

EARNINGS REVIEW 3Q17

Turkey | Petrochemicals | 10 November 2017

Petkim

Addicted to plastic...

Expected impact: Positive

We maintain our BUY recommendation for PETKM and revise our FV estimate upwards to TRY7.41 from TRY6.80/share with the contribution of favourable product spreads, the weakness of TRY supporting operational performance, the completion and commencement of operations in Petlim's 1.5 million TEU capacity container terminal's Phase 1, and the future benefits the company can have with the completion of Star Refinery. We will keep a close eye on the management's conference call on Monday 13th of Nov, 2017 at 4PM local time for further details.

Petkim announced its 3Q17 results with TRY1,776mn revenues (+83% YoY, -5% QoQ), TRY423mn EBITDA (+143% YoY, -4% QoQ), and TRY374mn net income (+174% YoY, +26% QoQ). The top line results were a little below both our call and the market consensus mainly due to some squeeze in the prices compared to previous quarter. EBITDA came in line with the expectations with EBITDA margins in parallel with market consensus and our expectations. Lastly, even though the company posted another hefty FX loss in 3Q17, earnings were above the expectations with a 20% deviation from market consensus and 9.4% deviation from our estimate owing to an increase in the income from investments.

- Middle East LDPE prices remained flat in 3Q17 at \$1,180/ton when compared to last year whereas European Ethylene prices climbed 10% YoY and 1% QoQ to reach an average of \$1,146/ton. Yet, the increase in TRY terms is 20% YoY in Middle East prices and 29% YoY in European prices. These positive developments were reflected on the company's top-line figures as a substantial increase on a yearly basis whereas the TRY depreciation since 2Q16 also underpinned the sales performance. If crude oil prices were not to pass the 60-65\$ range in 2017, naphtha-based producers like PETKM would continue to enjoy favourable spreads compared to ethane-based producers. We believe, this strong sales performance should continue for the remaining part of the year as well, especially with the rising Ethylene prices in Europe.
- Although the rising trend in sustainable EBITDA performance did falter a little bit on a quarterly basis in 3Q17 with the minor drop in revenues due to lower prices, PETKM achieved another quarter of strong outperformance of profitability on a year on year basis (+143% YoY). High capacity utilisation (9M17: 96.3%, 6M17:96%, and 9M16: 89%) with no shutdowns resulted in steady volumes in the 3rd quarter with a 44% YoY and 3% QoQ increase. Robust volumes backed by stronger margins with rising spreads made the way to the sturdy operating performance where TRY depreciation compared to last year also helps the company in terms of margins. Potential further depreciation of TRY against USD might solidify the market position of PETKM against its importer competitors since PETKM's revenue is totally USD-based where its COGS are 15% TRY-denominated.
- PETKM's earnings deviated very positively in 3Q17 with increasing FX gains and the rise in the investment income where net income rose 174% YoY and 26% QoQ. As a result, company achieved a very impressive net profit margin of 21% in 3Q17 (2Q17: 16%, 3Q16: 14%). Please note that the company also managed to lower its net debt position to TRY1.1bn which has been TRY1.3bn in 2Q17, pointing out to a healthy cash generation capacity.

The stock is trading at a 16% premium and 4% discount in terms of 2017E and 2018E average EV/EBITDA and P/E multiples compared to int'l peers, respectively.



BUY 12% upside
Fair Value TRY7.41

Bloomberg ticker **PETKM TI**
Share Price TRY6.62
Market Cap USD2.6bn/TR9.9bn
Free Float 44%

TRY mn [3Q17]	Actual	Consensus	Deviation	Global Est
Revenues	1,775.5	1,813.2	-2.1%	1,916.2
EBITDA	422.8	430.8	-1.9%	448.9
Margin	23.8%	23.8%	0.1%	23.4%
Net Income	374.1	312.1	19.9%	341.9
Margin	21.1%	17.2%	3.9%	18%

TRY mn	3Q17	3Q16	YoY	2Q17	QoQ
Revenues	1,775.5	967.7	83%	1,860.2	-4.6%
EBITDA	422.8	173.9	143%	440.7	-4.1%
Margin	23.8%	18.0%	6%	23.7%	0.1%
Net Income	374.1	136.7	174%	296.8	26.1%
Margin	21.1%	14.1%	7%	16.0%	5.1%

Performance	1M	3M	6M	12M
Absolute	8.7	3.9	23.3	85.4
Relative	-0.1	2.5	6.6	28.1
Relative \$	4.3	-4.6	14.9	53.3

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Petkim

Recommendation:

Fair Value:

Share Price:
Upside / Downside:

Previous Fair Value:
% change to Fair Value:

Bloomberg ticker:
Reuters code:

BUY
TRY 7.41

TRY 6.62
11.9%

TRY 6.80
8.9%

PETKM TI
PETKM.IS

Shares In Issue Less Treasury (m) 1,500
Market Cap (TRY m) 9,930
Net Debt (17E) 1,132
Adjustments For Associates & Minorities -
Enterprise Value (TRY m) 11,062
Net Pension Deficit (Surplus) -

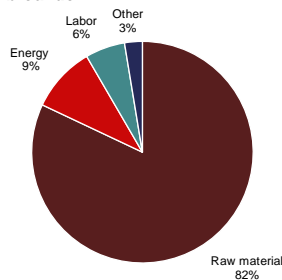
Forthcoming Catalysts

4Q17 financial results March 2018

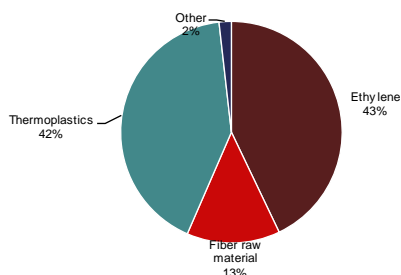
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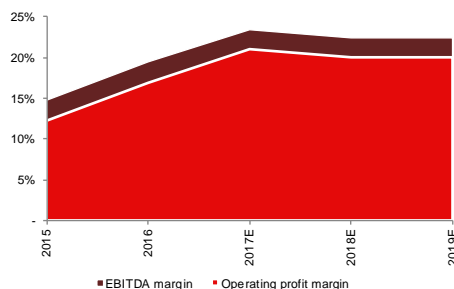
Cost of sales breakdown



Sellable production



Margin Trends



Valuation Metrics (Year end Dec)	2015	2016	2017E	2018E	2019E
P/E	7.33	7.65	7.6	7.6	7.4
EV / Sales	0.8	1.6	1.3	1.3	1.2
EV / EBIT	6.8	9.2	6.1	6.3	6.1
EV / EBITDA	5.7	8.0	5.5	5.6	5.4
P/BV	1.67	1.85	2.6	2.5	2.3
FCF Yield	13.5%	0.4%	3.1%	13.0%	13.4%
OCF Yield	27.8%	6.3%	9.6%	19.8%	20.6%

Key Ratios	2015	2016	2017E	2018E	2019E
EBITDA margin	14.7%	19.4%	23.4%	22.4%	22.4%
Operating Profit margin	12.2%	16.9%	21.0%	20.0%	20.0%
Capex / Revenue	(12.7%)	(12.5%)	(8.4%)	(8.5%)	(8.7%)
Capex / Depreciation	(5.06)	(4.86)	(3.52)	(3.58)	(3.65)
Net Debt / EBITDA	(0.3)	0.5	(0.5)	(0.5)	(0.5)
ROA	11%	12%	20%	18%	18%
ROE	22%	24%	34%	32%	31%

P&L Summary (TRY m)	2015	2016	2017E	2018E	2019E
Revenue	4,533	4,533	7,102	7,315	7,535
% change	9.7%	(0.0%)	56.7%	3.0%	3.0%
EBITDA	668	881	1,660	1,637	1,686
% change	1,371.2%	31.9%	88.4%	(1.4%)	3.0%
% margin	14.7%	19.4%	23.4%	22.4%	22.4%
Depreciation & Amortisation	114	117	169	174	179
Operating Profit	554	765	1,491	1,463	1,507
% change	-1355.4%	37.9%	95.1%	-1.9%	3.0%
% margin	12.2%	16.9%	21.0%	20.0%	20.0%
Associates	-	-	-	-	-
EBIT	554	765	1,491	1,463	1,507
Net Financials	19	17	-29	-30	-30
Other Pre-tax Income	-	-	-	-	-
Pre Tax Profit	574	782	1,463	1,433	1,477
Income Tax Expense	65	(50)	(149)	(117)	(121)
Discontinued Operations	-	-	-	-	-
Minority Interests	(13)	(6)	(11)	(11)	(11)
Net Income	626	726	1,303	1,306	1,346

Reported EPS (TRY)	2015	2016	2017E	2018E	2019E
Reported EPS (TRY)	0.42	0.48	0.87	0.87	0.90
Underlying EPS (TRY)	0.42	0.48	0.87	0.87	0.90
DPS (TRY)	0.32	0.40	0.71	0.71	0.74
Payout Ratio	73.9%	82.0%	82.0%	82.0%	82.0%
Shares In Issue Less Treasury (m)	1,500	1,500	1,500	1,500	1,500

Cash Flow (TRY m)	2015	2016	2017E	2018E	2019E
EBIT	554	765	1,491	1,463	1,507
Taxes paid	65	(50)	(149)	(117)	(121)
Depreciation	114	117	169	174	179
+ Increase in accounts payable	473	(27)	(531)	41	34
-Increase in accounts receivable	29	123	201	(14)	(15)
-Increase in inventory	(68)	241	198	(11)	(23)
Cash flow from operations	1,115	541	879	1,819	1,880
Capex	575	566	594	624	655
FCFF	539	(25)	285	1,195	1,225

Balance Sheet (TRY m)	2015	2016	2017E	2018E	2019E
Cash & Equivalents	1,502	1,267	2,057	1,942	2,000
Inventory	364	604	803	792	769
Trade Receivables	551	674	876	862	846
Fixed Assets	2,295	1,926	2,329	2,779	3,255
Other Assets	749	1,796	449	779	639
Total Assets	5,461	6,269	6,513	7,154	7,509
Interest Bearing Debt	1,276	1,690	1,293	1,190	1,211
Trade Payables	1,142	1,115	584	624	659
Other Liabilities	238	395	618	637	656
Total Liabilities	2,655	3,199	2,725	3,123	3,197
Shareholders' Equity	2,741	3,002	3,705	3,942	4,217
Minority Interests	64	68	84	89	95
Total Equity	2,805	3,069	3,788	4,031	4,312
Net Debt (Cash)	(226)	422	(763)	(752)	(790)



Changes in estimates

We have revised our revenue, EBITDA and net income estimates both for 2017 and 2018 due to changes in product spreads, volume forecasts, and our expectations regarding CAPEX and WC.

Figure 1 PETKM: Changes in estimates

	2017			2018	
	Old	New	Consensus	Old	New
Net Sales	4,855	7,102	6,431	5,201	7,135
EBITDA	1,038	1,660	1,347	1,111	1,637
EBITDA Margin	21.3%	23%	22%	21.3%	22%
Net income	828	1,303	935	885	1306

Valuation

We use a discounted free cash flow method (DCF) and international peer group comparison to reach a fair value for PETKM of TRY11bn, which corresponds to TRY7.41 per share price. DCF and peer group comparison methods have 80% - 20% weights as we think the initial method is a better measure considering the strategy differences among the peers.

Figure 2 PETKM: Summary of valuation

Valuation Methodology	Weight	Implied Valuation	Contribution
DCF	80%	8,446	6,757
International peer group comparison	20%	14,782	2,956
Petlim			1,630
Star refinery			902
Net Debt			1,132
Fair value (TL mn)			11,112
Current mcap (TL mn)			9,930
Fair value (\$ mn)			2,884
Current Mcap (\$ mn)			2,577
Upside/downside potential			11.9%

Source: Global securities estimates



DCF Analysis

In the DCF analysis, we have forecast financials based on expected sales volume, estimates for product prices and feedstock prices. We used a weighted average cost of capital (WACC) of 13.50%.

Figure 3 PETKM: DCF Analysis

(TLmn)	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E
EBITDA	1,660	1,637	1,686	1,720	1,754	1,789	1,825	1,862	1,899	1,937
- Taxes paid	-149	-117	-121	-123	-125	-128	-130	-133	-136	-138
- Increase in accounts receivable	201	-14	-15	-25	-27	-28	-29	-31	-32	-34
- Increase in inventory	198	-11	-23	-33	-34	-36	-38	-39	-41	-43
+ Increase in accounts payable	-531	41	34	29	30	31	32	33	34	35
Cash flow from operations	879	1,819	1,880	1,930	1,971	2,012	2,055	2,098	2,142	2,188
- Capex	594	624	655	688	723	759	797	836	878	922
FCF	285	1,195	1,225	1,242	1,248	1,254	1,258	1,262	1,264	1,265
Discounted FCFF	251	926	836	746	660	584	516	455	402	354
PV of Terminal Value	3,115									
PV of FCFE	5,729									
Fair Equity Value	8,844									

International peer comparison

We calculate that PETKM is trading at a 30% and 7% premia in terms of 2017E and 2018E average EV/EBITDA and P/E multiple respectively compared to int'l peers.

Figure 4 PETKM: International peer comparison

Company	EV/EBITDA		P/E	
	2017E	2018E	2017E	2018E
BRASKEM SA-PREF A	4.3	4.9	9.0	11.6
LOTTE CHEMICAL CORP	3.8	3.8	5.6	5.8
SAUDI BASIC INDUSTRIES CORP	7.5	7.2	14.8	13.9
SAUDI KAYAN PETROCHEMICAL CO	9.0	8.8	16.9	13.0
YANBU NATIONAL PETROCHEMICAL	9.0	8.7	14.1	13.3
SAUDI INTERNATIONAL PETROCHE	7.8	7.1	14.1	10.9
SAHARA PETROCHEMICAL CO	10.6	9.8	14.0	13.8
ADVANCED PETROCHEMICALS CO	11.3	11.7	13.5	13.0
PTT GLOBAL CHEMICAL PCL	7.4	7.4	10.4	10.4
MITSUI CHEMICALS INC	7.7	7.2	12.2	9.7
Average	7.8	7.7	12.5	11.5
Relevant value	1660	1637	1303	1306
Implied EV	13,024	12,540	17,358	16,207
EV from peers	14,782			

PETKM**Exhibit 1 Publication schedule**

Date	Publication
05.03.2018	4Q17Earnings release

Source: Public disclosure platform

Exhibit 2 Recommendation history

08.08.1994 (Initiation date)	Rating	Target Price	Prev. Day's close	Upside
11.08.2017	Buy	6.80	6.33	7.4%
05.05.2017	Buy	5.54	4.98	11.2%
03.03.2017	Hold	4.78	4.10	16.6%
27.12.2016	Buy	4.52	3.27	38.3%
16.09.2016	Hold	4.73	4.24	11.5%
12.08.2016	Hold	4.70	3.98	18.2%

Source: Global Securities

Exhibit 3 Coverage universe recommendation overview

	Buy	Hold	Reduce	Sell	U/R
Universe	17	17	2	2	0
Universe %	45%	45%	5%	5%	0%

Source: Global Securities



Date of completion of this report: 10.11.2017 9:06 UTC+3

Date of email-distribution of this report: 10.11.2017 9:20UTC+3

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BUY: Buy stocks are expected to have a total return of at least 20% and are the most attractive stocks in our coverage universe on a 12-month horizon.

HOLD: Hold stocks are expected to deliver a positive total return of up to 20% within a 12-month period.

REDUCE: Reduce stocks are expected to achieve a negative total return up to -10% within a 12-month period.

SELL: Sell stocks are expected to post a negative total return of more than -10% within a 12-month period.

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