

TOFAŞ TÜRK OTOMOBİL FABRİKASI A.Ş.

TOFAŞ Türk Otomobil Fabrikası A.Ş. 4Q19 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 Bepalov Vladimir with VTB Capital. Please go ahead.

BESPALOV V: Hello congratulations on the good end of the year. I have a couple of questions. First, I would like to ask about the extension of the MCV project. Could you elaborate a little bit on this, whether there is a take or pay component, if there is such a component, what are the volumes covered and what is the capacity allocated to this project?

And my second question is on CAPEX, like if we look at several years ago when you had a heavy CAPEX cycle, this spending was quite high and higher than you guided for 2020. So does this mean that the projects are smaller or the CAPEX has shifted towards 2021, because you have a number of projects to invest during this period? Could you elaborate on this, a little bit as well? Thank you.

RENZI F: Okay, good afternoon Vladimir, thank you for your questions. Let's start from the first one MCV. Just after the approval of Tipo, we start to elaborate and investigate this situation of the... our MCV projects and basically what we realized that with only €20 million of investments, this is the amount that we have approved. We could prolong the contracts till 2024.

Of course there is an interest in the persecution and the expansion of this contract because the car is performing very well. So also in 2019 you can check from the presentation the result was good in export and was good in the local market.

The major part of this investment is for the engine upgrade, so in this moment if you want to prolong the life of a commercial vehicle, starting from 2022, you have to be compliant with the new rule of the Euro 6D Final, so basically this is the major part of the investment. So major part of the investment is related to this upgrade of the engines in order to stay on the market.

But of course there is an interest first of all because the car is performing very well. So as I mentioned this is an extension, so nothing will change till 2021 because the contract is...the previous contract is till 2021, will be prolonged till 2024, so the scheme will be the same so any discussion about the take or pay, any discussion about the cost plus so the rule will remain the same.

About the volumes... about the volumes, so the station is 100,000 vehicles and the split will be more or less 50... 50%, so we believe that in the extended periods the car will perform well in the local market, because the Fiorino in the European market will encounter some problem in term of emission, in term of CO2 emission in particular. So this is... let me say the summary of the MCV project prolongation.

But let me add another comment, in terms of investment it's not so huge, but it's really meaningful for me that Tofaş and FCA decided to prolong the co-operation on the LCV till 2024. So in my opinion this is the strong message from this prolongation of MCV.

Second question is investments. You're right, so €250 million is not the peak of investment in this company. We have seen in the past higher number. The major part of this amount €250 million is related to Tipo, because the Tipo restyling will be the start of production of the Tipo MCA will be in the fourth quarter, so major part of this amount let me say half of this amount is related to Tipo. A small amount is related to MCV.

As you know also we have a structure and delegated investment. The remaining part €250 million is for the Doblo project. But of course, we expect to see higher number in 2021.

BESPALOV V: Okay, thank you very much. That's very clear.

OPERATOR: The next question is from the line of Kunter Selim with AK Investment. Please go ahead.

SELIM K: Hi, everyone. Thank you for the call. My question is on your guidance. How do you see the export markets, there is a slight retreat expectation in your export shipments in 2020. Is this because of slowdown that you see in the market or is it mostly related to the deceleration in demand ahead of the facelift of Tipo?

And on domestic side, the LCV segment has been lagging over the last couple of years. And do you see some recovery this year and how do you see the composition of your sales? I see that you are expecting a 2 percentage point of market share loss, is this related to just on strong base or do you see some

recovery in LCV segment as well, because this is going to be reflected on your PBT margin, eventually?

And just linking to this question, do you see some upside to your margins in 2020? Thank you.

RENZI F:

Thank you. So let's have a look to the outlook for next year starting from the... your first question exports. On our guidance, if I take into consideration the middle of the range, we are assuming 8% reduction compared to this year. As I mentioned at the beginning, on the export we prefer to be realistic, let me say. In 2020, we will not have any positive contribution from the market in Europe and in Italy. So the market is expected to be flat, some association has forecasted minus 2%, but the market will be flat let me say.

So we cannot expect any support from the market. Also the structure of the European market and the Italian one that is very important for us is now clear. So the direction is very clear. So diesel is losing position, gasoline is going up, but the most important trend is hybrid is going very well there is a growth in Italy, I remember this for the moment 23 growth in the hybrid versions. And there is another strong direction in the market that is the preference of the customer for the SUV.

So, unfortunately FCAs is a little bit delayed and with FCA also we are a little bit delayed with this... late with this process. The most important one is the hybridization in my opinion. So this is the reason why our guidance is so conservative on my opinion realistic.

Coming back to FCA, I believe that FCA could come back in the battlefield in the second part of the year. They have just announced the hybrid version of Panda, the hybrid version of 500- family, that means 500 Classic, 500L, 500X.

In July, we'll be also launching the 500 electric. When it comes to Tofaş, as you know, we have approved Tipo, the restyling of Tipo; the car will be produced at the end of the last quarter. So the tangible effect of this car will be visible in 2021. So, let me say for FCA for our export 2020 will be a transition year, this is our view. Second part... like to add something...

EROLDU C:

I can ask with the local market, what Cengiz is speaking. So first of all our expectation for the light commercial vehicle is higher than the last year, because as you know, last year we used to have the scrap incentive which mainly applied to the passenger cars and that's also generated a small gap or better reduce the gap between the turnkey prices of the passenger cars and the light commercial vehicles, but this year we started without this incentive so then the light commercial vehicles will be better positioned in the market.

January is not a so indicative month. So we will see the real result at the end of the first quarter, but we still are planning to have better LCV sales in the domestic market. We reduce our market share forecast from 16% to 14%, because this is mainly due to the scrap incentives also because as you know, the Fiat brand was the more benefited, more gains obtained by Fiat brand with Scraps Law. Now we are working without these incentives.

So for this reason, we are waiting more balanced market, but of course we want to protect our market leadership, and this 14 plus figures will also carry to the leadership in the market.

But as I said, January is not a real indicative month because the... we are also without products in January because our original plan for January was half of what realized, but we are a flexible company from this perspective and we will adjust ourselves to these higher market conditions and we will see also better numbers in the coming months in the Fiat brand.

OPERATOR: Mr. Kunter, are you finished with your questions?

SELIM K: Just a follow-up. Since I can... I understand that you are expecting a... more balanced sales in terms of LCV and PC breakdown in 2020. And since LCVs in the domestic market have a higher profitability, would you expect or should we expect a higher profit before tax margin in 2020? Thank you.

EROLDU C: This is natural result, if you can sell more light commercial vehicles. Of course the profitability is better than the passenger car in our case. So we will see.

SELIM K: Okay. Thank you.

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

HANZADE K: Thank you for the presentation. My question is about your export contract cycle. I know you answered the questions, but I'm trying to understand, so Tipo contracts have been extended,

so you have the contract, if I'm not wrong until the end of 2024. I think you'll also extend Fiorino or Mini Cargo until the end of 2024, and you are Doblo going to, I mean, I don't know whether you're... it's going to announce, but it's... it will start by 2022. So, does it mean that Tofaş will be in a big CAPEX cycle starting from 2021, because I think we need to renew this Tipo and Mini Cargo when we come to 2022, right?

EROLDU C: Right, but for the new generation of the passenger car is a possible project. So we can have other people invest in 2023. And we will start in 2022 because the... as you said, the lifecycle for a moment of our passenger car line is ending at the end of 2024. So the possible project will start in 2025. So far heavy investment mainly in 2022.

HANZADE K: Thank you, Cengiz. And one more question, this Mini Cargo Fiorino model is, I couldn't understand the answer about it, it was extended for another 2 years at a size of 50,000 units or because I remembered it was around 36,000 units under the take or pay contract...but maybe?

EROLDU C: What Fabrizio said, we are waiting at additional 100,000 units for this two-and-a-half year of prolongation.

HANZADE K: Okay. The total volume for the two-and-a-half year, alright.

EROLDU C: For this period will be. So we saw there is opportunity because Fiorino is a very convenient car. So is the... is still attractive for the low-end part of the market, and still there is a customer for these kind of cars, and we want to continue till, we will have the demand.

HANZADE K: Thank you very much.

EROLDU C: You' re welcome.

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

KURBAY B: Good afternoon. I also have a few follow-up questions for clarifying the remarks that you have already made, about Mini Cargo extension. So the 100,000 unit figure you mentioned is the additional volumes that you will receive from FCA between 2022 until 2024. Is that correct?

EROLDU C: FCA and Turkey together.

KURBAY B: Okay. So these 100,000 units includes the sale you will make in Turkey and you will ship to FCA.

EROLDU C: Right.

KURBAY B: Okay. I'm a bit confused about that, because it seems that you are already exporting over 30,000 units to FCA every year, it was 37,000 last year, and 33,500 in 2019. So, these 100,000 for three years basically and plus 33,000 every year. And that excludes the...?

EROLDU C: No it is the conservative site of the... business

KURBAY B: Okay, okay. But, this 100,000 unit is actually what is guaranteed, is that fair to interpret it that way?

EROLDU C: Yes.

KURBAY B: Thank you. And also you mentioned that the investment to be made is only around €20 million and is this going to be completed in 2020 or is that going to be split between 2020 and 2021, until 2022?

EROLDU C: Two years.

KURBAY B: In two years? Thank you. And my final question is about the investments CAPEX budget for this year, €250 million, I just wanted to clarify if I heard it correctly, half of this is people and then part of it is the structural investments as we have seen in the last couple of years. And it also, includes a little bit of Doblo and a little bit of this MCV extension correct?

EROLDU C: That's correct.

RENZI F: It is right.

KURBAY B: Okay. And just one final question, should we expect to see almost no tax expense for 2020 as well as was the case in the past 2 years?

EROLDU C: No, expense but we can have some positive taxes.

KURBAY B: Okay, okay. So, basically no tax in perhaps...?

RENZI F: In case will be a positive effect because, you know, part of this line item is based on the deferred tax, you know, and this is

strictly linked with investments. So, no negative but in case we will have opportunities, the size of the investments will be higher like it seems. But, no negative effect on this like for sure, only opportunity.

KURBAY B: Okay. But, just one final question that popped to my mind, in terms of the new Tipo, that will... that you will start producing from the fourth quarter onwards, is that going to involve a hybrid version or anything dramatically different from what you were having at the moment?

EROLDU C: Now Berna... so, for the commercial purposes we don't want to answer to this question.

KURBAY B: Okay. Alright, thank you very much.

EROLDU C: Thank you.

OPERATOR: We have 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. So, I have a question on your leverage. This year we saw a significant reduction of leverage which was partially due to good working capital management and things like this. For 2020, how do you expect this to evolve, given that you will probably pay dividends, you have much higher CAPEX requirement, maybe some additional working capital outlay, how do you see the evolution of net debt and working capital in 2020? Thank you.

EROLDU C: But, as you know Gentlemen, we are very keen of the working capital management. What we are seeing at the yearend balance sheet is not sustainable for the long period. But, as you know, as a Company we are also trying to be at the zero working capital level. So, this is our managerial target. And last 5 to 10 years, we were always at that level.

Of course, this year due to the uncertainty in the market and we are also very keen about the stock management, you are seeing also we have also drastically reduced our inventory level. We want to keep this performance also for next year. And we will be zero from negative working capital also for the next year. So, this is our target as a management. But, not at the level of as I said, this year.

For the financing of the new investments, we don't see a problem because as you said, we have a good financial deleverage, we are continuing to pay the existing loans and our...the total debt level now is very low. This year we are...we will be getting €300 million less levels so we don't see any issue regarding the financing of the new investments and continuing also with the distributing also with the maximum dividends, so we will continue as we did in the last years also in the future with the same positives.

BESPALOV V: Thank you and maybe one more question. Could you explain a little bit, in the presentation, you explained some reduction of exports in the fourth quarter by shifting more volumes to the domestic market due to surge of demand, but how was the take-or-pay contracts working in this respect. Are there fewer players because the export volumes are below the levels which

are contracted in this take-or-pay arrangement? Could you maybe give some technical details on how this works?

EROLDU C: It is only a shift issue and we are not losing anything from the pay part.

OPERATOR: Mr. Bespalov, you are done with your questions?

BESPALOV V: Yes. Thank you.

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

KILIÇKIRAN H: Sorry. I forgot to ask about the question on dividends. I know you are not... you didn't decide probably yet, but is it possible to share your distributable income with us at the moment because I think it is different from what you have in IFRS, so I just wanted some sort of idea about income you generated on dividend accounts as well.

EROLDU C: But also this is a... this is for a moment not a public information, so for this reason...

KILIÇKIRAN H: You don't... that is done for the tax purposes, right?

EROLDU C: As I said, we will continue with maximum dividend distribution policy

KILIÇKIRAN H: Okay. Alright. Thank you.

OPERATOR: We have a follow-up question from the line of Kurbay Berna with BGC Partners. Please go ahead.

KURBAY B: Just one question on debt. The balance sheet is already healthy and you are generating a lot of cash, so you don't actually need to borrow but would it be fair to assume that in order to finance this year's CAPEX programs, you will still borrow because it is all part of the agreement that you have with the FCA.

EROLDU C: Yes, so we will continue with the existing framework, so we will finance the product investments with the financial loans...bank loans.

KURBAY B: Okay. Thank you very much.

EROLDU C: Welcome.

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

DEMİRTAŞ C: Thank you for the presentation. My question is related to your export performance. We see that over the last several years it's in a declining trend. And you know I see a similar trend for 2020. When do you think we are going to be seeing some improvements strategically over the next 3 or 4 years?

What's the optimal capacity utilization that you can handle, with take-or-pays you can just... you have good profitability but do you have any... what are the levels that you are going to be comfortable with your utilization, in terms of exports performance? Thank you.

EROLDU C: But from the utilization level, of course, for the plant is, we will be much more... healthy, if we can have the balanced passenger cars and light commercial vehicle demand first of all because as you know we have 2 separate lines. We are also managing both... let's say both demands coming from the Europe, so for the plant side the optimum level will be around 300,000 and assuming that we will continue to stay at 2-shift level.

Now, we are a little bit below but mainly we are short of the passenger, so light commercial vehicle side, so of course, with the mid-cycle action that we are finalizing at the end... the last quarter of this year, as Fabrizio said also in the beginning of the meeting, we are forecasting to improve our sales on the passenger car side.

But for the light commercial vehicle side for the Europe, we need to wait for the new generation of Doblò because we take this in structure, so the... we are not losing Grande, but also we are not improving the... we are not able to improve the export sales. So what I can say is for a couple of years, we will continue between this range of 260,000 and 300,000 of production.

DEMİRTAŞ C: Thank you, Cengiz and as a follow-up regarding the pricing environment and you know, you are making some investments for the engine side I guess. I don't know how much cost it will have... additional cost. How do you see the pricing environment going forward? You know, what are going to be the factors that you think will affect the pricing going forward in both domestic and export markets? Thank you.

EROLDU C: But as you know in 2019, we had the...we changed to homologation level for the Turkish market and we passed from...or this has mainly from 60 homologation levels to the 60 times levels. And at the beginning of 2021, we will have the 60 final application for the passenger cars. So we don't see a problem of pricing for this year. But of course, next-year with this 60-final application, we will face with another increase on the diesel engine. But today you are following also Tofaş figures, we are good with our gasoline offers, so now we are a little bit out of competition with our gasoline engine.

So I think we have a good competitive position in the local market with the offers, because now most of the brands in Turkey, they are also stopping with their, these automatic cars, but we will continue also with the automatic this year. So for this reason, I don't see any particular problem for the pricing side. So we will try to improve our profitability in local market this year also.

For export as you know, we are deciding... we are working under the cost plus environment and also we are trying to offset the increases coming from the labor contracts or the gap between the devaluation and inflation with the productivity and the cost activities. And these activities in the past years, so although we had an increase on the labor, energy side and the other local cost increases, we were successful to keep our competitiveness in euro terms. So I think also this year we will continue the same trend. We have heavy targets for the productivity also this year.

I strongly believe that not also... not only Tofaş but all the Turkish automotive industry should keep the competitiveness level versus Europe, because also in Europe, the market demand is not increasing, so also the competition in Europe is increasing every year. So our target is also to keep Tofaş competitive as we are today. Another?

OPERATOR: Unfortunately, we have lost communication with Mr. Demirtaş Cemal. 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: Thank you, operator, and thank you all for participating to this meeting and for your interest. I wish you a pleasant day. I look forward to meeting you in the next conference call.