products made, all the approvals to be taken from the OEM stand. You have, to some extent, the necessary opening in the supplier portfolio to those OEM so you can do business with them. So we have been able to penetrate to the larger OEMs already in widespread geography. So I cannot name that it is only limited to a couple of countries. At Şişecam level, exports are spread around so many European and Middle Eastern countries and including some faraway destinations even like U.S. But none of those countries, excluding only one country, which is Italy, is beyond 10%, I should say. So it shows that the widespread portfolio that we can extend or just add some additional countries or increase the portfolio as necessary.

As for glassware, I can say that it is not coming only from the Turkish lira translation effect. We have been doing the turnaround of the glassware segment like our global competitors for the last 3 years, I should say, and we have done the rightsizing of our production portfolio, which is giving us enough opportunities that we can be selective in the SKUs, which was not the case before. Because to be able to fill the capacity, which is key in glass business, we were not selective and with the capacity optimizations we have done especially in the last two years, being able to pay the necessary one-off costs in the last 2 years' P&L, now we are in the phase that we are more selective in the SKUs, especially moving more onto the more profitable one, and the main performance is coming from that part. So I believe that we will continue to some extent with rightsizing of the portfolio within this year, and starting from next year and 2020, being very cautious of the global market conditions, we can consider increasing our production capacity, and we believe that especially, the acquisition we made out in Egypt is giving us real opportunities for a possible capacity increase.

[No further questions]

Görkem Elverici
Thank you very much for your attendance. We believe that it has been a very strong first half, and we will be doing our best to continue this performance in the second half also and hope to meet with you again, apart from the individual meetings and the conferences that we will be attending, for the year-end results in the next year. Thank you very much.

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