Turkey: Electronics retail sector

Bimeks: An info note

April 17, 2014

- **Bimeks became the consolidator of the organized electronics retail market** by acquiring ElectroWorld in Sep. 2013 and Darty in Jan. 2014. Once the conversion of the stores is completed, the company will reach 130 stores with ca. 120K sqm sales area vs. 85 stores with 44K sqm sales area before acquisitions, contending for the 3rd place in the sector. The company will continue store openings and targets 150 – 160 stores by the end of 2014 and 190 stores by 2016 with 8% cagr in sales area.

- **Despite consolidation, price competition is expected to continue** with the remaining 5 players, according to the management, though their own focus will be profitability rather than price competition, going forward. Despite the rising bargaining power, Bimeks expects gross margin between17%-18% (18.2% in 2013 adj. for one-offs) due to declining margins in the sector. Yet, management guides a substantial but gradual decline in inventory days (at 144 as of 2013), which will lead to a drop in financial expenses.

- **Regulatory change regarding credit card instalments negatively affected the sector** but reduced the relative disadvantage of Bimeks as the company was anyway offering only 10 installments vs. up to 15 in the sector. Company's results are within the conservatively budgeted figures as of 1Q14. With the new in-house credit mechanism, as well as the appreciating TL (positive for consumer perception), first figures in April are positive, signaling a better 2Q14. While 2M14 TSS sector sales with credit cards are 6% higher y/y with Jan up by 21% y/y and Feb down by 10% y/y according to Interbank Card Center (BKM) data, sector representatives think that 1Q14 might still be better than 2013.

- **Price competition in online sales prevails**. Online sales were 7% of total in 2013 and will stay around these levels in 2014, according to the management. The company has a unique model for fast and accurate delivery, using closest store's inventory instead of the warehouses' located in Istanbul. The management believes that online customers are still price sensitive, which is negative for Bimeks, yet once speed and accuracy become more important, Bimeks will be ahead of the competition.

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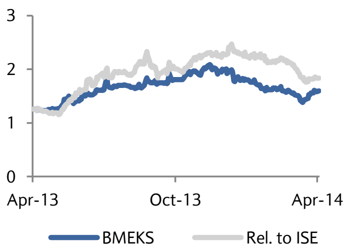
Ticker	BMEKS TI
Close, TRY	1.58
Mcap, USDm	88.9
3M avg. volume, USDm	0.93
Free float, %	33%
Shareholders	SPV Bilisim 30.7%, Murat Akgiray 18.5%

Performance, %	1M	3M	12M
Absolute	4	-10	26
Relative to ISE	-9	-17	48

Performance chart



Source(s): ISE, Integras analysis

Prices as of April 16, 2014

Exhibit 1. Technology super stores in Turkey

	No. of stores	Sales area (k sqm)	2013 revenues (TRYm)
Teknosa	294	166	2,957
Vatan	100	164	n.a
Media Markt	37	145	1,212**
Bimeks (before acquisitions)	85	44	n.a
Bimeks (after acquisitions)	130	120	697*
Gold	54	n.a	500***

Source(s): Company data, press
Latest available data for no. of stores and sales area
* Excluding Darty, EW last 2M only
** FY Oct.'12 – Sep.'13
*** 2012 revenues

We paid a visit to Bimeks (BMEKS) and met Mr. Mustafa Selcuk, member of the Executive Committee. Mr. Selcuk is working for Bimeks since April 2013 and prior to his current position, he was CFO of Ihlas Media Holding for 9 years.

Below are the key takeaways from our meeting:

When will the integration of ElectroWorld and Darty stores be completed?

Bimeks acted as a consolidator of the Turkish electronics retail market lately and acquired EloctroWorld (EW) and Darty, the major acquisition targets, in Sep.'13 and Jan.'14, respectively. As we mentioned in our note, *Vatan Computer visit,* dated 27 June 2013, both EW and Darty failed to reach desired profitability due to high level of opex and lack of a focused strategy, among other factors, in a market with harsh price competition.

Before acquisitions, Bimeks had 85 stores and 44K sqm sales area. Bimeks acquired **ElectroWorld** back in Sep.'13 for TRY7m. EW had 14 own and 18 franchise stores, which were analyzed by Bimeks for their performance and location prior to the acquisition. The company kept 23 (14 own - 9 franchise) stores with a 51K sqm sales area, while franchise agreements were terminated for 9 stores which were either located close to existing Bimeks stores or franchisees did not agree to Bimeks' terms. Almost all EW stores acquired were located in desired locations, where Bimeks had no presence or smaller stores. Thus, the management does not plan to close any further EW store unless the store underperforms within the first year.

Darty was a different merger process, as Darty stores were branches of Kesa Turkey established in the UK. Hence, Bimeks acquired the stores (and not a company) suitable to their business plan (23-25 stores out of 28 with ca. 26K sqm) one-by-one starting March '14 with all their inventories, fixed assets and personnel, while other stores were closed by Darty. The management targets to complete the transfer of all stores by the end of April. After the process is completed Bimeks will reach 130 stores with ca. 120K sqm.

Exhibit 2. **Bimeks: acquisitions and store expansion**

	No. of stores	Sales area (k sqm)	Average store size
Before acquisitions	**85**	**44**	**518**
ElectroWorld	23	51	2,217
Darty	24	26*	1,083
After acquisitions	**132**	**121**	**917**
2014 YE target	150-160		
2016 YE target	190	8% cagr	

Source(s): Company data
*estimated

The major advantage of these acquisitions is the increasing bargaining power over suppliers, which means better purchasing terms for Bimeks. Yet, the management believes the gross margin impact of higher bargaining power will be limited due to the trend of declining margins in the sector. The gross margin adjusted for one-off expenses related to EW acquisition stood at 18.2% in 2013 (vs. headline 17.1%), and it may hover around 17%-18% in short/medium term, according to the management. One other positive impact of increasing bargaining power will be on the inventory days. Before acquisitions, in order to get similar terms with bigger players, sometimes Bimeks made bulk purchases hard to digest within its scale, which inflated the inventory days up to 144 days (vs. Teknosa's 84 days) as of 2013. This resulted in higher financial expenses. The management believes that, with increasing selling space, and their current bargaining power, inventory days will decrease substantially over time, which will positively affect the financial expenses and thus the bottomline.

In addition, both EW and Darty had mostly big box stores with more than 1,000sqm, where Bimeks had limited exposure. So the company now has more space for other product categories, such as major and small appliances (MDA-SDA), personal care and accessories, which have traditionally higher margins than IT, telco or CE. After the acquisition, Bimeks also started to work with new suppliers such as BSH, Electrolux and Vestel whose products required significant space for exhibition which Bimeks couldn't afford in its relatively smaller formats. The additional SKU's from these two players were successfully integrated swiftly into Bimeks' inventory owing to its in-house ERP system.

Yet, part of the space acquired form EW was downsized which was originally not allocated as sales area anyway. The company also renegotiated rental contracts in shopping malls.

Exhibit 3. Bimeks: Category breakdown of revenues

	2012	2013
CE	29%	32%
IT	40%	29%
Mobile	18%	21%
Peripherals	5%	6%
MDA - SDA	2%	4%
Accessories	2%	2%
Personal care	0%	1%
Digital game	1%	1%
Other	4%	4%

Source(s): Company data

With the increase in available space, as well as specialized personnel coming from Darty and EW, Bimeks targets to increase MDA – SDA sales to 10% in 2014, from 4% in 2013. MDA – SDA shares in EW and Darty were 10% and 20%, respectively. The increase in MDA – SDA sales is expected to compensate the margin decline in main categories and support profitability.

Darty personnel were also successful in extended guarantee sales, which have a very little share in total revenues, yet high impact on profitability thanks to their high margins. For instance, in white good sales, ex-Darty personnel has a success ratio of 50% in service sales vs. 27% of Bimeks personnel. Rotation of personnel of acquired stores has positively impacted Bimeks' personnel's performance in this area as well.

Turkish technology super stores (TSS) market now has 4 local (Teknosa - 38% market share, Vatan Computer, Bimeks - 8.6% market share and Gold) and one international (Media Markt) players. The management will seek no further acquisitions, and they believe that the price competition will continue even if 2 players were left in the market.

Exhibit 4. Technology super stores in Turkey

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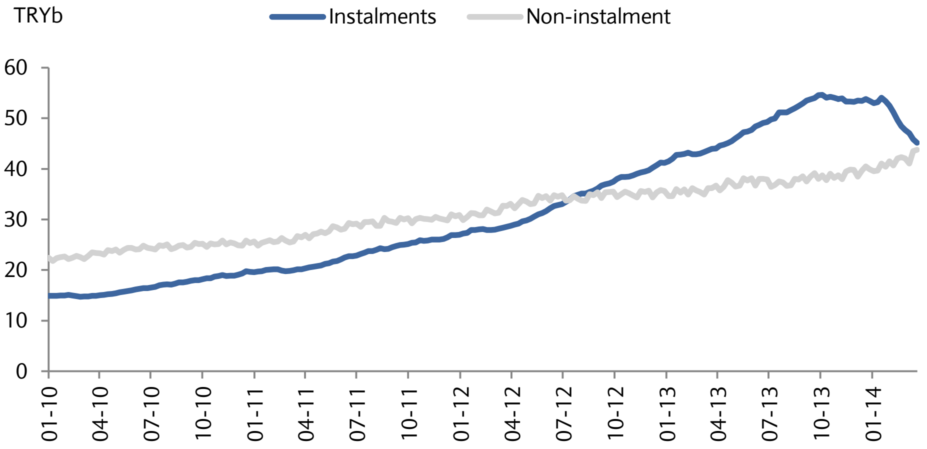
What were the impacts of the new regulation on cc instalments?

BRSA limited maximum credit card instalments in technology sales with 9, while banning instalment sales in communication (including mobile phone) related purchases, effective as of February 2014. This resulted in a sharp y/y increase in sales with credit cards (cc) across all categories, especially in mobile phones, in January, followed by a y/y decline in February and March. According to Interbank Card Center (BKM) data, sales with credit card in TSS increased by 21% y/y in Jan, followed by a 10% decline in Feb[1]. Separately, according to CBRT data, credit card balances with instalments have come down by 16.4% from end-January to April 4th (Exhibit 5). Yet the overall impact in 1Q14 was limited according to the sector representatives, with possibly overall higher sales.

Exhibit 5. CC instalment balances collapse



Source(s): CBRT

Nevertheless, 1Q is not representative at all. 1Q is seasonally the weakest quarter, demand was pulled forward to January to make purchases before the new measures kicked in, while looming elections may have hurt March sales. Therefore overall impact will be more visible starting from 2Q14. One of the reasons of the sharp decline in sales was the perception of the consumer that instalments were banned across the board and not just in mobile phones. It took some time for this perception to be rectified, however Bimeks management states that consumer is well informed of the details of the regulation by now.

In response, the sector tried to offer different options to the customers, such as

i. selling gift cards with instalments, which are used for mobile phone purchases, which the BRSA plans to ban as well

ii. phones bundled with long-term contracts mainly implemented by telco shops/operators, giving them an uneven competitive edge in this segment of the market

iii. IOU sales which was very popular in unorganized technology retail market before cc instalments. Now Evkur, a major household retailer with 78 stores, offers up to 24 months thru IOU sales.

iv. in-store credits where several TSS chains made agreements with different banks

Yet, none of these measures are a perfect substitute for cc instalments.

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[1] This segment of BKM data does not include electronics sales in telco shops or unorganized electronics retailers.

TSS, including Bimeks, cannot offer bundles into long term mobile subscription contracts and do not want to initiate IOU sales because of its risks as well as financing needs it would create. Bimeks does not offer gift card sales unless the customer asks for it, trying to comply with regulation. They made an agreement with Bank Pozitif for an in-store credit mechanism, in which customers may choose 6 to 30 instalments with an interest. Generally customers choose 12 or lower. The share of mobile sales in total declined to 17-18% levels in 1Q14 vs. 21% in 2013, which the management does not find particularly worrisome because of the low margin in that category.

As of early April, the management sees signs of improvement in consumer sentiment and sales. They are also working on campaigns for Mothers' and Fathers' days, which will boost sales in May and June, according to the management.

What's the impact of TL depreciation?

Around 65 - 70% of Bimeks' purchases are in TL and 2/3 of fx exposure is hedged, hence the impact of the TL depreciation was limited. Furthermore, suppliers not always reflect the full amount of TL depreciation as they hedge their own exposure. Besides, TL is appreciating since the end of March, which creates a perception of price decline in technology products for customers which actually may not exist. According to the management, this perception also positively affects sales performance of TSS stores.

What are the store expansion and growth targets?

Bimeks will have around 130 stores with ca. 120K sqm sales area, after the conversion of Darty stores is completed. The company plans to open 20-30 more stores and reach 150-160 by the end of this year. By 2016, the management targets to reach 190 stores with 8% cagr sales area expansion.

Currently 48 out of 130 stores are franchise. These stores typically have less than 600 sqm space and are located on streets of smaller cities and towns where local market knowledge is a valuable asset. The company has a different franchising model. They do not sell the products to the franchisee and transfer the ownership of the inventory. Bimeks uses its own ERP software to monitor sales and the inventory. Franchisee finds the store and pays the rent (but they usually own the store) and employees. Bimeks is responsible for store layout and capex, which is collected from the franchisee. Bimeks also gets a one-time franchise fee.

With this model, Bimeks does not take any receivable risk due to selling the product to the franchisee. At the end of the month, Bimeks gives 6-7% of store sales to the franchisee, to cover rent, personnel & utilities, which fixes the opex/sales ratio for Bimeks for that specific store. This model also eliminates the risk of franchisee setting/reducing prices. Growing with this model also has a positive impact on total capex, which is reduced as the franchisee pays it back to Bimeks.

Around 15 openings in 2014 will be via the franchising model. Going forward, the company targets to grow in small cities and outside the shopping malls via franchising model due to (i) local knowledge of franchisees and (ii) high lease terms on high-streets. In shopping centers and big cities, they will not use this model.

Bimeks is likely to more than double its 2013 revenues in 2014, however considering that EW and Darty will be included in 2014 sales, Bimeks' organic growth will be around sector growth range of 15% - 20%. The management targets to reach a market share of 14%-17% in 2014 vs. 8.6% in 2013, thanks to EW and Darty acquisitions, as well as store openings.

Most of the opex related to the restructuring of EW was booked in 2013, and very little opex is expected in 2014, related with the acquisitions. The company will focus more on profitability and will not be aggressive in price competition. Bimeks targets an 17%-18% gross margin (18.2% in 2013 adjusted for one-off expenses related to EW acquisition), 5% - 6% EBITDA margin (5.3% in 2013 adjusted for one-off expenses related to EW acquisition, including other income/expense) and 1% - 2% net profit margin (net loss excl. one-off income due to EW acquisition in 2013) for 2014 – 16 period. Increasing bargaining power and a more favorable sales mix with increasing share of MDA – SDA, accessories and personal care will support the profitability. The management also targets to distribute dividends if targets are achieved.

Growth in online market?

Electronics retail grabs the lions' share in online sales in Turkey with more than 60% share as of 2012. Hence, it is very important for all players in the market. As of 2013, online revenues were around 7% of Bimeks' total revenues (vs. Teknosa's 6%), management guides a 50%+ growth for online market in 2014. Unlike other pure online players like hepsiburada.com or Teknosa's kliksa.com, they are not in price competition in this market. Online prices are either same or 3-5% below store prices, unless there is an online focused campaign. Bimeks differentiates itself with fast delivery (same-day depending on customer request) using closest store's inventory to the online customer, which is enabled by its in-house ERP. The management believes that currently, online customers are price sensitive and prefer the cheapest product, which is negative for Bimeks. Yet, they hope fast and accurate delivery will become more and more important in the coming years, which is the main advantage of Bimeks. Of course, arguably they may see their edge in speed erode as other companies improve their logistics effort.

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