AYGAZ Q4 2020 Financial Results Conference Call

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Corporate Participants:

Mr. Gökhan Dizemen, Chief Financial Officer

Ms. Selin Sanver, IR Manager

OPERATOR: Welcome and thank you for joining the AYGAZ conference call and Live Webcast to present and discuss the Fourth Quarter 2020 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. Selin Sanver, you may now proceed.

SANVER S: Thank you. Good afternoon. Welcome to our Earnings Webcast for the Fourth Quarter of 2020. I am Selin Sanver, and we are together here with our Finance 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's believed that the expectations reflected in these statements are reasonable, they may be affected by a variety of variables and change in underlying assumptions that could cause actual results to differ materially.

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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.

Let's start with the key highlights for the Fourth Quarter of 2020. According to Energy Markets Regulatory Authority, EMRA November report, Aygaz sustained its market leadership, while improving its autogas market share.

2020 will always be recalled as a year that was shaped by the effects of the COVID-19 pandemic. In such a year, while Turkish LPG demand contracted by 7% year-on-year in January and November period, Aygaz 12-month domestic retail sales decreased by 8%. Then again, Aygaz managed to increase its total sales by 4% year-on-year, thanks to growing trading and domestic wholesale volumes.

Starting from the end of November, with the second wave of the pandemic, weekend lockdowns were back into our lives. Consequently, Q4 autogas consumption contracted year-on-year where cylinder demand increased by 2%.

In terms of financial highlights, gross profit and operating profit got the impacts from the weakening domestic retail sales especially in autogas. After the sharp fall of commodity prices in April, the gradual upsurge in LPG prices led to consecutive inventory gains in the last three quarters of 2020.

Aygaz retained its strong cash position through close monitoring and managing of receivables, as well as effective costs and CAPEX management that was sustained all through the year.

Gökhan Bey will be sharing more details regarding the financials.

Now, we can take a look at the key highlights for Turkish LPG market on Slide number 2. According to the latest LPG market industry report published by EMRA, the total Turkish LPG demand for January-November period together with bulk amounted to 3.6 million tons. That indicates a fall of 6.6% year-on-year, which can only be explained by the impact of a pandemic.

Just to sharpen the comparison, when we look at the yearly variation of the Turkish LPG market for the same period in 2019 and 2018, we see that the total Turkish LPG market grew by 0.5%, thanks to a growth of 2% in autogas consumption.

Total Turkish cylinder and autogas demand contracted by 2% and 8% respectively year-on-year in the 11 months of 2020. Under normal circumstances, cylinder contraction will be a little higher and autogas market will be growing. Our company's total market share stand out to be 26% for the January-November period of 2020, and our cylinder and autogas market shares were 42% and 22% respectively. National autogas players keep on getting a more negative effect from the pandemic limitations, compared to local ones since a higher proportion of their dealer networks are located in big cities.

Aygaz 12 months total domestic retail LPG sales volume is 1 million tons, and on top of that, wholesale, export and trading volumes reached 1.2 million tons, with an increase of 17% year-on-year. As a result, our total sales volume is well over 2 million tons and up by 4% year-on-year.

Being an LPG company that handles 2 million tons of LPG annually, makes Aygaz one of the most important players and traders in its region. This also creates it is own economies of scale and advantages on both supply source diversification, prices and trading.

At this point, we should mention the role of Aygaz UK, our trading branch in London, whose physical quantities reached 279,000 tons as of year-end, and it generated a revenue of U.S. $140 million. Wholesale volumes that sums up to 370,000 tons for the whole year is the other contributor to our total sales volume growth.

Aygaz 12 months autogas sales are down by 10% year-on-year, just at the same rate of the end of September. We would have seen some further improvement if the normalization process that's worked in favor of consumption during the third quarter was here to stay longer. However, with the second wave of COVID-19, it has to be put on the shelf.

Starting from the end of November, weekend lockdowns were back and consequently autogas consumption was suppressed. Aygaz Q4 autogas sales are down by 9% year-on-year where for Q3 it was only down by 1%. We also validate the data from our stations whose weekend sales contracted by 80%.

Our 12 months and Q4 cylinder sales are both down by 2% year-on-year. Cylinder sales contraction slowed down basically due to COVID-19 related measures that lead more people to stay and cook at home, especially at times when all restaurants or cafes are closed, but only allowed for delivery services.

Total Q4 LPG sales increased by 16% year-on-year, thanks to the contribution of Aygaz U.K.'s trading volumes since both wholesale and export sales were down by 10% and 19% respectively. Finally, LPG exports and transit sales generated a revenue of U.S. $180 million and reach to 510,000 tons in 2020.

Now, let me give the floor to our CFO, Mr. Dizemen, for the financial highlights.

DIZEMEN G: Thank you, Selin. Welcome all to our Earnings Webcast for Q4 2020. Even when we are finalizing the year COVID-19 remains to play the leading role on our agenda. In such a challenging year, I'm proud to say that Aygaz continued all of it is operations without any interruption and sustained its strong balance sheet.

Aygaz also managed to generate operating and net profits in Q2, Q3 and Q4 of 2020 repeatedly, where Q1 was the exceptional one, historically sudden and strong falling commodity prices led to an inventory loss that had a serious impact on our profitability.

Speaking about the commodity prices, when we look at the LPG Brent World Price Chart on Slide number 6, the steady rise in LPG prices since May led to a total inventory gain of 115 million Turkish lira in the last three quarters of 2020, which worked to eliminate the major part of 181 million Turkish Lira loss created by the sharp price fall in March and April.

As a result, the total inventory loss calculation for 2020 came down to 66 million Turkish Lira for the whole year. At this point, it may also be worth mentioning that we continue to see the rising trend of LPG prices in January and February of this year as well.

Moving on to Slide number 7, we have presented a summary of our Q4 2020 financial results with year-on-year changes. Starting from the top line, our consolidated revenue of 2.9 billion Turkish Lira generated in the last quarter of the year was up by 15% due to higher wholesale and trading volumes and higher exchange rate.

As COVID 19 related precautions including weekend lockdowns were back in effect starting from November, autogas sales were pressurized and this led to a deterioration in both gross profits and operating profit levels in the last quarter of the year.

Q4 gross profit is 259 million Turkish Lira and down by 8% year-on-year. As you can imagine, it becomes difficult to sustain our growth and operating profitability when demand is suppressed by uncontrollable factors such as weekend lockdown due to pandemic.

Q4 operating profit is 89 million Turkish Lira down by 22% year-on-year. Operational expenditures are generally higher in Q4 due to deferred spending throughout the year. Still, we were able to sustain our saving efforts on costs and CAPEX, which created a positive impact on cumulative numbers. Our EBITDA generation for the fourth quarter is 131 million Turkish Lira 11% lower year-on-year.

On Slide 13, we can get into the details of contributions coming from EYAŞ and Entek. I would like to highlight the fact that these investments are consolidated by using equity pickup method in our consolidated financial statement hence the contributions coming from these two companies are based on their net profits.

Q4 was the first quarter in 2020 that EYAŞ's contribution was positive with a 29 million Turkish Lira of gain coming to our consolidated profit and loss. Obviously, this was not enough to offset losses recognized in the first three quarters of the year. EYAŞ's total contribution in 2020 was realized as a loss of 267 million Turkish Lira versus a gain of 48 million Turkish Lira in 2019.

In the case of Entek, total contribution to Aygaz's consolidated financial statement in 2020 was a gain of 72 million Turkish Lira versus a gain of 88 million Turkish Lira in 2019.

All-in-all, our net profit, including the contribution coming from EYAŞ and Entek for the quarter was realized as 78 million Turkish Lira and 5% higher year-on-year.

Now, let's move on to Slide 15, for an analysis of our key balance sheet items. Our net debt increased by 16 million Turkish Lira to 604 million Turkish Lira as of the end of December 2020. We are keeping our cautious approach and continue to keep an efficient level of gross cash in order to maintain our resilience against market turmoils, like the one we experienced in this year.

Looking at our debt profile on Slide 16, you can see that the bulk of our financial depth is denominated in Turkish Lira. In terms of FX, we have a policy of keeping a neutral position and we remain well within our risk management rules.

Our net working capital figure is 247 million Turkish Lira, which is 50 million Turkish Lira higher compared to the end of September. We try to optimize our net working capital requirement by managing our inventory, receivables and payables efficiently. Also, we continue to keep an eye on our dealer risks and track them on a regular basis.

When we come to forward looking statements on Slide 20, our sales volume and market share guidance for 2021 are as follows. Cylinder sales volume ranges at 285,000 to 295,000 tons, and autogas sales volume ranges at 700,000 to 730,000 tons. Our cylinder market share is expected to be between 41% to 43%. Our autogas market share is expected to be in between 21.5% to 22.5%.

Now, I want to give you some more insight about the long-term strategies of Aygaz. In my opinion this triangle on Slide number 22 summarizes it quite well.

The first corner represents our core business where we aim to create sustainable value through supply and distribution of LPG in Turkey.

As you all know, we have been leading the market for 60 years now and always target to keep our leadership position in Turkey.

On the second corner there stands overseas LPG distribution, where we aim to find liberal and growing LPG markets to utilize our expertise.

And finally, the third edge belongs to new business models where we always target to explore on new business opportunities where we can utilize from Aygaz's platform and brand. We believe that these three pillars create a synergy that Aygaz needs as a catalyst.

Our company recently announced two major disclosures via public disclosure platform, which are directly into these long-term strategies of Aygaz.

First, let's talk about Bangladesh investment which has been made in line with our international expansion strategy in the LPG market. As of 20th of January this year, we have signed a partnership agreement with United Group of Bangladesh and established a joint venture based on the principles of equal management. We will have greenfield investment through this joint venture to operate in LPG supply, filling, and distribution business in the Bangladesh market.

Just a few words regarding the country, Bangladesh is 1/5th of Turkey in terms of its land size, and is one of the most densely populated countries in the world with around 160 million people, and its average GDP growth rate between 2015 and 2019 is around 7%, and the LPG market in Bangladesh is the fastest growing liberal market in the world where 85% of the consumption is for domestic use, and it reached around 1 million tons in 2019 and grew by 45% on a CAGR basis, since 2015.

All of this makes it as an attractive investment for Aygaz's overseas LPG distribution strategy. Our JV Partner United Group was established in 1978 in Bangladesh and has become one of the pioneering companies in the country. We can say that they are quite similar to Koç Group. They have a diverse investment portfolio spanning from power generation to health care, education, real estate, and construction.

To fund the investments that is planned to be made by this joint venture in the first 5 years, it is envisaged to raise $75 million of capital from JV partners and $80 million of long-term bank loan financing at the operating company level.

This shall be made in line with the developments and the progress in sales, as well as the business needs of the joint venture company. We firmly believe that our 60 years of expertise in this sector, combined with the local market knowledge of our JV partner will create a successful company in Bangladesh.

On Slide 24, there comes the third corner of the triangle, new business opportunities that we explore on. Cargo distribution through our brand-new subsidiary, Aykargo is an exact match for this definition. Aygaz aims to create additional value in this business segment by utilizing its current assets. These assets can be listed as its generic brand, widespread dealer network, facility infrastructure and home delivery expertise that reaches around 50,000 homes per day.

Our key value proposition at Aykargo will be to establish a leading e-commerce focused cargo player in Turkey. E-commerce is growing significantly in Turkey and the penetration is still low compared to developed countries. And the good news is that this growth is achieved, irrespective of the macroeconomic conditions. As you can imagine, cargo distribution business is also growing in line with e-commerce activities. We therefore believe that there is a really good business opportunity in this sector.

As announced on January 15 this year, we have also signed a partnership framework agreement with McKinsey for the purposes of building a strategic collaboration on Aykargo operations. As mentioned in our public disclosure on this subject, in the first 5 years, Aygaz and McKinsey envisage to invest in Aykargo by injecting a total of $75 million as capital contribution, and to have a partnership ratio of 80% and 20% respectively. We believe in the long-term value generation capability of the cargo distribution business and target to be one of the leading players in this industry in Turkey.

I think, this concludes my presentation today. Thank you for your patience and now we can take your questions.

Q&A

OPERATOR: The first question is from the line of Alagoz Can with QNB Finansinvest. Please go ahead.

ALAGOZ C: Okay, thank you. Thanks for the call. I have a question on your Bangladesh investment. Share transfer is completed as you said, but I am wondering what is going to be your next step? What kind of investments will be taken for this year? And when do you expect any contribution from this business at earliest, and also how much do you plan to inject cash for the joint venture for this year? Thank you.

DIZEMEN G: Thank you for the question. As you mentioned the share purchase agreement was signed back in March 2019. Now, we have concluded the closing process for this acquisition and we've formed a joint venture company right now. The name of the company has been changed as the United Aygaz LPG Limited. We are talking about a greenfield investment in Bangladesh that will be done through this joint venture company, and basically for 2021, we will be establishing the storage tanks that will be used to store the supplied LPG and then we will be establishing the filling facilities as well as the distribution network in Bangladesh. So, 2021 will be an investment year for us, and it will be highly likely to start operations by the end of this year, but you know, it will very much depend on the progress in the market and our investment schedule.

We have already appointed our CEO and CFO for this joint venture. They are from our side and have already started working on a detailed business plan. So hopefully, as I said, by the end of this year, we will be able to see the results of this joint venture to contribute to our consolidated financial statements.

And as also mentioned in our public disclosures, the total CAPEX plan for this investment is $150 million for the next 5 years, of which 50% will be coming as equity injection from JV partners and the remaining 50% will be the long-term financial loans that will be raised at the operating company level.

ALAGOZ C: So do you plan to inject the cash this year or it's going to be divided in 5 years?

DIZEMEN G: Yes, there will be an injection this year, but as I said, this will evolve depending on the detailed business plan as well as the progress that we will have in the markets.

ALAGOZ C: Okay. Thank you very much. And as a follow-up, if you can share any guidance for your cumulative CAPEX budget for this year? It will be appreciated.

DIZEMEN G: Alright.

SANVER S: As we have discussed earlier, our annual CAPEX for an ordinary year only for LPG business is around 100-150 million TL on average, but for this year if anything comes up as Gökhan Bey mentioned regarding other activities, we will see.

OPERATOR: Our next question is from our webcast participants. It is from Slama Ondrej with Wood. Could you please sum up the main milestones for the Aykargo and Bangladesh project in the coming quarters? Could you shed some light on the margin you achieved on the London trading in 2020? What do you expect in terms of LPG pricing in 2021? Could you pay dividend from reserves or we shall expect no dividend given the net income loss?

DIZEMEN G: Thank you for the questions. Let me start with Aykargo and Bangladesh projects. I think that we already discussed Bangladesh project and we have provided the key milestones there. In the case of Aykargo project, as we have announced through our public disclosure there will be $75 million of planned capital injection to the operating company and of this $75 million, $60 million will be coming from Aygaz. And this will be mainly used to fund the growth and rollout of the business across the country.

The key CAPEX would include establishing the transfer centers across Turkey and fleet of vehicles. So, our target for Aykargo project is to reach 81 cities of Turkey by the end of this year. So again, this will very much depend on the progress in our sales as well as development in the markets.

Regarding your second question on our London trading office; the target for us to open a trading office in London is to optimize our supply chain and create additional value from third-party trading volumes. So, we would want to be more proactive in LPG business.

In this business, as you can imagine, the gross margins are thin, especially $5 to $10 per ton are seen as good levels for traders to lock-in their margins. And because of that the profit contribution will be small for Aygaz within its big picture, but if we can increase volumes there then the profitability coming from UK trading office will be beneficial for us.

And your third question was on the LPG pricing. In January and February of this year, the prices continued to increase, and we expect the prices would be much more stable in 2021 compared to 2020, and we will see the benefit of increasing LPG price through inventory gains that we will recognize in our profit and loss statements.

And the final question was on the dividend. As you all know, Aygaz is an important dividend player in the BIST universe and our dividend payout ratio which we already presented in the slide deck is above 50% for each year for the last 5 years. We also have a dividend policy that's been publicly announced and according to this dividend policy, we target to distribute a minimum 50% of our distributable profit to our shareholders.

We always take into account our cash flow projections, investments, financial policies and we always want to make sure that our balance sheet is healthy and that capacity is available to fund our projects. I think that it would be sensible to expect a similar dividend from Aygaz for 2021. And as I said, we are a consistent dividend distributor in the BIST universe.

I think all questions are now covered. Now, we can move on to the next one.

OPERATOR: The next question is still a webcast question. It's from Ulukartal, Esen Koray from Integral Yatirim Menkul Degerler. Hello and congratulations on the financial results. Can you reiterate the share percentages of Aygaz and McKinsey, again, please? And when do you plan to have a positive contribution on your financials from Aykargo? Thank you very much.

DIZEMEN G: Thank you for the question. As we mentioned in the presentation, the share contributions on the Aykargo project will be 80% Aygaz and 20% McKinsey. We have also mentioned about the CAPEX plans for the next 5 years. Hopefully, we will be able to see the positive contribution of this new company by the end of this year. Thank you.

OPERATOR: Thank you. The next question is from the line of Marsan Onur from Garanti BBVA Yatirim.

Thank you for your presentation. Can you please give some detail regarding your new wind power generation acquisition from the STEAG energy?

DIZEMEN G: You may already know that Entek's current portfolio consists of 377 megawatt of power generation, of which 112 megawatt is natural gas and 265 megawatt is hydro. Entek is always scanning the marketplace for new investments and their priority is always renewables.

This new investment of 60 megawatts of wind power generation would also help them to diversify their portfolio. The share purchase agreement has been signed for this new investment and we are expecting for the closing process. The details would be provided once the closing has been completed. Thank you.

OPERATOR: Our next question is from another webcast participant from Demirtas Cemal with ATA Invest. Any guidance on CAPEX for 2021 and 2022?

DIZEMEN G: We have already covered this question as well; we are not providing any CAPEX guidance for the following years. Thank you.

OPERATOR: We have another question from the line of Yilmaz Ezgi from our webcast participants with BGC Partners. Could you provide more color on Bangladesh investment such as plant capacity, targeted sales volume, margin environment, expected revenues, EBITDA? Any figures that you can provide would be helpful, so that we can understand the potential contribution to the evaluation? Thank you.

DIZEMEN G: We have already discussed Bangladesh investment and as I mentioned we have appointed a CEO and CFO for this joint venture. They are working on the details of their business plans for the upcoming years. And the CAPEX plan, the EBITDA contribution might change depending on the progress in our sales as well as the developments in the markets, so I think we cannot give further guidance on that for now.

OPERATOR: Thank you. And we have another question from one of our webcast participants, Oztürk Umut with Oyak Securities. Thank you for the presentation, how much contribution from Aykargo should we expect on Aygaz financials into 2022 and going forward? Thank you.

DIZEMEN G: As I mentioned this Bangladesh and Aykargo projects are greenfield projects. So, 2021 will be our CAPEX year and we hope that we would be able to start operations fully by the end of this year, so that the contribution to our consolidated financial statements in terms of EBITDA, net profit, would be miniscule for this year, as I said, this is basically a CAPEX year for us. The contributions would be much more visible in the next year, I believe.

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.