AYGAZ Q4 2021 Financial Results Conference Call

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Conductors:

Mr. Gökhan Dizemen, Chief Financial Officer

Ms. Şebnem Yücel, Finance Director

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 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: I would like to welcome you to our earnings forecast for the Fourth Quarter of 2021. This is Selin Sanver, and as usual, I am here together 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 the change 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.

So, as usual, I will start with a summary of the LPG market and operational highlights, then Mr. Dizemen will comment on the financial overview, and provide you with an update on our new investments including Bangladesh LPG investments and Sendeo. And at the end, as usual, we will have time for our Q&A session.

Let's start with the key highlights for the Fourth Quarter. According to November report of Energy Market Regulatory Authority (EMRA), Turkish cylinder gas market contracted by 2% year-on-year, whereas autogas consumption is up by 2% year-on-year in the first 11 months of the year. Total LPG market grew by 1% and Aygaz sustained its market leadership. Q4 LPG demand was suppressed by the increasing end-prices due to global LPG price hikes and rise in USD/TL currency rates. Autogas and cylinder gas prices rose by 120% and 100% respectively during 2021. Additionally, the price advantage of LPG over gasoline has been hampered due to the elimination of excise tax on both products and higher LPG cracks over Brent. Accordingly, Aygaz domestic retail sales volume contracted by 6% year-on-year in Q4.

In terms of financial highlights;
Despite narrowing retail sales volumes, Aygaz's consolidated revenue and gross profit in Q4 has enhanced due to increasing LPG prices and FX rates. Operating profit has eroded because of rising operating expenses with inflation, and our new investments in parcel delivery business (i.e.,Sendeo) as well as increase in other expenses from operations including FX losses on trade payables. Net profit excluding non-controlling interests is up by 91% year-on-year and is equal to 149 million TL, with a positive contribution of 164 million TL coming from EYAŞ and Entek that are accounted under equity method.

Now let's take a look at the key highlights for Aygaz market shares and Turkish LPG markets on Slide #2. According to EMRA's November report, for the first 11 months of 2021, Turkish autogas consumption grew by 2%, whereas cylinder gas demand contracted by 2% year-on-year. Overall LPG demand including bulk gas is 1% higher compared to the same period in 2020. Our cylinder market share is 41.2% and autogas market share is 21.5% for the January-November period. In terms of total retail sales, Aygaz market share is realized at 25.4%. All market shares are slightly below last year's figures, which can be explained by the competitive pricing environment in LPG sector.

On Slide #3, let's have a look at cumulative sales performance of our company in 2021. Aygaz 12-month total domestic retail LPG sales volume is 1 million tons, and on top of that, wholesales, international and trading volumes reached 1.2 million tons with an increase of 8% year-on-year. As a result, our total sales volume is 2.2 million tons and up by 4% year-on-year. Handling more than 2 million tons of LPG each year keeps Aygaz as one of the most important player and trader in its region. This also creates its own economies of scale and advantages on both supply source diversification, pricing and trading.

Our yearly autogas sales is up by 1%, while our cylinder gas sales are down by 3% year-on-year in 2021. As a result, Aygaz domestic sales volume reached 992 thousand tons indicating the same level of 2020. COVID related mobility restrictions like the weekend lockdowns in the first half of the year and price increases in the second half had negative impacts on the sales performance of autogas segment. Average purchase volumes of consumers decreased by approximately 20% due to higher prices.

Cylinder gas sales were in line with our program until the end of November 2021. Price increases in November and December caused tangible contraction in especially our dealer demands.

Our wholesale and international sales volumes are equal to 422,000 tons and 550,000 tons, respectively. Aygaz UK's third-party trading transaction volume reached to 282,000 tons in 2021, it's up by 1% year-on-year. Aygaz UK handled third-party traded 6 VLGC cargoes in 2021. Main outlet for these cargoes was the petrochemical companies in the Far East.

Finally, LPG international and transit sales together with Aygaz UK's trading activities constitute a substantial portion of our company's FX denominated sales revenue where a total turnover of $538 million was generated in 2021.

Moving on to Slide #4, let's look at the Q4 sales performance. Our domestic sales volume in Q4 is down by 6% year-on-year, with the pressure caused by higher prices on consumer demand. Aygaz cylinder gas sales and autogas sales contracted by 7% and 5%, respectively.

The total of international, wholesale and trading LPG sales shows our performance as an LPG trader. This figure excluding domestic retail sales also contracted in Q4 by 9% year-on-year. It was basically due to lower trading volumes. Aygaz UK's trading transactions with third parties stayed limited in Q4 and most of its trading activity was for Aygaz's own procurement.

The total third-party trading volume of Aygaz UK was 48,000 tons in the current period compared to 138,000 of Q4 2020. Wholesale sales volume is 133,000 tons and its up by 63% year-on-year, thanks to our expanding customer portfolio with new collaborations.

International and transit sales volume reached to 146,000 tons and is 5% higher year-on-year in Q4 of 2021. These are mostly transit trade transactions with other LPG distributors in Turkey structured to optimize our LPG supply chain, which also enables Aygaz to become a scale LPG player in Med region.

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

DIZEMEN G: Thank you, Selin and welcome, everyone. As Selin covered through the operational highlights section, we were able to sustain our leadership position in both autogas and cylinder gas segments in a not so easy year dominated by various market risk factors including rising commodity prices, inflation, and FX rate hikes.

Speaking on commodity prices, let's have a look at Sonatrach LPG prices graph on Slide 6. Throughout 2021, there was an upsurge in demand as negative sentiment due to COVID-19 eased off slowly, thanks to the increase in global vaccination rates.

On the other hand, supply was not able to keep up, which caused global stocks to be historically low, pushing LPG prices higher. After closing September-end at 661 US dollars per ton, LPG prices reached 7-year highs and realized at 720 US dollars per ton as of December 2021. In the last quarter of 2021, forward market curves for the next year were showing a backwardation structure. Nevertheless, due to general bullish sentiment in energy markets, both crude oil and LPG prices have remained strong in the first two months of 2022. January and February Sonatrach LPG prices are at 711 and 772 US dollars per ton, respectively.

LPG prices are still expected to follow a backwardation structure during the remaining part of this year, falling around 100 US dollars per ton until the year end. It is worth reminding once again that we are actively using financial hedge transactions to manage the effects of possible price movements on our profitability in order to eliminate swings in our annual earnings and dividend distribution capacity.

Our average LPG inventory level is around 60,000 tons as the optimum “priced-in” stock level to maintain our operations efficiently. And this optimum inventory level mainly generates inventory impact for Aygaz. As of the year end, around two-third of our optimum priced-in stock level was hedged with financial instruments including propane and butane papers traded on European markets.

Moving on to Slide 7, let me summarize 12-month 2021 financials first and then get into more details about our Fourth Quarter financial performance. Aygaz generated a revenue of 15.9 billion Turkish lira in 2021, that is 57% higher year-on-year. All profitability figures are higher year-on-year due to the low base effect of 2020 when we were unexpectedly challenged by the COVID-19 pandemic and its negative consequences on almost all businesses and markets.

Our net profit for 2021 reached to 670 million Turkish lira and is positively affected from the contribution coming from our investments accounted under equity method.

On Slide 8, we see the summary of our Q4 2021 financial results with year-on-year changes. When we look at the quarterly figures, Aygaz's Q4 revenues and gross profits were 5.7 billion

Turkish lira and 509 million Turkish lira, respectively, almost doubled the last year's figures on the back of higher LPG prices and exchange rates despite declining sales volumes.

Current quarter's gross profit includes an inventory gain of 260 million Turkish lira compared to a gain of 26 million Turkish lira in Q4 2020. On a cumulative basis, annual impact of inventory valuation for 2021 is a gain of 360 million Turkish lira, whereas it was a loss of 66 million Turkish lira in 2020. On the inventory valuation, it is important to note that these valuation gains booked under gross profit includes both the impact of rising LPG prices as well as US dollar/Turkish lira currency rate due to FX linked pricing mechanism on end-product prices.

You should also note that the impact of increasing US dollar/Turkish lira parity-related inventory gains on gross profit are offset by FX losses on US dollar denominated trade payables, booked under "other expenses from operations" line according to Capital Market Board's reporting requirements.

When we look at the operating profit in Q4, we see 5% year-on-year decline. As mentioned, higher FX losses stemming from US dollar denominated trade payables and increasing operating expenses due to inflation and our new investments in the parcel delivery business (i.e., Sendeo) were the key factors for the deteriorating year-on-year performance at the operating profit level.

Sendeo's total operating expenses in Q4 of 2021 was realized at 49 million Turkish lira. Rising personnel and logistics costs in line with the jump in inflation and energy costs are the other components of the increase in operating expenses that are generally expected to be higher in Q4 due to the deferred spendings throughout the year. As a result, we have generated an operating profit of 40 million Turkish lira in Q4 of this year. Excluding the initial business roll-out operating expenses of Sendeo, our quarterly operating profit is 89 million Turkish lira.

Moving on to our year-on-year performance at the bottom line, we see Aygaz's net profit (excluding non-controlling interest) of 149 million Turkish lira in Q4 2021, up by 91% year-on-year. The contributions coming from our investments that are accounted under equity pickup method, namely EYAŞ and Entek were the main drivers of our strong net income performance in the last quarter of the year. EYAS's contribution to Aygaz's consolidated financial results in Q4, was a gain of 145 million Turkish lira, thanks to continued recovery in refining margins.

Together with Entek's contribution of 19 million Turkish lira, the figure came up to 156 million Turkish lira in Q4 whereas it was 11 million Turkish lira for the same period of the previous year. Despite the negative impact of countrywide draught on the company's hydropower plants, Entek managed to increase its net income in 2021, thanks to higher markets clearing electricity prices. Entek's total contribution in 2021 is 88 million Turkish lira whereas it was 72 million Turkish lira in 2020. Entek's main strategy is to strengthen and diversify its portfolio within the renewable space and currently around 75% of its total generation capacity is renewables.

On Slide 9, you can see the evolution of our net financial debt position in 2021. As of the end of December, our net financial debt stood at 859 million Turkish lira. As you can see, our leverage is still at a comfortable level with our year-end net financial debt over EBITDA of 1.4 times.

Moving on to our debt profile table on Slide 10, considering our projected capital expenditures related to our new investments and due to the increasing working capital needs caused by FX rate and LPG price hikes, we focused on strengthening our gross cash position in Q4. Accordingly, in early December, we completed a new US dollar borrowing and made a TL bond issuance as a precautionary measure to increase our gross cash position. As a result, we see cash and cash equivalents increasing by 385 million Turkish lira compared to September end to 1.7 billion Turkish lira.

As seen on the pie chart on the right side of the slide, our total debt proportion now includes 17% of FX loans corresponding to 30 million US dollar. In terms of FX position, we have a policy of keeping a neutral position after considering our LPG inventories as natural hedges due to our ability to reflect US dollar/ Turkish lira parity increases to our pricing. We continued to remain well within our risk policy limits in 2021.

Looking at the evolution of our net working capital on Slide 11, we see a normalization on net working capital at the end of the year after a decline observed in Q3 due to Aygaz UK's trade payables with extended payment terms. On the other hand, all components of net working capital including trade receivables, inventories and trade payables increased due higher FX rates and LPG prices. To illustrate; there is an increase of around 65% in our Q4 inventory amount in Turkish lira terms compared to previous quarter, whereas inventory volumes held for September and December were almost equal.

On Slide 12, you can see our forward-looking statements for 2022.

Our sales volume and market share guidance are as follows; Cylinder sales volume ranges at 280,000 to 290,000 tons and autogas sales volumes ranges at 690,000 to 720,000 tons. And our cylinder market share is expected to be within 41% to 43%. Our autogas market share is expected to be in between 21.5% to 22.5%.

On Slide 13, let's look at the updates regarding our joint venture, United Aygaz LPG that is on the verge of becoming a player in world's fastest growing LPG market in Bangladesh. You can see from the photos on this slide, construction works are still ongoing as planned at our Chittagong facility. You may recall from our previous calls that our envisaged CAPEX for this first phase Chittagong investment is around 25 million US dollar.

A couple of updates regarding our investment process; Assemblies of two sphere tanks have been completed and installments of cylinder filling system and conveyer have finished. We aim to make these two sphere tanks operational by June 2022. Production of all 200,000 cylinders by Aygaz's Gebze plant was completed, and they reached to Chittagong.

Negotiations continue with local manufacturers for the procurement of an additional 800,000 new cylinders needed in 2022. Hence, our cylinder park target for 2022 is around 1 million units. Approval from the Chittagong port Authority in relation to berthing operations of LPG vessels to the jetty at our terminal was received in December 2021.

We will be able to discharge our own LPG vessels to the terminal once the sphere tanks become operational. In the meantime, our sales team is also actively working towards forming a dealer network in Chittagong and Dhaka. Currently, we have completed and signed contracts with 12 dealers.

In line with our investment plan, we have recently increased the joint venture company’s paid-in capital from 1.1 billion Bangladesh Taka to 2.1 billion Taka in February 2022. After this capital increase, total paid-in capital of United-Aygaz LPG has reached to 25 million US dollars.

On Slide 14, let's go over recent updates regarding Sendeo, our new subsidiary in parcel delivery business. After starting operations of 16 cities in September 2021, we target to complete the rollout of our operation to 81 cities in Q1 of 2022. Sendeo is currently delivering around 15,000+ daily parcels through 8 transfer centers and 5 distribution depots across the country.

Regarding customer satisfaction, we are very pleased that in approximately 400,000 deliveries made between September and January; on-time delivery rate was 96% and quality score tracked by customer surveys was reported as 4.9 out of 5.

Sendeo’s young and talented office and field staff reached 580 employees as of end of December 2021. Putting technology at the core, the company completed development of a new mobile application to be used by all couriers and 17 new technology talents are hired in the past two months. Also, as it is the case in Bangladesh investment, in line with our investment plan, we have increased Sendeo’s capital by 280 million Turkish lira to 423.5 million Turkish lira in February 2022.

As Aygaz, we paid 77 million Turkish lira out of our total portion of 154 million Turkish lira, and the remaining amount is planned to be paid before the end of 2022. Just to remind, Sendeo is operating under 45% Koç Holding and 55% Aygaz ownership.

This concludes my presentation today. And thank you for your patience. And now we can take your questions.

Q&A

SANVER S: We have a written question from Ahmet Cetin. The question is what's your estimated time to start adding revenue of United-Aygaz and Sendeo to Aygaz's financials?

DIZEMEN G: Thank you for the question. As we discussed in our previous conference calls, and as we also indicated in our previous communications, both United Aygaz LPG in Bangladesh and Sendeo businesses are strategic ones for Aygaz. As you all know, these are greenfield investments, and we are making these investments from scratch.

The positive side of such greenfield investments is that the capital injections can be made in installments as needed basis. But on the other hand, the negative side is that it takes time to see the revenue and EBITDA contributions to Aygaz's consolidated financial statements. Given the fact that we are still in the rollout phase of our investments in these two new business initiatives, it will be sensible to expect a minimal revenue and EBITDA contribution in the short-term. But once the rollout of the businesses has been completed, we will see more contribution to Aygaz's consolidated financial statements in terms of revenue and EBITDA. Nevertheless, we strongly believe in the long-term value generation capacity of these two investments to Aygaz's equity value. Thank you.

OPERATOR: We have another question from one of our webcast participants. Ms. Banu Dirim with Global Menkul. Can you give long-term guidance related with new investments contribution to the EBITDA? Thank you.

DIZEMEN G: I think this is more or less similar to the previous question that's been asked by our participants. As I said, we strongly believe in the long-term value generation capacity of these two investments to both our consolidated results as well as equity value. And apart from that, I think we cannot give any more guidance in relation to the P&L contribution of these new investments.

OPERATOR: Thank you. And we will continue with one of our webcast participants, again Mr. Oguzhan Kaymak with Tacirler Yatirim. Thank you for the presentation. I want to ask a question about the dividend distribution. Will there be a dividend payout for this year? Thank you.

DIZEMEN G: Thank you for the question. As you all know, we have a publicly announced dividend distribution policy where we target to distribute around 50% of our distributable profit calculated in accordance with the Capital Markets Board's requirements. When making a decision on our dividends, we always look at our operational cash needs, the CAPEX requirements, capital injections to our new investments, cash generation for the budget year as well as our leverage. And we always want to make sure that after the distribution of dividends, our balance sheet is healthy and our leverage levels are comfortable.

Accordingly, this year's dividend proposal will be made by our Board of Directors in the next couple of weeks and it will be announced through the public disclosure platform, which will also be subject to the approval of the General Assembly to be held by the end of March 2022. This is the general information that I can provide to you regarding dividends at this point. Thank you.

OPERATOR: We will continue with another question from one of our webcast participants Mr. Ugur Bozkurt with Deniz Yatirim. What do you think about dividend distribution? Thank you.

DIZEMEN G: Again, this has been covered within the previous question, so I think we can skip this one.

OPERATOR: The next question is from one of our webcast participants again Ms. Banu Dirim with Global Menkul. Can we hear a little bit about your expectations related with the LPG prices for the short-term and medium term? Thank you.

DIZEMEN G: Thank you for the question. As discussed during the presentation, LPG prices in 2021 reached a 7-year high and currently they are around 750 US dollars per ton levels. The market structure currently is showing a backwardation trend and there is an expectation that the prices will decline by around 100 US dollars per ton by the end of this year. Obviously, there was a similar expectation for Q1 of 2022 when we see those highest levels of seven years as of the last quarter of 2021. However, this expectation was not realized given the bullish sentiment in the global energy markets which had an impact on both Brent and

LPG prices. All in all, in short-term when you look at the market curves, there is an expectation that the prices will decline, but it very much depends on the global macroeconomic conditions as well as supply and demand dynamics. So, when we look at our budgets, we also included this market structures that are driven by the forward curves. As previously discussed, we try to eliminate the impact of the LPG price fluctuations on our P&L by entering financial hedges for propane and butane papers that are traded on the various exchanges.

OPERATOR: Thank you. 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: We thank everyone for their interest and patience.