

TOFAŞ TÜRK OTOMOBİL FABRİKASI A.Ş.

TOFAŞ Türk Otomobil Fabrikası A.Ş. 4Q21 Financial Results Conference Call and Live Webcast

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Conductors:

Mr. Cengiz Eroldu, CEO

Mr. Fabrizio Renzi, CFO

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Conference Call Conducted by Chorus Call Hellas



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Q&A SESSION

OPERATOR: The first question is from the line of Lanka Sashank with Bank of America, Merrill Lynch. Please go ahead.

LANKA S: Yes, thank you very much for the presentation, and the opportunity to ask questions. I have three questions if I may. The first question is, are you updating your PBT margin guidance given what we saw this year, I think the previous guidance you gave us was around 8% if I am not wrong.

The second question is on your volume's expectations for both the domestic and the export shipments. You are expecting a pick-up in both of them year-on-year, so what is the downside risk to this and what is your assumption that you are having on the return of the semiconductor chips and the shortage being solved. That's the second question?

And the third question is, I think Stellantis has their strategy update in March, so should we expect an update from your side as well at that time? Thank you.

RENZI F: Good afternoon, Fabrizio Renzi speaking. Thank you for your questions. Let me start from the PBT. As you have seen from the presentation, we achieved an outstanding level, 11.8% well above our previous guidance of 8%. Of course, this... and believe our result is the combination of different factors, some of them are, we can consider permanent, so we will carry on this. Some of them, it's temporary.

So, for sure we can consider that now the level of profitability of the local market is much better than the previous years, so we can consider this part as permanent. We can expect similar... or we are targeting similar performance in the future.

Second factor is the take or pay. Take or pay is there, so in case of drop of the volumes, we will have this protection. We had this protection in 2021, in 2020 so no doubt about the protection of the export volumes. And we had also another factor in December... and November and December that is the strong devaluation of the Turkish lira that support this result. So, this is the reason why in the full year but also in the last quarter we achieved these very good results.

In terms of future expectation, yes, you're right; we are revising our sustainable level of PBT. From now on our target will be 2-digit target, so this is what we are planning for the next year in terms of PBT guidance. This was the first question.

About the volumes 2022, in this moment, in the guidance that we released, we prefer as usual to have a very, very conservative approach, both in local market, in export. In the local market we have two main risks that are in our guidance, in our expectation of the industry for 2022.

First of all, the macroeconomics evolution, so the inflation, the trend of the currency, but on top of that the increase of the cost due to the commodity is something that could affect the market. We have seen the markets in January losing around more than 10%, so this is the reason why we are very

conservative, and this is our concern from the point of view of the demand... commercial demand and customer. Remain also some concern in terms of production capability, so the micro chips electronics crisis is not finished yet.

In the first quarter we are experiencing more or less the same problem we had in the second half 2021. So as a combination of some potential risk in the demands, and some potential risk in the production capability at the shortage of the electronics component, for the moment this 700,000 to 750,000 cars for 2022 is our guidance that, to summarize imply some risk in terms of demand and production capability.

Last question was related to Stellantis. As you maybe know 1st of March will be presented the strategy for the coming years from Stellantis in the Capital Market Day. Of course, we are already working with Stellantis in some projects and some in a multiple scenarios.

So, for the moment what I can say is that we are in line, we are cooperating with Stellantis for the electrification strategy and also for the software strategy. I can make sure that with our R&D center, for example, we are working already in this strategy to reinforce the skill of the company for the future development of the software skills in the company.

So, for the moment, this is... that's all. We don't have any news in this moment that we can officialize in term of future product plan, but we are working on multiple scenarios, if this is the question, and this is what we can share with you today.

LANKA S: Thank you for that. If I can just follow up on the PBT margin guidance, you mentioned double-digit, I think you did 11.1% in 2021. So, I guess, given you are expecting volumes to be higher and also the fact that there could be some inflationary and depreciation of the currency impact, should we assume that it should be ideally higher than this 11% and maybe close to mid teens in terms of percentage or it's...or is that a very bullish assumption?

RENZI F: Okay, I repeat what I mentioned before. So, we need to differentiate permanent effect and what I mentioned temporary effects. In this moment I cannot guess if the temporary effects will be present again in the future. So, for the moment I confirm what I said before. So, the target is double digits, then it depends on which will be the environmental condition, the macroeconomic condition, the export and so on.

LANKA S: Thank you for that.

OPERATOR: The next question is from the line of Demirtas Cemal with ATA Invest. Please go ahead.

DEMIRTAS C: Thank you for the presentation. Hold on. Thank you for the presentation. My first question is about the margin side. While you look at the fourth quarter and when we all look at the details of the FX sides, you know, the gains s on the cash flow hedges below the net income line in the total comprehensive income side, I see around 500 million Turkish lira FX losses from hedges. Could we assume that went through the balance sheet and that just had a positive impact

on your EBITDA figure? So, could we make adjustments to just differentiate the FX side from your EBITDA figure through making such an adjustment to understand the FX impact of that margin expansion? That's my first question.

So directly I'm trying to understand what's your...what was the effect of the currency... steep currency movement on your EBITDA margin? That's my first question.

And the other question is about the domestic market side. The picture was mixed last year, and partially this was related to chip and partially it was maybe related to demand. But as far as I see, demand was stronger. How do you see the outlook at least for the first half of the year, you know, your full year perspective? But how do you see the first half of the year with the current prices, and you know, the conditions. Thank you.

EROLDU C:

Hi, this is Cengiz. Thank you for the questions, Cemal. So, the second... I would like to start from the second one. So, for the domestic market. Actually, we are waiting that there is very strong demand in the market overall, but what you see there is attention for our affordable product range. For this reason, we also expect... we also strongly believe if we can handle the semiconductor shortage issues. We can also outperform in the first quarter.

Your first question regarding the hedge accounting application. So... is in a simple way hedge accounting is a correction of the depreciation, because we are carrying our fixed assets in the Turkish lira terms since long years and

there is a huge... they say difference between today euro and the 7, 8, 10 years before euro and we are making this kind of correction on the depreciation and what we are reflecting on our transfer prices with the mechanism of hedge accounting.

So, for this reason, we also in the past meetings always discussed that the EBITDA margin is not representative margin for the country due to the Turkish lira bookkeeping reality. So, I know it's a little bit complex issue, but I think this is the only explanation of what's happening.

DEMIRTAS C: Maybe Cengiz, I'm trying to understand is, you know, in our minds always there is a sustainable EBITDA margin under normal conditions. So just, you know, as I see this very, very high numbers, I'm trying to understand, I mean, you gave some indication about the profit before tax, say the double-digit, I understand that. So just I just want to, you know, be able to compare what could be the sustainable level for that, though, you said that you know, it shouldn't be a reference?

EROLDU C: Because there is a 50% of devaluation in one week, because this is... this also created this week full of, let's say, fluctuation in our site between the OP and the PBT numbers, unfortunately had a material effect.

DEMIRTAS C: Ok.

EROLDU C: But it's important that the company has a strong PBT, a good double-digit, and as Fabrizio explained at the beginning, and this is also thanks to weak Turkish lira partially which is a temporary. So, for this reason, this kind of high PBT also is

not sustainable, but now as a management as Fabrizio said, we increase also our target to stay at the double-digit level. Thank you.

DEMIRTAS C: Thank you and as a follow-up, Cengiz Bey, what was the first impression of the Stellantis team, you know, visiting Turkey, could you say... share any anecdotal issues that's surprising for them about your plan because when we... when I did go there, we are always impressed but I want to understand at least as an initial expression, could you share any you know critics or any feedback about your operations, just you know an anecdotal thing? Thank you.

EROLDU C: I can say that also for them was a surprise when they understood the level of the plant, also Mr. Tavares underlined at different times also level of the energy and the commitment of people working on the lines.

So, I think it was a completely positive visit and also, we started to make the first benchmarks and there also we are seeing one of the best production center inside the Stellantis, mainly in the European area. So that's also good for us.

DEMIRTAS C: Thank you.

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

BESPALOV V: Hello, congratulations for good numbers and thank you for taking my question. I have a few. First will be media short-term one. As far as I understand this stream in Turkish lira

volatility created I would tailwinds for your margins and in the fourth quarter of last year, but now, we have a different situation. So like probably, you had some costs in late 2021, but now the prices in Turkish lira terms on export markets share probably lower given that the lira appreciated, and I don't know how this works on the domestic market, maybe you could provide some color on that, so whether the prices in Turkish lira are lower on the domestic market as well.

So, can we face a situation when for example in the first quarter of this year what helped you to increase margins in the fourth quarter? Well, act in I would say reverse direction and put some pressure on margins like with some costs being higher and revenues and prices are lower in Turkish lira terms. This is the first question.

The second question is, I looked at this phrase in your presentation that Tofaş is well positioned to serve multiple brands of Stellantis, so maybe you could provide some color on that, what kind of multiple brands you are talking about? And are we... should we expect some changes in the model range and things like this.

And the third question is on Doblo and this project and we discussed many times in the past that you need about one year to one year and half to launch the next generation version of a product. So, the current contract, as far as I understand, expires in 2022. So now, we have like less than 12 months. So, if that's, okay, could you update how you see this project and whether there will be another change of the deadline of the timeline or whatever? Thank you.

EROLDU C: Okay. Hello Vladimir. Let me start from the second. First of all, you mentioned Doblo, no final decision has been taken. So, when we say we are working on multiple scenario means that on the table now there are different solutions, different solutions and different brands under investigation. The good things for us is that in every scenario, we carry on.

The target is to saturate the production in Bursa and there is the objective of Stellantis to exploit the cost advantage in Turkey. So, from this point of view, all the scenario that I confirm, multiple brands meet that. In the future, you will see not only Fiat produced in Bursa but other brands.

But in every scenario, the target is to use the competitive cost advantage in Bursa and to saturate the plant. So, this is the first message.

At this stage, we are not in condition to share the product plan. What I can say is that our target is to approve all the future projects within this year and most probably the first products will be approved in the first semester or maybe before. This could be the good news for all of us. This is what we can share in this moment. So, I confirm that is a multi-brand project. I confirm that the approval will become... within this year will be finalized and most probably the first step will be in first semester or might be before.

This is for. Okay, for the... first your question, if we can see the reverse effect of the fourth quarter in the first quarter 2022? I believe not but let me explain a bit. So first of all, for

export you know, our model is a cost plus, so we don't have the risk to have let me say... we don't have the risk not to charge to the customer some costs whatever is the cost, if the cost is commodity, if the cost is coming from the fluctuation of the currency.

When it come to the local as well everything depends... from us, let me say, because we are able to adjust, let me say our position... pricing position every month.

So, for us independently if the currency or the cost is going up and down, we follow the evolution of the cost in order to protect our profitability. So, all in all, I don't expect any reverse effect if this is your doubts. I don't know if I answered your question, but I confirm that double-digit is now our new target for the year, and we will try to achieve this target from the very beginning of the year. So...

BESPALOV V: Thank you very much, very clear.

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

KILIÇKIRAN H: Thank you. I do apologize, but I just want to clarify again around say PBT margin guidance. I want to just understand if I am on the right track. So, when we look at your quarterly PBT margin evolution, the first half observed something around 200 bps expansion and in the second half, particularly in the fourth quarter, there was a substantial expansion, which I presume the currency move has positive impact.

So, is it, I mean, for the full year you have around 400 bps expansion? So, is it reasonable to assume that that permanent cost savings achieved so far has something around 200 bps addition to your PBT margin, because I think first half is a bit more reasonable period to, I mean, analyze the data, because there was a much, I mean, demand weakness and also there wasn't much currency moves in the first half?

RENZI F: Okay. Hello Hanzade. Okay, I believe that we are at the same page because I mentioned that the target now is 2-digit, and our previous guidance was 8. You remember last year we improved from 7 to 8. So, basically, what I said before means that the increase we are seeing in 2021 is 4% we can consider that 2% is something that will be permanent and stable.

So, I confirm what you, let me say, what you said. And so, we are in line with your understanding. So, 2% is what we gain in terms of performance if you want.

KILIÇKIRAN H Okay, thank you very much. And the second question, I know this is not affecting the PBT, but it is important from our side on modeling, because we have to put some EBITDA. I mean, how much unit production cost increase do you expect in 2022, assuming that there won't be much more supply issues, I mean, maybe you did something on the budget?

AĞYÜZ M: Hanzade, this is Mehmet. Yes, there will be some increase from the higher commodity prices which the full impact will be more visible this year, and there will be some increase, but as a fixed-percentage mark-up cost-plus exporter, the higher the cost, the higher EBITDA generation capability of the

company in export business. In domestic market, the cost increases will continue to be reflected to our prices.

KILIÇKIRAN H: Alright. Okay. Thank you very much.

AĞYÜZ M: Sure.

OPERATOR: The next question is a follow up question from the line of Bespalov Vladimir with VTB Capital. Please go ahead.

BESPALOV V: Thank you for taking my follow up question. It's quite specific one, you mentioned that Tofaş would be a software development center for Stellantis. So, my question is, there is a huge competition for talent and like there is a shortage of software engineers.

So, how you handle this issue and are there enough software engineers available to service such a software development center? Thank you.

RENZI R: Thank you for the question. This is really one of the toughest issues, but we are increasing our collaboration with the... with couple of universities... important universities in Turkey in order to have the better internship and after the recruitment. So, we would invest much on this kind of relation in order to find the right talents also in right quantity, you know, because also we have the ambitions in order to increase the software capacity in Turkey and we see an opportunity there.

But, of course, it's not easy. Your question is also is a correct question, but we are aware, and we are working as I said,

with couple of universities in order to increase their internship programs and recruitments from them. Thank you.

BESPALOV V: Thank you very much.

OPERATOR: There are no further audio questions at this time. And we will now move to our webcast questions. Our first webcast question is from Mehmet Mumcu with Oyak Securities and I quote:

“Congratulations for the laudable 2021 results. I was just wondering, how do you build your Take or Pay receivables when invoicing receivables arising from Take or Pay agreement, are they invoiced at the end of the period as bulk. If so, how much do you think the one-off impact of this situation on gross profitability is since the euro to Turkish lira rate, is at its ATH at this year's billing date?”

AĞYÜZ M: Hi, this is Mehmet, again. Thank you for the question. We are... how we account take or pay on our financials is that we go with the accruals throughout the year. We are billing at certain periods for the Take or Pay throughout the year. But we know how much we will be generating at the beginning of the year because of our Take or Pay contracts. So, we apply accruals on a quarterly basis. As a result, the level of the currency at certain period doesn't have much of an impact on our financials.

If you are referring to the question about, when do you bill, and when do you receive the cash, if there is any currency movement between those two; either devaluation or

appreciation, it will be recorded under other income as FX income or FX loss. So, it doesn't impact our EBITDA that we report on operational level.

OPERATOR: The next question is a follow up question from Mehmet Mumcu with Oyak Securities and I quote:

“We see that your working capital requirement is growing compared to pre-pandemic level. In this regard, what will be your inventory policy for the upcoming quarters? Please give some color both for under the situation of semi-conductor shortage and under normal circumstances?”

AĞYÜZ M: Thank you for the question, again. As you know, we have been operating with a very limited working capital, of which last year due to COVID was distorted slightly. And, of course, we maintain our policy to remain neutral to close to zero on working capital management, external conditions can cause some deviation from this from time to time.

But, nevertheless, you know, if you are referring to the specific inventory level, it is dependent on the... the situation in the market like availability. So, we have been running with the limited availability, but due to sharp depreciation of TL in December, there is obvious currency impact on our inventory. So, rather than going into those in a detail, but on a normalized level you should assume we stick to our policy to maintain our net working capital at relatively very low levels.

OPERATOR: The next question is from Alper Özdemir with Azimut and I quote:

“Hi, should we expect a similar dividend payout proposal to the board versus last year considering a flat CAPEX target and improved leverage position? Thank you.”

AĞYÜZ M: Thank you for the question. Yes, it is technically reasonable to expect a similar payout given the robust free cash flow generation and probably the CAPEX cycle will likely mainly begin next year. So, this year we are in a quite comfortable position to be able to propose a similar payout, but of course it's up to shareholders to decide.

OPERATOR: The next question webcast question is from Alper Özdemir with Azimut:

“Hi, should we expect a similar dividend payout proposal to the board versus last year considering a flat CAPEX target and then improved leverage position? Thank you.”

AĞYÜZ M: I think we answered this question. Next please?

OPERATOR: Next one is from Burak Salman with Degerler and I quote:

“Hello and thank you for the presentation. Could you give us some color on payout ratio from our 2021 earnings? Please.”

AĞYÜZ M: Yes, this has been addressed as well. Any other question?

OPERATOR: There are no further audio or webcast questions at this time. I will now turn the conference over to Mr. Renzi for any closing comments. Thank you.

RENZI F: Thank you, operator. I would like to thank you all the participants for the interest on Tofaş. I wish you all good day, good weekend.