

WEB CAST TRANSCRIPT- November 8, 2019

Corporate Participants

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Aygaz – IR Manager

Presentation

Operator

Welcome to Aygaz third Quarter 2019 Financial Results earnings conference call. I will now hand over to IR Manager, Selin Sanver. Please go ahead.

Selin Sanver

Welcome everybody and thank you for joining us on our earnings webcast for Q3 2019. I am Selin Sanver and I have here with me Ferda Erginođlu our CFO and Şebnem Yücel, our Finance Manager. After the call, you can access a replay facility on our website together with the transcript.

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 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.

I will start with a summary of the market and operational highlights, then I will hand over to Mr. Erginođlu for the financial overview and at the end, we will have time for questions and answers.

Let’s start with the key highlights for Turkish LPG market. According to the latest LPG Market Industrial Report published by Energy Market Regulatory Authority, the cylinder gas market has tightened by 4.6% year-on-year in the first eight months of 2019, whereas the autogas market was 0.4% higher than the previous year’s figures. The total Turkish LPG demand for January-August period together with bulk was 2.8 million tons and down by 1.1% year-on-year.

In terms of market share, Aygaz continued to be the market leader in all LPG segments. When we compare with the May market share data that we have stated in Q2 earnings webcast, we see enhancements both in cylinder and autogas market share as the summer months of June, July and August are added into the picture. Our cylinder LPG market share as of August is 41.8%, which is down by 0.5% year-on-year; however, it is up by 0.7 points compared to May cumulative data. Autogas market share is 21.9% and one point lower than the previous year, whereas it is up by 0.6 points compared to the first five months of 2019.

These market share improvements between five-month and eight-month figures are basically due to dealer specific action plans undertaken by our sales teams. Additionally, the productivity of newly opened stations were better than the closed stations was.

Regarding cylinder gas market share improvements, we can talk of the loosening price competition that was dominant in the market after the plunge in prices. As our competitors also became keen on profitability, it enabled Aygaz to increase market share through its brand power.

As of the end of September 2019, total Aygaz LPG sales reached 1,548,000 tons resulting with a consolidated revenue of TL 7.645 billion. Aygaz cylinder LPG sales are 232,000 tons and autogas sales are 555,000 tons that sums up to domestic retail sales of 818,000 together with bulk sales. LPG exports and transit sales constitute a significant portion of our company's overseas sales revenue and have reached to 466,000 tons up by 13% compared to last year, and USD 211 million was obtained for the first nine months of 2019.

When we look at the yearly changes in Aygaz sales volumes, starting with the cylinder LPG segment, nine-month cumulative sales were 4% lower than last year. The main reasons stand out to be the continuation of lower commercial sales, due to precautious spending of households, expansion of natural gas transition in locations where cylinder gas consumption is still strong, and our company's choice to remain relatively unresponsive to the price competition in the market in line with our profitability priority.

Urban transformation is another factor that affects cylinder LPG consumers' profile too. Aygaz nine months cumulative autogas volumes are down by 3% compared to last year, which can be explained by the lower demand due to economic slowdown in a market where price sensitivity of the consumers is high and our cautious sales policies towards our dealers aiming to manage trade receivables and risks.

In this environment, Aygaz Q3 total domestic retail LPG sales are up by 1% year-on-year. The sudden economic climate change in [inaudible] 2018 caused a base effect that explains this hike. Furthermore, the falling LPG prices triggered demand favorably. Aygaz Q3 autogas sales are up by 2% year-on-year. The product prices fell by 11% in July and August that led to consumption increase. Summer time is, as usual, the high demand season for autogas and September with a low rainfall came as a gift. Cylinder sales are also up by 0.3% year-on-year. Q3 total LPG sales, as a result, are lower by 3% compared to last year, due to bulk wholesale and international sales that are down by 12 and 5% year-on-year respectively. Wholesale sales continued to be lower to be more national LPG companies started importing for themselves.

So now, let me give the floor to Mr. Erginoğlu for financial highlights.

Ferda Erginoğlu

Hello, this is Ferda Erginoğlu. I will start with the LPG-Brent world prices. I have mentioned this chart before in our first debut webcast. As you can see in the summer months, the average LPG price has seen the levels that hasn't been seen often for the last five years, even though the Brent price is not that low as it was before, three years ago. We followed this ratio between LPG and Brent, and it was very low in the months of July and August.

You can see \$304 per ton for Sonatrach prices and has widened so much, but for the last two months – those are public numbers and you don't see the effect of those increase in our numbers yet, Sonatrach price considerably improved and the ratio went up to 85% levels, that is Sonatrach price versus crude oil. Normally, in the winter months, it should go up to 100%, because of the demand for propane in those regions where it is used for heating purposes, so with the last two changes in September and October, Sonatrach price went up to 377 and 416, so you only see this 304 number here. We expected the Sonatrach price to improve.

The next page is about sales. Well, the only story here is, again, Q3 2018 was based on higher Sonatrach prices, or product prices and it went down by approximately \$240 as opposed to third quarter of 2018. Apart from that, I think our natural gas turnover performed better than last year, but you don't see that in our numbers in this chart, so it sort of removed the effect of decrease in the Sonatrach price, but at the end, turnover quarter-to-quarter was 12% lower.

For the gross profit, well, I think the major story is the inventory difference between Q3 2019 and Q3 2018, and we have outlined this, as the difference between these two quarters is TL 68 million.

Let me give you further information about that. I think it attracts some attention from our investors. We had stock effect of negative TL 13 million during the first three quarters of 2019. Last year it was TL 94 million positive, so there is a big gap between the first three quarters of last year and first three quarters of this year, but in the last quarter of 2018, we have seen a big drop in Sonatrach prices, which was mainly because of the crude oil prices, and we lost about 81 million there. So, as a whole, in 2018, we gained TL 14 million and currently our stock loss stands at TL 13 million.

One of the other reasons and very important reason why our Q3 gross profits have improved also apart from the net effect of inventory valuation, was that we managed to increase our margins, especially in the cylinder gas, and we try to improve our autogas prices as well, but not as much as cylinder gas margins and we tried to control our production costs, therefore, even though there was a difference between inventory valuation in an amount of TL 68 million between these two quarters, we managed to increase our gross profit with our margin increase. We still have a hedged position of 20,000 tons propane and the remaining butane inventories remains unhedged, therefore, if there is any increase in the Sonatrach prices or decrease in the Sonatrach prices, that affects our profits.

As far as operating profit is concerned, we see an improvement around 50%. That is due mainly to foreign exchange related losses in last year, because of the FX increases in the third quarter of 2018. Obviously, this explanation is on top of what we have explained in our gross profit value. The other positive effect is our cost control, we managed to control our costs better than inflation.

So let me switch to net profit. I think the main story here, the difference between Q3 2018 and Q3 2019, apart from what we have explained and financial expenses that went up because of the increase in the interest rates, was TL 50 million effect coming from the investments accounted under equity method, namely and EYAŞ and Entek and our JV with Opet, Opet Aygaz Gayrimenkul.

Obviously, the star of this last quarter as well as the first three quarters is Entek, and Entek has shown a better third quarter comparing to last year. You can see those numbers – I think we mentioned those numbers, but I will highlight it for you. It was TL 6 million last year third quarter and it was TL 29 million this year. It shows that hydrology is still showing positive effects on our hydro plants, even though in the summer, the effects of hydrology becomes less and less, but we still see a better performance, and that is why, as far as EYAŞ is concerned, I am sure you are following the [Tüpraş] numbers, so it is purely a reflection of those numbers.

I briefly mentioned Entek, so I don't need to go into the details of the Entek highlights. It is mainly hydrology and we are seeing the full effects of our eight hydroelectric power plants this year.

Our EBITDA, which is TL 160 million, is better than last year's TL 106 million, and one reason is, as I said, we were able to increase our margins.

The net cash position has shown some improvement. Even though we are still keeping our stocks at a very optimum level, that is one effect, but I think the main effect is the profits are increasing and turning into cash, and we distributed less dividends this year. I think that is the main reason. Even though we provisioned for natural gas price difference, we did not pay, therefore it doesn't have any effect on our numbers yet.

Working capital shows a little improvement, but that is mainly declining prices and, I think, our stock levels are still very much in the same levels with 2018 third quarter.

As for the debt profile, we mentioned our net debt position, it shows an improvement as opposed to last year, and we are still trying to have long-term portfolio of borrowing. Meanwhile, I think we mentioned that before, we are refinancing some of our long-term borrowings by using our prepayment options. It had some negative effects on our numbers, but it will show positive effects – it started showing positive effects in our financial expenditures, it will also show it in the future. I would say that the borrowing environment has been very much relaxed and we are getting better rates than last year.

I think that is about it with respect to explanations of our numbers. I am not going to go into the income statement summary and balance sheet.

As far as forward-looking statements for 2019 is concerned, we are still keeping our numbers and we are very highly confident that we will achieve these numbers.

So I think that is about it and if you have any questions, let me get those and try to answer them as much as I can or we can.

Q&A

Selin Sanver

We have one question coming from ÜNLÜ Menkul Değerler and Koray Pamir.

Koray Pamir

Hi, thank you very much for the presentation, three questions if I may. You mentioned that the Sonatrach prices has been improving in the quarter, although it may lead to financial gains. Do you think it will also impact your margins at the cylinder segment negatively, as the capability to reflect it to the prices may be limited? Essentially, I am asking whether the strong performance of the third of the cylinder segment can be repeated in the next quarter also.

Secondly, regarding the Entek contribution, as you mentioned, the nine months was strong. Obviously, with the normalization in hydrology, are we expecting a tangible decline of the asset to your bottom line over the coming quarters?

Thirdly, regarding your venture in Bangladesh, can you provide a brief update and specify the timing of the next major step or milestone?

Ferda Erginoğlu

The first one is easy. I tried to explain to you the last two increases in the month of October and November, those will positively affect our inventory, definitely, this is public information, but it has nothing to do with our margins. It will be shown as an inventory effect in our numbers.

Is that clear?

Koray Pamir

Yes, no, I understand that. I am wondering if the increase can be reflected to the prices and end user prices at the cylinder segment, or whether the strong profitability of the cylinder segment in the third quarter can also be duplicated in the fourth quarter as well despite this increase in the Sonatrach prices.

Ferda Erginoğlu

If you are asking it from the end user prices, how would the end users are affected and how would they respond, I mean the cylinder gas, it is used mainly for cooking purposes, and if the price goes up, they don't have any fuel to replace. But in the case of autogas that might be difficult, but again once the autogas users are switched to autogas, they continue to use autogas and we are seeing a very strong demand as opposed to last year and the market is growing in the first nine months of 2019. Also, the cylinder gas has been quite strong in the last quarter of this year (the third quarter), and we have seen similar numbers with last year, which is very good. Our numbers have not declined; it hasn't declined in terms of cylinder gas, which is very good.

So if I understood correctly, the increase in Sonatrach price will give us a strong inventory gain, which is a one-off number, it is not a recurring gain. We also managed to increase our margins already, so it will not have any big further effect, but having said that, we try to increase our margins in competition with our competitors, so I cannot comment

on that because it is the result of competition and once the competition is very stiff, if we try to transfer an important dealer, then we increase our discounts, therefore it affects our margin as well. Margin is not a reflection of increasing the price to the customers, but the result of competition.

In the case of cylinder gas, switching is not so easy, but in the case of autogas, it is so easy or there is a huge price competition still going on, even though it might be lower than last year, but luckily, the demand is very good, the demand is very strong.

As for Entek, well, we have seen the hydrology numbers for the – the best hydrology numbers in the last 20 years. I don't know how this last quarter and the remainder of – or next year is going to be, but that would be very tough to see similar hydrology, as we cannot predict Mother Nature.

For Bangladesh, I think we are seeing some improvements there and we plan to close it by the yearend. That is our target. We are still expecting some conditions precedent to be cleared. If we can close it as soon as possible, we are going to invest in the beginning of 2020, start investing for the construction of the facilities, and meanwhile while we are constructing, we would like to start operations as well by introducing two small storage tanks to be used for introductory purposes. We are in full agreement with our JV partner there, things are improving, so I think we will see 2020 with a new company, new operations and it will have some effect on our, hopefully, in our cylinder production, as well as our trading activities in London. It might have a positive effect on those activities as well. We are very optimistic about that, we will see.

Koray Pamir

Understood, thank you very much.

Operator

[Operator instructions]

Conclusion

Selin Sanver

I see that we don't have any further questions. Hopefully everything was clear for everyone. I would like to remind you again that we are always here to answer your questions.

Thank you so much for joining us on our third quarter earnings webcast. Goodbye everyone.

Ferda Erginoğlu

Bye-bye, thank you.