



Transcription for PEGASUS AIRLINES

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Corporate Participant

Serhan Ulga

Pegasus Airlines – Chief Financial Officer

Conference Call Participants

Alexander Kazbegi

Renaissance Capital

Alper Paksoy

BNP Paribas

Kerem Tezcan

Citigroup

Osman Memisoglu

Bank of America

Presentation

Operator

Ladies and gentlemen, welcome to Pegasus Airlines' First Quarter 2016 Results conference call. I now hand over to Mr Serhan Ulga, CFO. Sir, please go ahead.

Serhan Ulga

Hello everyone and welcome on board to our Q1 2016 webcast and presentation of the first quarter results. As usual, we're going to go over the presentation that was shared with you earlier and highlight some of the points in the presentation, and then once that's concluded, we'll go to Q&A and we try to answer the questions that may come up, and we'll conclude the presentation and the webcast today. Most of the points are made and the numbers have been put together one next to another, but I nevertheless will touch upon some of the key highlights which I think are worthwhile talking about.

First of all, I think the first quarter was still resilient growth in terms of revenue and deployment. Unfortunately, the European traffic was impacted by the attacks that took place in Brussels, Istanbul, Ankara, and recently in Bursa as well, and overall perception has faded a little bit. In terms of the rest of the operation, the non-fuel CASK in Euro terms increased slightly and there were some reasons behind this we'll talk about, and we are still



continuing to grow our capacity, given under the current constraints that prevailed in the marketplace.

If you look at the operation performance on slide three, the growth in passengers is about 19%. Load factor is slightly down, but mostly from the European operations, and landed yield is in Turkish Lira terms slightly down, and ancillary is the best perhaps part of this set of numbers after passengers growth is the ancillary revenue per PAX is flat and, in fact, the revenue performance bridge, if you go to slide number four, the growth in revenue is basically driven by operational volume and also impacted by higher FX which has a positive lift on the European order and international operations revenue base. That was countered by especially international scheduled RASK mostly coming from load factor, but then also accompanied by yield drops quarter-over-quarter.

The growth and yield update, which I think is the picture for what has transpired in the first quarter compared to the previous quarter in 2015, is that... a couple of highlights. We have grown more than the market growth in domestic and almost three times the market growth in international. The seat increase is in line with both operations, domestic and international, but I think on the constant currency basis, on the international... not the [inaudible] Euro basis, international yields came down 15% and the loads were down 4%. I would say that it was a rather flat load factor in domestic on the back of such growth, and also the yields were slightly lower than last year same quarter.

The fleet update, no new big news for the fleet other than what has been already communicated with you guys; still the fleet composition and the fleet growth on a contracted current basis remains the same, and I think we are just getting closer to taking delivery of our first CFM-powered A320neo, which will be the first in the world, we'll be the launch customer in July, which we hope that this aircraft will bring in about 15% fuel savings into our operations, as we continue to take delivery of these neo engine aircraft. We also... I guess this may not be the place to touch up on this, but we also have on-going engagements with various banks, which we have secured the financing of this year's incoming aircraft in 2016.

Route update, there are only a few to report: new route from Istanbul to Gabala and also a route from Ankara to Jordan, Amman long-awaited destination we wanted to get into, but we but this happens to be from Ankara, and I think going into the EBITDAR performance of this quarter, as you can see, there are two big items that actually make up the composition of the change in EBITDAR from quarter-to-quarter is scheduled flight RASK drop or the lower performance, again mostly arising from international operations, probably I would say three-quarters of that 64 million is related to international operations performance. The fuel cost including the hedge



had a counter uplifting impact on the EBITDAR bridge, providing TL 94 million uplift. This was offset by some of the other pieces, of which there's the annual inflation impact on TL base costs, structural impacts which has been going on, as the mix of the fleet is changing; there is the effects that had an impact on the Turkish [inaudible] EBITDAR basis, and airport disruption costs continued as part of the first month. The small related and other strong related disruptions and some congestion there resulted off of it, which resulted in a negative TL 15 million EBITDAR line at closing of the first quarter. Non-fuel CASK performance is relatively in line, but slightly up compared to after TL inflation and FX impact base. The Turkish Lira and inflation on TL costs and net of it provides the downside shift, brings the cash down by €0.06, but now that is countered by the continued ramp handling start-up costs without major production, and our reduction on handling costs on the auxiliary side, continuing our fleet restructure, the shift in the mix has continued to help that, and also as mentioned before the delayed costs stemming from snowstorm related delays and deferrals had an impact, bringing up the non-fuel CASK to 2.92. I'm sure there will be questions about this and we will talk about it.

On the balance sheet side, no major news; it's just that the first quarter, we had some PDP payments made for the incoming aircraft and 2017 Boeing aircraft, plus we also had to make the deposit payments for some of the [LLPs], the engine maintenance refurbishment related contract that we entered into with CFM last year. Those were the reasons and plus about TL 100 million worth of operating cash burn resulted in a decrease in the cash balance. The rest of the lines overall were in fact – and this was natural – paying down the financial debt of the aircraft engine PDPs for the reasons I just mentioned. On the foreign currency exposure, compared to Q1, we have shifted the revenue mix in Dollar revenue mix so to speak, as part of total revenue base, has gone up quarter-over-quarter due to our pricing of fares from Turkey to Europe on US Dollar basis starting in July 2015, so that has an impact. The mix has increased on the revenue to 29%. This trend is going to continue as our European operations' revenue base grows, and on the expense side, the portion of the Dollar expenses came down slightly, like about 6% compared to Q1 last year, due to a lower pie of the fuel prices in overall expense or cost base, because of the fuel price decline.

Again, no news so to speak on the hedging proportion and the volumes and so forth from the last quarter; our percentages provided on a 12-month utilisation basis are pretty much the same, the strike prices are the same, and if you look at the P&L, you see actually not much of a move this quarter. There's almost... if you look at the total P&L, there's almost a very small amount of movement in the exposure, so in the P&L side, as the fuel prices continued their upside... peaking upside. Our previous lower level reserves that we have provided for the open positions now start to reverse and so that provides a relatively stable P&L for the hedge side.



The last page, I guess, the outlook, I have read in some of the comments that our outlook is the same. Yes, our outlook is the same. I think this is the time to talk a little bit more on a broader scaled basis about the Istanbul airspace, what's happening at Sabiha Gökçen Airport, the second runway, the speed taxiways, and the capacity issues at Sabiha Gökçen and so forth, I think I will give you a flavour for that. The authority has limited the air traffic movement at the airport using the August months [inaudible] air traffic movements, which may be applicable for 12 months, so airlines operating out of Sabiha Gökçen cannot exceed at any months the number of air slots, so to speak, in any month more than what they had last year in August, so that actually gives us over the course of 12 months some growth opportunity, because we were talking about the peak cap, which is capped at the peak month, so it gives us, again, production capability in off-peak months and that would be evenly distributed over the course of the year. However, on the other side, so this is the good news on the other side, there doesn't seem to be too much happening on the second parallel runway construction process and I think what is being talked about out there is that our hopeful assumption that this will be hopefully up and running in 2018, maybe even pushed out a little further to 2020 time period.

We will, as I said... before we have said... we communicated to you before, so the strategy will be then to use other bigger bases and cities in Turkey to make a new home for the company, for Pegasus, and launch the operations from those bases. Those bases may be strengthening İzmir, Antalya, you know, our capital, and even using some of the other ethnic-sensitive Anatolian cities and connecting them to Europe on a seasonal basis. All of them... we have our applications at the Civil Aviation Authority, ready to deploy the operation in June and July timeframe. I hope that will be a good change for our... a change from our congested Sabiha Gökçen Airport operation to a different level of comfort. Therefore, it's a long way of saying the capacity increase and the overall growth expectations, we still are hopeful that we can deliver those numbers, those growth numbers, and load factors and yields.

The ancillary revenues are... we're seeing we'll be comfortable with delivering in the range we have provided you for. The total CASK is going to be driven down, even though there are some headwinds coming from the ramp operations and from airport-related congestion costs. We think that the fuel impact overall will help us bring down the CASK 2-3%. That's still intact for us, so we hope to be able to be in the range of 19-20% EBITDAR margin, so that they still are the pillars behind our outlook as of today, but I also have to say that the overall market in Turkey, as you may know, is subject to unfortunate factors that are beyond our control, that may be related to overall geopolitical circumstances and situations which may unfold and bring in other challenges ahead of us, so we don't know those,



but as an airline, what we know and what we are happy to share with you are those, as you can see.

The question then... to take some of the questions that may be coming after, so how was April and how is the summer looking? April was difficult for us, May slightly better, and I see a lot of hope in third quarter and seeing the traffic picking up as the weather gets warmer. We are seeing resilient demand on domestic on the back of such growth on the domestic side as well. [Inaudible] load factor 82% plus levels. Our Turkish Lira base yields are relatively flat still; we see such like that into the future, but European destinations and European destinations' impact on transfer traffic into Middle East and beyond, and also... as the other airlines, whose business plans we don't really know and don't understand too much other than our main competition, also has appetite getting into the European landscape and deploying their otherwise parked aircraft and trying to mimic hub-and-spoke small operations; the other two smaller airlines or three airlines are... the hotbed of those start-ups are typically Germany, France, typical ethnic destinations, and then trying to capture some market share, and so that force is also active. That means not only we are facing demands or geopolitical based challenges from European market base, but we are also facing some challenges in terms of competition or more capacity being brought into the picture by otherwise... by those airlines who otherwise... which they don't know what to do with their excess capacity, the typical charter airlines and airlines that serve to bigger tour operators, so they have their tour operators and charter customers facing the same difficulties, so they are deploying their aircraft for the summertime to get their share of the pie.

That's my long way of giving the outlook, but basing and providing you ground that supports this outlook and also providing you some flavour as to the marketplace and competition, and what is going on beyond our control and desire, so to speak. I hope this is helpful. At this point, I will stop and if there are any questions, we'll take those.

Question and Answer Session

Operator

[Operator Instructions]

Our first question comes from Alexander Kazbegi, Renaissance Capital. Please go ahead.

Alexander Kazbegi



I was just wondering, is there any flexibility in reducing the amount of the planes you might be taking in 2016, because again given the outlook you have given, it is probably with a big... so to say, it would have been maybe better to have less planes. Is there any flexibility again to not to get over-deliveries?

Serhan Ulga

The answer is no, because these contracts are not entered today. They have been entered into in the previous year before most of the stuff that has been unfolding becomes more of a routine to us and to the people who live in Turkey, so it's not possible. But what is possible is that giving some of these aircraft on a [inaudible] basis to other geographies, which this company used to do in the past and has an experience base for that, a couple of aircraft maybe, if such circumstances warrant themselves, may be deployed that way and we have some work being done and some contracts actually waiting for our decision to happen, but I think that decision won't come in the next couple of days or couple of weeks, so it depends, as we see further into the summer how the summer traffic we think is going to shape up, then we may react accordingly.

The other thing is Alex Bey, you know, this is a difficulty that pertains to our life here in Turkey, you know, we need to be able to force with our last aircraft effort to get, as I said, the maximum capacity that's available at Sabiha Gökçen, so we will... and this is not such an easy and transparent process. Even keeping track of the slots, making sure everybody gets their fair share is an effort, so the priority for us to make sure we have our footprint and slots available and given to us, and become ours into the future until 2020 perhaps, then to worry about coupled aircraft becoming less usable and we're carrying these aircraft a few more months on a less utilisation basis, which is actually not [audio] will be the best. These are the pieces of answers I can give you to circle the question.

Alexander Kazbegi

I appreciate it, thank you very much. Just one more maybe, you touched, of course, on the situation with the yield and with the load factors, but again I just wanted to touch on that one again. Let's say, looking just on the domestic side, if DHMİ revised their forecast down to 8% growth and you're looking at the double of that. Your main flag carrier is adding quite a considerable amount of the new capacity also to the market. How realistic do you think these flat load factor, flat yields is? It is probably not going to hold. I am just trying to understand, so to say, when you might revise those downwards, because for me it seems that the outsized pressures or outside situation is quite obviously pointing to overcapacity at the moment.



Serhan Ulga

I have to disagree with you on the domestic comment you make, because if any signs – the domestic is probably one of the, not brightest quarters we have experienced. On the back of 22% fleet growth or seat growth, load factors, to me, a -0.25% is a flat load factor and to the extent that you get there and you induce the marketplace with lower fares, which is what this airline is known for and famous for, I think domestically with our existing brand name recognition, and we don't see in the booking curve of such a warning sign today. Having said this, again, I need to qualify this with what may happen and what is happening in the European marketplace. The European marketplace...

Alexander Kazbegi

No, that is clear.

Serhan Ulga

... total different animal. Yes, depending on how things evolve in the European marketplace, I think... but again, if you have to make a decision to revise this, the culprit will not be domestic problem what we can see, but it may be probably from international.

Alexander Kazbegi

Okay, understood. Thank you very much.

Operator

Our next question comes from Alper Paksoy, BNP Paribas. Please go ahead.

Alper Paksoy

Hi, Serhan Bey, thanks very much for the presentation. You mentioned possibly basing some of the aircraft outside your main hub. Can you give a bit more detail about that, how many aircraft you are talking about, and which airports, possibly? How could this affect your costs, distributing the aircraft to other airports? How could that affect unit cost evolution if done as planned? Thanks very much.

Serhan Ulga



Sure, as I said, our application is with the Civil Aviation Authority to deploy these aircraft, so before I get these approvals, I don't want to divulge on the number of aircraft here and there, but you can do a math backwards looking at our third quarter capacity last year, in terms of cycles and apply that over the year to Sabiha Gökçen. The rest, whatever comes out the rest, on... you may think that that kind of capacity needs to be deployed based on our guidance elsewhere. Izmir, we already have a base, we have a company also doing an operation with seven aircraft out of Izmir, so that is not new news for us. Antalya, we have a summer scheduled type operation base that we had historically over the years, so that is not a new operation for us, so the only other things may come from, for example, basing – which we had in the past – basing aircraft in Ankara and perhaps in Kayseri and something like that, which provided based on the permissions received will be deployed.

I think it is not – moving cabin crew is not a big issue to get there in those cities I just mentioned at all. The cockpit crew in Ankara and the rest of Izmir, Antalya, is not a big issue. Perhaps you may need to have some captains layover in one or two of other Anatolian cities for the season, which I don't think will be – the costs will be marginal, so I don't... and as you know, the emptier airports and airport operators are more likely and keen on getting your business and provide you a fair amount of concessions for you to deploy those aircraft, which we certainly will be doing.

I am not saying it is going to be better. I just don't think that this will add any more marginal cost to the operation base because of this. This is the cost picture.

In terms of load factor pictures, I don't anticipate much of a shift, because those cities will be finding new city pairs and connections into other destinations, so there will be more vessels, so to speak, feeding the body of that region or that hinterland. There may be a month or two of weakness in the load factor upon deployment, but I don't think that based on what we are seeing that that would be, again, an issue overall domestic performance.

Alper Paksoy

Thanks very much. One more question, this is about Sabiha Gökçen. In one of the previous earnings conferences and in the meeting at the headquarters of Pegasus, we had discussed measures proposed by Pegasus to State Airports Authority that would alleviate the runway congestion. Have those measures been implemented and to what extent? Thanks very much.

Serhan Ulga



Good question, Alper Bey. I wish I could tell you more positive things on this. Of course, from our side a lot is being put in, this effort, including our new CEO, our operation people, commercial people, our flight-ops people. I think from all the efforts, meetings that had been held and discussions, talks and everything, the speed taxi runway project which could have been, which we thought could be deployed this year is going to be operational for next summer. This would have saved a few more air traffic movements per the hour, because it would have helped the aircraft, landing aircraft to be less on the runway, so the departing aircraft can take off quickly. It would not have been an earth-shaking change, but it would be few ATM per the hour, which is welcome by everyone, but that, unfortunately, is not – against our will and expectation – is not going to be operational in 2016, so it is a 2017 issue.

The other issues of separating the air traffic control for Sabiha Gökçen, decreasing the approach distances between approaching aircraft, increasing therefore the capacity 30, 40% etc, I don't know when those things are going to happen. I don't think, as I mentioned before to some of you guys in different conferences, it seems to me that before we see more concrete start-up dates and operational viability at the big projects, the third airport comes into place, it seems like we are not going to get too much clarity and hope for the second part of the runway operation, so that may put us – the reason why I am pronouncing 2020, the third airport becomes operational in the third quarter in 2018, to some degree, let's say fully, and then finishing up the second runway in Istanbul, Sabiha Gökçen is 2019, then a year worth of single-runway operation continues, they repair the first existing runway. Then the earliest time we have a full two-runway operation in Sabiha Gökçen maybe – and this is just a feeling based on what we are seeing and hearing around the marketplace – is 2020. Therefore, maximising and getting the last drop of this traffic at Sabiha Gökçen is critical, and we are doing it this year and that will be the end of it. Then deploying capacity and operations in other parts of Turkey, which used to be, as we discussed from the initial dates of IPO days and stuff, other bigger hubs and more point to point within Turkey, and half of these destinations.

As I said, currently, with the geopolitical conditions and situations, even if you were to deploy, let's say, more traffic from Izmir or Kayseri or Germany or whatever else, you're not going to have European traffic coming in. You're just going to have ethnic traffic. It does have its challenges, so that is why you keep on saying, domestic, domestic, because domestic seems to be the lifeline through these difficult times, and I think it looks like on the horizon that will be the way to continue, hang onto, given our position at Sabiha Gökçen.

Alper Paksoy



Thank you.

Operator

Our next question comes from Kerem Tezcan, Citigroup. Please go ahead.

Kerem Tezcan

Serhan Bey, thank you for the presentation. A couple of my questions answered actually. One more question that I have left is, actually, you have TL 7.1 million of airport [interruption] costs in the first quarter, given the fact that we are approaching to high season in the airports. To what extent should we guess this number would be growing, especially in the third quarter? Thank you.

Serhan Ulga

Kerem, I think most of these – the predominant number behind this figure we shared with you is resulting from the bad weather we had experienced during the first quarter, the beginning of first quarter. The snow storms, if you remember, we had a couple of them and plus [CB], what is called the lightning strikes that came after in the first quarter because of the changing weather, there were some lightning strikes that the aircraft had to be grounded and that resulted in shuffling up the schedule, resulted in layovers and stuff like that. None of them resulted from our operation that had any issue in terms of inefficiency on the ramp or whatever. Seriously, mostly from snowstorms, because snowstorms last a day or two but the impact lasts four or five days, at least, which results in many overnights, meals, refunding tickets and so forth and so on. Unless there is a weather-related incident or series of incidents that may happen in the third quarter, I do not expect major disruption cost at the airport. I think the airport is congested, necessary precautions have been taken in terms of number of crew, aircraft and everything else on our side, but anything beyond that will be in the hands of air traffic control.

I doubt there will be so much of an issue in that quarter because of this, but I have to bite my tongue again on this one when I say this.

Kerem Tezcan

Thank you so much.

Operator



Our next question comes from Osman Memisoglu from Bank of America. Please go ahead.

Osman Memisoglu

Hello, Serhan Bey, thank you for the presentation. Can you give us an idea on what the current share of Sabiha Gökçen is in the ASK or cycle. I am trying to confirm, is it like 80%, 90%. Would that be possible?

Serhan Ulga

No, it is about 65% overall.

Osman Memisoglu

65% or so.

Serhan Ulga

Not much has changed...

Osman Memisoglu

So the remaining part is mostly Izmir.

Serhan Ulga

No, no, 65% of the traffic out of Sabiha Gökçen is ours is what I mean.

Osman Memisoglu

Okay, let me rephrase the question. In your total operation, what is the share of Sabiha Gökçen?

Serhan Ulga

I don't have it with me right now, but you have to look at it how you understand the total operation, because total operation – if you count it on the outgoing flights or if you count it also, include the incoming flights into Sabiha Gökçen, so I don't know what you mean by that. Our market here, it is out of Sabiha Gökçen, you can consider it 65%, around 65%.

Osman Memisoglu



Okay, but would it be fair to say, currently, before these upcoming changes on moving aircraft to other airports, primarily most of the business of Pegasus is operated in Sabiha Gökçen. Would that be fair or am I missing...?

Serhan Ulga

I would want to think that, yes, that is a fair statement, because as a hub-and-spoke system, you distribute the passengers and then you collect them back and redistribute them again. Majority of the operation is based on that, but there is still, of course, point to point from Izmir, from Antalya to European and other destinations and from Ankara to Middle Eastern destinations, those will be outside of this, but you are right to assume most of it goes through Sabiha Gökçen.

Again, the 65% I just need you to know that 65% is counted as the exiting out of Sabiha Gökçen percentage, but it is a hub-and-spoke system, you can similarly think that incoming 65% is also ours, yes.

Osman Memisoglu

All right, got it. Just to confirm on another point, ramp-handling transfer is going to happen at the beginning of third quarter if I remember correctly.

Serhan Ulga

The [inaudible] is going to be the end of May. Actually, we have started handling a fraction of our existing flights out of Sabiha Gökçen in April, a little more in June, it is almost like a training exercise, but this does not have a major impact on the cost line, this is more so like doing it on our own, but it doesn't have a significant impact on the cost line.

In June, 1st June let's say, you will see Pegasus taking over the entire operation at Sabiha Gökçen Airport. What you will see is that you will see lower handling expenses in the P&L, but relatively a similar payroll in the payroll section in the P&L, because those people, as we said, over the past year and this year, it is growing, so we are hiring-training, hiring-training, now, they are going to be fully operational and fully deployed in June, but that, again, will take out what we pay to Çelebi on a per cycle basis. There will be a deduction on the handling line.

Osman Memisoglu

The rise we saw, almost a 50% rise year-over-year in the first quarter is due to bad weather, I would assume, for the ground handling business, or is there something else in there.



Serhan Ulga

Ground handling, those are not accounted on the ground handling. Ground handling charges are only related to what we pay to the ground handling, but most of the bad weather related disruption is going to overhead expense, you know that are part of the other DOC expenses that are part of the P&L. They are not in handling expenses, so to speak.

Osman Memisoglu

What about de-icing, I thought de-icing was in there?

Serhan Ulga

... then there was a little increase in the de-icing inventory as well, but we don't have it anymore, that of course was winter time for snow.

Osman Memisoglu

What is driving that 50% increase then? Do you think that is normal? That is positive or under control.

Serhan Ulga

The de-icing is under the operating costs, so there was a bulk purchase and expense also used to this winter weather storm, and those are as part of delayed costs as in other DOC.

Osman Memisoglu

Thank you. If I may just take one more minute of your time, regarding this EU visa saga, with a big if, if it happens, do you have any guidance for us to how your metrics could improve, load factor, yields? That will be helpful. Thank you.

Serhan Ulga

I am confused about this whole visa situation thing. I don't know if it is on again, off again, so I don't know how it is going to transpire. Honestly, even if it does transpire, I don't know if so much of attitude and behaviour is going to change soon enough on both sides of the... I think the Turkish tourists will still even go through further questioning and grilling at the borders even if their visas were raised, and I don't think that Turkish tourists right now understand what is going on, and even though they would



understand it one day in the next month or so, then it would be kind of passed to make their summer plan and vacation to turn too much. Meaning to say, I don't think there should be a huge jump just because visas have been waived this year, but next year may be a better story as the whole thing becomes more clear and understandable by everyone, by the consumers, so that the consumers may make their selection or election to go to Europe, as opposed to going to Antalya. I don't know what they will do.

I think this may be a better question to tackle if you ask me for next year, but there is one interesting thing that is happening this summer is that there is a European football cup being held in France, if I am not mistaken. We may see a little more traction because a Turkish soccer team is playing there, but I don't know what kind of a margin impact it makes and the overall demand is yet to be seen.

Osman Memisoglu

Okay, thank you very much.

Operator

[Operator instructions]

We have no other questions. Back to you Mr Serhan Ulga for the conclusion.

Serhan Ulga

Again, thanks for everyone taking the time to join and listen to me on this conference call or webcast. We will meet up again in the next quarter webcast and will see how our discussions today has transpired in the next three months and we will go from there.

Thank you.

Operator

This concludes our conference call. Thank you for participating. You may now disconnect.