Question and Answer Session

Operator
[Operator instructions]

Our first question comes from Mete Ozbek, Unlu & Co. Sir, please go ahead.

Mete Ozbek
I have a question on your gross margin performance. After adjusting with the financial income expense related to the payables and receivables in your P&L, I calculate that you have achieved a quarter over quarter gross margin improvement on a purely operational basis by 220 basis points, which is a very solid improvement, I should say. Could you please elaborate more on these improvements, how you have achieved this and what we should expect through the fourth quarter of this year in this high inflation and volatile environment. I would appreciate that, thank you very much.

Uğur Demirel
Yes, I appreciate that you have seen that we have improved the gross margin. It is mainly coming from the operational side, although we have seen some inflation and also we have some gains from those price increases during the period, but this is not big impact from our big balance sheet, I would say. Many of them are coming from the operational side. Just to remind you, we have taken over Teközel from Yildiz since the beginning of the year, so that we are able to make better negotiations with our suppliers. Also, we have improved some gross margin in fruit and vegetables thanks to, again, Mersin taking over the Mersin management, so that these enable us to improve our gross margin.

Mete Ozbek
Based on your performance in the first nine months, are you planning to revise your full year guidance for this year with an upside? Thank you.

Ziya Kayacan
No, in the previous discussion, we were generally talking about the five-year plan. Of course, the current stage that our margin is just over 23% in last year, so what we said at that time that we have an upside, mainly we expect some margin improvement after Teközel takeover, mainly private label margin and mainly fruit and vegetables. It is reasonable much more now that we are getting better utilisation of these actions in third quarter. Compared to 23%

margin, it is for the coming quarters, we are much more positive thinking about the margins, so we believe that we can keep up with the current margin level it is for the third quarter.

Ziya Kayacan
Overall, Mr Mete, starting from the IPO market has some consensus about our performance; I believe that at the end of the year will be much better than the market consensus.

Operator
[Operator instructions]

Our next question comes from Berna Kurbay, BGC Partners. Please go ahead.

Berna Kurbay
I have three questions. The first one is about your remarks on the last question. You said that you could beat the consensus estimates at this point. When I look at Bloomberg, I see around 4.4% EBITDA margin for this year. I was wondering if you were referring to that figure and 30% revenue growth, I was wondering if those two are the ones that you think you could beat for the full year.

My second question is also referring to your earlier remarks on the gross margin. You mentioned that inventory gains play a small role and it is mostly because you have better margins on the private label and fresh fruits and vegetables. I was wondering if you see any further room for improvement and how much of that gross margin gain do you think is sustainable.

Also related to that, is there any change in terms of your payment terms to the suppliers and have you been able to get, perhaps, better discounts this time.

Finally, you mentioned during your speech, Ziya Bey, that you could elaborate a little bit more on the CapEx side, so what is your new store CapEx at this point. Also, if you can elaborate on the warehouse costs, you mentioned relocations as well as the opening of a new warehouse. How much do these expenditures cost at the moment and how many more do you plan to open in 2019, or relocate in 2019. Thank you.

Ziya Kayacan
About the first question on the Bloomberg numbers, currently, if you look at the nine month results, we have already 35% growth year-on-year basis, so it seems that, clearly, we will be much better than the Bloomberg consensus on the 30%, so we assume that we can continue with that, and if you come to the EBITDA margin, again currently 5.2% EBITDA margin we have

got, and last quarter 7%, so that we will be considering these numbers we will again much higher than the Bloomberg numbers in terms of consensus.

If you look at the gross margin side, our gross margin last quarter is 25.4% so almost 2% than last year’s 2.3% even and most of them comes from the operational performance, but we achieved especially private label margins already, so we've already got it. Fruit and veggies was also, we substantially got an advantage of it, so you remember when we talk about 23% we expect some margin, because we've already got it, so to further improve in the short-term we don’t see any further improvement areas for the gross margin, which is already in a very good shape, so in terms of payment terms, remember in our second quarter webcast what we said was that suppliers especially in this macroeconomic environment are trying to get their payments earlier than the agreed terms, so what we do, especially small suppliers are coming and asking for early payments, and so we are getting the benefit of them in the sales side and also in the financials side, asking for early payment fees from them, but other than that, the big suppliers, we don’t see any early payment, so the opportunity arises of course, so we will get the benefit of it. It will comply with our strategy or our benefit. This is about the payment terms. I mean, absolutely, from the small to medium sized suppliers, it is the right time to get additional discounts against the early payments, so [attached to our] current position, financial position, and this could be a flexibility for us.

About the CapEx per store, I mean I have the numbers per store what our spend for this year, the CapEx per store in nine months level, it is about TRY 230,000 per store. If you look at last year’s openings, the number was TRY 198,000 so we see almost 15% increase on a year-on-year basis. If you consider that [inaudible] is about 14.2% on nine months average I am saying and considering that some parts of our CapEx per store is in foreign currency, and you know that foreign currency increased tremendously, we also had very good performance in CapEx per store spending. It shows also our ability to use our size, size of our business, so in terms of warehouses we opened one warehouse. The cost in general for the specific warehouse is about TRY 4 million. It depends on the size of the warehouse of course. We will open one more in the next… I mean this quarter, in the last quarter of the year, so we will be opening two warehouses in 2018. For next year’s plans, now we’re in that stage of budget, so that we are discussing the openings for next year, but too early to say something. Hopefully we will share this when we decide on the budget numbers, maybe towards the year-end in different occasions.

Berna Kurbay

If I may just have a follow-up on that warehouse CapEx spending, if I understand the chart here correctly, you spent TRY 14 million on warehouses in terms of CapEx and you mentioned that the new warehouse costs 4 million, so the rest is the relocation of the warehouses, is that correct?

Ziya Kayacan

Correct.

Berna Kurbay
Do you plan to relocate anymore?

Ziya Kayacan
This year, no, we don't have any relocation plans, but we will see for the next year, but this year, as you remember, we relocated two warehouses and one opening, so that in total this gives the numbers, including of course some warehouse maintenance as well, the warehouse costs are included.

Operator
Our next question comes from Ms Ayaz, Deniz Invest. Please go ahead.

Ms Ayaz
I have got three questions and apologies if I am repeating the first one, if you've already answered it. Can you tell us if you have got any IFRS 18 impact on your gross margin, because of increased discount rates, because of higher interest rates? The second one is what kind of action did you take for the Government's campaign of fighting against inflation previously? The finance minister asked retailers to discount the items on the food basket, so how was your action there and what kind of pain impact should we expect on your margins in the coming period? My last question is KPI is still very high and ahead of the CPI number, so do you continue to see price pressure from your suppliers' side and do you expect to increase your prices further in the coming period?

Ziya Kayacan
So I'll try to answer your first question and then I will give the word to Mr Demirel. About our tariff adjustments on the gross margin, yes, there is increase in the rates, the exchange rates and also the interest rate, so that we see the numbers accordingly, but generally we took the average of the last 12 months instead of giving right away the third quarter, because it is a P&L item, so this somehow the impact of this interest expense or revenue expense on the gross margin, so that's why within the 2.3% improved margin, as Mete Bey already mentioned that number that the majority of the figure comes from the operations, very insignificant let's say, like between 30 bps roughly, I mean this IFRS 18 impact which we see in the gross margin improvement, so the remaining more than the 2% level comes from the real operational performance.

Uğur Demirel
To the second question, yes, we have taken some actions for the inflation as the Government suggested. As you know, the food retail market is very price sensitive and Government launched a programme so we have participated with around 55 products and we have applied a 10% discount, and we have some impact, but the impact is not that big compared to our competitors because we carrying more SKUs than the other ones and we need to sell more branded items compared to private label. We are having the advantage of those business models that also we are taking some part of those contributions from our suppliers. At the end, having the board much more numbers of SKUs and having the more blended suppliers that the impact on our business model will be limited for the action.

In terms of CPI, coming to the third question, because of the base of the inflation compared to last year, [audio] imagine that, so we can expect that the inflation will continue, but we have seen some stabilisation on the FX spread that helps us especially compared to September and maybe it's more stable I would say. Whatever the situation is, again thanks to our strong business model, we don't have any difficulties to reflect to our consumer, so that our gross margin will not be affected by the inflation.

Operator
Our next question comes from Cemal Demirtas, ATA Invest. Please go ahead.

Cemal Demirtas
My first question is related to your EBITDA figure. When we adjust your interest income expense compared to trade liability, all those factors, we come up with an adjusted EBITDA of 3.4 versus the reported 7%, and when we look at the previous quarter we see the reported 4.8 and adjusted 1.2% based on our numbers, and I would like to understand, do you expect any improvements on that front in terms of recording interest income and interest expense related to trade liabilities? Could we see narrower differences between these numbers, because you don't have any debt but you have some… the finance expense as related to your operations, so I would like to understand what could be the potential EBITDA figure based on your numbers or based on the adjusted numbers I can adjust with the other factors, so what could be the optimal level for you? I see that your store quality is improving every day, as I am one of the customers on a daily base, I am following, and I see significant improvements. Do you have any room for improvements in terms of the layouts or the logistics etc? So I would like to see whether we are going to see higher margins and growth going forward. Could you give us some picture about the future? Thank you.

Ziya Kayacan
Your first question about we call it IFRS 18 impact on our gross margin and EBITDA, so when we look at quarter-to-quarter, the second quarter our EBITDA, the margin was 4.8 and it jumped to 7%, which is about 2.2%. If I look at that, there is almost 2%, 2.3% or so… about

1.7% comes from the gross margin improvement, which we have seen that most of that comes from the operational performance and in part coming from these inflation increases, but I think the real thing we should mention that our operational expenses over sales they should drop almost from 18.9% to 18.4%, half a percent, and it is also getting lower and lower each quarter. This is because of our sales performance, so that we achieved almost 2.2% better EBITDA margin than Q2.

About our direct impact, narrowing it, is purely linked to our working capital and our business model. What we said is that our company is generating significant cash flow from operations and especially from the working capital generation, so we are working the negative working capital, but from some time, especially in these times, what we do is we take the opportunity, use our flexibility, and to pay some of our suppliers, especially small to medium sized, and we get some early payment fees, which can narrow especially this IFRS impact, but we couldn't have said that it will be the permanent one. We still stick on our company capability to negative working capital and to generate from both our operations and also from the working capital generation, I mean cash flow from the working capital management. We strongly [inaudible] and believe that these two work hand in hand and could be some transition between, but again we will be generating cash flow from both sides and we will show free cash flow at that even after the CapEx spending, especially in the third quarter it's quite visible our cash flow from operations, like last year.

Uğur Demirel
Coming from the operations side, thank you very much for your feedback as our customer, so as you say our operations is getting better and better every day. One of the improvement areas that we can do better is the fruit and vegetables in our operations, in our stores. You can appreciate that it's not easy to operate 6,000 stores on a fresh product like fruit and vegetables. It's not easy. So that every day… I mean day-by-day stores' fruit and vegetables operations is getting better and better, and import for us, it's a strategic category, it's a differentiator category for us compared to our main competitor, so that we are investing there a lot. Especially this year, after taking over the management of [inaudible], which is the procurement company for the fruit and vegetables, we have started to work directly with the farmers and they are very happy. There is now trading between farmers and shops nowadays, so that we are having the advantage of purchasing power and best purchasing price, volume, and sustainable quality and sustainable price, and maybe if you follow that, we have fixed about 10 SKUs in the fruit and vegetables until the end of the year, just an example of how we are investing for the fruit and vegetables.

Cemal Demirtas
I'd say your fruit and vegetables is by far… in your category… I'm not exaggerating, it's one of the best as consumer, that's one the good things your advocating, but maybe related to logistics like bags, it's a small item that you carry what you bought, from time to time I see

some dysfunctioning on that front. For instance in Ankara there was no availability for larger bags and it's just a quick feedback as a consumer.

Uğur Demirel
Thank you and again it's moving very fast. Sometimes we are lagging behind quantities from the customer demand, so it's a good thing; it's an opportunity for us, they are demanding more quantities for us, so that we are very happy for the development of the fruit and vegetables.

[No audio questions]

Company Representative
[Inaudible] ICBC, he says, "Hello, thank you for your time. Could you please tell what is the store number that you used for like-for-like calculation?" The second one, "Do you see any traffic or website impact from the lower price you introduced for the fight against inflation? For example, do you see any extra purchasing for [inaudible] products? How much [concession] should we expect in the fourth quarter margins from these lower prices?"

Ziya Kayacan
Regarding your first question about the like-for-like stores, the number is 3,515, the exact number, so it corresponds with 57… if am not wrong, the percentage of our total stores. About your second question about the inflation and traffic [inaudible] impact for the lower prices, we introduced for the fight against inflation, although it is only short periods past on this application so we should wait of course for November and December. For the extra purchasing, again this is what we should expect, but as I said it will be just start maybe the middle of the month, so it's working to wait for… at least for November let's say. Maybe the remaining part of your question, this is about minimum wage, the minimum wage of course [inaudible] early January… so it's another question I think, sorry.

This is another question about the minimum wage, it says, "Could you please share your view on the potential rise in the minimum wage? How much will your personal expense rise if minimum wage will be higher by 25% CPI?" So the minimum wage, you know, it will be announced in January but there could be some colour on that we can hear towards the year-end, but our aim is that whatever the minimum wage will be, this is already budgeted in fact, so taking into consideration potential scenarios, our aim is to come over that and not to dilute our margins, and so we will be working on the sales improvement, like-for-like sales growth, as well as the cost actions, already given to you our initiative for the rent contract management, so we were able to lower our rent contracts, increased rates, much lower than the inflation, possibly inflation increased, so these kinds of actions we will also consider for the next year to be… to fight against a minimum wage dilution… I mean risk in our margins, so our aim is not to [audio] just because of that, so our past performance already shows that we can handle the minimum wage and typical cost increases quite efficiently and not let them dilute our margins. This will be the same thing according to our planning.

[No further questions]

Ziya Kayacan
I think that's all about the questions. Thank you very much for your participation. I believe that we'll talk already for the coming quarter thanks to our [audio] business models and the strong operating model, we will deliver our promises, maybe a better situation, and so that we are expecting to reach better than our expectations. Thank you very much for your participation. Have a good weekend.
