Ford Otosan A.Ş.

Ford Otosan First Half 2024 Financial Results

Conference Call

Wednesday, 7th August 2024, at 16:00 (TR Time)

Conductors:

Mrs. Gül Ertuğ, Chief Financial Officer

Mrs. Bahar Efeoğlu Ağar, Head of Investor Relations

Mr. Ünal Arslan, Corporate Finance Leader

Mrs. Duygu Yalınkılınç, Investor Relations Specialist

Mr. Hamza Sümer, Investor Relation Specialist

Conference Call Conducted by Chorus Call Hellas

CHORUS CALL HELLAS

PROVIDER OF TELECONFERENCING SERVICES

TEL: +30 210 94 27 300

FAX: + 30 210 94 27 330

Web: www.choruscall.com

OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Mina, your Chorus Call operator. Welcome and thank you for joining the Ford Otosan A.Ş. Conference Call and Live Webcast to present and discuss the First Half 2024 Financial Results.

At this time, I would like to turn the conference over to Ms. Gül Ertuğ, Chief Financial Officer and Ms. Bahar Efeoğlu Ağar, Head of Investor Relations.

Ms. Ertuğ, you may now proceed.

ERTUĞ G: Thank you very much, Mina. Dear investor community, welcome to our meeting for the disclosure of Ford Otosan's 2024 First Half Financial Results. Usually, I'm used to giving results which are better than last year's same period, but this time around, unfortunately, it won't be like that.

And last night when we have issued our results on AP , I have been following some of your early comments, some reports from some of you, and I see that overall results have come also in your perspective a little bit slightly below your expectations. So, in this presentation, we will give the physical details for the outcome as well as how we see the rest of the year, what we are doing, what we value, our guidance. So, let's dive directly into the First Half results evaluations.

So let me start with the market performance. I will just provide the highlights over here with some key points, then I will leave the work to my team, Bahar, Duygu, Hamza, Ünal are with me. As for the market performance in the Turkish domestic industry, in fact if we speak about the entire industry, we can say that there is an overall experience of slight growth in fact, especially with the passenger vehicle segment and mostly coming from the import vehicles.

Over there in the total performance, we have maintained our third position in the domestic market with 8.2% share and we have protected our number one position in the total commercial vehicle segment with 25.6% market share. I would like to give a little bit insight how this is relating to Ford Otosan results. Bahar will provide more details, but this section is important.

In fact, overall PV, I said passenger vehicle, this is the growth engine for the industry. The area where we are most strong are MCV and LCV, the light commercial vehicles, where our Couriers out of Romania filling our pipeline were a little bit slow in the First Quarter. And now with the current pace, in fact we have caught up with the intended, our planned pace. However, it wasn't large enough to catch up with the market share. Later in the year, you will observe that we are all set to overcome this because we are approaching this in the planned manner.

In medium commercial vehicles, due to our staggering and a little bit deferring of the vehicle launches, vehicle introduction into the domestic market happened with a segment mix or vehicle product line mix less than ideal. Mostly we were missing our vans and buses but later in the staggered launches, as we recovered this and we have done so, we will maintain our solid position in the CV leadership.

In heavy commercial vehicles, we suffered in the domestic market some volume loss due to the lower tractor mixes and reduced government sales. I'm sure you have followed that. There is also because of this economic inflation preventing measures, there were also some limitations in the government sales, but they have opened.

So over there, we are expecting to come back to our levels, even if currently the domestic volumes contracted by 17% and our revenues came down by 19%, we are expecting to recover this area over the course of the year.

If we look into the export operations, again the effect of the deferrals in the vehicle launches, unfortunately this affected us. The volumes still rose by 3%, but our expectation was for a larger value because with the capacity involvement and the vehicle launch involvement, we had ramp up plans.

We are now catching up with them and I'm sure most of you noticed when you looked into our financial reports, due to these deferrals in the launches, the okay to buy, okay to sell, ready to go sign was not given, but since we have overall full year targets, in fact, we have made our production. That's why in this quarter, ending the quarter, we have a significant vehicle inventory built up in our overall stocks. You must recognize this.

And with the go ahead sign of these launches, now we are good to go to deplete that inventory. And as the already produced vehicles turn into wholesales, this is also going to improve our performance, both in terms of the overall market performance and also looking into our liquidity measures, working capital measures, overall cash position, that will improve. Within this picture, the overall capacity utilization we had in Türkiye was 81%.

And in Romania, where we are building the Pumas and the Couriers, we have reached 90%. Because of these actions, we have -- also I should mention the impact of exchange. Unfortunately, exchange didn't help us, didn't support us this year.

And also later in the discussion, Ünal will mention or maybe you will ask questions, the effect of inflation accounting, how it affects our essentially cost of goods sold when we are having a lot of inventory at hand, that also impacted our EBITDA.

Of course, when you walk into the PBT level, because of the asset you have and the asset revaluation, the monetary gain is washing away that impact. But still, we have seen deterioration in our margins. EBITDA landed at 8% and EBITDA per vehicle reached EUR1,805. So, these constitute the highlights.

Let me now pass the floor to Bahar and let's look into our segment-by-segment performance in a little bit more detail. Bahar, please.

AĞAR: B: Thank you, Gül Hanim. Hello, everyone. Thank you all for joining us today. Gül Hanim has already mentioned, but let me elaborate domestic market outlook and our performance in the First Half in more detail. After all-time high sales in the market last year, we were expecting some level of correction, and we were shaping our guidance accordingly. However, thanks to the market supportive factors so far, we have not seen this normalization, including July actually, because we already had the recent figures.

And as a result, market went up by 3% despite strong base year impact. I should say that this growth is mainly coming from the robust performance of the passenger car segment, where Ford Otosan is a small player with around 3% market share. Let me also explain the main reasons behind this performance.

First of all, we have seen a pull forward demand in the pre-election period in First Quarter. Another reason can be counted as the increase in the base price for the special consumption tax exemption, which was applied to disabled individuals, and especially passenger vehicle segments benefited from that. Third one is that we have seen very aggressive campaigns and also price wars from the market players to eliminate their inventories, which are not compliant with the general safety regulation and ADAS regulation, which should be executed to heavy commercial vehicles.

Just as a note, especially Chinese brands adopted very aggressive pricing strategies in this period. Also, this performance was supported with the better availability in medium commercial vehicle segments, where oppositely we were the main beneficiary of this growth with our flagship products.

Now let's look at our performance in this market conditions. In this environment, we maintained our leadership in total commercial vehicle market with around 26% share. If we look at our performance segment by segment, we recorded a 13% decline in our total sales with 48% year-on-year growth in medium commercial and 10% growth in passenger sales, while we were having 55% and 25% year-on-year low volumes in our LCV and HCV sales when we look at the figures in detail, actually.

And in HCV segment, even though we performed better in Second Quarter with the accelerated Courier production, we were not able to close the gap in First Half, but we expect better results in Second Half from this segment with the rising pace of production and higher allocation.

Whereas in medium commercial vehicle segment, although we surpassed the market performance, we were not able to meet van and bus demand sufficiently in the transition period. But with the completion of ramp up of our new models and with the launch of improved version in transit, which we call it ICA, we expect even much more better market share and volumes from this segment. Currently, we are undisputed leader with around 34% market share in MCV side.

On the other hand, two main factors affected our performance in truck segment, which Gül mentioned in brief. Firstly, we experienced volume loss in municipality sales due to government saving plans, since we dominated the market with around 70% market share.

Secondly, stocks that could not be registered in Europe due to the ADAS regulation, they all shifted to Türkiye from the players in this segment, and high availability in market triggered price wars, where we had limited room to respond. And as you'll recall, we also continued our pricing discipline in this period. And as a result, the combined effect led us to reach around 8% market share in total in First Half.

Let me move to the export performance. When we look at the First Half figures of European Automotive Manufacturers Association, despite strong base year, 11% and 5% growth were recorded in European commercial, commercial and passenger vehicle markets, respectively.

And we saw -- I should say that we saw remarkable double-digit growth in largest van markets, such as in Germany, France, Italy and Spain. The strong industrial outlook is mainly driven by the GSRB derogation. So, it's also an important factor, important driver behind domestic performance, as I mentioned earlier, which also increased competition in the export markets.

Other reason behind the performance seems like the accelerated fleet renewals in export markets, considering the aging vehicle park in Europe. In this environment, Ford maintained its number one position with a growing market share of 14.6%. You may recall that their market share as of the end of 23 was around 14%.

But with the acceleration in the new model order banks, we have seen an improvement in that side, and they are leader for nine years in a row. In this period, three quarters of Ford's

European CV sales are produced by Ford Otosan and with the pickup of Courier and custom which we see from the figures that we doubled our Courier sales, and we increased around 30% our custom export volumes.

So, the main supporter to their performance is coming from our flagship products. We believe that with the launch of ICA transit and growing sales of custom variants including plug-in hybrid and all electric we will see better export volumes in the remainder of the year. I would also like to share that we had a weak truck performance in also international markets in this period as a result of the ramp-up delay in our F line model for trucks and we were not responding pricewise that much in international markets as well.

I would also like to give brief update about PC, passenger vehicles performance. In this period, we continue to contribute to Ford's position which is our best-selling Puma model by producing 37% of Ford's PC sales in Europe. However, when you look at our Puma export volumes, you will see 17% year-on-year decline which is mainly driven by the MCA a facelift of Puma in Second Quarter and also the strong base-year impact plays an important role in their performance.

Since last year you may recall that since last year, we only produced Puma with a very high daily production tempo. However, by adding Courier to the production platform, this year we make our plans and allocations for considering both models demand outlook, but with the completion of facelift we expect better figures in the remainder of this year actually. On the other hand, we should also note that planned production suspensions due to two religious holidays in Türkiye and Easter holiday in Romania also affected our production and export performance in Second Quarter.

Let me finish my part with the good news. As you recall, we launched our all-electric transit in 22 which is now segment leader in Europe with almost 50% market share. And also, recently we have completed another important milestone that a plug-in hybrid and all-electric versions of our new custom rolled off the production line which we started to produce at our Yeniköy plant. We offer to our customers 55-kilometer EV range with PHEV plug-in hybrid option and a 337-kilometer EV range with all-electric model.

And we believe that with the inclusion of these variants, Ford will further strengthen their presence also in electric vehicle markets. Next year we aim to add all-electric variants of the remaining products in our production line up. What I mean with this, Courier, Puma, all-electric truck will also have all-electric options next year. This is all from my end. Thank you for listening.

Now I will hand over to Ünal Bey, our Corporate Finance Leader, for explaining our financial performance in First Half.

ARSLAN Ü: Thank you, Bahar. Hello, and good afternoon, everyone. Thank you for joining the call. I'll give information about our First Half financials. Our revenues in total, as you can see on the screen, decreased by 5% to TRY241 billion versus same period of previous year, whereas our total volume decreased only by 1%. Main driver of total revenue reduction is domestic sales because of the reasons that Gül Hanım and Bahar already explained.

Revenue reduction being higher than volume decrease is mainly because of the mix of the products that we sold. Our EBITDA, on the other hand, also decreased from TRY32.8 billion to TRY19.2 billion and EBITDA, excluding other items, decreased to TRY19.1 billion from TRY26.8 billion.

Main reasons behind these decreases are lower domestic sales where we have the highest profitability. In fact, last year, the highest profitability, historically highest profitability, and that's partially because of extended ramp-up period of new models this year and partially increased competitive environment.

One other reason is the increase in export sharing, our overall business, which is a solid business portion, but also comparably lower profitability portion, continuation of strong Turkish lira versus euro and inflation accounting impact, as Gül Hanım already mentioned, on increased inventory levels, mainly because of being in intense launch period.

In parallel to EBITDA, looking at our operating profit, it also decreased year-over-year by 51% to TRY13.7 billion. Reason of higher decrease in operating profit is basically this year we couldn't enjoy as much good news coming from exchange movement as we had seen First Half of last year.

During first six months of last year, average euro rate appreciated by 26% and 23% of this was in Second Quarter of last year, whereas this appreciation was around 10% this year and only 1% in Second Quarter of 2024. Because significant part of our business is export, euro appreciation helps us in terms of export profits and profitability as well.

And when we come to the PBT and PAT, decreases versus same period of last year, 2023, are lower. We continue to have monetary gain in PBT because of our high monetary liability position in the balance sheet that we discussed in our previous calls. And in terms of PAT, we continue our investment subject to incentives, which derives a good level of deferred tax income. And this year we also don't have earthquake tax impact like last year, which was a one-off item.

If we move to next page, here we see the margins as well. You may remember that we had been talking about some level of normalization for the margins of this year in our calls last year. Just to remind that that was mainly over an expectation of increased availability and hence an increased competition in the domestic market, along with continuation of new model launches.

This had been realized parallel to our expectations. However, the level of decrease in our margins are higher than our expectations as well, mostly because of revised launch plans. And that's mostly due to our desire of offering high quality products to the market and higher inventory carrying. Inflation accounting impact on high inventory is significant this half of the year. Shifting more of our business portfolio to the export business also has a dilution impact on our overall margins.

And as a result, our EBITDA per vehicle became to be EUR1,805, which was EUR2,333 last year. If we look at our cost dynamics in the next page, our production volume is similar to the First Half of last year, however, lower by 4% quarter-over-quarter. Cost of production in terms of raw materials is similar as well.

However, although we see that on that page, euro rate increased by 60% versus last year's same period, what impacts our profits more is, as I just told, the increase during the reporting period. As I mentioned in the previous slide, euro appreciation was significantly higher, both in the First Half and Second Quarter of last year compared to this year. So, as I mentioned, that had a much more positive impact on our last year's financials that we don't see the same in this year's financials. Interest rates, on the other hand, show that cost of acquisition and cost of holding a vehicle increased significantly. That also drives profitability to be lower and competition higher.

In the next slide, we already talked about sales volumes and market shares. I'll not go deep into this slide, but what I can very shortly say, this may be a second time, but especially regarding domestic market, is that our Courier sales are 53% lower compared to previous year's First Half, but the gap reduced to 31% in the Second Quarter. Looking at monthly sales trend, what we can say is after completing ramp up by almost middle of Second Quarter, our monthly sales stabilized on a desired level for courier.

In the next slide, regarding financial indicators, this is for the income statement, and we already discussed in the previous slides the year-over-year movements. So, you can see the details in this page as well. If we move to next page, our balance sheet is, we can say that as healthy as it always was. However, parallel to the EBITDA generation and because of the same reasons, mainly net cash from operating activities is lower than previous year's First Half and we ended First Half of this year with a cash and cash equivalence level of TRY18 billion.

Also, the high level of inventory that we already talked about is one of the reasons in the reduction of net cash from operating activities. And if we look at our debt profile and financial ratios, our net financial debt increased to TRY95.7 billion from TRY75.5 billion compared to 2023 year-end. We continue our investments for new models and it's basically the main reason of increasing debt and our financial ratios including current ratio, liquidity ratio, current SS over total SS and so on are very similar to the previous year and healthy only other than the net debt over EBITDA ratio and that's mostly because of the pressure on EBITDA that we just talked until now.

So, now I give word to our CFO again to give more information about our guidance for the rest of the year. Thank you.

ERTUĞ G: Thank you very much Ünal. So, it has been very helpful. Thanks for the explanation and when we look into the guidance, in fact, you will realize that the area we touched, we changed is just the total industry volume. All the rest we kept the same and for that one, I believe Bahar explained the dynamics in the environment very clearly. So far, in the run rates of the industry with the effect of the passenger vehicles, the disabled car certificate allowances, the GSR-related, regulatory change-related rush of all parties in order to deplete their stocks, we have seen an increase pattern in the industry.

Looking into the numbers and making our projections into the end of the year, also taking into account our projections, what we will be doing as we committed within our presentation, combining all of them together, we see that the industry will be on the dimension of 1.1 million units. Over there, we also see like in the rankings, you have witnessed there is this new players from China. We have Cherry sitting in the third position for the passenger vehicles. So, looking into all that, we expect this again to be a strong industry.

Within that industry, we are keeping our outcome results, our projections the same. The retail sales volume will be around 100 to 110. Export volume will be protected because even if so far it looks like we had some headwinds and we had some troubles, especially for the launches and the vehicle deliveries, we should note that currently while we are in the yearly maintenance shutdown period of all of our plants, both in Türkiye and in Romania, we are heavily engaged with just clearing our vehicles to make them okay, to put them on vessels to ship them out if they have any final checking needs to make the okay to buy and okay to sell readiness.

We are busy doing that even if we are at the shutdown. That's why the missing link or the lagged effect of production versus all sales will reveal itself, will come back to normal in the upcoming period. That's why we didn't touch anything over there. Even if this year we are seeing a big churn in our environment, these launches have proven up to be very challenging. Like in some presentations, we have said just with the new tools and items, we have been touching around 9,000 parts on different vehicle lines. So, in essence, this year Ford Otosan is kind of reinventing its products over there.

But as we reach the happy end and we have come there, now we are seeing that ahead of us, the future is bright. Of course, I'm not counting anything about the geopolitical risks. If there is something going on with Iran, Israel, if something happens, this environment has been quite volatile, especially this week. Of course, I'm taking them away while speaking about this guidance because it's something not under our radar. We are focusing on the items which are under control. Looking into them, we are committing to our guidance.

And as you will remember from earlier discussions, we are involved in heavy CapEx period because last year, this year, following year, there are important actions going on in our both Türkiye and Romania plants. That's why the capital investments both under general and product-related section are protected. We are on track. So that would be my message for this one. I think that is the end of our presentation, right Bahar? So, we can open up the floor for your questions.

OPERATOR: The first question comes from the line of Kilickiran Hanzade with JP Morgan. Please go ahead.

HANZADE K: Gül and Ünal Bey, Bahar thank you very much for the presentation. My questions will be on the margin impact of these temporary issues in the rest of the year and also on your export guidance. You have explained this in detail, but I would like to clarify it once more. When I look at your guidance, your guidance would imply roughly 25% year-on-year growth in exports in the rest of the year, which is quite ambitious. And I wonder if this is already guaranteed to be taken by Ford Europe. So, it's a firm guidance.

And do you expect strong market conditions to continue in the European markets in the rest of the year? Because I think you already missed the opportunity in the fleet market, in the fleet renewable. So, I wonder what could drive this export growth in the Second Half of the year. And this is actually for Ünal Bey. Would it be possible to quantify the margin impact of these issues you discussed so that it can provide us a good base to assume the profitability for the rest of the year, actually? Thank you very much.

ERTUĞ G: Thank you, Hanzade. Let me start with your first question. I think you are saying you're questioning the export volume, given where we are, the export volume guidance over here. Like, is it going to be realistic? Like, I should say the answer is yes. Because maybe you will remember last year in the Ford Pro results, Ford Pro like protected its position number one ranking in the market. And they have a very healthy market share. However, because of the availability issues related again with our production and delivery out of these launches, they were a little bit missing on the volume. So now we are recovering that.

And there is, in order to support the Ford Pro within the Ford Motor Company, we are just like, everybody's number one goal is just look into the actions, look into the issues of the launches, just clear them away and send them. And when I was speaking about what we are doing in the shutdown period, in fact, in mind I had your question, I had seen it on the screen. Over here, even if currently we are not producing, we are catching up with the volumes to turn them into deliveries and wholesales.

And in the rest of the year, when the shutdown period is going to be over, the un-complete so far in the First Half, the ramp up period, which was un-complete, is now being complete. That is the reason why we are doing the maintenance, the general controls and general certain developments that we have to put into the lines, which we cannot do while we are producing. So those impacts will be in place. The demand is there. And as long as we do not have an unforeseen quality issue, problematic thing, which we've suffered so far because of these delays, of course, we didn't want these delays, but there were several tests or actions which stopped us.

So far, we think now we are at the end of those. That's why I think we will be able to deliver our guidance. In fact, this is the reason why we didn't change it. We know that we lost some pace at the start of the first two quarters, but looking into our pace for the following time, we believe we will be doing it.

HANZADE K: , is this also guaranteed for Ford Europe to be taken?

ERTUĞ G: I'm not using the word guarantee, because even though we are working towards an order bank, of course, the order bank itself is not full for six months. However, looking into the European market dynamics and seeing that the demand over there is quite lively. Last year, at the end of last year, we were talking about some recession possibilities. So far, we haven't seen that. In fact, when it comes to these availability discussions for peak LCV, for example, the light commercial vehicle in Türkiye is a little bit less allocated because there is a lot of demand in Europe.

And when we do our own programming meetings, we always have a nice discussion with our Ford colleagues, which market is going to get what. Because as we now explained, in fact, domestic market is much more profitable for us. That's why to the extent possible, we want to pull the vehicles to the domestic market. It helps profitability, it helps market share. But on the Ford side, there is also vivid demand, very lively market on the European area. That's why we are kind of, "fighting over the vehicles". With this logic, I'm saying that the demand is there, and we will deliver.

If anything happens, this wouldn't be coming from the demand side. It could be coming from the supply side. And during this summer shutdown, all the actions, all controls, all readiness is prepared such that, that doesn't happen.

HANZADE K: Thank you very much.

ARSLAN Ü: You have any follow up question to Gül Hanim, Hanzade? Or should I continue with your second part?

OPERATOR: We have a few more of the audio questions. Would you like to take them now?

HANZADE K: Yes, but the second part...

ARSLAN Ü: In fact, Hanzade...

HANZADE K: Okay, let me recall…

ERTUĞ G: Please go not. Go ahead…

ARSLAN Ü: Hanzade, maybe first just a small contribution, what Gül very well explained already regarding the guaranteed part. You may remember, maybe you are asking because of our previous guaranteed discussions regarding Ford business. The guaranteed part is the investment recovery. We don't have a volume guarantee, but investment recovery guarantee between Ford and us. So that's the part. Volume is derived from the market and demand. I can add this one. And as an answer to your question, second part, the margin impact of the, let's say, inventory build-up because of those temporary launch issues.

Of course, we are tracking it very closely and we try to isolate the impact. And I made some calculations. I can say that it's hard, by the way, very strictly isolate this impact. But it's around, I can say, 2% to 2.5% in the First Half. But normally in an inflationary environment as we are in and when we apply inflation accounting, even though you have a very high inventory turnover, we may still see an impact from inflation accounting in the cost of goods sold calculation. But with the increased inventory turnover, this will be very, very low.

So, in the First Half, because of the reasons that we already explained, it's around, the impact is around, I can say, 2% to 2.5%. Thank you.

HANZADE K: Thank you Ünal Bey here. Can I please ask a follow up question? So, your inventory days increased to around 40 levels in the Second Quarter, where it used to be around 30. So, is it reasonable to assume that after this ramp up in the exports, you will be back to around one month inventory holding period, right? So, your inventory turnover is going to normalize to the previous quarter's level?

ARSLAN Ü: Of course, the plans and our plans, production and sales plans and expectations are to reach our normalized levels. For the Second Half of the year, we are planning, and we are acting to reach those levels. But this is just an expectation and planning right now. So, during the operations, we will still have some launches for the rest of the year, especially for the last quarter of the year. Our plan is not to see such a situation again. But of course, it's not guaranteed. It will depend on how we will run the operations and the environment as well. So, we can say that the plan is to reach our normalized levels.

HANZADE K: Okay, thank you very much.

OPERATOR: The next question comes from the line of Uz, Aytunc with AK Invest. Please go ahead.

UZ A: Hi, thank you for the opportunity. I have several questions. So, the first question is, can you share some soft guidance on domestic vehicle market for 2025? I mean, I don't mean any specific numbers, but like would you expect the 15% to 20% year-over-year decline in the domestic market next year? And I also have a similar question regarding exports from Türkiye in 2025. Again, I don't mean any specific numbers, but would you think like is it reasonable to expect a 30% or maybe higher year over year growth in 2025?

Another question is, do you plan to expand your truck production capacity further in the next three years? I know you recently expanded in 4Q ‘23, maybe some more. And the last question is, do you consider any expansion in production capacity in Craiova plant in the next three years? I mean, you recently took approximately EUR400 million debt in Romania. Are you going to spend all of it on Courier and

Puma's next generation or will we see further capacity expansion? Thank you.

ERTUĞ G: Thank you very much. Thanks a lot. I got the message from your, the tone in your voice, but I have to be careful in answering this question. Some of the questions are like relating to some actions we haven't publicly announced. So if something is not ready to go, I will not be able to answer that. So just let me apologize from the beginning for the use. You said soft guidance on 2025 regarding Türkiye markets export 2025. I cannot declare anything at this point. In fact, from a process perspective, we are going into the time zone where we work on our business plan and budget preparations.

Currently, I would say those calculations would be just in the oven. They are work in progress. They are not ready to be shared. And that would be a forward-looking statement. That's why I cannot give that. Maybe your question has in itself, there is, could there be some worries regarding the overall economy growth and the movement of the economy in Türkiye? Maybe it is related with that. If that was the intention, we are seeing this in this manner. Let me try to just make a comment on that.

Currently, there is an important macroeconomic normalization period that Türkiye is going through with the Ministry of Finance and the central bank actions. We are seeing that they are trying to take inflation under control. And to some extent, there has been some progress. Most of the commentary is related with we are just passed by the worst of it, the most difficult of it. However, looking into the numbers, in fact, we still see some impacts of the inflation, even if yes, it's coming down. And while it is the case, the economy management chose to keep Turkish lira levels strong.

And being an exporter, in fact, this has given us a hard time, as Ünal explained in his speech. But we think that the economy will eventually come back to normal. When those signals are taken, the interest rates are expected to come down again in a staggered way. That's why we are expecting it to take a little bit of more time. During that period, the exporters and most possibly tourism companies will have a little bit of a difficult life. But in this period, we will look into other activities that are under our control to manage our margins better.

Overall, looking into the economic activity, we are not expecting an overall bad economic result. We are going through an important normalization period. And we will weather some winds during this time, but we will manage that. So maybe a little bit of a closed answer, but this is what I can say for that one at the time being. For your question regarding expanding the truck capacity, our trucks, the trucks business is a very vital, very successful business, but also a very cautious business. In fact, now we have been operating in more than 50 markets.

And wherever we see the business feasibility, wherever we see the synergies and the growth opportunities, we are making use of it. However, if the signals are not there, we are not aggressively fighting for it. That's why in the overall setting, you can think that as long as the product portfolio, the product value proposition and its feasibility supports, there could be such action. Currently, there is nothing to be publicly announced yet. It is certainly a very important part of our business, and it is supporting our profitability. This year, maybe the only a little bit slowing down or how should I say, the price wars, price effectivity in the export markets just gave us some trouble on the trucks area and we have taken necessary precautions for that.

In the earlier talks, you will remember we are quite nimble and agile on our truck operations. Just like last year, when we saw the effects of the earthquake, we had the ability to shift our plans. Instead of selling to Europe, we converted the production towards the local markets, and we managed in quite a nimble and a successful financially healthy way. The same actions are being taken over there. That's moving well, but we do not have anything to declare publicly for a further capacity increase.

Likewise, for the Craiova case, we are fulfilling the earlier announced already publicly shared actions, which was like, you know, the acquisition of the plants and its overall action, the investments through the acquisition and investment we have declared for the next generation Courier are going. If there are other things appearing in the business plan with their materiality, we will let you know. But currently, for the time being, I don't have any extra news to share.

OPERATOR: The next question comes from the line of Campos Gustavo with Jefferies. Please go ahead.

GUSTAVO C: Hi. Hello. Yes. Thank you very much for taking my questions. I just have two comments on my side. Firstly, how are you planning to fund your CapEx for the remainder of the year? And I guess in line with this question, like, where do you see total debt by the end of the year as well?

And the second question would be in terms of the domestic performance, would you consider that the weak price environment that you've seen, this will be kind of like the bottom performance for the year with some recovering on the price environment in Türkiye? And should we expect the contribution from Türkiye to revenue to EBITDA to remain lower than 2023 like we've seen year to date? That's it for me. Thank you.

ERTUĞ G: Thanks very much. In the earlier calls, I think we had notified you of our successful inaugural euro bond issuance. So that was an attempt to support our overall borrowing portfolio, diversify it and manage it both from a segmentation side and also the cost perspective.

We have enriched our borrowing portfolio. That is how we are going to manage the financing of all capital investments going forward. And we have sound plans in place to support all the actions going in for this year and also next year. For the recovering of the price, I think you asked about the domestic market price environment. So far, in fact, Bahar explained that we were very careful not to engage in any pricing war. We have been careful keeping our pricing discipline. We will keep on doing that with these launch and ramp up issues with their resolutions. In fact, our availability will be going up and the product mix available in the market will change into the ideal situation. That's why it is going to support us through the volume piece.

It will reflect itself in the gaining of the volume. But for the pricing environment, we are not planning to go into a price war. I'm not in a position to talk about the rest of the competitors. Some of them might choose to go ahead with this route. But our target is we have, of course, I cannot provide the details over here, but in our strategy setting for all of our portfolio product line, we have target competitors, we have target settings, equipment adjusted, visually adjusted pricing. We are acting towards a strategy. We will be holding on to that strategy. Let me answer your question in that way. I hope this has been answering it.

GUSTAVO C: Yes, yes, it mostly does. And just to follow up, in terms of your funding of your investments, of your future outflows, I expect you're still going to consider a mix of internal sources and potential future debt rating. Am I correct? It's my question.

ERTUĞ G: Yes, yes. We are looking into that. And also, we are, since on the export operations, our revenues are mostly Euro, they are all Euro denominated. We have natural hedge; we have hedge mechanisms. We are careful with that.

We are matching it with the needs. Wherever we have Turkish lira denominated payments, we are tapping into the resources for that. And it's like good news that Eximbank credits are now again back in the system. It's open to us with considerable, favourable interest rates.

And in the investments where we conduct, where we need the hard currency, we have the tools to access them. And for the earlier announced big investments, I think you have already been notified in our presentations.

Regarding the EBRD, IFC like supranational funding plus the Euro bonds. Over there at that end we see ourselves quite strong. And in fact, the Euro bond issuance this year also revealed that we have been able to manage to get rates much better than the sovereign rates. So at that end we are quite strong. We will work on this EBITDA generation over there.

So far, we had some issues year-over-year when we look into that. We will be working on this one a little bit more in detail. But for the debt financing and the diversification of the portfolio we do not see an issue.

GUSTAVO C: All right perfect. Thanks a lot.

ERTUĞ G: You are welcome.

OPERATOR: The next question comes from the line of Demirtas Cemal with Ata Invest. Please go ahead.

DEMIRTAS C: Thank you for the presentation. My question is mostly related to inflation accounting side. We see EBITDA marginal 6.6%. Could you give us some maybe additional indication about the impact of inflation accounting in Second Quarter? In full year 2023, I see around 1% impact. What was the approximate impact on that? And what portion of it should be attributed to inventory side?

And we see some one off possibly in this quarter, but what might be the sustainable EBITDA margin under inflation accounting because in the past we were not following the numbers or even maybe you were not. Depending on those numbers now we have some numbers and maybe it's very difficult to give because we got used to the nominal numbers. But what might be the sustainable EBITDA margin at current conditions? Just more elaboration on that and when I look at your monetary assets, maybe I can ask the second one after answering this one?

ERTUĞ G: Yes, I will give the word to you now for this question. But before going into the details of inflation accounting, I'd like to remind a point we had made in our earlier discussions. We were saying that especially for the year 2023 we were saying this is extraordinary performance and we said we would expect some level of normalization even when the inflation accounting was not on the table?

The reason for these normalizations were looking into our volumes, the capacities. We explained that more and more the wholesales will be shifting towards the export side. So within our revenues the export mix would go up. With the inclusion of Craiova, passenger vehicle sales would go up.

And as the capacity of Puma units go up, that is also having a diluting effect. Plus, the last comment was regarding the electric vehicles because the electric vehicles themselves had similar contracts with Ford Motor Company where Ünal was just mentioning about the investment recoveries.

Those main principles, main rules are over there. They are protected. However, looking into the overall transfer price of the vehicle since the vehicles at the entry of their life cycle they are more expensive, the overall margin would be a little bit less than the earlier one.

So, if you combine these three impacts in fact a long-term expectation of a margin dilution is something normal and this is something you need to model. And we were saying like the large single-digit levels are our healthy margin. Now since everybody now we are in the inflation accounting mode and we are calculating it like learning it, learning its details while doing it over there with this stock impact especially we have seen some bad news affecting our EBITDA.

So from this point, I will give the word to Ünal. Looking into the projections we should be careful in calling out again a forward-looking statement for the inflation accounting. But putting it aside, please remember those three points we made in expecting a final healthy margin level for the Ford Otosan. So please Unal.

ARSLAN Ü: Thank you, Cemal Bey for your question. By the way, I mean, inflation accounting it kind of complicated all of us our lives. You are right. Comparing last year, I mean to your first question let me say last year versus this year First Half of this year you mentioned that last year the impact was around 1%. I believe you made the calculations and that's right we can say. And I will not go into technical details a lot. We don't have time for that, but in the income statement the major impact over EBITDA through inflation accounting is because of the higher inventory both for finished goods and raw materials etc. Low inventory turnover creates lower EBITDA and high monetary gain in the PBT level, but EBITDA becomes lower.

So, First Half of this year as we discussed through our presentation and also answering to Hanzade’s question at the beginning of the Q&A session, I mentioned that the First Half of this year the impact of inflation accounting on cost of goods sold and on margins this First Half is around 2% to 2.5%. So it's hard to calculate what will it be in the coming period.

But as I also tried to explain our expectation is to have a normalized level of inventory and increase our inventory turnover for the rest of the year and also of course coming years normalize it.

And at normalized levels maybe I expect to be the impact would be at most around last year's level let me say maybe 1%, maybe lower than 1% versus nominal values. That's what I'm trying to say. So, we are expecting a normalization and improvement in terms of inflation and negative inflation accounting impact on our financials. But this does not mean that it will be zero.

DEMIRTAS C: Thank you. It's very helpful. I understand that the impact is in the past, maybe this quarter around 2.5%. And you have 6.6% the announced figure. So, if we exclude that impact, as Gül mentioned you are going to be to like 8, 9% levels which might be sustainable excluding the inflation effect.

But if this is the case, I would like to understand your covenant requirements. Right now, you have 1.9 times net debt to EBITDA. But going forward, it's going to be determined based on the inflation accounting. If we go this way, because with the inflation accounting numbers your EBITDA will be understated because of the accounting change. So, what might be the requirement?

If we go with this trend if we just multiply this quarter by 4 times, we can come with 3.5 times net debt to EBITDA, and you have some investment. So, I would like to understand your standard related to the covenant you have because in the past it was nominal. Now it's going to be based, that requirements will be based on inflation accounting number. That's my question.

And related to just the combined, you mentioned that going forward we should expect some normalization. But when I look at your monetary assets versus monetary liabilities, I see it's increasing from 55 billion Turkish lira to 85 billion based on our rough calculations from your assets and liabilities. So, when we are heading to Third Quarter we are likely to be facing with the same concerns related to domestic market, international market and the currency impact combined with this inflation effect. So, for the Third Quarter should we just assume that it's going to be a testing quarter for overall because all the negatives are together for an exporter Company? Thank you.

ARSLAN Ü: OK, let me try to very briefly answer Cemal Bey. For covenant parts, in terms of EBITDA margin, you are right. I mean, the inflation accounting methodology is impacting our EBITDA margins and EBITDA.

But this doesn't mean that, I mean, covenant is calculated over, as you know, net debt over EBITDA, not the margin. So, this will be our projections, and our plan shows that our covenant will be under control through increase of the business and increase of the EBITDA, nominal EBITDA. So, margin may be a little bit lower, but business is growing, profits and EBITDA is growing.

So net debt over EBITDA, that's a ratio, simple ratio. So we will keep tracking this very closely and keep it under control. You are right, the covenant is 3.5, the threshold there and we are still very below of that threshold. And regarding your second question, I mean, the monetary assets being high. In fact, I believe you are including our fixed assets in that calculation as well, not only the inventory. So having a high monetary asset will not hurt us in the coming period.

Until now, you know that we have accounted for a significant amount of monetary gain because we have a high non-monetary asset position or in other words, high monetary liability position. So, this helps in terms of PBT.

DEMIRTAS C: Sorry, by the way, I say your monetary liability is higher than your assets. So, you have negative monetary assets. Sorry for interrupting.

ARSLAN Ü: Our monetary liability, no problem. I mean, we have a high monetary liability, so high non-monetary asset. That's what I mean. And that creates a monetary gain in terms of calculation, right? That's what I tried to explain. However, in terms of income statement and EBITDA calculation, Cemal Bey, a high inventory carrying creates a monetary gain in the income statement in terms of PBT, but high cost of goods sold, so lower EBITDA.

That's the problem. And that's where we are attacking and where we are trying to solve, we will be solving. And this will improve our EBITDA. That's the plan and the expectation. So, carrying high assets will not hurt us in the rest of the year or in the coming period. In that sense, when we standardize or normalize our inventory levels.

DEMIRTAS C: Okay. So, we would rather expect normalization. And when you mentioned about the tech side, again, maybe a little bit technical question, but when we look at the statutory accounts and your accounting, the inflation accounting, the CPI and PPI difference was higher. So, CPI was higher. Did it have some also impact on your tax income or could be just attributed to your incentives and other items you had?

ARSLAN Ü: By tax income, you mean deferred tax income, I think, right, Cemal Bey, just to understand your question.

DEMIRTAS C: Yes.

ARSLAN Ü: Yes. Because in the legal books, you know, as we mentioned, we also switched to the inflation accounting. So, of course, that changed all over the calculation. However, I mean, very brief answer to your question, both IFRS and statutory accounts are applying, we are applying inflationary account. Our tax expense is calculated according to inflationary accounting.

However, we are utilizing our investment incentives and our effective tax rate in the statutory books is still very low. I mean, it didn't change, applying inflationary accounting didn't change at all our overall tax payment, I can say, because it was already very low. And we are continuing to invest in new models with incentives as well.

So, we are continuing to build deferred tax asset and deferred tax income for that. Of course, in terms of, you know, this is too technical, but in terms of indexing both IFRS and statutory financials, it creates some difference because of the deferred tax calculation. But I would say that it's not significant. It has not changed very significantly versus previous periods.

DEMIRTAS C: Thank you. It was very helpful. Thank you.

OPERATOR: The next question comes from the line of Bystrova Evgeniya with Barclays. Please go ahead.

Bystrova E: Hello, good afternoon. Thank you very much for the presentation. I just have a quick follow-up on your inventories. So, you said there was an inventory build-up during First Half of the year. Could you please differentiate between the quarters? Was the most of this effect seen in the Second Quarter or was it equally spread out between the two? Because I think it affected your cash flow generation in the Second Quarter. So, I would like to just understand if that was the main factor. Thank you.

ERTUĞ G: The Second Quarter, I would say, was higher.

ARSLAN Ü: Yes, yes. Basically, we can say, Evgenia, the inventory pile-up was mostly concentrated on the Second Quarter of the First Half.

BYSTROVA E: Okay, thank you. And would you say this is the reason that affected your maybe cash flow generation also in the Second Quarter?

ARSLAN Ü: That's correct as well.

ERTUĞ G: It certainly had an impact, yes.

ARSLAN Ü: When you look at our cash flow, I mean the detailed cash flow, especially other than our presentation that we shared, but the financials that we shared publicly, the cash flow there shows that we have a significant amount of finished goods inventory. That means that in the Second Quarter, I mean by the end of Second Quarter, so by the end of First Half. So this means that we built the inventory.

Working capital-wise, we couldn't enjoy the collection of those, I mean sales and collection of those inventory. So this will flow to the Third Quarter and rest of the year. That's why we have a, that's one of the reasons, main reasons we have a lower operating cash flow in the Second Quarter. That's correct.

BYSTROVA E: Yes, thank you very much. It's just with the inflationary continent because you report cash flows on the annual, on the semi-annual basis. Well, in this particular case, I was just trying to understand what happened in the Second Quarter in particular. But thank you very much. It explains things. Thank you.

ARSLAN Ü: Thank you.

OPERATOR: Ladies and Gentlemen, we will now move on to questions from our webcast participants. The first question is from Baris Senol with Oyak Portföy and I quote, how should we think about revenue per vehicle going forward? Do you expect it to be above inflation due to increasing regulation?

ERTUĞ G: Well, I think I answered that question, but quickly let me recap for the, this question must be relating to the domestic markets because export market already we have contracts in place. It's a transfer prices like cost plus markup methodology. So, in the domestic markets, of course, now the availability from the different models, the different competitors is high because of the market dynamics in the, like GSR application after the 7th of July, the new regulation kicking in some special global safety regulatory pack vehicles, only the pack existing vehicle will be sold.

The other ones will not be able to sold. That's why everybody trying to like deplete their stocks. There was an aggressive pricing over there, but looking afterwards, at least we can speak for our Company. We have a certain price discipline that we deploy, and we rely on our products thinking that looking into our product portfolio. In fact, we have renewed our product portfolio. They are like very, very good, high quality, versatile vehicles.

That's why from a cycle life perspective, even that's not the right time to go into a price war. That's why we will be keeping our pricing discipline. That's our intention on all passenger vehicle, LCV, MCV, HCV, all segments. But having said that, we will look into the dynamics of the environment and just having spoken so much about inventories, of course, if it comes to the level that the demand supply curve necessitates a certain price point in the market so that we protect our intended inventories, intended market share, we will act accordingly, but we will not be engaging in a price war. And I think this ability to price, rather than the inflation, now that everybody in the market has this availability, all OEMs' ability to price has been reduced. And after some time, I'm expecting everybody to follow course.

In the first entry, there were like the Chinese coming into the market, their pricing, I can pick up cherry, the pricing was quite aggressive. But after some point when this, I would say trade barriers, the tariff wall came on top of them, looks like the pricing over there will need to change. So, we cannot speak on behalf of the other OEMs, but we will follow quite carefully, we will follow suit, protecting our pricing discipline is going to be my answer. I hope this will be satisfactory for you.

OPERATOR: Thank you. The next webcast question is from Erman Yildiz with Is Portfoy, and I quote, what is the ratio of EV sales in your total sales in 2024 and what do you expect for 2025?

AĞAR B: Let me answer this one.

ERTUĞ G: Please, okay.

AĞAR B: I thank you, Erman Bey. In the first time, we had around 5000 units of e-transit production. And as I mentioned earlier, our plug-in hybrids and all electric variants of our new custom model rolled off to production just a few weeks ago, as we have not seen its impact on our sales yet.

But with the rise of sales in our available zero emission models by adding new variants, like in Korea, Puma, and Truck side, we expect higher contribution from EV sales in the upcoming years. But now it's at low single digit level, constricting our total export volume size. Hope this answers your question.

OPERATOR: Thank you. The next webcast question is from Feruh Erim Isparta with ATA Portfoy, and I quote, do you observe that Chinese manufacturers are making any attempts in commercial vehicles after passenger cars?

ERTUĞ G: Yes. In fact, I mentioned several times in my speech about these Chinese actions. We have seen CHERRY in the rankings and like you all follow the news, there is going to be a BYD investment in Türkiye.

Most probably, since in the global world, China is seeing some trade reaction, they are trying to take some precautionary action coming into the country and trying to make their life easier in approaching the European markets, because otherwise they will be facing just tariffs, depending on what happens later this year in November timeframe, when we see the US elections, things can be different. But all in all, we see there is interest in Türkiye, both from a market, like sales markets, yes, vehicles are coming in, and also from an investment perspective.

First, I want to make a comment on the investment perspective. I think we should all take this as a very good sign. So far from the start of the presentation, in fact, we have spoken about bad things. We said there is inflation, there are the inflationary pressures, cost pressures, this inflation accounting hurting our EBITDA, blah, blah, many things.

But apparently, whatever is going on in the Turkish auto industry, it is still attractive that people come over to make an investment. So we are reading this as a very good sign, which also supports my comment saying we will be going through a little bit of a difficult time, maybe in the one and a Half Year, maybe two years, but afterwards the Türkiye dynamics, the Türkiye competitiveness will prevail. I think that is a signal for it.

So, this is the good part. The difficult part currently, even if the market is kind of, quote unquote, protected by the tariffs, of course, going forward, this cannot be the case. And the single sellers, if they cannot constitute a good service base where the vehicle uptime, vehicle services, value added services are not provided, I think they will be losing competitive edge.

And on this front, especially the Ford Pro logic in Ford's commercial vehicle segmentation, Ford Pro intends on this, which means selling something more than the vehicle itself, more than the hardware, selling the experience, selling the uptime, because commercial vehicle owners are having these vehicles for their own profession, their own job. So having the 100% uptime is very important for that. And combining their vehicle with certain value-added services, enhancing the connectivity features of the vehicles, this is going to be more and more important going forward.

So, for that reason, we are also deploying this, our energy and our investments into the augmented product, not just the vehicle itself, but the experience as a total. As we put the experience in the best quality for the customer, and as it comes with the value price, I think it will not cause a big problem.

Currently, as I said, the tariff walls are kind of protecting. Most probably, this will continue sometime, and Chinese competitors will try to fit in, maybe by doing such investments, or they will try to partner with other parties in Europe to open up this space. And there are certainly, of course, the OEMs need to do something against that.

I think starting from a commercial vehicle position, on the commercial vehicle segment, we are seeing ourselves quite strong versus their vehicle and service experience. For the passenger segment, I think this is more of a risk. For the commercial vehicle segment, we feel we are making the investment at the right place to be equipped in order to be competitive with them.

And not many Chinese vehicles appearing on the commercial vehicle market. I don't think that is going to be a short-term risk. And in order not to have the long-term risk, we are acting accordingly.

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

ERTUĞ G: Thank you very much. I think it has been a good discussion. Thanks for your attendance, checking the clock. We are almost half past five, which shows great interest. So, thanks for being with us. And I know it was a quarter where maybe none of us liked the questions as much as we would be willing to see. But further on, I can close my speech by saying that the guidance is over there, and our plans are in place to make it much, much better. So, thanks for your interest. And take care. Until next time. Bye-bye.