

# TOFAŞ TÜRK OTOMOBİL F

## TOFAŞ Türk Otomobil Fabrikası A.Ş. 1Q20 Financial Results Conference Call and Live Webcast

Thursday, April 30<sup>th</sup> 2020, 16:00 (TR Time)

### **Conductors:**

**Mr. Cengiz Eroldu, CEO**

**Mr. Fabrizio Renzi, CFO**

**Mr. Mehmet Ağyüz, CFA - Investor Relations Manager**

Conference Call Conducted by Chorus Call Hellas



CHORUS CALL HELLAS

PROVIDER OF TELECONFERENCING SERVICES

TEL: +30 210 94 27 300

FAX: + 30 210 94 27 330

Web: [www.choruscall.com](http://www.choruscall.com)

## **Q&A SESSION**

OPERATOR: The first question is from the line of Bespalov Vladimir with VTB Capital. Please go ahead.

BESPALOV V: Hello, thank you for the presentation. Congratulations on good numbers. I would like you ask you first about the current situation in general. With the April being almost over, how the things are going on, on your export markets and on the domestic market in April?

And the other question is like your take or pay contract how should we look at profitability especially margins, let's say, in the second quarter and maybe throughout the year, because when I tried to insert the new guidance into my model, I got extremely high margins there, both for EBITDA and for profit before tax, maybe you could comment on this a little bit? Thank you.

RENZI F.: Okay, good morning Vladimir. Thank you for your question. Let me start from the second one, because I expected this question about take or pay could be one of the drivers of this call. But I don't... really I don't want to disappoint you, but we don't like to discuss the take or pay mechanism into detail, because we cannot. So the take or pay is a confidential part of the agreement with FCA. We cannot disclose exactly the terms. As you can imagine, this is not only a question of confidentiality, but this is also a question of competitiveness for FCA on the European market.

Nevertheless, I am conscious that in the current situation...in this extraordinary situation, this is an important factor for you. What I can say in this moment is that this mechanism...this, take or pay mechanism remain in force, and it is not suspended first of all.

I can add that as usual the shareholder will discuss in a cooperative way the moment, and they will find the right way to protect and preserve the joint venture in this difficult period. This happened in the past 15 years and this will happen also in the...in this additional challenging period. What I can add, the major portion taking into consideration that the major portion of the take or pay consist in the investment reimbursement.

The investment for the products manufactured by Tofaş, this is a due amount never questioned in the past. Having said that, please trust in the longstanding success story of Tofaş. So in summary, take or pay mechanism remain there, it's not suspended.

About the trend of the demand, we can say that apart the result of April as you know; we are not ready to discuss April. We have read on the newspaper that the Italian market for example that is an important market, for Tofaş, it is expected a reduction of 97%. So you can imagine what is the situation in Italy and in the other markets due to the lockdown. If you want, I can move a little bit attention on the guidance, and what we expect for this quarter.

For this quarter in export, we expect a drop of around 70% compared to the initial guidance, and we expect a kind of normalization in the second part of the year...in the second half. We expect around 20% drop in the second half. This is basically bring to our new guidance...bring us to the new guidance that is 30% around all over the year, considering that the first quarter was 11% down.

For the local market, the situation is severe, but if you want the drop is not so dramatically like we expect in Europe and in Italy, so for the local market, we are...we expect around 50% in the second quarter, but we are more optimistic on the second half, so on the second half we expect a recovery that means to be in line with the guidance released at the beginning of the year, or maybe a little bit better. This is in summary what we expect, what we included in our guidance.

BESPALOV V: Yes, thanks very much, helpful. And maybe you could comment a little bit on the CAPEX reduction, you mentioned during the presentation that all product investments are in place. So, basically what are you expecting then, and maybe you will do the postponement of some investments, maybe some more color on this if you could provide?

EROLDU C: But, no big news on the product side, so what does it mean, that all the program remain alive. Of course, the major part of this €200 million is related to Tipo MCA, the project remained in the track and we expect to start the production of the restyled model by this year...by the year-

end, at least for some version we are planning to launch on the market.

As you know, we are working also on the Fiorino prolongation, so we start to also work on this prolongation. And also we continue to work on Doblò, the project is there, we don't know when we can discuss further news about Doblò, and when we can discuss the approval of the project, still it's under discussion technical solution and other kind of technical things. But, the reduction of the investment that you can see in the... in our presentation is not due to the product, but it's basically a kind of cash protection.

So, we are cutting all the investment, mainly the structural one, because we believe that in this period to protect the cash it's one of the priorities of the company. So, the reduction is not linked to summarize, the reduction is not linked to the project programs that remained there, all the program remained active, but it's due to the no product investments.

So mainly structure, and of course, when we can see the possibility to postpone some spending, this is welcome at this year, because we want to take care, we want to protect the liquidity of the company.

OPERATOR: Mr. Bespalov, have you finished with your questions. Okay. Thank you.

BESPALOV V: Just the last one. Just a last one, maybe it's still far away from now, but there was some new regulation regarding dividends in Turkey, a cap of 25% was there, is it like for this year or like it could affect your dividends for 2020 which are distributable next year. Could you maybe comment on this? Thank you.

AĞYÜZ M.: It is still early to comment. Vladimir it is Mehmet here ...but per our understanding for the moment, it impacts this year and it expires, unless they further prolong this it would not impact our next year's dividend, but I would say it's still a very new development and still early stages that we have to see how it progresses for the remainder of the year.

BESPALOV V: Okay. Thank you very much.

COMPANY REPRESENTATIVE: Sure.

OPERATOR: The next question is from the line of Kılıçkiran Hanzade with JP Morgan. Please go ahead.

KILIÇKIRAN H: Thank you very much. There are many scenarios in the market, given the significant uncertainty in the demands outlook, and thank you for sharing the guidance with us. I just wonder, how will your strategy be impacted in case of a U-shaped recovery, something that delays the normalization both in Turkey and Europe? Maybe you can help us to understand the room for cost savings here, what is the fixed cost and the variable that you can save and production schedules?

And the second question is again on the demand side, consequent to pressure and...in the auto companies and also they are the backbone of the economic growth, would it be too optimistic to assume that there could be some easing in the regulations in Europe that could have the production in Europe in general or any thought that you have in various incentives?

RENZI F:

Okay, Fabrizio Renzi speaking. Let me start from the second one that for me is one of the most important points for the future in Europe, in Italy, of course. Of course, this sector needs support and needs subsidy and support from the government. So, in the second half of the year will be very important to see what the governments will put in place to support the sector.

For the moment, we... in our guidance, we didn't take into consideration any support, any subsidy any incentives around Europe. But of course, the expectation is very high. I know better the Italian situation I can comment on that. There is a strong pressure on the Government to implement incentive scheme, and I believe there is a possibility... the possibility that is happening in the second part of the year.

Only take into consideration, the characteristic of the Italian car park, 40% of the car park is old, it's before the EUROFOR. So, it means that there is a car park in Italy older than 15 years. I believe that the government could

focus on this car park, very old and also very polluted. So there is an high expectation on this.

There is another item that is very important for the European carmaker, and this is the CO2 regulation. And this is not an Italian phenomenon, but this is a European phenomenon. So, as you know, this 2020 is the first year of application of the fine connected with the consumption of CO2 of the CO2 emission in Europe. And this fine...and this scheme will be implemented financially at the end of the year.

So, I believe that to implement this year, this kind of scheme, it's really critical for the major part of the carmakers. So, a part of the incentive that in every country the government could introduce will be very important, if the European community could postpone for 1 or 2- year, the application of this fine. These are in my opinion, the 2 main drivers for to revitalize the sector in the second half of the years.

AĞYÜZ M. Related to the first question, Hanzade, could you please repeat?

KILIÇKIRAN H: Yes. So basically, when I look at your guidance and you mentioned that you are expecting a recovery to start by June, more normalization towards August, but no one is sure about this trend, at the moment. So if there's going to be a prolonged duration to reach this normalization like a U-shaped recovery that goes into 2021. How will this be

impacting your strategy? I mean, what are the cost savings that you can initiate?

I think this is the most important thing for us to understand on the business model. I don't know if you can share it. I mean, like fixed cost, variable cost, on OPEX what can you do? Okay.

EROLDU C:

This is a good question, but I don't know if we have all the data to answer your question. Let me start, our guidance is based on the assumption that the health emergency is going to be settled in May or in June. And then, due to the normalization of the emergency, the health emergency, the economy is going to recover in Turkey, but also in Europe. So this is the... I don't know if it is optimistic or pessimistic, but this is the assumption we use to build our guidance, so a kind of normalization in May, June.

If this will be not the case, we need to understand what is next. So we need to understand how long will be the health emergency. And in this moment, we are not able to answer the question. So to answer this question, we need to understand what will be the support by the government in Turkey.

So, for example, you know, in this moment, the major part of the entrepreneurs are using...applied for the short time working allowance. But what will be after June? Same story for Italy, so same story for Europe. So it's a bit premature to answer the question. If the recession or if

the emergency, the health emergency will be longer than expected one, what could happen.

KILIÇKIRAN H: Okay. I think fair enough. Just final stuff about the first question that you answered, you mentioned about that there could be some scrap incentive scheme in Italy because of the very old car park. If it's reasonable to assume that if that would be the situation, you may have a higher chance to gain market share because of the Tipo model? Because that's the... at the low end of the segment, which can benefit from scrapping centers.

EROLDU C: Okay. Of course, on this question we should verify, which is the incentive scheme implemented. But taking into consideration that these old car park I mentioned before, 40% is very old, I suppose, it's the cars owned by people that could be attracted by a cheaper car like our offer. So, I believe that we could have a chance to gain position from these incentives in Italy.

Of course, we need to verify which will be the scheme implemented. But if the target is to renew this old car park, our car could be eligible to be well positioned within these segments of the markets.

KILIÇKIRAN H: Thank you very much.

OPERATOR: The next question is from our webcast participant Onur Marşan with Garanti BBVA and I quote, congratulations on the results. Could you give color on the April sales and the motives behind the revised domestic market, would you be

expecting some incentives to support the domestic markets, especially passenger car sales, or do you believe the low interest rates will continue to trigger domestic demand? Thank you.

EROLDU C: Okay. This is Cengiz speaking, so regarding the local market, of course, the financing is important, and also in this period, it will be most important leverage in the market for the sales, but of course in our assumptions, we take into consideration a normalization after the August. So, in these conditions we are seeing size of this market in this... in that level.

And also today is a common understanding I can say for the duration of the coronavirus, but of course, we have the other B and C, a C plan also, what we are thinking? Also, we will be...we will benefit also in the Turkish market in the coming months because after the coronavirus issue the customer behavior will change most probably and the light commercial vehicles and the low-end passenger car will be more, much more favorable than the past.

But still in April, in Turkey, there is a business, so we are also due to the stock level; we are also missing some sales.

So probably in April the market will also close around, 25,000 or 28,000 units. So, we are making also additional improvement in May. So, the Turkey compared to the Europe is doing very well. So, all our dealers and services are active, so 100%. For this reason, we don't see any

problem, if the assumptions are correct, or will be realized with the numbers of our guidance for the local markets. Thank you.

OPERATOR: The next question is from our webcast participant Selim Kunter with AK Investments. And I quote; your guidance implies 70 to 100K export volume and 55 to 60K domestic sales. Now that we are halfway through the second quarter, did you project the evolution of the sales performance on quarterly basis going forward? You already mentioned that you expect economic activity to resume starting in August. How do you see sales and production trends in the April and August periods? Thank you.

AĞYÜZ M. Thank you for the question. For domestic market, obviously the major part of our revision is mainly stemming from the lost volumes in the second quarter. So I would say in the domestic market, 70% to 80% of the revision is mainly attributable to the second quarter, with an improvement gradually in the second-half of the year.

So for now, we will say, as Cengiz mentioned, that the domestic market trends are not as drastic as in Europe, so there's still activity and we try to be prudent in our domestic market expectation. And let me remind you that there was a sizeable pent up demand ahead of COVID-19 and if the market scenario materializes as we expect, this pent-up demand, assuming macro conditions remain similar, could still be unleashed in a relatively short-time period.

On the export front, the dealerships are as you are aware in Italy and in Europe due to lockdown in the past 2 months, have been closed. There are some positive developments there, but I will say on the export front, the most drastic cuts would be in the second quarter, compared to our previous guidance; around 75% to 80% contraction in our export volumes in the second quarter on a year-over-year basis.

And after that, we would be following the pace of the ending of this lockup period, normalization in Europe, but our guidance, I would say is taking a very cautious approach for this specific report in the second quarter of this year.

OPERATOR:

The next question is from our webcast participant Berna Kurbay with BGC Partners. And I quote, 2 questions, please. First, could you provide a breakdown of your cost of goods sold in terms of how much is fixed costs, including depreciation and how much is variable? Second question, does your current best-case scenario assume no production break in August unlike previous years? Thank you.

AĞYÜZ M.

From cash cost point of view, excluding depreciation, it is around 5% of our cost base is fixed, but of course, you know there is flexibility to bring it further down with some government support but this is the base number, we can provide to begin with.

EROLDU C.: Well, during this time period, we are taking some actions; of course, it will be also dependent on the recovery of the domestic markets. Yes, we may still take a break but the extent of that will be determined by the level of domestic demand. If... actually it is not in our best-case scenario, but if domestic demands recover better than our expectation actually we may... there is a chance that we may move to the second half or in the fourth quarter to achieve...to be able to make. But we have...I would say, like we demonstrated in the past, we have good flexibility at the plant to adjust our production tempo and this will be mainly driven by the demand.

OPERATOR: The next question is from our webcast participant Lutfu Gazioglu with ATA Invest. Thank you for the presentation and congratulations for the results. Is there any potential to extend the production halt beyond 5<sup>th</sup> of May 2020? Many thanks.

AĞYÜZ M.: As you know, we were the last plant that closed operations in Turkey, and we are from a operational point of view ready to open. But, of course, as we mentioned in our public disclosure, the disruption mainly stemmed from supply related issues, and we remain in contact with our major suppliers abroad and we should know in a short time period.

EROLDU C: But I would like to also add one more thing, so to open a plant is not a priority issue. The priority issue are the markets, so when we love the customers, right demand, enough demand and so on, because now everybody is

focused on the opening. You are asking when you are opening, if you are going to open more and...okay, I opened, so what happened?

So if the...Europe is not doing well, so we should not lose also the productivity issue now, because here in this case, which we are facing first time is important the demand, not the opening of 2 plants. It is important that you should not think that every plant is opening, is working with a...working in a productive way.

So, also by opening, you can create also damage to the company so for this reason, it is an important issue, but you should be careful so the opening, I want to repeat again, doesn't mean that you are creating a benefit for the company, because with the social distance, the productivity of the 2 plants now is going down. So also we should fight with this issue. So it is always much more important if we had the demand or not.

So I think, we will have a problem also in the coming months for the part of the demand. Don't forget that 86% of the Turkish industry in the first quarter was export. So when you see the situation in Spain, in Italy and in other countries, so we will need the time also for the...facing the good demand.

OPERATOR:

The next question is from our webcast participant Maria Kolesnikova with Millennium and I quote. Hello, thank you for the presentation. How should we think about pricing strategy for the domestic segment in the light of weaker

demand and especially post such strong pricing trend we observed in Q1 2020? Also how has your input cost basket changed lately, and what sort of impact should we expect when looking at Q2 full year 2020 pricing and margins? Thank you.

RENZI F:

Okay. Thank you for the question. So also because I would like also to continue the statement of Cengiz, the Q2 will be a very challenging period also for the production for the cost, so it is important not only to restart the production but it is important to restart production in a sustainable way. What I mean? The cost during this second quarter will be high, the cost of the production also because the safety measures are expensive.

So when we implemented in our plant the social distancing that has been recommended by the International Health Organization. But, this is expensive, so we are going for example to reduce our speed in order to guarantee the distance between the workers.

So, coming back to the point, pricing and profitability. Of course, will be... the pricing will be under pressure for the high cost of this quarter, but also for the local market we cannot forget the sharp devaluation of the Turkish lira. So, if we combine these 2 elements, of course, the period will be very, very challenging. But, you know, we want to protect our profitability and to protect the profitability is in our DNA and we will do the same also during this quarter, but will be very, very challenging to do this.

OPERATOR: The next question is from our webcast participant Michael Jacks with Bank of America Securities. And I quote. Hi, thank you Fabrizio, Mehmet, it seems that the net FOREX for loss included in other income and expense line items was significantly higher than in previous quarters. While FX impact was expected due to the currency depreciation, hedge accounting makes the income statement impact difficult to predict. Are you able to provide more insight into the Q1 net loss and provide some guidance for Q2 assuming the lira remains near current levels? Thank you.

RENZI F: Okay. To comment the financial part our P&L it's a complicated exercise, because even though in the financial parts you can see some negative effect coming from the FX. You have to take into consideration that in the take or pay mechanism, we receive from FCA the reimbursement of the investment denominated in euro.

So, even though it seems that we suffer some negative impact from the FX, the reality is not like this. As you know, we have the hedge accounting system to compensate all the FX losses.

But, we cannot look only at the financial part of the P&L because there is also the recovery of the FX losses in the operating part through the pricing for export. And due to the take or pay mechanism at that for item is denominated in euro. It's a bit complicated, but I hope I answered the question.

OPERATOR: The next question is from our audio participant. It's a follow-up question from the line of Kılıçkiran Hanzade with JP Morgan. Please go ahead.

KILIÇKIRAN H: I have a follow-up on the inventory level, you mentioned about that there was a sizable inventory increase in the first Q, because of a couple of reasons. And so, is it reasonable to assume that entering into Q3 there is a reason to assume that there will be a de-stocking on your side, so production will be slow, but you will focus more on destocking and how comfortable are you with the current inventory level?

AĞYÜZ M.: Sure, there should be some normalization, but it would be unrealistic to expect something like the level as of yearend last year. But, yes, there should be some normalization.

KILIÇKIRAN H: So you will focus on those things, sorry?

RENZI F: No, please, I want to remark that December is not a reference for the stock because usually you stop the production and the activity for 2, 3 weeks. So, you can reach a level of stock that is the normal one. So, it's not the reference, but for sure we can reduce a bit.

KILIÇKIRAN H: Okay, great. Thank you.

OPERATOR: Ladies and Gentlemen, there no further questions at this time. I will now turn the conference over to Mr. Renzi for any closing comments. Thank you.

EROLDU C: Thank you, operator. And thank you all for joining the call today, and the interest that you show on Tofaş. We look forward to speaking to you the next quarter, it will be July. So really hope that the situation will be better for everyone. I wish you a safe week, a safe weekend. Thank you.