

EARNINGS REVIEW 1Q18

Turkey | Steel | 27 April 2018

Erdemir

Spectacular now...

We maintain our BUY rating and FV estimate of 12.66/share for Erdemir on the back of the positive outlook regarding the product spreads and steady volumes. The rising trend in sustainable EBITDA performance has continued without a break in 1Q18 as the increasing product spreads support operational profitability. Moreover, the recent substantial increase in the hard-currency net cash position of the company also beefs up the investment case considering the recent depreciation of TRY against USD and EUR.

Erdemir announced its 1Q18 results with TRY5,419mn revenues (+29% YoY, +0.3% QoQ), TRY1,711mn EBITDA (+30% YoY, +1% QoQ) and TRY1,063mn net income (+18% YoY, -11% QoQ). Without a doubt, the company posted better than expected results in terms of both top-line growth and the operational profitability thanks to still soaring product prices and robust profitability margins. Nonetheless, the company posted a net income figure below expectations mostly due to hefty tax expenses.

Looking into details:

- Total sales volume has increased 5.5% YoY in 1Q18 where the flat steel sales continued to be the main contributor with their robust 9.9% growth. Furthermore, both cold-rolled and hot-rolled prices seen YoY improvements in 1Q18. Hot-rolled prices averaged \$754/tons in 1Q18 with a 21% YoY increase (+21% QoQ). Similarly, cold-rolled prices climbed 11% YoY (+2% QoQ) to \$744/tons on average in 1Q18. Consequently, the rise in the sales volume has been coupled by the increase in product prices, leading to very strong quarterly top-line figures that were up 29% from a year ago. We expect this robust revenue growth to continue for the rest of the first half of 2018 as well, backed by the rise in prices and steady volumes.
- In 1Q18, EREGL maintained its strong performance in terms of gross profits by mitigating the negative effect of the moderate rise in feedstock prices by achieving a balance between old inventories and spot purchases, and we expect a similar scenario for the second quarter as well. During 2017, it has been observed that steel companies have been able to pass higher feedstock costs to buyers, leading to a robust margin expansion. We observe a similar phenomenon for 1Q18 during which the product/feedstock spreads have soared; hot-rolled/coal spreads have averaged \$527/ton in 1Q18, up 15% YoY (+28% QoQ) while cold-rolled/coal spreads have averaged at \$517/tons with a 2% YoY increase (-1% QoQ). Given the current market trends, we anticipate that the strong operational performance of EREGL would most probably continue for the following quarters.
- One of the strongest blessings of EREGL has always been its strong cash position. The net cash position of the company showed a phenomenal improvement in 1Q18, increasing to TRY4,322mn from TRY2,545mn at the end of 4Q17. 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 preferred as a defensive play. Considering a further 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 11% premium and 14% discount in terms of 2018E and 2019E average EV/EBITDA and P/E multiples compared to int'l peers, respectively.

Management will hold a conference call at 5PM today to present the results.



BUY

14% upside

Fair Value

TRY12.66

Prev. (BUY)

Prev. (TRY11.91)

Bloomberg ticker

EREGL TI

Share Price

TRY11.10

Market Cap

USD9.5bn/TRY38.91bn

Free Float

48%

TRY mn 1Q18	Actual	Consensus	Deviation	Global Est
Revenue	5,419.9	5,297.2	2.3%	5,477.6
EBITDA	1,710.5	1,657.4	3.2%	1,733.8
EBITDA margin	31.6%	31.3%	0.3%	31.7%
Net profit	1,063.2	1,145.6	-7.2%	1,208.1
Net profit margin	19.6%	21.6%	-2.0%	22%

TRY mn	1Q18	1Q17	YoY	4Q17	QoQ
Revenue	5,419.9	4,191.0	29%	5,405.5	0.3%
EBITDA	1,710.5	1,313.0	30%	1,699.3	0.7%
EBITDA margin	31.6%	31.3%	0%	31.4%	0.1%
Net profit	1,063.2	902.0	18%	1,192.2	-10.8%
Net profit margin	19.6%	21.5%	-2%	22.1%	-2.4%

Performance	1M	3M	6M	12M
Absolute	4.6	10.2	29.5	75.1
Relative	13.8	24.3	29.9	54.6
Relative \$	2.2	1.3	19.9	54.3

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Erdemir

Recommendation:
Fair Value:

Share Price: TRY 11.10
Upside / Downside: 14.1%
Previous Fair Value: TRY 9.26
% change to Fair Value: 36.7%

Bloomberg ticker: EREGL TI
Reuters code: EREGL.IS

Shares In Issue Less Treasury (m) 3,500
Market Cap (TRY m) **38,850**
Net Debt (2017Q3) (2,771)
Adjustments For Associates & Minorities -
Enterprise Value (TRY m) **36,079**
Net Pension Deficit (Surplus) -

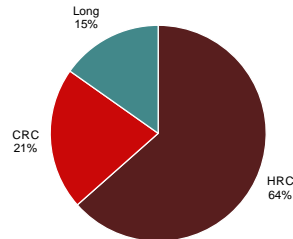
Forthcoming Catalysts

2Q18 financial results Aug 2017

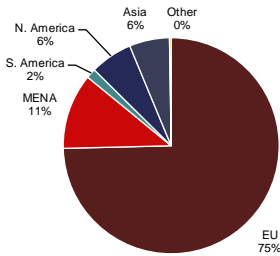
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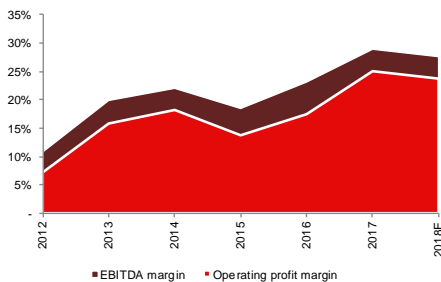
Sales Volume breakdown as of 2017YE



Export Volumes Breakdown as of 2017YE



Margin Trends



Valuation Metrics (Year end Dec)	2014	2015	2016	2017	2018E	2019E
P/E	9.75	9.45	11.86	9.34	9.3	9.0
EV / Sales	1.2	1.2	1.2	1.2	1.7	1.5
EV / EBIT	6.7	8.8	6.9	4.9	7.1	6.8
EV / EBITDA	5.5	6.6	5.2	4.2	6.1	5.8
P/BV	1.56	0.87	1.18	1.88	1.7	1.6
FCF Yield	15.2%	10.6%	4.0%	8.9%	9.1%	11.3%
OCF Yield	17.9%	14.6%	7.3%	11.9%	11.1%	13.0%

Key Ratios	2014	2015	2016	2017	2018E	2019E
EBITDA margin	22.0%	18.4%	23.1%	28.9%	27.6%	26.5%
Operating Profit margin	18.2%	13.7%	17.4%	25.0%	23.7%	22.6%
Capex / Revenue	(3.0%)	(4.8%)	(4.1%)	(4.0%)	(3.7%)	(2.8%)
Capex / Depreciation	(0.79)	(1.02)	(0.73)	(1.04)	(0.96)	(0.72)
Net Debt / EBITDA	0.5	0.0	(0.2)	(0.5)	(0.4)	(0.4)
ROA	10%	6%	6%	13%	13%	12%
ROE	16%	9%	10%	20%	18%	18%

P&L Summary (TRY m)	2014	2015	2016	2017	2018E	2019E
Revenue	11,484	11,915	11,637	18,644	21,739	23,511
% change	17.4%	3.7%	(2.3%)	60.2%	16.6%	8.1%
EBITDA	2,525	2,197	2,687	5,383	5,991	6,221
% change	30.0%	(13.0%)	22.3%	100.3%	11.3%	3.8%
% margin	22.0%	18.4%	23.1%	28.9%	27.6%	26.5%
Depreciation & Amortisation	437	561	658	720	839	908
Operating Profit	2,088	1,635	2,030	4,663	5,152	5,313
% change	35.1%	-21.7%	24.1%	129.8%	10.5%	3.1%
% margin	18.2%	13.7%	17.4%	25.0%	23.7%	22.6%
Associates						

EBIT	2,088	1,635	2,030	4,663	5,152	5,313
Net Financials&other income	-123	-199	242	291	340	367

Pre Tax Profit	1,966	1,436	2,271	4,955	5,492	5,681
Income Tax Expense	(305)	(274)	(700)	(1,057)	(1,168)	(1,204)
Discontinued Operations						
Minority Interests	(59)	(36)	(55)	(144)	(145)	(153)
Net Income	1,601	1,126	1,516	3,754	4,179	4,323

Reported EPS (TRY)	0.46	0.32	0.43	1.07	1.19	1.24
Underlying EPS (TRY)	0.46	0.32	0.43	1.07	1.19	1.24
DPS (TRY)	0.40	0.30	0.38	-	0.95	1.06
Payout Ratio	84.3%	90.3%	86.7%	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	3,500.00

Cash Flow (TRY m)	2014	2015	2016	2017	2018E	2019E
EBIT	2,088	1,635	2,030	4,663	5,152	5,313
Taxes paid	(305)	(274)	(700)	(1,057)	(1,168)	(1,204)
Depreciation	437	561	658	720	839	908
+ Increase in accounts payable	(31)	28	487	28	81	(8)
-Increase in accounts receivable	48	(124)	384	565	396	(79)
-Increase in inventory	(125)	(20)	1,017	784	178	26
Cash flow from operations	2,265	2,096	1,073	3,004	4,331	5,062
Capex	345	571	482	751	801	655
FCFF	1,920	1,525	591	2,252	3,529	4,407

Balance Sheet (TRY m)	2014	2015	2016	2017	2018E	2019E
Cash & Equivalents	2,187	2,935	4,587	7,035	7,174	7,523
Inventory	3,258	3,238	4,255	5,040	5,217	5,243
Trade Receivables	1,757	1,633	2,017	2,582	2,978	2,899
Fixed Assets	8,368	10,437	12,357	13,283	13,315	13,277
Other Assets	364	392	435	1,875	4,536	5,790
Total Assets	15,934	18,634	23,651	29,815	33,220	34,732
Interest Bearing Debt	3,414	2,976	3,919	4,490	4,742	4,884
Trade Payables	417	582	915	943	1,024	1,016
Other Liabilities	1,792	2,538	3,157	5,154	3,926	4,279
Total Liabilities	5,623	6,096	7,991	10,587	9,691	10,179
Shareholders' Equity	10,003	12,180	15,208	18,684	22,863	23,859
Minority Interests	307	358	452	544	665	694
Total Equity	10,310	12,538	15,660	19,228	23,529	24,553
Net Debt (Cash)	1,227	41	(667)	(2,545)	(2,432)	(2,639)



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	13,568	17,629	17,092	15,386	18,495
EBITDA	3,847	5,086	4,466	4,363	5,022
EBITDA Margin	28.35%	29.4%	24.44%	28.35%	27.1%
Net income	2,383	3,047	2,998	2,704	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 TRY44.3bn, which corresponds to TRY12.66 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%	40,926	28,648
International peer group comparison	30%	42,981	12,894
Net Debt			-2,771
Fair value (TL mn)			44,314
Current mcap (TL mn)			38,850
Fair value (\$ mn)			10,896
Current Mcap (\$ mn)			9,553
Absolute upside potential			14.1%

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	5,383	5,991	6,221	6,664	7,001	7,355	7,727	8,118	8,529	8,961
- Taxes paid	1,057	1,168	1,204	1,290	1,375	1,445	1,452	1,526	1,603	1,684
- Increase in accounts receivable	565	396	-79	-1	74	74	74	74	73	73
- Increase in inventory	784	178	26	118	3	-10	34	24	78	72
+ Increase in accounts payable	28	81	-8	19	-4	-7	-11	-14	-18	-23
- Increases in other non-cash WC										
Cash flow from operations	3,004	4,331	5,062	5,275	5,544	5,839	6,157	6,481	6,757	7,110
- Capex	751	801	655	653	641	625	606	583	557	527
FCF	2,252	3,529	4,407	4,622	4,904	5,214	5,551	5,898	6,200	6,583
Discounted FCFF	2,252	3,096	3,391	3,119	2,903	2,708	2,528	2,356	2,173	2,024
PV of Terminal Value	16,010									
PV of FCFE	26,181									
Fair Equity Value	42,191									

International peer comparison

We calculate that Erdemir is trading at a 11% premium and 14% discount in terms of 2018E and 2019E 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	6.0	5.7	15.0	11.8
ARCELORMITTAL-NY REGISTERED	5.1	5.2	8.7	9.1
SALZGITTER AG	3.9	3.7	11.9	12.1
VOESTALPINE AG	6.1	6.0	10.4	10.0
NUCOR CORP	6.6	7.1	10.3	11.0
AK STEEL HOLDING CORP	7.0	6.3	7.2	5.7
BLUESCOPE STEEL LTD	6.3	5.9	12.5	10.7
SEVERSTAL - GDR REG S	5.1	6.0	7.8	9.0
NIPPON STEEL & SUMITOMO META	8.0	7.4	11.1	9.6
TATA STEEL LTD	6.6	6.2	9.3	8.0
EZZ STEEL	6.5	5.6	76.1	17.7
EL EZZ ALDEKHELA STEEL ALEXA	5.3	4.8	6.3	6.1
ACERINOX SA	7.3	6.9	13.5	12.2
ANGANG STEEL CO LTD-A	5.9	6.0	7.7	7.7
UNITED STATES STEEL CORP	4.3	4.3	7.1	7.0
OUTOKUMPU OYJ	5.6	5.0	10.0	7.8
SSAB AB-A SHARES	6.3	6.2	13.7	12.7
SCHMOLZ+BICKENBACH AG-REG	4.9	4.4	14.6	10.8
USINAS SIDER MINAS GER-PF A	7.8	7.0	16.2	10.9
GRUPO SIMEC S.A.-SER B	4.0	3.6	8.7	8.0
CIA SIDERURGICA NACIONAL SA	7.4	7.1	16.0	12.2
MAGNITOGORSK IRON & STEEL	4.2	4.6	7.6	8.5
EVRAZ PLC	4.7	5.7	6.4	8.3
Average	5.9	5.7	13.4	9.9
EV from peers	42,980.6			



EREGL

Exhibit 1 Publication schedule

Date	Publication
10.08.2018	2Q18 Earnings release

Source: Public disclosure platform

Exhibit 2 Recommendation history

29.05.1992 (Initiation date)	Rating	Target Price	Prev. Day's close	Upside
04.01.2018	Buy	11.91	10.18	17.0%
18.12.2017	Buy	10.80	9.33	15.8%
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%

Source: Global Securities

Exhibit 3 Coverage universe recommendation overview

	Buy	Hold	Reduce	Sell	U/R
Universe	21	17	2	0	1
Universe %	51%	41%	5%	0%	2%

Source: Global Securities

Date of completion of this report: 27.04.2018 08:20 UTC+3

Date of email-distribution of this report: 27.04.2017 08:25 UTC+3

Explanation of Rating System

12-MONTH RATING DEFINITION

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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