Transcription

Şok Marketler, 07/11/2019

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Presentation

Operator

Ladies and gentlemen, welcome to Şok Marketler Third Quarter 2019 conference call and webcast. I now hand over to Ms. Çağrı Demirel, Investor Relations Manager. Madam, please go ahead.

Çağrı Demirel

Good morning and good afternoon ladies and gentlemen. Welcome to Şok Marketler third quarter 2019 financial results audio webcast call and thank you for standing by.

Before turning to the call over to management, I would like to remind everyone 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. At the end of the presentation, we will be happy to take your questions.

On the call today, we have our CEO, Mr. Uğur Demirel, and our CFO, Mr. Ziya Kayacan. I will now turn the conference over to Mr. Demirel. Sir, please go ahead.

Uğur Demirel

[Technical difficulty]

…and reminding that we have similar trends in the first six months of the year, the current market trend also continued in the third quarter. Traditional channels continued to suffer, while discounters were the winners.

We, as Şok, recorded revenue growth of 36% in nine months and 32% in the third quarter, compared to the same period of last year, and as a result, we continue to sustain our leading position as one of the fastest growing retailers in the market.

When we turn to the consumer reflection, despite the ease in inflation rate in last months, high inflation rate resulted in a change on consumption habits, resulting in increase in price awareness of consumers, so increasing price sensitivity also resulted in acceleration in private label products and inflation. In order to benefit from this change all along the year, we continued to stress our marketing campaign and communication on Şok is Cheap concept, with a specific focus on our strong heritage brand and, for example, [inaudible].

To summarize what we have achieved in another challenging quarter of the year. In the third quarter of the year, despite ongoing volatility in the market, we have continued our new store openings, which reflect our trust in unique and defensive business model. As of September 2019, our total number of stores exceeded 7,000. With 159 net new store openings in the third quarter of the year, we are keeping our yearend guidance of opening 800+ new stores, and in nine-month period, we have reached 639 net new store number.

We have recorded 36% revenue growth in nine-month period an 32% revenue growth in third quarter of the year. Our like-for-like sales grew by 20%, which is including remarkable traffic growth of 5%, and I can say that we clearly continued to keep our leading position in the market in terms of revenue growth. Our EBITDA margin was 5.2% in the nine months, while 5.9% in the third quarter of the year, mainly due to higher operating leverage supported by successful cost management initiatives. We have finished the nine months with nearly TL 200 million positive free cash flow.

Let's move to the next page for key figures of the period. In the third quarter, our net sales increased by 32% and reached TL 4.3 billion, despite high base of third quarter of 2018 and volatile market conditions, thanks once again to our dynamic and defensive business model. Our like-for-like sales growth per store also showed a good performance of 16.9% in this quarter with noticeable traffic growth, and our EBITDA number was recorded at a level of 254 million with 5.9% EBITDA margin excluding IFRS 16 impact.

As I mentioned at the previous slide, we have continued our store openings in the third quarter and opened 159 net new stores. In nine months, our net sales increased to TL 11.8 billion, with 35.7% growth and we finished the period with 27% like-for-like growth. In nine months, our EBITDA, excluding IFRS 16, was TL 612.3 million and EBITDA margin was 5.2%. Currently, we are serving our stores with 27 warehouses across Turkey.

Now, we may talk all store opening details at the next slide. In the third quarter of the year, we continued to enlarge our footprint in line with our yearend target. Total number of new store openings reached 639 and our total number reached to 7,003 stores. For our long-term strategic outlook, we believe that there is a huge, wide space opportunity in the market. Current market conditions also catalyze some opportunities, and we are giving maximum effort to benefit from these opportunities, while keeping our eye on payback period.

Let's move to the next slide. In the third quarter, our consolidated net sales grew by 32% and increased from 3.3 billion to 4.3 billion, despite high base of third quarter of 2018, supported by the current downtrend in inflation rate. Our remarkable traffic growth continued in this quarter as well. On a year-to-date basis, with the support of strong traffic and new store openings, we have recorded 35.7% increase in nine months compared to the same period of previous year. All these figures show that we sustained our leading position to be one of the fastest growing retailers in the market.

Let's move to the next page. We have predominantly continued to focus on traffic growth in the third quarter, as we mentioned, in the different platforms. Traffic growth is a key metric of our growth strategy. In the third quarter of the year, our traffic growth was recorded at 4.1% and 5% in year-to-date. The increasing share of private label in total sales and continued downward trend in inflation, in addition to high base effect of third quarter of 2018 resulted in relatively lower basket size growth compared to previous quarter. In the third quarter of the year, our basket size growth was recorded at 12.3% and at 14.2% in year-to-date. And, as a result, our like-for-like growth increased by close to 17% in the third quarter, while almost 20% in nine months of the year. The private label share in total sales was still high in the third quarter as a result of changing consumer sentiment in the market. Our private label share reached 32% in the third quarter. As of end of September, our like-for-like stores constitutes only 67% of total stores. Having a young portfolio enables to feel confident and optimistic in terms of higher top line and higher operating leverage.

Now, let's talk about the financials, Ziya.

Ziya Kayacan

Good morning and good afternoon ladies and gentlemen, I welcome everybody here again. I will briefly take you through our third quarter and nine months financial results.

On page eight about the gross margin, after having a considerable improvement in our gross margin in the second quarter after the end of the inflationary campaign, our gross margin relatively sustained at second quarter level and, therefore, recorded a 23.5% gross margin in the third quarter of the year. Increasing share of private label product, lowering our gross margin level, was balanced with our product mix, especially supported by [local] price increase. Compared to the same period last year, our gross margin was relatively low, as you can see, follow from the margin evolution graph on the right. To remind that the third quarter of 2018 was the start of high inflationary period, where we had experienced significant price increases, which positively contribute to gross margin level, as one-off inventory gain. In cumulative, our total gross margin in the nine months was 24.2% versus last year number of 23.3%. The first quarter inflationary campaign had ongoing direct impact of private label share increase on gross margin, resulting in lower gross margin on year-to-date basis, while tobacco price increase is a negative impact on margin deterioration to some extent in the last months. We should also point out once more that there is a partial impact of one-off inventory gain recorded at inflation last period last year when we compare quarters in a cumulative basis compared to last year.

The next page is about our cost performance and, as you can see from the numbers on this page, we managed to decrease our operating expenses over sales ratio with a continuous focus on operational excellence and smart cost management actions, despite the cost pressure due to increased inflation. We succeeded to decrease our OpEx to net sales ratio to 16.7% in the third quarter, which is 30 basis points lower than previous quarter and 80 basis points lower than the same period of previous year. In the third quarter, we continued to negotiate on both our rental contracts and linked to inflation, you know that its increasing due to inflation, and we continue to achieve strong results out of this action. Besides this, we continue to utilize from higher operating leverage as we emphasized at our previous communication with you.

I would like to mention one important point that we don't have any FX exposure in our cost items.

With this, let's move to page 10 for our EBITDA performance. In terms of EBITDA, we managed to increase it to 254 million, from the level of 228 million, excluding IFRS impact, indeed this quarter, with an EBITDA margin of 5.9. As we mentioned at the previous slides, due to high base of third quarter of 2018, which created a one-off inventory gain following inflation-based price increases, our EBITDA growth was limited. With the impact of new standards, EBITDA margin reached to 9.8% in the quarter, and in absolute terms, EBITDA increased to almost 423 million. After having a considerable improvement in our EBITDA margin in the second quarter, after the end of inflationary campaign, our EBITDA margin relatively sustained at second quarter level and, therefore, we recorded 5.9% EBITDA margin in the third quarter of the year. We succeeded to keep our EBITDA margin at 5.2 level in nine months, in line with our yearend guidance.

On page 11, I would like to give an update on our bottom line profitability. Gross margin erosion in the first quarter and half of the second quarter due to inflationary campaign caused some deviation in our nine months targeted profitability levels. On the other hand, we achieved to reach breakeven levels in net profit for the last two quarters. In these circumstances, before IFRS impact, our third quarter net profitability was recorded at breakeven levels, while our profit before tax number was 15.8, almost TL 16 million, again thanks to higher turnover levels leading to operating leverage, supported by quite successful cost management initiatives, and also recovered our gross margin level.

Cumulative basis, before again IFRS impact, we recorded almost TL 64 million loss, with the impact of the first quarter apparently. Although it seems even lower than last year, please let me remind you that we have recorded one-off deferred tax income in 2018, excluding it, we performed much better than last year on cumulative basis as well.

Let's move to slide 12 for our performance on CapEx. On page 12, as you can see that our CapEx over sales ratio decreased significantly from 3.1% to 2.1. In order to remind you, we opened 639 new stores and one warehouse in nine months. Of course, we are keeping an eye on our payback period, clearly, with our cost management initiative like in OpEx side, such as negotiation with suppliers and contractors, we succeeded to decrease our…

[Technical difficulty]

…we finished the quarter with a positive free cash flow of 200 million, and it gives us a strong balance sheet, clearly gives us strong flexibility, of course while increasing our operational performance.

In the next couple of pages, 14, 15, 16 and 17, I would like to give some update on the consolidated income statement. In the third quarter, net sales increased by 32% and gross profit by 23%. OpEx to net sales decreased from 18.4 to 17.6 quarter-over-quarter, while our EBITDA margin was recorded at 5.9 excluding IFRS, and our net income excluding IFRS 16 was at breakeven level, as I already outlined in the previous pages.

In cumulative basis in nine months, our net sales increased by 36, gross profit 31, OpEx to net sales ratio decreased from 19 to 18% [audio]. Excluding IFRS impact, our EBITDA increased by 34% and EBITDA margin recorded at 5.2% excluding IFRS impact, which is in the range of our yearend outlook.

Regarding consolidated balance sheet, as you can see from the related pages, we already touched our working capital, CapEx and cash performance at previous slides, therefore, here I want to underline that we have a much stronger balance sheet structure and it gives us great flexibility doing our expansion plans.

Now, at this stage, I would like to leave the ground to Mr. Demirel for the closing…

[Technical difficulty]

Uğur Demirel

Thanks, Ziya. I would like to close the webcast by our expectation for the rest of 2019 and with a summary of latest development on the fourth quarter, and then we will be happy to take your questions.

As Ziya also mentioned, we experienced relatively high inflation rates starting last year third quarter, and in the first and second quarter of this year. Starting with the third quarter, we have observed a downward trend in inflation rates, this trend and last year's high base resulted in a lower growth level. It seems that this picture is also going to continue at the last quarter of the year. In any circumstances, we at Şok, we have continued to keep our leading position in growth by focusing on new store development, keeping an eye on traffic growth, take new initiatives to sustain our gross margin, while continuing strict cost management initiatives. In short, we fully concentrated on fulfilling our strategy.

We spent TL 250 million CapEx in these market conditions, which was mainly driven by new store openings and created job opportunities, around 3,000 people in 2,000 so far. Obviously, as management, our focus in our operation is to enhance our footprint while increasing our traffic per store, and we are planning to increase our top line with the support of increasing traffic number in our mature stores.

In this type of volatile market environment, cost management is a very crucial item. Due to high inflation that has been experienced in the last three to four quarters, we had an important pressure on the cost side like other retailers. Nevertheless, we succeeded to manage our costs quite well. We focused on management of the rent, logistics, and energy costs to reduce the inflationary hit to maintain our operational efficiency levels.

In terms of cash management, we generated and we are focused on generating further cash in order to support the coming year's expansion plans. We are also working on several initiatives in order to increase our traffic in our stores, decrease our cost, and increase operational efficiency. For example, during the third quarter, we have continued to invest in direct procurement for fruit and vegetables from farmer to store. Another example, we have also developed smart financial solutions for our customers in our stores to increase traffic and customer loyalty and have started the financial services with utility invoice payment service. With utility invoice payment service, customers can pay their electricity, water, telecommunications, natural gas invoices of contracted providers, while making their shopping. I can proudly say that we have the highest wide space, widespread network in invoice payments in Turkey with our 7,000 stores. The convenience of carrying out similar transactions at doorstep will bring us traffic and customer loyalty and increase our brand equity in the coming periods. In the fourth quarter, we will continue to focus on these consumer-centric new initiatives in order to increase our top line and traffic.

Besides these initiatives, we are aware that our sustainability is strongly linked to our development with societies living in the regions where we operate. In this sense, we are aware of the importance of supporting women's participation into the business life. So in order to support the empowerment of women to participate in socioeconomic life and financially empowering the women, we are taking a role in some social responsibility projects. We are selling handmade shopping bags made by the housewives in our stores. It is a non-profit project for Şok. This social responsibility project is very well appreciated by the housewife community.

We are also managing our human resources process based on diversity in line with HR policy, and I can proudly say that current rate of female employees in our company is 44%. In 2018, the rate of the women returning to work after maternity leave was 98% in our company. I can say that we have continued to contribute positively the employment in Turkey with our new store openings and our total number of employees increased to over 30,000 people.

Recently, we were awarded in the highest number of employees category within the scope of Fortune 500 with the employment created. Şok is one of the top 10 companies that is steadily increasing its employee number. We are also giving at most importance to corporate governance and I would like to inform you about the recent development in our board structure to support this.

As it was approved at the Extraordinary General Assembly Meeting held on 31st October 2019, the board seat number increased to eight from six with two new board members. With Extraordinary General Assembly Meeting, it appointed one more female independent board member and our female board member percentage increased to 25% and three independent board members.

Finally, I would like to say thank you to analyst community and esteemed shareholders and investors, which always support us.

So with that, now, we will be happy to take your questions.

Q&A

Operator

[Operator instructions]

We have a question from Conroy Gaynor from Bloomberg Intelligence from London. Please go ahead.

Conroy Gaynor

Hello, Conroy Gaynor from Bloomberg Intelligence. Thank you for taking my question. So I wanted to ask, your gross margin fell around 190 basis points in Q3 versus 2018, how much of this was because of the lower inflation impact versus last year and how much of it was because of the increase in private label share?

Ziya Kayacan

You are right. There is a discrepancy, as you already outlined, almost half of it comes roughly from the one-off last year inflation increases and the remaining is mainly from the private label percentage increase, and a part also related to – you know that we have partly a financial charge on it, which can differ according to interest rates applicable in the market. So there are three things, but mainly the last year one-off inventory gain and private label affected this.

Conroy Gaynor

That is very helpful. Thank you.

Operator

[Operator instructions]

The next question comes from Cemal Demirtaş from Ata Invest. Please go ahead.

Cemal Demirtaş

Thank you for the presentation. My question is related to operational efficiency. Considering the declining inflation right now, what kinds of efforts you will have to improve the operating efficiency when we are in a heavy competition by all discounters or the other retailers. What are the actions you are planning going forward in this environment.

Another question is related to the impact of financing cost of your payables. It is similar in the second quarter and third quarter, do you expect some decline in the interest rate you are paying your purchases? Do you see any improvements for the following quarters? Thank you.

Ziya Kayacan

Cemal Bey, thank you very much, first of all. For the, of course, operating leverage, there are two folds of it. The first one is sales revenue increase. You know that inflation is getting down and our basket size, we try to align it with the inflation increase, of course, you know that we are able to pass as much as possible to our shelf prices. But what is important to traffic growth, we are kind of delivering very strong traffic growth, which will affect our operating leverage for the coming periods as well, although the inflation low.

Another part of the leverage, of course, the cost management. Cost management, of course, the ease of cost pressure because of the inflation will help us. Beyond this, we have our own initiatives like cutting electricity cost and improvement in our negotiation with suppliers on the logistic side, and rental fees negotiation, although the inflation coming down is still in our agenda and we are executing it, of course, headcount [on non-cards] follow-up and strictly control it, is another theme we already achieve very good results. All these things will help us to keep our eye on or deliver the operating leverage in the coming period.

Coming to financial income on trade payables, of course, you know that that impacted our gross margin a bit, as well as our financial expenses. In the coming period, since the interest rates are going down, we will see some dilutive impact on our margins, but financial expenses side in positive way, so no hurt, or no impact on our net income level. But, of course, as interest rates are going down, we could have some dilution on relative figures, but no impact on our net income as I said.

Cemal Demirtaş

Thank you. As a follow-up related to monthly changes from September to October, do you see some changes in consumer – the consumer behavior in this environment, because we have seen some increase in tobacco prices, and in that environment, even we see the beverage sales are declining. In third quarter, there were some interesting things happening because of maybe less disposable income of the consumer and tobacco was an important item. Do you see any changes in July, August, and September, inflation starts declining by September, do you see some changes in behavior starting by October or early November, just from your long time experience in the sector, do you see some changes in the consumer behavior lately? Thank you.

Ziya Kayacan

Cemal, you know that July and August because since there is not any high base still last year, but July and August was relatively good growth levels because of this, but starting by September and even October and November even, we will see high base impact of the last year which clearly affects our growth levels, for everybody in fact. But in terms of consumer sentiment, things did not change so much in September and October, and in terms of our performance in traffic growth, which is very clearly important for us, we are still going in the right direction and we see good numbers over that.

But in general, other than the high base lower wage impact and inflation, the consumer sentiment did not change so much from September and October, at least this is what we see from our numbers, but as I said, the basket size is relatively affected because of high base of last year's peak in inflation.

We don't see the big demand increase, that kind of thing; things are in line with the previous trend.

Operator

[Operator instructions]

Ladies and gentlemen, there are no further questions by phone. We are now ready to take your questions over the webcast. Thank you.

Ziya Kayacan

There is one question about personnel costs, this is, I think, if I am right on this. The question is, "Can you talk a bit more about the personnel costs, it seems to be much higher than the industry average. How much we can expect it to reduce in the near term?"

This could be true as a pentane of sales, but on the other hand, if you look at it on TL basis per store, we can say that we are performing well compared to industry average. Our number of people per store, which is close to 12 people almost, which is below the industry average, and personnel costs are almost the same per person, because of minimum wage generally, so in terms of TL basis, we cannot say that we are not performing well compared to industry, even we are much better in that sense, but as a percentage of sales, of course, it is much more related to sales per store, sales actually per store, this is also much more related to how much percent of our stores are mature. So as our store becomes mature, our sales, actually, per store increases. You will see the percentage of sales of our personnel costs also will decrease, and this is the case over the quarter.

The second question is about the two or three main areas that will enable and will lead to profitability.

Of course, we want to continue this strong like-for-like, especially traffic is key, to grow in positive terms considering above inflation, which is important.

The second one, young stores will clearly be mature over the quarter and, as you can see, this is operating leverage we are getting advantage year-on-year basis. Of course, to keep gross margin at a sustainable level is clearly important. And the cost management, of course, this is the fourth one, I should say, this will be always in our agenda.

Another question about in the next three to five years, how many stores do you think that you can open without cannibalization, and about the competitive landscape, what is the last update.

The first thing that we don't see any risk of cannibalization, a significant one in the medium-term, so our five-year outlook since IPO time, let's say, still it seems that we can achieve it, and that maybe three to four years' time, we don't see significant cannibalization in the current macro environment. Why I am saying that, still, the modern channel keeps around 45 while the traditional channel keeps 55% of the market and significant number of players in the market and only discounters are growing and Şok is growing faster, so that these are the things why we don't see any cannibalization risk in the near to medium-term.

What was the second one? Just a second. Competitive landscape, it is going on, not so big change, let's say. As I said, modern players are penetrating more and more, especially discounters, and as Mr. Demirel outlined that mom and pops stores (traditional channel) in negative level, so lower than inflation, especially this increase when the inflation hike came, and still continues. This is the latest update on competitive landscape.

"Current share of private label", another question, it is about 32% while last year same quarter, 32, but year-to-date there is almost 3-4% increase period-to-period basis in nine months, let's say. It seems that current macroeconomic environment also leads to higher level of penetration in private label.

We don't have any target for private label. You can see that we discussed – the discussion that we don't have any private label target, but the customer will decide on, because we are providing both private label and branded products to the customer's attention.

Operator

[Operator instructions]

Ladies and gentlemen, there are no further questions. This concludes today's webcast. Thank you all for your participation. You may now disconnect your lines.