AYGAZ Q2 2021 Financial Results Conference Call

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Conductors:

Mr. Gökhan Dizemen, Chief Financial Officer

Ms. Şebnem Yücel, Finance and Risk Director

Ms. Selin Sanver, IR Manager

OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Gelly your Chorus Call operator.

Welcome and thank you for joining the AYGAZ conference call and Live Webcast to present and discuss the Second Quarter 2021 Financial Results.

At this time, I would like to turn the conference over to Ms. Selin Sanver, IR Manager and Mr. Gokhan Dizemen, CFO.

Ms. Sanver, you may now proceed.

SANVER S: Welcome to our Earnings Webcast for the Second Quarter of 2021. I am Selin Sanver, and we are together here with our Finance and Risk Director, Şebnem Yücel and our CFO, Gökhan Dizemen. After the call, you can access the transcript on our website.

I would like to remind you that our presentation and the Q&A session might contain forward-looking statements that reflect the company management's current views with respect to certain future events. Although it is believed that the expectations reflected in these statements are reasonable, they may be affected by a variety of variables and changes in underlying assumptions that could cause actual results to differ materially. Neither Aygaz nor any of its directors, managers, or employees, nor any other person shall have any liability whatsoever for any loss arising from use of this presentation.

I will start with a summary of the market and operational highlights, then Mr. Dizemen will talk about the financial overview, and at the end, as usual, we will have time for questions.

According to Energy Market Regulatory Authority EMRA May report, Turkish cylinder gas market contracted by 3% year-on-year, whereas autogas consumption in the first five months of the year was at the same levels as the previous year. Aygaz market shares improved for both segments compared to same periods of the previous year and our market leadership is sustained.

When it comes to our sales volume in Q2, our Autogas sales are 16% higher year-on-year, and our Cylinder gas sales are down by 5% year-on-year, due to the high base effect where both dealers and households increased their purchases and made stockpiling given the uncertainties at the start of the pandemic. As a result, Aygaz domestic retail sales are up by 9% whileour total sales volumes contracted by 16% year-on-year due to the fall in wholesale, export and trading sale.

In terms of financial highlights, our gross profit is 226 million TL and EBITDA is 113 million TL with an inventory gain of 13 million TL in Q2, 2020 versus an inventory gain of 35 million TL in Q1 2021. We also see a positive contribution from the investments accounted under the equity method that led to an increase in net profit. Gökhan Bey will be sharing more details regarding financials.

Now let's take a look at the key highlights for Aygaz market share and Turkish LPG market on Slide #2. According to EMRA May report, autogas consumption and the total Turkish LPG demand for the first five months of 2021 are at the same levels as previous year. On the other hand, cylinder gas consumption contracted by 3% year-on-year.

Aygaz however, preserved its market leader position once again. Our cylinder market share is 41.1%, up by 0.5 percentage point year-on-year and autogas market share is 21.4%, up by 0.7 percentage point year-on-year. We witnessed market shares improvements for both segments compared to the same period of previous year. In terms of total sales, including bulk gas sales, Aygaz overall market share is 26%.

Moving on to Slide #3, our domestic sales volume in Q2 is up by 9% year-on-year and is equal to 235,000 tons whereas wholesale, exports and trading volumes were 206,000 tons with a fall of 34% year-on-year. Accordingly, our total sales volume is 441,000 tons and is at 16% lower year-on-year. In line with the market trends, our Q2,'21 cylinder gas sales are down by 5% year-on-year on the back of a base effect of the start of the pandemic where consumption was higher.

Regarding autogas sales volumes, we see that Q2 autogas sales were 16% higher year-on-year due to the gradual normalization in early June, and again, with low base effects of the start of the pandemic where there were full lockdowns for a longer period of time. Wholesale volume where Aygaz as a supplier of the LPG distributor are 80,000 tons, which is down by 8% year-on-year in Q2, 2021. This is basically due to lower demand in the market. Aygaz UK has no third-party trading transactions in Q2 whereas it was 94,000 tons in Q2 of 2020. They only handled cargos to be used in Aygaz procurement.

Export and transit sales volume reached to 126,000 tons and it's 3% lower year-on-year in Q2 '21. This segment sales constitute a significant portion of our company's international sales revenue where a total of $67 million revenue was obtained in Q2.

On Slide #4, we see 6 months cumulative sales volume performance of our company. Our 6 months domestic sales volumes reached 451,000 tons, and is up by 2% year-on-year. Cylinder sales volume was 140,000 tons and 1% lower year-on-year, whereas our 6 months autogas sales volume is 293,000 tons and 3% higher year-on-year due to the mobility and the demand created in the market by the gradual normalization. Our 6 months exports and trading sales volumes are higher by 6% and 47% respectively, whereas our wholesale volume is lower by 11% year-on-year. Accordingly, our total sales volume reached 977,000 tons for the first 6 months of the year and it's up by 5% year-on-year.

After these operational figures, let me give the floor to our CFO, Mr. Dizemen for the financial highlights.

DIZEMEN G: Thank you, Selin. Welcome to our earnings webcast for the second quarter of 2021. As always, let us start with the Sonatrach LPG prices graph on Slide #6. As you already know, this slide is essential to understand inventory valuation of

Aygaz. After closing March end at U.S. $538 per ton, April and May Sonatrach prices were U.S. $507 per ton and U.S. $462 per ton respectively, which were down by 6% and 9% monthly. Later in June, price has come up to U.S. $493 per ton. This is almost double the price we saw during the same period of the last year.

We have recognized an inventory gain of 13 million Turkish lira in Q2, which is 22 million Turkish lira less than the figure we have recognized in Q1 of this year. Due to the sharp decline in Sonatrach prices in the first half of 2020, we had incurred inventory losses in the amount of 97 million Turkish lira and 34 million Turkish lira in Q1 and Q2 of last year respectively.

With the recovery in demand and positive statistics regarding vaccinations, July Sonatrach LPG price further improved by U.S. $109 per ton (up by 22% monthly) and reached to $602 per ton. This increasing LPG price environment would also contribute positively to Aygaz's Q3 financial results due to the inventory gains to be recognized.

Final note on inventory valuation is that on average, we hold around 60,000 tons of LPG inventory in our tanks as our optimum "priced-in" stock level in order to maintain our operations efficiently. And this optimum inventory level mainly generates the inventory gains and losses for Aygaz.

Moving on to Slide #7, we see the summary of our Q2, 2021 financial results with year-on-year changes. As you can follow on this slide, our quarterly revenue is 2.5 billion Turkish lira and up by 30% year-on-year due mainly to higher LPG prices and exchange rates. On the other hand, total Q2 revenue is down by 13% compared to Q1 of this year, due to lower volumes of Aygaz UK trading. Q2 '21 gross profit is realized at 226 million Turkish lira, up by 1% year-on-year and down by 17% quarter-on-quarter.

Let me give you some additional information regarding our performance at the gross profit level. As mentioned, despite the positive impact of inventory gains recognized in Q2 '21, our year-on-year performance at the gross profit level is almost flat. This was mainly due to the rise in our labor costs and other expenses that are booked under cost of goods sold because of inflation impact and deferred expenses coming from last year.

Given the rising LPG price environment, our ability to increase our distribution margins was also limited during this year. In addition, negative arbitrage between Texas based LPG pricing index (namely, Mont Belvieu) and Sonatrach pricing index led to an increase in our supply costs in Q2 of this year, due to 2 VLGC cargoes that are procured by Aygaz UK on behalf of Aygaz's supply needs and priced-in with Mont Belvieu pricing index.

Refinery closures and decrease in gasoline stocks has resulted in unusual increase in U.S. butane pricing, whereas butane pricing in the Med region did not follow this increase occurred in U.S. due to COVID related lockdowns in Q2 '21, and this has also led to an increase in our supply costs. 17% decline in our quarter-on-quarter performance at gross profit stemmed mainly from the decline in inventory gains, recognized in Q2 of this year compared to Q1.

Moving on to operating profit on Slide #11, we see that our operating profit in Q2 is realized at 68 million Turkish lira, down by 19% year-on-year, and 42% compared to the last quarter of this year. Increase in our operating expenses resulting from the inflation impact, deferred expenses coming from 2020 and expenses in relation to our new investments deteriorated our performance at operating profit level both year-on-year and quarter-on-quarter basis.

On Slide 14, looking at the contributions from our investments that are accounted under equity pick-up method, namely EYAŞ, Koç Group SPV through which Aygaz holds shares of Tupras and Entek, Koç Group's power generation company. EYAŞ's contribution to Aygaz's consolidated financial results in Q2 was 172 million Turkish lira, thanks to recovery in refining margins and inventory gains from rising crude oil prices. Together with Entek, the figure came up to 198 million Turkish lira, and that became the main driver of our strong performance at the bottom line in this quarter. With this positive contribution, especially coming from EYAŞ, Aygaz recorded a net profit of 196 million Turkish lira in Q2 and the net profit margin came up to 8%.

Moving on to Slide 16, our net debt came up to 1.1 billion Turkish lira, increasing by 14% compared to the March end figure. This increase is mainly due to 150 million Turkish lira of dividends distributed to our shareholders and 35 million Turkish lira of capital contribution to Aykargo in April this year.

Our net financial debt to EBITDA multiple is at 1.7 times as of the end of June 2021.

Looking at the debt profile table on Slide 17, our total gross debt increased by 50 million Turkish lira, while net debt increased by 128 million Turkish lira as of the end of June 2021, compared to the end of March. As you can see on the pie chart on the right side of the slide, our total debt is fully denominated in Turkish lira. We want to reiterate the fact that as part of our financial risk management policies, we always target to keep a neutral FX position after considering our inventories as natural hedges, due to their FX linked pricing mechanism.

Looking at the working capital chart on Slide 18, we see that trade receivables are back to its normal level after the temporary rise in Q1, which was due to Aygaz UK's receivables from their third-party trading volumes. And you can also note that there is an increase of 70% in our inventory compared to March-end level. This increase resulted mainly from the rising LPG prices as well as the increase in stock volumes due to seasonal impact.

And finally, looking at forward-looking statements on Slide 19, we update our Autogas sales volume guidance down by 10,000 tons for 2021 from the sales range of 700,000 to 730,000 tons to 690,000 to 720,000 tons due to the negative impact of the full lockdowns that were put in place during Q2. On the other hand, we have not revised our autogas market share and it is still expected to be in between 21.5% and 22.5%. Cylinder gas sales volume ranges at 285,000 tons to 295,000 tons and our cylinder market share is expected to be between 41% to 43%.

Now, let's look at the updates regarding our Bangladesh investments and Aykargo business. Let us start with Bangladesh and our joint venture United Aygaz LPG on Slide #20. The most recent news is that the JV's capital has recently increased by U.S. $12 million in order to fund the first phase of our Chittagong investment and the corresponding share of Aygaz, which is around U.S. $6 million, was paid in early July.

As you might recall from our previous calls, our LPG facility investment plan in the country includes 3 regions of Bangladesh namely Chittagong, Dhaka and Mongla. The first phase of our LPG facility investment in Chittagong, which is the biggest export and import hub of the country, started in May where we envisage a total CAPEX of $25 million. This investment amount includes 2 sphere tanks with a total capacity of around 5,000 tons, one cylindrical tank, LPG filling systems and equipment and cylinders to be procured. Construction of these 2 sphere LPG tanks at our Chittagong facility is planned to be completed in the last quarter of 2022. However, we target to start our cylinder filling and sales operation in the last quarter of this year by using the small bullet tank investment in the facility. Initial orders for cylinders to be procured and then to be sold in the local market has been given to Aygaz's Gebze Plant.

On Slide #21, I also want to share the most recent updates regarding our parcel delivery business under our recently established subsidiary Aykargo. As we have recently announced through public disclosure platform, Koç Holding has acquired 45% of Aykargo shares with a cash price of approximately 16 million Turkish lira. To fund the rollout of Aykargo’s business across Turkey, as I mentioned in the presentation, Aygaz already injected 35 million Turkish lira of capital to the company in Q2 of this year. Additional capital increase of up to 110 million Turkish lira is planned during the second half of this year and Aygaz and Koç Holding will contribute to this new capital increases in their shareholding ratio at Aykargo.

Operation-wise, the company started its operations in Istanbul as a pilot region in early May with 2 transfer centers and 2 distribution centers and they are delivering between 1,000 to 2,000 cargoes per day on average. And regarding the key milestones ahead, we don’t foresee any change as we discussed in our last call. By September 2021, it is planned to start operations in 8 large cities and 8 nearby cities and finally in the first quarter of 2022, we aim to complete our expansion to 81 cities across the country and become a nationwide cargo distribution company.

This concludes my presentation today. Thank you for your patience and now we can take your questions.

Q&A

OPERATOR: We have a question from one of our webcast participants Slama Ondrej with Wood & Co. Hi, everyone. Could you please 1) provide your expectation of Entek's full year contribution in 2021, 2), what is the behind the drop in LPG trading, 3) could you remind us how much cash you plan to invest this year in Aykargo after the Koç transfer and how much as a Koç Group? Thank you, Ondrej.

DIZEMEN G: Thank you for the questions and let me start from the last one. In the second half of this year, our envisaged plan for the capital injection to Aykargo is around 110 million Turkish lira. This amount will be shared between Aygaz and Koç Holding in their respective shareholding ratio at Aykargo.

As for the second question on LPG trading volumes, I think you mean the trading volumes that we make through our Aygaz UK office. In the second quarter of this year, all volumes of Aygaz UK were for Aygaz's own procurements. There were no third party trading and this was also our plan at the beginning of this year. You may already know that Aygaz UK handles one VLGC cargo per month as per its term contract with a US supplier. Our plan was to procure Q2 cargoes for Aygaz Turkey's needs and because of that, we haven't made any third party trading in the second quarter of this year. That's the main reason of our decline in LGP trading volumes in Q2 2021.

And, regarding the expectations of Entek's contributions to our results, we don't provide such detailed financial information on our subsidiaries, but we don't expect any big volatility in Entek's results in the upcoming quarters. You may know that

Entek has already closed a new deal by acquiring 60 megawatt of wind plants from STEAG. We expect that this will also contribute positively to Entek's financial results in the upcoming periods. Thank you.

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

SANVER S: Gelly, we thank you so much. Thanks, everyone, for your participation.