Tat Gıda Sanayi A.Ş.

Tat Gıda Sanayi A.Ş. First Quarter 2018 Financial Results

Conference Call

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Conductors:

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OPERATOR: Ladies and Gentlemen, thank you for standing by.

I am Gelly your Chorus Call operator. Welcome and thank you for joining the Tat Gıda Sanayi A.Ş conference call to present and discuss the First Quarter 2018 Financial Results.

At this time, I would like to turn the conference over to Mr. Ahmet Çağaşan YILMAZ, CFO.

Mr. Yilmaz, please proceed,

YILMAZ Ç: Hello, dear participants. Welcome to the Q1 financial results call conference of Tat Gıda. I would like to give some brief information about the First Quarter Results of Tat Gida.

I would like to start my presentation with the net sales breakdown by categories. I would like to state that we finished the year 2017 with 9.5% increase in turnover. The 2017 turnover was 1.074 million Turkish lira. When you check it by category, tomato segment turnover is 374 million Turkish lira, and in dairy we had 635 million lira of turnover in 2017 full year. The sales growth was flat in tomato, growth in dairy was 17% and in pasta, we realized 12% of increase in 2017. The turnover realized for Pasta category was 65 million Turkish lira.

Now, I would like to come to the main subject. the quarterly turnover breakdown. In Q1 2018 our turnover is 264 million Turkish lira. This is almost the same level like the previous quarter of 2017. In 2017, Quarter 1, we realized 265 million Turkish lira of turnover. When you check the turnover by categories, we see that in tomato segment, the total sales amount which is realized is 96 million Turkish lira, the growth is 2.4%. In dairy, the total turnover realized is 154 million Turkish lira and the growth is 1.8%. In pasta, we realized 14 million lira of turnover and the sales contraction is 30%.

I would like to give you some brief information about segments. The main drivers or the main issue in Q1 was especially passing the cost pressures to the market, and I will be telling some highlights about this in the following profitability slides as well. Nevertheless, this had some sales effect as well in Q1. Passing the cost pressures to sales prices has really put some headwinds in against of us, in realizing our volume targets especially in the Q1. And this had some minor effects on the profitability as well. This factor mainly affected the dairy segment.

In gross profit… the gross profit percent is 22.6, in the first quarter of 2018. The total gross profit that we have generated is 60 million lira more compared to the previous quarter of 2017.

As you see in this graph we illustrate, gross profit evaluation; despite the mentioned cost pressures which happened in 2018, we realized, almost the same level of gross profit generation in amount and we have kept our margins, let's say, better in gross profit margin side.

On the operating profitability, we realized 9 million lira of operating profit, which corresponds to 3.3% of operating profit margin. In the previous quarter of 2017, the operating profit was 10 million Turkish lira and the operating margin was 3.8% as a percentage.

And let me state some more facts about the EBITDA margins. In EBITDA level, we generated 12 million lira of EBITDA in the first quarter, and this is 4.4%. In the previous quarter 2017, the EBITDA margin was 4.7%. We generated the same level of EBITDA level in amount wise in the first quarter of 2018.

And I would like to briefly mention facts about the income before tax. The income before tax margin realized in the first quarter of 2018 is 4.1%, the total income before tax that we have generated is 11 million Turkish lira. In the previous quarter of 2017, in the first quarter of 2017, the income before tax which we have generated is 15 million Turkish lira. So we realized 4 million Turkish lira of contraction in income before tax compared to the previous quarter.

And I will be mentioning some net income level. In the net income, we generated 10 million Turkish lira of net income and this corresponds 3.9% of net income margin. In the previous quarter of 2017, it was 12 million Turkish lira and the previous quarter's net income margin was 4.4%.

I would like to give you some brief facts about the Company's net financial debt to EBITDA. In the first quarter of 2018, we finished the quarter with 62 million lira of net financial debt. The recent leverage ratio, or net financial debt to EBITDA, EBITDA we are taking as a rolling perspective, is 2,0. The net financial debt is 125 million TL.

And these are the brief results or outcomes of Q1, 2018. And if you have any questions with respect to categories and if you have any questions about the financial results, please don't hesitate to ask and I can answer you now. Thank you very much for listening to me.

Q&A

OPERATOR: The first question is from Mr. Kumar Sahil with Moody's Analytics. Please go ahead.

KUMAR S: I am Sahil from Moody's. Thank you for the call presentation.
I have two questions, the first one is on your raw material prices in the milk and dairy segment and in the tomato segment. How do you see your raw material prices in the coming quarters and would you be able to pass on the increase in costs to the market because it seems when you start increasing the prices, there are competition in the market, which the other players trying to increase the

market share, so how you see this thing in the coming quarters?

YILMAZ Ç: Thank you very much for your question. Especially, the main issue was the raw material prices as I mentioned in the first quarter. Turkey has been going through really hard times from the inflation pressures point of view. As you know, there is a stubborn inflation trend since three years especially in the food inflation. It's always double-digit and it's over-passing the total, let's say consumer price index especially. If the consumer price index is 8, so food inflation is 12%, and every time there is a gap of 3 points or to 4 points in the food inflation. And this overshooting is still continuing and in our industries, unfortunately I would like to mention first of all the dairy, that the raw milk price increased 35% in the 14 months period. This increase is not only limited to the raw milk, but also the packaging cost which is directly correlated to the euro due to the Turkish lira depreciation has already increased. Labour and other major inputs (like energy) is also having a cost pressure on the final product.

All these pressures, you need to pass through the price. And after passing it through the price, taking into account, the current macro environment, end user confidence, and especially the shrinking disposable income, it’s not, let's say, turning into trade in an efficient way. This quarte did not let the players to fully reflect their cost pressures as an increase to their shelf prices due to the weak end user sentiment and strong trade down tendency.

However, I believe, that in the dairy, we just pass through most of the shock and it's partially reflected to our quantities. Nevertheless, now the market is stabilizing and most of the players are increasing their price because there is few to do to survive in such high inflation environments. Especially raw milk is around 80% of the cost of goods sold. And you need to reflect this reality into your sales prices. Especially, the competition in the first quarter came from the private labels, the hard discounters were rather less aggressive in shifting cost increases to their prices. Nevertheless, we see that the shelf prices on the private label site is step by step going up as well and it needs to do so.

On tomato, the industry is rather static compared to dairy. As you know, tomato is an industry that you build up the inventory from July to September in tomato season and you sell the products throughout the year. In this sense, the costs are mainly generated from July to September period and we already had the costs of the tomato especially in the tomato products. As you know, we sell some non-tomato products as well in our portfolio. In that sub segment, there are cost pressures as well, but we are rather not affected from these increases. Now we are looking forward to the new tomato season. In the new tomato season, I believe that this cost pressures, this high inflation environment's outcomes will also be effective on the costs as well.

So at that time we will be shifting the cost pressures through our share prices as well, and we will be checking the competition dynamics as well in the tomato. And…however due to the expectation in the tomato that the raw material prices are up to increase, we see some, lively demand as well. And, of course, after passing all these cost pressures to prices, we will have better & stronger turnover levels with the same quantities as well. As long as, we shift the prices and we don't experience demand issues, we will be maintaining better gross profit generation capability in TL terms as well in the following quarters.

KUMAR S: Yes understood. So do you see your gross profit margin to increase in the coming quarters considering that you are saying that you would be able to pass on the prices, and how you see the full year gross profit margin in that case?

YILMAZ Ç: As TAT, we are not providing any guidances. TAT is not a guidance company. Nevertheless, this excessive or overshooting price pressures coming from the raw milk will not have this immense effect on our margins I believe. Also the main issue was that the high shelf prices of the branded players led to some down trading and also played negative role on sales quantities of the branded players. However, this issue needs to be stabilize in the further quarters. This is our expectation. Nevertheless, on the margin side, the margin is mainly tied to the fact that what kind of portfolio you are going to sell in the following quarters. We believe that tomato demand will be rather strong in the following quarters, and tomato has a better contribution to the margin despite the fact that we don't disclose the margin by categories. I can state that tomato segments…lively tomato segment sales will have positive effect on the gross margins.

KUMAR S: So you are saying that the worst has happened in first quarter and we see a gradual increase in the coming quarters, maybe like in the second half of the year.

YILMAZ Ç: That was another question. I cannot give guidance on this issue. Nevertheless, I would like to state one more temporary factor. I mentioned to you this, price ups and the effects on the shelf and the competition dynamics, especially on the dairy. And another thing is that we shifted our ERP system from an old platform which is called Netsis and Oracle to a new platform SAP. And we are now using highest version of SAP. The company will be utilizing a lot of benefits in terms of visibility and up to date ERP system of the new platform in the coming quarters.

Nevertheless, especially in the first month of 2018, in January, due to the change in the system, due to some adaptation of human resources to the new processes, some re organizations, had some quantity effect on sales figures. The issue recovered very fast compared to our expectations. In February and March, we are pretty much okay. In April, we are rather okay as well. I think this is a temporary effect which affected the Q1 as well, especially from January effect. This fact is not valid in Q2.

KUMAR S: Okay, understood. Thank you. That's all from my side, I guess.

YILMAZ Ç: So anymore verbal questions or I can pass through…work through some questions which come in a written form.

OPERATOR: I will now proceed with the webcast participants questions. We have a question from Mr. Pocar Melis with Oak Securities. "Can you enlighten us on reasons behind weak 1Q results, volumes, margins, dairy volume down by 22% plus the segments volume decline 33%?" The same participant has a second question, "Can you give us some color on Q2? Are you observing pressure on consumers taking into account recent adverse, macro developments?" Thank you.

YILMAZ Ç: So, I mainly mentioned about the highlights of the Q1 results, the volume drivers. I mentioned to you the temporary effects such as this shock of the cost pressures or increasing highly increasing shelf prices and its effect on the demands. And apart from these volume issues, we believe that we really maintained our margins in a way let's say that contraction in the EBITDA is rather less than anticipated because we are sticking to the strategy that we are now launching new product lines and the value added products to the market. And in this sense, profit generation capability of the company is rather high compared to the normal conventional competition products. We call these highly price sensitive products; commodity line. These new product lines and high value items enabled us to at least maintain or generate better gross margins in the Q1 2018.

Our main issue was the volume issue, that the shelf price increase was not really well absorbed by the end user and the second thing are ERP change played the temporary role in January, especially in one month sales. So, I believe that when these factors will be solved or vanish, we will be experiencing better quantities in sales, but I would like to say to you one thing that this is a good question that if we are observing pressure on consumers taking into account the recent adverse macro developments. So, we are all aware that the depreciation of Turkish lira is really a consumer confidence barometer or end user confidence deteriorating factors. Further depreciation in TL would have increased cost pressures on all raw material side as well.

Recently, everybody's disposable income is decreasing, in this sense, we track some trade down activity in the market that the consumers may be more price sensitive or consumers would be shifting themselves to less pricy products or to private label products. These trends may continue as long as the depreciation of Turkish lira or the high inflationary environment doesn't stop. This is a drawback that we already experienced in the Q1. I hope it's clear.

So, any more questions. So, thank you very much for listening to us. If you have any further questions or anything unclear, please don't hesitate to contact us via email or a phone whichever you like. Thank you and have a nice day. Bye.