

# TOFAŞ TÜRK OTOMOBİL FABRİKASI A.Ş.

## TOFAŞ Türk Otomobil Fabrikası A.Ş. 2Q19 Financial Results Conference Call and Live Webcast

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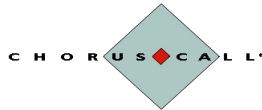
### **Conductors:**

***Mr. Cengiz Eroldu, CEO***

***Mr. Fabrizio Renzi, CFO***

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

Conference Call Conducted by Chorus Call Hellas



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## **Q&A SESSION**

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

BESPALOV V: Hello congratulations on good numbers, and thank you for taking my questions. My first question will be on the outlook for the domestic market. What do you expect in the second half of the year, given that there are no longer...that the incentives are no longer in place? How do you expect the sales mix to change in between passenger cars and light commercial vehicles for Tofaş? And how in general this could affect your margins given that, for example, LCVs as Mehmet mentioned, to generate higher margins on the domestic markets? Thank you.

RENZI F.: Okay good afternoon Vladimir. Thank you for your question. As you have just seen, we decided to review the...our view, our outlook of the markets, so it means that we expect drop on the market because of the termination of the incentive and also having a look to what we have seen in the first 3 weeks of July, the Quarter 3 will be very, very low. But despite this reduction of the markets, we believe that we can keep...we can defend our strong position in the passenger car. So if you have a look our number we are planning to have a market share of around 15% in the second semester, when in the first half we reached an excellent result of 16% market share.

So we are confident that the leadership position...the strong position we acquired with our Fiat Egea could be also confirmed in the second part of the year. For sure, the market will change a little bit, so now we expect that the lower interest rate could

revitalize a little bit the segment of the market that remain far from the markets for the last year, because of the high cost of interest. So we believe that we can attract this part of the markets, also because you know we can...we have the advantage to have our consumer financing company. So this is a little bit the reason why we believe that the strong performance achieved in the first semester could be also not replicated, but as I mentioned 14%-15%, this is what we are planning for the second semester.

BESPALOV V: And in terms of the recovery of LCV sales in the second half, given that there will be no longer...probably to that extent cannibalization by PCs, with no incentives?

RENZI F.: But let me say this recovery will be automatic. If you have followed the explanation of Mehmet in the first semester due to the incentives and due to the way the incentive has been implemented, the passenger's cars receive a particular boost in particular with our Egea we were able to combine the incentives coming from the reduced LCV and also the incentives coming from this scrappage scheme.

So in the second part of the year most probably the advantage for the passenger car will diminish but we can recover a little bit in LCV in particular the segment of the LCV where we suffered the most important reduction is the combi-segments. So this is the part that most probably we are going to acquire again or to recover in the second part of the year. So let me say 15% is our targets in terms of market share, most probably with a rebalanced weight or percentage between passenger car and light commercial vehicle.

BESPALOV V: Thank you very much. And the second question is on margins. First...in the first half of the year we saw that profit before tax margin is quite significantly above your yearly guidance of 7%. So is this kind of a new reality and given that again you switched to 2 shifts and some recovery probably in the domestic LCV sales. So can we expect that margins could stay probably higher than you guided previously? Thank you.

MANAGEMENT: You are right, in the first quarter, the PBT was very, very high, interesting 8.1% in first quarter and we replicate with 7.9% in the second quarter. But as you know, in our...the guideline that we always announce to you is 7% as a sustainable level of marginality at the PBT level. So, let me explain better why we cannot assume that this 8% is the new level that we could reach in the future.

We are having in this result, some structural phenomena, some structural action, so, for example, the reorganization of the plan in 2 shifts is for sure something that give us the possibility to optimize the industrial cost. On top of that, our reduction project continues to go very well. This year, we have a challenging target of €150 per car to be achieved. So this is a part of the structural action that give us the possibility to respect this 7% that for us is the sustainable level.

In the first semester, we have some additional factors that maybe we could not replicate in the coming period. The excellent performance and excellent profitability of the local market is for example, something that could be questionable in the coming period. In particular, in terms of profitability, the Q3

will be very challenging because the competition will be much higher compared to the previous period. So the profitability of the local market will be...not may be in line with the first semester that was excellent. So because of that, coming back to your question, 7% full year is once again the level that we can consider achievable. So.....

BESPALOV V: Okay. Thank you very much.

OPERATOR: We have a follow-up question from Mr. Bespalov Vladimir with VTB Capital. Please go ahead.

BESPALOV V: Okay. Thank you for taking my follow-up question. So one more question is on your CAPEX profile. It was reduced for this year, but we probably know that you're going to spend €200 million euro for the Tipo phase late next year, and probably there will be some more CAPEX coming from for the new Doblò. Maybe you could provide us how significant could be the increase in your CAPEX next year with all these projects in line, may be not an exact guidance, but how we should look at this and going forward may be?

RENZI F.: Okay, let me. You are asking for this year or next year??

BESPALOV V: Next year, next year because there will be the Tipo facelift right? And probably you start the project on the new Doblò. And maybe you could also give some update what's going on with this project and how the talks with FCA are going on?

RENZI F.: Yes, let me start from the last point and then we can come back to the investment. I don't have any news about Doblò

compared to our last conversation. So, what I can confirm is that our engineers are working with FCA engineer in order to find the best option, the best option from economical and technical point of view. There are more than one option on the table and this moment the project is not finalized.

So on this behalf, I'm not able to provide any level of investment for next year due to Doblò because as we repeated, as we mentioned also in the previous conference call, by the end of the year, we can update you but in this moment, we don't have any news to share.

About this year, okay €120 million is the new investment level that we officialize. Basically a major part of the amount is related to Tipo. The slight decrease is only due to the very strict control of the new project investment in the first part of the year, but once again, for the moment, I would like to emphasize the approval of the Tipo project. So only 2 months ago, we have officialized €200 million of investments. In my opinion, this is the best news of the last period for Tofaş. And then the time to discuss Doblo will come before the end of the year.

BESPALOV V: Okay. Thank you. And one more question. Given that probably especially from the next year, we can assume that investment requirements will be much higher, what...how can we think about the dividend policy. Are you still going to distribute pretty hefty dividends like last year? Thank you.

RENZI F: Okay, Vladimir. As usual, this is a question for the shareholders, but as a CFO, I would like to help you. We got the same question 6 months ago and in March, we distributed

the highest paid dividends in the history of the company. If the idea of the shareholders was to keep liquidity to use this liquidity for the new investment you saw that this was not the case. So we distributed investments. So what does it mean? That most probably also for the future, the financing scheme of this Company will remain the same...will remain the same means that external search will be used to finance the project and the dividend distribution will continue like before. This is the story of this Company. But once again, we will see the decision of the shareholders at the right time.

BESPALOV V: Okay. 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: Hi. Good afternoon. My question is on Egea/Tipo contract. I see that you extended this for another one year you mentioned 150,000 units. And I'm trying to understand, are you going to...I mean, this CAPEX that you are going to do \$220 million is it related to facelift in Tipo. And if so, do you think that this may create some sort of weakness in your exports next year ahead of the facelift?

RENZI F: Yes, the 200 million is the facelift of the Tipo. So the investment is related to the technological upgrade of the powertrain. As I mentioned at the beginning...to be on the European market in 2021 it is necessary to upgrade all their powertrain to be in line or close as that is possible with the new emission limits. So yes, the investment is related to the

restyling of the Tipo. The question is if this restyling could help into boost again our sales of course, we hope that...

KILIÇKIRAN H: Not a boost, but we already know that before the facelifts usually the PCs kind of declined. So do you think that, could it be reasonable to see some sort of decline in passenger car exports next year as well because of this investment?

RENZI F: Yes. Sorry, I misunderstood the question. Of course, the risk is that in the second half of next year there could be some reduction. This is the reason why we are trying not to spread the information...and spread all the information about the content of the new generation of Tipo. But, of course, this is a risk that is present to have a...in the second half to 2020 lower volumes.

KILIÇKIRAN H: But these are still, I mean, the new agreements is still under take-or-pay, right, Fabrizio.

RENZI F: Yes, the scheme will be the same. So I mentioned also in the other conference calls that there is no change in the scheme already in place, so cost plus and take-or-pay is still in the contract. And no one for the moment questions these 2 pillars of this contract and of this joint venture so.

KILIÇKIRAN H: Alright. Thanks very much.

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



DEMIRTAŞ C: Thank you for the presentation. And congratulations for good results, my question is about the export potential next year after a slow year, and do you see any risk of lower than 200s, you know thousand units of export this year concerning to your plans and how do you see the output for the following year, do you have any preliminary thing or indication that you could give us? Thank you.

EROLDU C: Good afternoon. Cengiz is speaking. So this is the second question regarding the export performance in the coming years. So of course, Tofas export performance is linked also with the European demand. So how will be next year the European demand in the automotive industry will impact also Tofaş performance, but as you know overall, we are covered with a take-or-pay agreement. So to sell less or more...so we will not bring...of course, if we can go grow more than the European agreement it's good, but if you go to below also we are covered by the take-or-pay agreement. So last forecast for the next European market is slightly down. So we are not seeing an upside in the industry for the next year in the Western Europe, which is our main market.

But as I said, it's all linked with the Western European country industry performance. So we don't see any particular issue regarding our products in the European markets. So also, we need to divide into of course the European market, light commercial vehicles and the passenger cars. So in the one hand, the light commercial vehicles are doing well, also this year, in the first-half, we are monitoring an improving demand. So also from this perspective, we have a certain balance, so as you know, we are exporting more passenger than light

commercial vehicles, but we don't see any particular problem with our product for the next year.

DEMIRTAŞ C: Thank you Cengiz bay.

OPERATOR: The next question is from the line of Kurbay Berna with BGC Partners. Please go ahead.

KURBAY B: Good afternoon. Thank you for the opportunity to ask questions. I have got two. The first one is about the European LCV market, Cengiz where you just mentioned that the European LCV market is going better than the passenger car market. I was wondering why there is a decline in Tofaş commercial vehicle exports to Europe this year. Are there reasons pertaining to particular markets in terms of...

EROLDU C: But Berna, as Mehmet explained at the beginning, so as you know, we ended the Opel contract this year. So last year, we exported around 10,000 units to Opel, so if we take out the Opel from 2018, you can see that our exports are more or less flat compared to the last year.

KURBAY B: Actually even if we exclude that in Doblò and the MCV, there are declines that was why I was wondering if there's any particular reason for a market share losses or maybe inventory rebalancing in the dealers?

RENZI F: Hi Berna. Fabrizio speaking.

KURBAY B: Hello.

RENZI F: Hello. You are right. But if you ever look to the first semester and you divide the first quarter and second quarter, the picture could change a lot. And because we made this exercise. So let me start from the overall performance, so the decline in the first-half was 27%. But this is the combination of 37% of the first quarter where we have explained that most probably, that had come from the previous year. But if you look at the second quarter, so if you look at the trend, the reduction is 17%. But in particular, if you ever look to the LCV and you exclude the effect of Opel, we are pretty in line compared to the previous year.

So if I'm not wrong, we have some units above the previous year, if you compare peer-peer, quarter 2 on quarter 2. So means that this is the reason, if you want...the reason why we decided to confirm our guidance for the full-year. So despite the first quarter, very, very critical, the second quarter give us some hope to reach maybe the lower part of the guidance. I don't know, if I answered your questions, but also...

KURBAY B: That's very clear.

RENZI F: Also the trend of the market of LCV market in Europe and Italy as well, it's good. So this is the reason why we hope the future 2 quarters could be in line with the second and not with the first one.

KURBAY B: That's very clear. Actually, I missed that slide and the appendix of your presentation so apologies for that. And I have one other question and that's about the financial position. Looking at Slide 33 and it was also mentioned earlier that there is a

significant improvement in the cash flows and there is a decline in your net debt. I see that the financial debt has declined by around €140 million within the second quarter, and in fact it was mentioned that your trade payables has increased, and part of this situation is owing to structural changes, but part of it temporary. So I was wondering, in terms of capital structure, what are your thoughts going forward, given the fact that you haven't borrowed for the Tipo investment, as far as, I can tell. Should we expect to see a similar level of financial debts before this investment starts or is it going to...or what we see in the second quarter is quite temporary?

RENZI F.: Yes, let me say...I am not able to give you a right message, but we can assume that the major part of this improvement is a temporary effect that I will try to explain. We have specific payment condition with FCA, so we have a kind of flexibility in the repayment to FCA that will give us the possibility to pay in cash or apply at the late payment. But over the year, we have to respect some payment condition. So basically at the end of June, we decide to postpone the payment because there is this kind of flexibility that we can use with FCA, and this is let me say a very good opportunity for us because this give us the possibility to also manage...managing a better way the liquidity.

But the answer to your question is that part of this...or the major part of this include and will disappear maybe in the third quarter. But nevertheless in the first six months, the cash generation also you have to take into consideration that we distributed 880 million Turkish lira. So in the third quarter, we will continue to generate operating cash flow. Most probably, the investment will be in the last quarters, so I expect also a

good cash generation in the third quarter even though maybe this effect of the payable will disappear.

KURBAY B: Okay. Thank you very much.

OPERATOR: We have a follow-up question from Mr. Bespalov Vladimir with VTB Capital. Please go ahead.

BESPALOV: Thank you for taking another follow up question. On your guidance for the domestic market, I would assume that this guidance implies that the things are as they are now, so no incentives and things like this. But are there any discussions between the industry and the government about some kind of incentives maybe in the fourth quarter or from the next year which probably could create upside for you domestic sales and for the industry in general?

ERODLU C.: So before the end of the incentives, we already spoke with the government in order to obtain the some more period or we also proposed them to apply reduced incentive percentages, not cancellation of the incentives but put on the table a certain program which mark your quarterly can be managed with a different percentages in order not to create impact on the automotive industry. But of course, they are also...they have also the budget deficits so for this season and we are not only alone.

As you know in Turkey, the tax incentives are not only for the automotive industry but also white goods and the furniture businesses. So for this season, I think, they decided not to apply but they will follow so if the industry will not show the

good numbers or better numbers, acceptable numbers, they can apply again. Also this is the words that Mr. Albayrak talked couple of days ago to the press. He said that when they will see a problem in some industries in Turkey they are ready to make interventions.

So for in a short term, we are not waiting, but we will see the numbers of the industry, of course, the numbers of July are not so promising, probably July will close at the level of 15,000-16,000 as a total light vehicles, so this will show...this means around 70% reduction compared to last year. So...but we can see in September or October because August due to the vacation period will be a weak month for the automotive industry.

BESPALOV V: But, in terms of the consumer sentiment, because consumers will probably be waiting for some incentives and from this perspective the third quarter could be quite poor domestically for the industry in general, is this is the right way to look at it?

EROLDU C: That's like also after the Mr. Albayrak speech also, we are also seeing some rumors from the customer point of view. So...but more than also there is another issue because now the customers also are awaiting a reduction on the interest rates, now because after the rate cut of the Central Bank, now also the people in Turkey they are waiting better financing conditions, not only for the cars, but also for the other goods.

From other end, you are also following the exchange rates, it's going down, so also this is creating expectation from customers not only incentives...I think more than incentives, the interests

and the price reduction are the most important expectations, so for this season, I follow you. So, also August like this month probably will be a weak month.

BESPALOV V: Thank you very much.

EROLDU C: You are welcome.

OPERATOR: We have another follow-up question from Demirtaş Cemal with ATA Invest. Please go ahead.

DEMIRTAŞ C: Hi, Cengiz bey, I have another, you know, follow-up question, as you mentioned you know July figure looks like 15,000 units which is the lowest level maybe since 2001. I just wanted to hear, you know, from your previous experiences, could you compare a bit in terms of the, sentiments of the sector parts, could you compare the current, you know, levels or the environment with 2001 and 2008 maybe. You know, it could be helpful for us at least to compare, you know, how each Travel RV, RV are we close to the end of the down cycles. Maybe the incentives are not there, but possibly we can...we can still maybe in the next year. But, the key problem has been about the interest rate. So, interest and currency side. I just want to hear from your experience how do you compare these days with the negative days?

EROLDU C: But, I don't, for me it's not so much comparable with 2001, because in 2001, the issue was related with the fundamentals of Turkish economy, this time more the geopolitical issues are creating pressure on the Turkish economy. So, I cannot say

that the fundamentals of the Turkish economy are weak, like we used to have in 2001.

For this season too because at the beginning of this economical problem, I went to see...I went to see what happened in the last, to the crises in Turkey, at that time the recovery was in two years, both also in 2001, particularly in automotive industry, we faced the recovery in two years-time.

But this time, it is not easy to make a forecast because the geopolitical tension here is important. So, when the...not only Turkey but also the region will calm down and so that also will be important indicator. For this season, I cannot say that this time we will follow 2001. It can be more quicker or it can be more longer.

DEMIRTAŞ C: Above the affordability side, you know, already the car park is not small in Turkey right now and that they still make little bit activity in the second hand cars. But how do you see the affordable levels? You know, if the currency comes down or the interest has come down, do we think, you know, like could it become more affordable, do you think that affordability, you know, is also a problem right now?

EROLDU C: But, I think in Turkey there is still a young, a young demand for the cars. So, if we will see the low level of interest rate and low level exchange rate, of course this is not good for the exporters, but for the local market it is good. So, we can see some improvement on the sales, now because what we are waiting with starting with August and September, we will see much



more financing offers in the market in the automotive industry, so that I think can increase also the local market.

DEMIRTAŞ C: Okay. Thank you.

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

RENZI F: Okay. I would like to thank all the participants. Also I would like to thank you for the interest that you showed during the session on our business and the evolution of our business. So I would like to wish you a good week and also a pleasant summer break and looking forward to meeting you in the next conference call.