

MARKET UPDATE

Turkey | Steel | 18 December 2017

Erdemir

Sweet rolls fresh out of the oven...

We reiterate our BUY rating for Erdemir; while raising our TP from TRY9.26 to TRY10.80 on the back of positive outlook regarding the product spreads and steady volumes. The rising trend in sustainable EBITDA performance would continue in 4Q17, as the increasing trend in product prices is still supporting strong USD denominated revenue generation and increasing product spreads is still backing the strong operational profitability of the company.

Increasing product prices backing revenue generation:

So far, both cold-rolled and hot-rolled prices showed improvement in 4Q17 when compared with 4Q16. Hot-rolled prices averaged \$613/tons in 4Q17 with a 15% YoY increase while YTD average increased to \$619/tons (2016 average: \$493/tons, +19% YoY). Furthermore, cold-rolled prices increased to \$728/tons on average in 4Q17 with a 16% YoY rise where YTD prices averaged \$656/tons (2016 average: \$513/tons, +26% YoY). We expect the strong revenue growth of EREGL to continue next year as well backed by the rise in prices and steady volumes.

Margins supported by robust product spreads:

In November, China decided to decrease steel production in order to fight the deteriorating air pollution problem. It has been estimated that the supply cut would continue during Nov'17-Mar'18 which could put downward pressure on iron ore prices. For coking coal prices, it should be remembered that it has reclaimed its glory towards the end of 2016. Supply-side concerns in Australia and China's restriction on mining days resulted in a steep rally in coking coal prices. As supply problems have been solved and China softened its control on mining days, coking coal prices withdrew from their peak. Recently, premium hard coking coal has been consolidating near the \$200/tons. In contrast to last year when coal prices rose too fast and too soon, this year's price rise has been more gradual and fundamental. During 2017, it is observed that steel companies have been able to pass higher feedstock costs to buyers where the steel producers experienced a robust margin expansion. Moreover, the product/feedstock spreads have soured YTD where hot-rolled/coal spreads have averaged at \$416/tons in 4Q16 with a 57% YoY increase and cold-rolled/coal spreads have averaged at \$526/tons with a 48% YoY increase. Rest assured that the strong operational performance of EREGL would most likely continue for the following quarters.

All about the Benjamins:

One of the strongest blessings of EREGL has always been its strong cash position. The net cash position of the company showed a noteworthy improvement in 3Q17 to TRY1,448mn of net cash whereas it had been TRY225mn at the end of 2Q17. This strong hard-currency denominated cash position usually provides support for the stock price during times of market turmoil which is one of the main reasons EREGL is picked as a defensive play. Considering the recent depreciation of TRY against hard-currencies, EREGL could be one of the outperformers with its sustainable USD based revenue generation.

The stock is trading at 10% and 1% premia in terms of 2017E and 2018E average EV/EBITDA and P/E multiples compared to int'l peers, respectively.

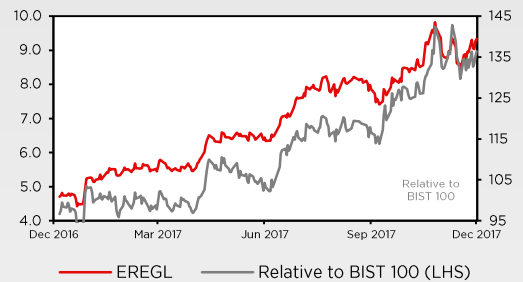


BUY 16% upside
Fair Value TRY10.80
Prev. (HOLD) Prev. (TRY9.26)

Bloomberg ticker **EREGL.TI**
Share Price TRY9.33
Market Cap USD8.5bn/TRY32.7bn
Free Float 48%

Estimates	2015A	2016A	2017E	2018E
Sales	11,915	11,637	17,629	18,495
EBITDA	2,197	2,687	5,086	5,022
Net earnings	1,126	1,516	3,074	2,965
P / E	9.45	11.86	10.7	11.0
EV / EBITDA	6.6	5.2	6.0	6.3
EV / Sales	1.2	1.2	1.8	1.7
ROE	9%	10%	17%	17%

EREGL Price Performance



Performance	1M	3M	6M	12M
Absolute	4%	19%	45%	95%
Relative	3%	17%	31%	38%
Relative \$	5%	6%	32%	78%

All share price data as at close on 15-Dec-2017.

Source: Global Securities, FINNET

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Erdemir

Recommendation:

Fair Value:

Share Price: TRY 9.33
Upside / Downside: 15.8%

Previous Fair Value: TRY 8.41
% change to Fair Value: 28.4%

Bloomberg ticker: EREGL TI
Reuters code: EREGLIS

Shares In Issue Less Treasury (m) 3,500
Market Cap (TRY m) 32,655
Net Debt (2017Q3) (1,448)
Adjustments For Associates & Minorities -
Enterprise Value (TRY m) 31,207
Net Pension Deficit (Surplus) -

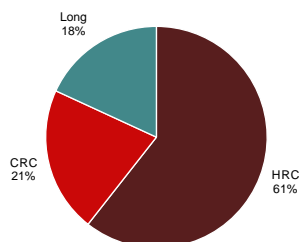
Forthcoming Catalysts

4Q17 financial results Feb 2017

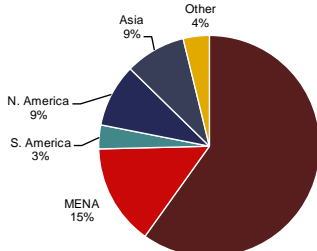
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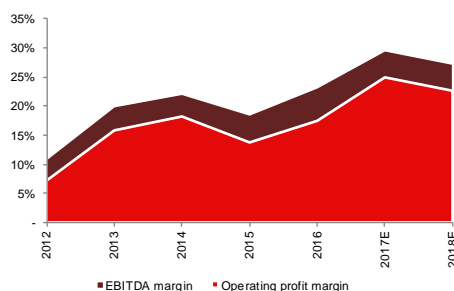
Sales Volume breakdown as of 2016YE



Export Volumes Breakdown as of 2016YE



Margin Trends



Valuation Metrics (Year end Dec)	2014	2015	2016	2017E	2018E
P/E	9.75	9.45	11.86	10.7	11.0
EV / Sales	1.2	1.2	1.2	1.8	1.7
EV / EBIT	6.7	8.8	6.9	7.1	7.5
EV / EBITDA	5.5	6.6	5.2	6.0	6.3
P/BV	1.56	0.87	1.18	1.9	1.8
FCF Yield	15.2%	10.6%	4.0%	7.6%	10.7%
OCF Yield	17.9%	14.6%	7.3%	9.3%	12.4%

Key Ratios	2014	2015	2016	2017E	2018E
EBITDA margin	22.0%	18.4%	23.1%	29.5%	27.2%
Operating Profit margin	18.2%	13.7%	17.4%	24.9%	22.6%
Capex / Revenue	(3.0%)	(4.8%)	(4.1%)	(3.1%)	(3.1%)
Capex / Depreciation	(0.79)	(1.02)	(0.73)	(0.68)	(0.69)
Net Debt / EBITDA	0.5	0.0	(0.2)	(0.4)	(0.2)
ROA	10%	6%	6%	12%	13%
ROE	16%	9%	10%	17%	17%

P&L Summary (TRY m)	2014	2015	2016	2017E	2018E
Revenue	11,484	11,915	11,637	17,269	18,495
% change	17.4%	3.7%	(2.3%)	48.4%	7.1%
EBITDA	2,525	2,197	2,687	5,086	5,022
% change	30.0%	(13.0%)	22.3%	89.3%	(1.3%)
% margin	22.0%	18.4%	23.1%	29.5%	27.2%
Depreciation & Amortisation	437	561	658	787	842
Operating Profit	2,088	1,635	2,030	4,300	4,180
% change	35.1%	-21.7%	24.1%	111.9%	-2.8%
% margin	18.2%	13.7%	17.4%	24.9%	22.6%
Associates					
EBIT	2,088	1,635	2,030	4,300	4,180
Net Financials&other income	-123	-199	242	16	17
Pre Tax Profit	1,966	1,436	2,271	4,316	4,197
Income Tax Expense	(305)	(274)	(700)	(1,161)	(1,129)
Discontinued Operations					
Minority Interests	(59)	(36)	(55)	(108)	(103)
Net Income	1,601	1,126	1,516	3,047	2,965

Reported EPS (TRY)	2014	2015	2016	2017E	2018E
Reported EPS (TRY)	0.46	0.32	0.43	0.87	0.85
Underlying EPS (TRY)	0.46	0.32	0.43	0.87	0.85
DPS (TRY)	0.40	0.30	0.38	0.75	0.73
Payout Ratio	84.3%	90.3%	86.7%	86.7%	86.7%
Shares In Issue Less Treasury (m)	3,500.00	3,500.00	3,500.00	3,500.00	3,500.00

Cash Flow (TRY m)	2014	2015	2016	2017E	2018E
EBIT	2,088	1,635	2,030	4,300	4,180
Taxes paid	(305)	(274)	(700)	(1,161)	(1,129)
Depreciation	437	561	658	787	842
+ Increase in accounts payable	(31)	28	487	(120)	(70)
-Increase in accounts receivable	48	(124)	384	267	(345)
-Increase in inventory	(125)	(20)	1,017	514	106
Cash flow from operations	2,265	2,096	1,073	3,025	4,063
Capex	345	571	482	532	582
FCFF	1,920	1,525	591	2,492	3,480

Balance Sheet (TRY m)	2014	2015	2016	2017E	2018E
Cash & Equivalents	2,187	2,935	4,587	4,783	3,699
Inventory	3,258	3,238	4,255	4,769	4,874
Trade Receivables	1,757	1,633	2,017	2,283	1,939
Fixed Assets	8,368	10,437	12,357	12,182	11,928
Other Assets	364	392	435	645	691
Total Assets	15,934	18,634	23,651	24,663	23,131
Interest Bearing Debt	3,414	2,976	3,919	2,618	2,499
Trade Payables	417	582	915	795	725
Other Liabilities	1,792	2,538	3,157	3,806	2,129
Total Liabilities	5,623	6,096	7,991	7,218	5,353
Shareholders' Equity	10,003	12,180	15,208	16,941	17,265
Minority Interests	307	358	452	504	514
Total Equity	10,310	12,538	15,660	17,445	17,779
Net Debt (Cash)	1,227	41	(667)	(2,165)	(1,200)



Changes in estimates

We have changed our revenue, EBITDA and net income estimates both for 2017 and 2018 due to changing product and feedstock prices with revised volume forecasts.

Figure 1 Erdemir: Changes in estimates

	2017			2018	
	Old	New	Consensus	Old	New
Net Sales	17,269	17,269	17,781	18,495	18,495
EBITDA	5,086	5,086	4,788	5,022	5,022
EBITDA Margin	29.45%	29.45%	26.90%	27.15%	27.15%
Net income	3,047	3,047	3,150	2,965	2,965

Valuation

We use a discounted free cash flow method (DCF) and international peer group comparison to reach a fair value for Erdemir of TRY31.2bn, which corresponds to TRY8.92 per share price. DCF and peer group comparison methods have 70% - 30% weights as we think the initial method is a better measure considering the strategy differences among the peers.

Figure 2 Erdemir: Summary of valuation

Valuation Methodology	Weight	Implied Valuation	Contribution
DCF	70%	36,985	25,889
International peer group comparison	30%	34,878	10,463
Net Debt			-1,448
Fair value (TL mn)			37,800
Current mcap (TL mn)			32,655
Fair value (\$ mn)			9,795
Current Mcap (\$ mn)			8,462
Absolute upside potential			15.8%

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 14.00%.

Figure 3 Erdemir: DCF Analysis

(TLmn)	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E
EBITDA	5,086	5,022	5,287	5,555	5,836	6,131	6,441	6,767	7,110	7,470
- Taxes paid	1,161	1,129	1,188	1,248	1,117	1,174	1,179	1,239	1,302	1,368
- Increase in accounts receivable	267	-345	-164	-78	27	25	23	21	19	16
- Increase in inventory	514	106	-138	-175	-205	-8	-20	-34	-48	-64
+ Increase in accounts payable	-120	-70	-31	-23	-12	-15	-18	-4	-6	-8
- Increases in other non-cash WC										
Cash flow from operations	3,025	4,063	4,370	4,537	4,885	4,926	5,241	5,537	5,831	6,141
- Capex	532	582	586	573	558	540	519	495	467	435
FCF	2,492	3,480	3,784	3,964	4,327	4,386	4,722	5,042	5,365	5,707
Discounted FCFF	2,492	3,052	2,910	2,673	2,559	2,274	2,147	2,011	1,876	1,750
PV of Terminal Value	15,242									
PV of FCFE	22,886									
Fair Equity Value	38,128									

International peer comparison

We calculate that Erdemir is trading at a 10% and 1% premia in terms of 2017E and 2018E average EV/EBITDA and P/E multiple respectively compared to int'l peers.

Figure 4 Erdemir: International peer comparison

Company	EV/EBITDA		P/E	
	2018E	2019E	2018E	2019E
THYSSENKRUPP AG	5.8	5.6	14.3	12.5
ARCELORMITTAL-NY REGISTERED	5.5	5.4	9.7	9.4
SALZGITTER AG	4.4	4.3	13.5	12.4
VOESTALPINE AG	6.6	6.4	11.6	11.3
NUCOR CORP	7.5	7.0	14.3	13.4
AK STEEL HOLDING CORP	6.6	6.9	8.8	7.7
BLUESCOPE STEEL LTD	6.4	6.4	14.1	13.6
SEVERSTAL - GDR REG S	5.8	6.0	8.7	9.3
NIPPON STEEL & SUMITOMO META	8.5	8.0	12.4	11.1
TATA STEEL LTD	7.1	6.6	11.7	9.4
EZZ STEEL	6.6	5.2	39.5	12.3
EL EZZ ALDEKHELA STEEL ALEXA	5.1	4.8	7.0	6.5
ACERINOX SA	7.2	6.8	14.0	13.2
ANGANG STEEL CO LTD-A	6.9	6.6	9.6	8.9
UNITED STATES STEEL CORP	5.5	5.0	13.9	12.1
OUTOKUMPU OYJ	5.9	5.5	9.7	8.5
SSAB AB-A SHARES	6.5	6.4	15.2	14.0
SCHMOLZ+BICKENBACH AG-REG	5.0	4.7	14.0	10.6
USINAS SIDER MINAS GER-PF A	7.9	7.0	22.5	14.2
GRUPO SIMEC S.A.-SER B	4.6	4.0	9.0	7.9
CIA SIDERURGICA NACIONAL SA	7.5	6.6	22.7	10.2
MAGNITOGORSK IRON & STEEL	4.7	4.8	9.5	10.0
EVRAZ PLC	5.1	5.0	7.1	7.3
Average	6.2	5.9	13.6	10.7
EV from peers	34,877.8			



Exhibit 1 Publication schedule

Date	Publication
01.03.2018	4Q17 Earnings release

Source: Public disclosure platform

Exhibit 2 Recommendation history

29.05.1992 (Initiation date)	Rating	Target Price	Prev. Day's close	Upside
27.10.2017	Buy	9.26	8.57	8.0%
26.09.2017	Buy	8.92	7.50	19.0%
09.08.2017	Hold	8.41	8.14	3.4%
21.04.2017	Buy	6.53	5.80	12.5%
08.02.2017	Reduce	5.41	5.34	1.4%
26.04.2016	Reduce	4.33	4.32	0.2%
31.12.2015	Hold	3.46	2.72	27.3%

Source: Global Securities

Exhibit 3 Coverage universe recommendation overview

	Buy	Hold	Reduce	Sell	U/R
Universe	18	16	2	2	0
Universe %	47%	42%	5%	5%	0%

Source: Global Securities



Date of completion of this report: 18.12.2017 15:15 UTC+3

Date of email-distribution of this report: 18.12.2017 15:20 UTC+3

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BUY: Buy stocks are expected to have a total return of at least 15% 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 15% 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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