

## PINAR SÜT 2014 EARNINGS PRESENTATION

March 3, 2015 10:30 AM



**Speaker:** Gürkan Hekimoğlu – General Manager

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If we revisit the information covered in the presentation titled Pınar Süt product portfolio, brand equity, production, quality and distribution network, and supply in the previous years, the company sustains its operations with its R&D experience covering more than 200 SKUs, growing its brand equity with novelties that add operational benefits. The award given by the Ministry of Industry and Trade endorsed the company's capability in making the most of its energy in production. Similarly, with its investments in brand equity, Pınar Süt "Büyüdüm" (I Have Grown Up) campaign earned Bronze Effie award. Holding numerous international and national ISO certificates, the company continues with audits within this scope in order to produce healthy and good quality products.

We turn the milk we collect from the farmers into products in our plants, and then we take them to numerous points of sale via Yaşar Birleşik Pazarlama, our sister-company engaged in sales and marketing that reaches 155 thousand points. Behind this, there are 25 thousand raw milk producers, who are constantly supervised, given training support and monitored. In 2014, Pınar Institute cooperated with a university, and we, as Pınar Süt, launched an education campaign for 4 thousand producers. We initiated it first in Milas, in the Aegean Region. This was followed by the area where our plant in Eskişehir is located, and all in all, we gave one-to-one training to 4 thousand producers. Covering milk quality, production quality, nutrition, and other topics that concern farmers, we are planning to continue with this education network in the years to come. As you know, erection and investment are ongoing in our Urfa plant, which is planned to become operational in 2015. Once the Urfa plant joins the system, we will reach a remarkable production potential in our three plants that correspond, in size, to 100,000 square meters of enclosed space on a land of 350 decares. If you draw a line from one end of Turkey to the other end, we will achieve a capacity and capability that can reach every corner. This is an important point I would like to mention.

When we look at market dynamics, agricultural products are rarely calm. There are different factors behind that. Years go by quickly, but when we look at 2014, we see intense meteorological drought, agricultural drought all over the world; in financial terms, the economy saw fluctuating exchange rates, especially in our country, and therefore, feed raw material prices were volatile, and producers were uneasy. In fact, it was not an easy year. Although there was an increase in overall livestock assets, there is some decrease in cattle assets, but there is growth in the quantity of milk owing to productivity and various supports extended by the government. In terms of production capacity, milk is exposed to much higher seasonal fluctuations in our country than in other countries. However, due to reasons I mentioned last year, there was a remarkable activity in milk prices, as you will see from the chart I will share in a little while. I will come back to that; but when we look at the good things, packaged hygienic products, which make the theme of our production as well, are increasing their penetration. Although slower in milk products, household penetration went up by 2% to 47.1%, and cheese group captured a higher acceleration and went up by 18% to 42.8%. Our investments in relation to cheese are underway. We will see its effects next year; we had some small-scale investments this year, some capacity increases, and we reaped their benefits in 2014. Although packaged milk consumption per person is well below the worldwide average, we continue to regard this situation as a potential.

With the young population of our country, this potential is constantly growing. School milk supports youngsters' predisposition to these products; this helps increase the tendency toward milk particularly among teenagers and children. This is closely monitored both by our company and the sector in our sales. Looking at market dynamics, we see that the cheese group is highly active. I already mentioned that our investments in this field are in progress. We supported the market in terms of quantity with the Keyif cheese we introduced in 2014 and with capacity increases in main product groups under which we produce different cheese variants. Kido is an important product group for us, and the increased sales in Kido is a pleasing development for us. It is among our value-added product groups that we deem significant.

To go into more detail, particularly about raw materials, the inflation in food prices, in processed food, it was 12.24% in 2014. When we look at raw milk specifically, please note that it was over 16% even in base price. The price of this raw material varies regionally, depending on the product quality and the quantity in the respective area. It usually moves upwards rather than downwards. Drought, the change particularly in feed raw material, its effect on producers, the lack of support from the season, the National Milk Council holding a third meeting with all of its stakeholders while it needs to meet twice a year and an additional, unexpected price increase was made to raw material. It took place three times: in January, February and July. While raw milk prices increased, there was increased awareness of hygiene in Turkey, increased penetration as I mentioned earlier, the expansion in out-of-home consumption, communication publications of producers; these are all good aspects aimed at improving the industry despite the challenges but it is a fact that it has a toll on our business. The market started recovering slowly in contracted markets. We see that the quantifiable retail milk products market is recovering somehow. Of course, it remains our target to maintain our leadership position in market share here, and to further increase the ones in segments where we are close to leadership. We sustain our leadership in UHT Light milk with 64%, UHT milk with 31%, organic milk with 92%, enriched children's milk with 66%, and fresh cheese with 87%. We are preserving our similar targets in our export operations that I will touch upon in a little while. You can see the data about our nearest competition in the chart here. Although our market shares fluctuated over the years, we keep working to maintain the top spot in market share through our marketing investments and new products.

In terms of our products, we increased our cheese variants. We increased our variants in value-added Kido products for children. We have renewed the Pinar strained yogurt line for use at home, for use by housewives. Organic milk is an area that we own; we introduced organic pasteurized milk. We have relaunched it in innovative 750 ml prism packaging. We introduced our organic butter. We also put on the market a new product, Pinar Pink, for women. Our target now is to increase their sales.

When we are making plant investments, when we are investing in the industry, we are not considering them as marketing expenses. In our marketing investments, which are crucial, we continued with above-the-line, below-the-line and TV campaigns. We carried out events with TV channels for Pinar Kido. We realized a prize give-away campaign with Pinar Ayran yogurt drink caps, which attracted quite a high level of interest. In 2014, we carried out campaigns using above-the-line and below-the-line media for Pinar Labaneh and Pinar Beyaz. We delivered products to homes for tasting, followed by one-to-one contact with the consumers. In plain milk campaigns, our campaign was awarded Bronze Effie by the Advertisers Association and the Association of Advertising Agencies. Our support to sports continued as always. In addition to our long-going support to Pinar KSK Sports Club, we took part in

2014 FIBA World Championship for Women as the official beverage supplier. And we supported our team in the process. You can watch our commercials pertaining to our kids campaign on TV.

Export is one of our key channels. When we look at it as Pınar Süt, Turkish milk and dairy products export does not make a up a large volume across the world, but Pınar Süt is single-handedly responsible for 16% of total exports. We continue to be a part of the Turquality program. Our exports increased by 10.3% on USD basis and increased to 12% of our total sales. 2014 was an atypical year. As a result of the sudden hike in exchange rates and the corresponding varying pricing in the world powdered milk market, both we, as Pınar Süt, and other market players in the Turkish industry had the chance to export powdered milk. This trend started in the last quarter of 2013 and continued in the first months of 2014. We had the opportunity to export to many countries including Japan, Philippines and Australia. This may look like a spot sale but I find it important in the sense that we had the chance to use our brand name of Pınar Süt. We saw that Pınar Süt brand created value also in the powdered milk segment to the extent that the prices are favorable. At the same time, we experienced how we can manage our operations in transatlantic countries. I think that we gained valuable experience here. In addition, we were also rewarded for our regular efforts that have been carried out for many years in our production facilities in order to be ready and to capitalize on potential opportunities in our neighboring countries, by keeping a close eye on the various developments in these nearby geographies. Based on the audits conducted by the Turkish Ministry of Agriculture and the related Russian agencies, we became one of the three companies to be authorized to export milk and dairy products to Russia. We continue with our efforts to this end as a forward-looking step. We want to reproduce the market shares we have particularly in Saudi Arabia, Kuwait and UAE also in different countries. This is also a key target for us. Although there is a war going on right now, I would like to talk about our Urfa plant's contribution in terms of exports, which will be available once our relationships with our neighbors are stabilized.

To give you brief information about Urfa, I already said that Pınar Süt has nearly 100,000 square meters of enclosed space on a land of 350 decares. We have a plant with an approximate enclosed area of 18,000 square meters. We have a plant where erection work and trials continued in 2014, and which will start production gradually in the first quarter of 2015. We have a logistical advantage here and we are going to create added value for the region. I can happily add that the local people we have employed successfully worked in the erection of the plant and they will also stay on board to further leverage the plant. Due to the benefits granted by the incentives in this region, combined with our future export potential, we believe that with Urfa we will take the flag further which Pınar planted 42 years ago in İzmir and then backed with Eskişehir plant later.

**Let us take a look at our financial results in the light of all these data:**

While our compound annual growth rate averaged about 13% in previous years, we grew by 16% in 2014 despite all these difficulties and reached a net sales figure of 940 million. This is a significant sum. This of course includes our growth driven by increased quantities, by product mix. The cheese product group has been influential on it, too. But when we look at our absolute EBITDA value and our margins, it is not far from last year's absolute value, but although we tried to reflect increased raw material prices, which I mentioned in the beginning, and significant differences in energy in the last quarter of the year on the products through price adjustments, we could only do that gradually. Also, we had to do that in a balanced manner due to the severe competition in the market. As a result, we

captured an absolute EBITDA value of 71.7 million. Our net profit stood at 87.1 million, corresponding to a net profit margin of 3%, which is a result of our improved operating costs, income from subsidiaries, and from the disposal of our warehouse, which remained within city center and as such led to operational difficulties.

When we examine the income statement, out of our net sales worth 940 million, 4.2% was contributed by quantity, 10.4% by price and product mix, and 1.8% by exchange rates. As I mentioned earlier, this refers to the annual change of 16.1%.

In reality, cost of goods sold sustained an increase above that; and it is not easy to balance that. It affects the entire industry. We hope that it will be more balanced and structured in 2015. We also think that the price adjustments we made in the last quarter of the year will be more effective in 2015 than they were in 2014.

When we look at our net financial liabilities from among the key ratios, we see that short-term liabilities went up to 7 million. This is due to the Urfa investment. We have, of course, not given up on our focus on risk management, effective working capital movement, and close monitoring of inventory balance and liabilities. We are maintaining the same discipline.

When we look at the company's overall dividend distribution, we see that it has been duly sharing its distributable profit regularly with its investors over the years.

If we were to make a brief, overall assessment of 2014, raw material prices increased by 16.4%; yet I would like to underline once again that Pinar Süt sustained its growth, attained increase in its net profit margin, is in the process of establishing a plant that will go into operation in 2015.

Our marketing investments are aimed at increasing our market share in many product groups in which we intend to sustain our market leadership. We closely watched our competition in the sector but seemingly, there is not much difference.

As always, we are taking on cost saving initiatives, measures to reduce costs, lean six sigma practices, and we want to support and improve them with new committees such as the wastage committees we set up. Because cost is the crucial part.

In general terms, our strategies and goals cover market-driven efficient price management targeted at growth, getting together with consumers with our extensive distribution network, working one-on-one with our producers, effective use of social media, development of new products in the out-of-home consumption channel that will drive and grow this channel, increasing exports not only in Gulf countries but also in other and neighboring countries, continuing with our marketing investments in Turkey and abroad, and outgrowing the market in product groups in which we have a presence.

You can see the share ratio and stock performance from the charts. Thank you all for your time. We will be happy to answer any questions you may have.

## Q&A SESSION

March 3, 2015 10:30 AM



**Speaker:** Hikmet Altan – Yaşar Holding CFO

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### 1) What are the turnover and profitability targets for 2015?

As you know, due to regulations, we need to have the Board of Directors' approval for that. We cannot say anything since we have not been authorized by the Board of Directors. Of course, we have expectations; as in previous years, we are anticipating growth and profitability rates above the inflation.

### 2) Will there be dividend distribution?

As we have included a slide at the end of the presentation, we are distributing the distributable profit to our shareholders. The General Assembly will make the decision about dividends, but we are anticipating dividend distribution to continue similarly also this year.

### 3) Does the arrival of new market entrants increase the competition in packaged milk segment?

Actually, not too many players entered the market; rather there were take-overs. Rather than new entrants, it seems more like consolidation. This does not mean that competition will not increase. Change in shareholding structures will open new areas of competition. The sectors we are engaged in are prone to intensive competition and we have been experiencing it for many years. Despite all the contention, our market shares did not decline. Therefore, we are not expecting radical changes in 2015 and thereafter.

### 4) What is the effect of powdered milk on your exports?

In 2013 and 2014, an opportunity arose for the companies in Turkey for exporting powdered milk. Under normal conditions, as a country, we cannot take on large quantities of powdered milk export due to our costs. Due to the issues with the producers and the drought in Europe, we were able to export powdered milk in 2013 and 2014. This is a business that we wish to do, yet we are not planning to do it regularly. But we are not willing to do it right now. We will continue to export powdered milk as opportunity arises. Under the current circumstances, it is not something we can concentrate on, actually.

### 5) You got an export license to Russia. What are the developments in this respect?

We are among the first companies to get export license to Russia. We are about to make an agreement with a very big food distribution company in Russia. Our plans are progressing accordingly. It needs to be said that we will not make a fast entry into this market after the conclusion of the agreement. As you know, the situation in Russia is also key. The prices hiked because of the devaluation in that country. The market dynamics in Russia also changed internally. Therefore, we are thinking of entering that market with Pinar brand, by the beginning of the second quarter of 2015, without taking any risk.

**6) Can you give information about Arev Company, the Group company, the real properties of which were disposed of? What are your projections in this regard?**

It was Pinar Süt's property that was being used by our distribution company. It was located in Ayazağa. It became impossible to keep using it as a distribution center. So our distribution system had to be relocated. As the property became idle for Pinar Süt, it was sold to Arev, which is a Yaşar Group company. At the appraised value, of course. The profit from this property sale reflected on 2014 profitability. It will also reflect on distributable profit. As for our distribution business, our distribution company will purchase land in İstanbul to set up the new distribution business. It is on the Asian side in İstanbul. This process is underway.

**7) At what stage is the Şanlıurfa investment? What will it contribute to the capacity?**

In general terms, our Şanlıurfa investment corresponds to 10% of Pinar Süt both in terms of capacity and turnover. This ratio may get higher in time but this is the case for 2015 and 2016. In the days to come, in March or April, we will open it officially and strive to fill its capacity. As it is in Zone 6 (incentive zone), we have utilized half of the solid incentives and the remaining half will be utilized over the course of the next five years. Our investment period is over; our operating period starts from 2015 onwards. These incentives will be utilized over 4 or 5 years in the operating period.

**8) How do you project the course of raw milk prices in 2015?**

We are not anticipating a significant price increase in raw milk as opposed to last year. We are making our plans and carrying out our projects on the anticipation that they could increase in parallel with inflation, provided that radical changes do not take place in raw material input and weather conditions.

**9) You said that the sales growth was driven by price increase and changed product mix by 10.4%. How does that ratio break down?**

This is substantially driven by price increase; the contribution of quantity increase is limited. The change in product mix had somewhat effect.