

TOFAŞ TÜRK OTOMOBİL FABRİKASI A.Ş.

TOFAŞ Türk Otomobil Fabrikası A.Ş. 3Q18/9M18 November 2018 Financial Results

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Q&A SESSION

OPERATOR: The first question comes from the line of Bespalov Vladimir with VTB Capital. Please proceed.

BESPALOV V: Hello, thank you for this presentation. Thank you for taking my question and congratulations on your anniversary. My first question is definitely on margins. The question that I have is as Erman mentioned this margin is not sustainable, but to me when I look at it, it doesn't even make much sense, in terms of estimating the company's cash flow generating ability which always is the case with the EBITDA. Maybe... I understand that this is driven by FX things, but maybe, you could walk us a little bit through how you book your revenues, how you book your costs, and how this is associated with cash flows? Because there was pre-significant cash outflow during the quarter, so if you could provide more color on this, so that we understand?

And like as a follow-up to this, if we assume that the lira is stable, let's say, or stronger in the fourth quarter, does this mean that we will see in the next for the financials margins going down quite significantly?

RENZI F: Okay, Fabrizio Renzi speaking. First of all, let me once again remark that this EBITDA is not a sustainable EBITDA, because the sustainable level for us is around 11.5%. As we mentioned before, the major effect come from the FX and in particular the sharp devaluation that we observed in the third quarter. Taking into consideration that what happened in the third quarter is a devaluation of around or above 30% in

three months, but if you want, the major effect was in few days in August. When this happened, the reaction or, if you want, the effect on the revenue and the effect on the cost has a different timing. So this different timing the revenue and the cost react or register the devaluation, make this effect on the EBITDA. So let me say more sharp is the increase and more we have this effect on the EBITDA.

On the other side, on the FX below, the FX effect below the EBIT compensated positive effect that we have in EBITDA. So the right way to look at our results, as we mentioned several time also in the last meeting, is that profit before tax. As you can see the real performance, if you want to measure our real performance, you need to move to the profit before tax, where you can see that 7.4%, 7.6%, it's above the previous quarter, the previous year, but when there is a sharp devaluation, the EBITDA is not the right way to measure our performance if you want.

So please move to the profit before tax, is 04% more that we can observe compared to the previous quarter, is the effect of our real performance, our cost reduction project, our optimization project, and this is the way we are following our improvement in the period and in the coming period.

BESPALOV V:

Okay. And on the fourth quarter, if we see a stronger lira, which is the case now, so can... and then if we look to EBITDA, can it go down quite significantly; the margin I mean?

RENZI F: Quite significantly no, but the most important thing is how sharp is the increase or the decrease in my view, so if the depreciation of the devaluation will continue but in a linear way, we will come back to our usual EBITDA, okay? I don't see the possibility to have a margin below this 11.5% that is the sustainable one. Sustainable one means without big impact of the devaluation.

BESPALOV V: Okay, thank you. My second question would be on the outlook for the Italian market which is the most important. Probably you discussed this with FCA, and how do you see the outlook for this quarter and maybe even more important for the next year? Do you see any threats coming from that part, any risks related to this market?

RENZI F: First of all, let me... let me come back to the result of the first nine months that for me are not so bad. Most probably Erman was a little bit more pessimistic than me, but if we observe the first nine months, and we exclude the effect of the MCV for PSA we are there. So on total, we commented a drop of 6.6%, but if we go into detail and if you want you can have a look to the Page 19, without the effect of the MCV PSA we are there, so we are 2% less. So let me say in the first nine months, this ratio was not so bad, generally speaking. Maybe we can observe decline in people, but an improvement and increase in the block, but overall it's not bad at all, the performance in the first nine months.

So this is the reason why in our guidance, we are forecasting a less quarter similar to the previous year, and this drive us to the 260k that is our guidance for the export.

For the next year... okay, usually when we speak about exports my view is flat, flat estimation, because you know this year the European market is growing a little bit to 3%. In Italy, we are experiencing and we are facing some problem, political problem mainly, but generally speaking the European market is flat.

So next year maybe we will see some recovery in Italy, maybe we will see some recovery in Great Britain, but overall I expect this potential is for a flat export for Tofaş.

BESPALOV V: Thank you, that is clear. And one more question that I have on the latest changes of taxation; on taxation issues. My question is would you be required to lower prices following these cuts in taxes, or this will go like to your margins in fourth quarter?

EROLDU C.: No, we will... Cengiz Eroldu is speaking so we will apply the new, let's say tax rates, and we are not keeping, we are not targeting to keep this tax... tax reduction on our side. So we will reflect to the customer.

BESPALOV V: Okay. Thank you very much.

EROLDU C. : You' re welcome.

OPERATOR: The next question comes from the line of Kayani Muneeba with Morgan Stanley. Please go ahead.

KAYANI M: Hi, thanks for the call, Muneeba from Morgan Stanley. I wanted to understand, given the consumer present changes that you've talked about in Europe, are you thinking about investments in an SUV version of the Tipo, as well as, kind of moving away from diesel engines? That's my first question.

And secondly, if you could talk a bit about dividends clearly large FX impact in the earnings so far given the lira moves. What are your options, could you be using possibly reserves to payout dividends or should we just be thinking about it from the tax financials? Thank you.

RENZI F: Okay, let me start from the second question. Our dividend policy remains the same, so technically as a Tofaş we are ready to remunerate the shareholder as much as possible, but so far we didn't receive any specific instruction and as you know, this will be discussed during the Board and the General Assembly. But we are ready to distribute as much as possible, you know, the distribution is based not on the result that we are analyzing today that is their first result, but we come from the statutory and fiscal result. But technically, we are ready to continue with our policy to maximize the dividend.

Let me introduce two additional topics that maybe is important to highlight for the 2019. First of all, in the second part of the year we are going to restart investments for the product for the next generation of Doblò, so most probably in the second part of the 2019 we will have new financial needs and on top of that we have to be careful because the interest of the... to finance the next product, projects, will be... might

be more expensive than in the past. So this is the reason why I believe that the Board Director and the General Assembly has also to take into consideration this... this part.

About the SUV. Okay, generally speaking, so I don't have any information about the SUV, you also, you asked exactly one specific model, I am not able to comment any news about the future of the SUV. But generally speaking, what I can say is that FCA and the new top management of HCA is reviewing a little bit the plan that was presented in the Capital Markets Day in June. So what does it mean? This doesn't mean that all the previous plan now is cancelled, but FCA is reconsidering some position... is reconsidering some position about, for example, the diesel engine and the future of the diesel and is reconsidering also the possibility to develop other model like the one that you are mentioning, so if it is possible to develop a SUV and more than this I cannot say in this moment.

KAYANI M: Thank you.

OPERATOR: The next question comes from the line of Mr. Demirtaş Cemal with ATA Invest. Please proceed.

DEMİRTAŞ C: Thank you for the presentation. So my question, my first question is related to your balance sheets. When I look at your equity, total equity number, we see a decline because of some production loss from your cash flow risk, and it looks like it's very significant. And, you know, when we look at your profitability we see an income in the, you know, income statement. But when we look at the overall balance sheet

effect the current changes are having, you know, currently you know, currency effects looks very much negative. Could you further elaborate you know, these details? Thank you.

RENZI F: Okay, the explanation of the equity reduction is technical; it's technical and is linked to the hedge account that we apply on the financial liability. So I don't know if you had a chance to comment in the previous meeting that on our financial debts, on our loan we apply our cash flow hedge that generate a negative impact on the equity, I don't know if Devran you want to add something on that or will you... The correct explanation?

AYDIN D: It's... since our investment loans are hedged undertake hedge accounting principle, when the FX rates goes up we account our FX loss under the equity so this is the main reason behind that.

DEMIRTAŞ C: So you know, is there are a critical currency level that could, you know, technically have some, you know further, you know pressure on your equity levels or does it balance it out you know, at certain level, how much could it go down if Turkish lira depreciates further more?

EROLDU C: But what I think Cemal Bey, so what we had in these last month's was one of the peak points. So of course, there is no limits if the euro will be 100 Turkish lira, then we can have also negative equity as a result, but also with only this kind of variation, may be are showing a strong balance.

So the impacts on the Tofaş balance sheet of this kind of sharp... has a sharp devaluation is very limited, and also we improved in total our profit and loss. So this is also showing how Tofaş is a defensive share in the Turkish market.

RENZI F: But let me add something; so the number we are seeing 2.9 billion Turkish lira is the amount at the end of September with an exchange rate of 6.9. So basically, today we are at different exchange rate. So if you want this effect is partially now recovered. And we will see by the end of the year this number that, of course, is... it depends from the impact of the exchange rate on the cash accounting technicality.

DEMİRTAŞ C: Thank you, and my second question is related to the outlook for 2019, you know, how do you need, you know, do we need to take some action on the cost sides for 2019? Because, you know, we experienced in the past you had you know, more difficult times and you passed through very successfully, as I remember you know, from all times.

And how do you, you know, how do you see the outlook for 2019, and how comparable with the previous down markets you know, from your previous experience? Thank you.

EROLDU C: But actually for the next-year, it is important the level of the local market. As you know, in the Turkish market we are the most local company, so 90% of our sales in the Turkish market are from our local production. So for this reason, now after also the incentives declared yesterday...yesterday afternoon, so this can change little bit the picture in 2019 also, because although they said that the incentives will be

valid until the year-end, but our expectation is to see the continuity of these incentives until a certain level of market.

As you know, in March, we will also have local elections, so what we believe is that this kind of incentives can continue also next year. But of course, for the local market to reach the pre-crisis yearly volumes will take some couple of years. As you said in the past also we experience such a period in 2001 and in 2009, and the comeback was more than two years after this kind of...we should be ready also...this kind of lower market also next year, compared this year.

From the cost perspective, it's also a delicate issue because Tofaş is not a short-term looking company. So also we should protect our competencies, but we will find the right size of the company for the coming year. I see most important, the survival of the network because now also our...in Turkey the dealer network is in a certain level of difficulty, because their business also now is going down.

So one hand, we should be careful with our costs, but also from other end, we should protect our network and this, will be the important challenge for the next year.

DEMIRTAŞ C: Thank you, gentlemen.

EROLDU C: Thank you, Cemal.

OPERATOR: The next question comes from the line of Memişoğlu Osman with Bank of America. Please proceed with your question.

MEMİŞOĞLU O: Hello, thank you very much for your time and the presentation. My questions are mostly related to cash flow. One is on CAPEX cycle and one is on a working capital trend. Going forward, how should we expect...you did talk about factoring, but is that going to be available in the fourth quarter or parts of 19 ... 2019, assuming rates stay around here?

And then going back to CAPEX, can you give us any idea on next year's CAPEX, maybe even following year. I am trying to have the... I guess the latest version of your CAPEX cycle, maybe some color on CAPEX for the new Doblò, those kinds of things. Thank you.

EROLDU C: First of all, regarding the working capital, part of the factoring, we can say that we have some small increase on our CBU inventories, but with... now with the incentives in the local market, I think we will fix this, kind of inventory level in November and December, so because for us...our important part of the value also the coverage day of our inventory on the direct material side.

So our inventory days are unchanged only, of course, we are seeing an increase on inventory in Turkish lira terms, but when you see in euro terms compared in June 2018, in fact it did decrease, and this is also normal, we have the same inventory days, but, of course, we have the impact of the...of our stocks currency so ...

Also we will see some, let's say, benefits in the last quarter from our stock currencies. So this also will improve, I believe also in the last quarter, the company financial numbers. So I don't see a problem...particular problem on the inventory side. In the meantime, also we are not pushing so much inventory on the dealers, because also now they are very little bit about their businesses. So now everybody is looking for the working capital issue.

MEMİŞOĞLU O: Sure.

EROLDU C: So also we are... as I said before also in one hand, we are also trying to protect our network and protect also them from the high stock problems, so because we are much more robust than them, but we will... I don't see... as I said, I don't see any issue on the working capital side.

RENZI F: Yes, I don't see any problem, so the cash generation continues to be very positive for me. So also if we have a look to the number of the first three quarters, if we exclude the dividend payment, and if we excluded also the repayment and the fact that we closed the position of the factory and the cash generation is very positive. So apart this particular attention of the inventory...to reduce the inventory, I don't see particular problem in term of cash generation.

MEMİŞOĞLU O: Okay.

EROLDU C: Regarding the investment, of course, we have two types of investments mainly, one first part we can say the structural investments, that is you know we have a certain level of

plants and we should continue to invest on the plant side. And in the meantime, we are also investing to solve our cost and quality problems and also we are investing on the efficiency side. The other chapter are the product investments.

At the Chapter one, next year we will try to spend only the must issues because now the value of the money is important also, so we will try to postpone the structural investments in order to benefit from the high interest rates in Turkey but of course from...when you see the product side, we will continue to invest.

So next year, hopefully, we will start the new generation Doblò investments as Fabrizio said at the second half of the year. But of course this is as, you know, the first year investments and a half year and are not huge amounts; so I can talk about €40 million, €50 million, mainly based on the R&D studies, so for this season also in next year, we are not forecasting future investments.

MEMİŞOĞLU O: Is there... thank you Cengiz, before that, is there a total figure broadly, roughly for the Doblò investment?

EROLDU C: But this is not defined yet because we are working on the different item, that is different versions, different content, but as you know a certain brand new car investments requires minimum of €500 million.

MEMİŞOĞLU O: Yes. And coming back to the working capital, if I may, just for one for minute, do you see any issues with your suppliers,

how are their financial health you think particularly when funding is really challenging and also, you know would that cause any risk to the working capital i.e. maybe you need to lower payable days to support them. Thank you.

EROLDU C: That's important point what you said, now also starting from September, we are following closely our supply chain, I mean not only our first year but also we should be careful with the second year's supplies not because as you know there is a different level of suppliers in this business, so until now we are not facing a bit... important problems.

Regarding the payments, of course, if the... we are looking case by case. In some cases, we are also making some down payments, so because the suppliers are important value for us, so for the sustainability of business we should also protect not only the dealers also the suppliers, so we are very cautious about it and hopefully, we are not seeing a problem for the next year.

MEMİŞOĞLU O: Okay. Thank you very much.

EROLDU C: Thank you.

OPERATOR: The next question comes from the line of Kılıçkiran Hanzade with JP Morgan. Please proceed.

KILICKIRAN H: Hi, thank you. I have questions about this investment in 2019 as well, the new generation Doblò. So I just wonder if there is any chance of electrical vehicle inclusion to this investment? And is there any cost advantage in Turkey to

produce the electric vehicle versus Italy for example? I mean can you please guide us; I mean give us some opinion.

And the second question is that I was looking into SA results. Actually, they report quite good numbers versus the expectations and they had a very good momentum in the U.S. with the RAM brand and doing this renewal process, do you think that you may have a chance to get higher volume for RAM. And the final question is that they were expecting to get rid of the inventory in the fourth quarter as well, so could it be a good sign for your exports in 2019? Thank you.

EROLDU C: Starting from the... you asked Doblò, if there will be Doblò electrical car, right?

KILICKIRAN H: Yes, electric version of the Doblò? I mean is there any cost advantage of Turkey I mean in this particular product? Because I don't have the data, so I don't know if it is reasonable to produce an EV car in Turkey or in Europe, maybe? I mean that's not option, but I try to understand. And second, I understand that you already agreed something so is there any... I mean do you see some sort of upside from the NAFTA region, particularly for RAM brand?

EROLDU C: But first of all, so now... still we are working on Doblò project and we are not... we didn't conclude the agreement and the content and the structure of two projects; is still an open issue between us and FCA, but looking the compliance condition in the western European market, of course, the presence of Doblò electrical version will be very important. And it will be very helpful to fight in the European markets, so we are working but there will be a probability that Doblò

will have the electrical version, but as I said, not defined finally yet.

Regarding the production of electrical vehicles in Turkey or somewhere else, I don't see any advantage for a moment because as you know on the electrical cars, the big portion of the cost is coming from batteries and the electric engine, so unfortunately those two important elements are not produced in Turkey yet, so of course in the future if in Turkey we will see...

So we know that last year, or at the beginning of this year, Zorlu Group made a declaration of a better plans in Turkey, but I don't... heard after the declaration any news about it, if they started to build a plan or still everything is on the paper for a moment. But of course if the so, Doblò will continue to produce in Turkey and also there is a B version is better from the logistic point of view to continue to produce in Turkey. But, I don't see any advantage of producing an electrical car in Turkey or in Europe.

KILICKIRAN H: Thank you. And do you see any opportunity for the U.S. market or NAFTA region on RAM brand?

EROLDU C: But as, you know, so our export to NAFTA region is limited, so yearly we are exporting around 15,000 to 20,000 per year. Of course, the RAM brand is a brand which is also trying to enlarge its area of control, so also not only in NAFTA, but we can see also some RAM cars in the South American markets. So we are also expecting improvement on the Doblò NAFTA

figures or the Doblò RAM figures but I don't think we are going to double export volumes.

KILICKIRAN H: Thank you, Cengiz Bey. And the final question is about export guidance, I know that you have mentioned like that it will be a reasonable to assume something flat exports in 2019. And FCA was giving a guidance that they can get rid of the inventory in the fourth quarter this year. So I mean, is it reasonable to assume at least a flat export volume guidance in 20...? I mean flat volume estimate for 2019, minimum or we can put something on top of that?

EROLDU C: We can take it, because also flat means that we are recovering 15,000 to 20,000 of Doblò GM, because as, you know, also 2018 was the last year of Doblò Opel agreement. So until now, if I am not wrong we produce around 15,000 of cars and in September, so to keep flat means that we are also... we will be try to cover also Doblò Opel volumes next year.

KILICKIRAN H: Yes, thank you.

RENZI F: Yes, on top of that the Italian market is the only one that is negative in 2018 for political reason you know, the new government appointed and all the discussion that is going on with the European community, but is not impossible to assume that might be next year the Italian market will recover something because this year it is three point less but there is space for some recovery in the next year. So could be, could be; the assumption is not absurd.

KILICKIRAN H: Thank you very much.

EROLDU C: Thank you.

OPERATOR: We have a follow up question from the line of Mr. Bespalov Vladimir with VTB Capital. Please proceed.

BESPALOV V: Thank you for taking my follow up questions. My question is on domestic pricing, how much of the lira depreciation has been reflected in your domestic prices so far. And do you see like scope for further increases here. And the other thing is that, could you share maybe what is the share of the local content in your production costs, and what is the share of FX denominated costs? Thank you.

EROLDU C: But reflection of the exchange rate is changing every month in Turkey nowadays as you know. But what can I say until now; we increased our prices around 40%, overall. So nowadays also Turkish lira euro level are there, so we can say that until now we recovered all the exchange rate in our prices not only us also the market. So also in Turkey the average market price increase was around, let's say 40%, but until now so after the August the important part of the transaction are coming from the cars only company stocks.

So new produced cars with the new price list are very limited still in the Turkish market. So for this season I think also...for November and December, I personally waiting that also still some important portion of the sales will continue to be exciting inventories and the production...because also the

flexibility from production to serve, let's say, from at the end of October to markets for the November and December is not easy for all players.

From this perspective we are much more flexible than all others as, you know, we are the only locally passenger car and light commercial vehicle producers in the Turkish market. So our response will be much more... quicker than the others, but of course, it will depend also the inventory levels of the other players in the market.

So from the cost recovery point of view, I can say we and also market is okay, so as average all the players we can say that they reflected in the price list is the impact of exchange rates. Regarding our costs structure, what we are purchasing in the Turkey is around 50% of our cost.

But, of course, don't forget that also Turkey is not a country of any raw materials, so also local suppliers they are obliged to purchase their raw materials from abroad, from this perspective, the real localization percentage in Turkey is lower than 50%.

BESPALOV V: Okay. Thank you.

EROLDU C: Thank you.

OPERATOR: The next question comes from the line of Kurbay, Berna with BGC Partners? Please proceed.

KURBAY B: Good afternoon. I have two questions; the first one is, about the profit before tax margin, you mentioned that would be the more relevant metric to measure performance with. And in the last quarter it was 7.6% and in the first nine months of this year you achieved 7.3%.

I was wondering if you view this as a sustainable level, somewhere around 7.5%, would it be sustainable going forward. Also taking into account the fact that you are probably receiving more on the take-or-pay agreements without production this year and that will go down, perhaps going forward? That's the first question.

And the second question is about the remarks that you've made about the inventory level at the dealers. As far as I understand from the numbers and it has become very clear with your comments, your retail sales actually are higher than your wholesale shipments to the dealers apparently in an effort not to overwhelm them. So where do you see the dealer inventory at this point?

How many months of coverage do you think they have and assuming that this tax cuts helps, would it be possible to see higher production for the domestic market on your end for next year? Thank you.

EROLDU C: But your question is mostly related for this year, so how we are going to end this year, and...but, I understood from the local market wholesales business, you are right, so until the end of September our wholesales figures were very low and were very limited and mainly the retail sales were coming

from the network stocks, but with the new taxation scheme and when I compare the network stocks they have half a month's stock now; because at the end of September, in our network, the total stock level will be around in a maximum... less than 4,000 cars.

So this means that now with the... now incentives we will continue with wholesales to the dealers, because they don't have a stock, so they use their stock during the August and September and October also. But in the meantime also October was a weak month like September. So also we will see a couple of days the market results but we'll get the level of September figures, so for this season this also will help our performance with the second semester, last quarter, because our wholesales performance will increase in local market compared to the third quarter.

PBT, your question regarding the PBT...

RENZI F: Yes, the sustainability of the result that we reach 7.6...

EROLDU C: But also now to give a precise figure is not easy, of course, it's a company management. So every year we are trying to improve our numbers; I mean our PBT in numbers. So, something below 7%, I believe is it should be our common target.

RENZI F: Let me add that we didn't mention before, but we continue with our cost optimization projects. That is going very well. So, also this year like in 2017, the target that we are going to

achieve is a saving on the material that is about €200 per car.

So this is a target achieved in 2017 and that we are going to achieve this year. In terms of cost efficiency project, let me mention also another item.

So we are going to increase continuously the efficiency in the plant, if you consider that we are maintaining the same daily production with... without replacing the turnover, so with the reduction of the headcount's normal turnover. So both of these projects will give us the opportunity to maintain a high-level of profitability before tax.

As Cengiz said, we cannot guarantee 7.6%, but we are there. For next year, you mentioned the duration of the contracts with Opel and impact on the take-or-pay, but we will see.

Of course, we have in mind some action in order to compensate the reduction of the take-or-pay, and so we will see in 2019, but we are confident that we will be able to recover also this negative impact.

KURBAY B: If I heard correctly, you said the unit targeting something below 7% or around 7% Cengiz Bey; I think I missed that part?

EROLDU C: Above 7%, I said.

KURBAY B: Above 7%, okay. Thank you very much.

RENZI F: For this year of course.

EROLDU C: Yes, but as you know when we are talking with the investors, we are always as a company culture also we are not so aggressive.

So we always want to stay at the conservative side, but every time also we are improving our numbers, you are following us, I don't know for how many years?

KURBAY B: Yes. That's very true.

RENZI F: So we are working on that.

EROLDU C: Don't worry.

KURBAY B: No, I'm not worrying at all. Thank you very much for that. And just on the dealer issue that you mentioned, so you're saying... the difficulties on the dealer level that you were referring to before was what you observed in the third quarter, which is why you lowered shipments to the dealers.

But at this point as of the end of October, you're saying that the dealer inventory levels are already low enough that you will now be accelerating your wholesale shipments given the tax cut, so...

EROLDU C: Because as I said, they have half a month the old stocks to cover November sales.

KURBAY B: Okay. Thank you very much.

EROLDU C: You are welcome.

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: Thank you. So dear all thank you very much for your attention, for your timing. We appreciate also your question and interest that you are showing on our company and so I thank all of you.

Good evening. And see you; keep in touch for the next meeting in January.