TURKISH EQUITIES / COMPANY UPDATE

Tekfen Holding

30 March 2023

Neutral
(Maintained)

Close Price: TRY33.80
12M Target Price: TRY44.34
Upside Potential: 31%

Reasons to remain cautious

We are transferring our coverage of Tekfen Holding with Neutral rating and 12-month TP of TRY44.34/share (previously TRY35.00), offering 31% upside potential. Over the last year, Tekfen Holding has posted a solid operational performance on the back of historically high margins in the chemical segment and improvements in the contracting business with higher-than-expected earnings from its affiliate, Azfen. The company posted 89% growth in revenue and 368% in EBITDA in 2022 with its EBITDA margin reaching 11.1%. We expect some normalization in 2023 in the chemical segment in parallel with declining energy costs. We maintain a cautious stance for the contracting business with the total backlog declining by USD98mn to USD1.15bn at the end of 2022. Based on 2023YE prospective earnings, the stock trades at a P/E of 3.6x and EV/EBITDA of 2.8x, implying an average of 33% discount to its historical averages. Despite its discounted valuation, we foresee some risks on 1) the uncertainty surrounding new tenders along with a declining backlog, and 2) slimmer profitability in the chemical segment for 2023. Along with an expected mere earnings growth for 2023, we keep our conservative approach and have Neutral rating for the stock.

Less visibility in the contracting business: In 2022, the backlog had decreased gradually from USD1.26bn to USD1.15bn. During the first 9 months of 2022, the company suffered negative EBITDA and depressed EBITDA margins, until 4Q22 when Azfen's operations supported the operating performance, at last taking margins into positive territory. Accordingly, the company recorded TRY10.9bn in revenue and TRY633mn in EBITDA from this business in 2022. For 2023, some risks such as the ongoing contraction in the backlog may result in lower growth as well as less favourable margins on bids in the future projects, and hence forecast USD646mn in annual completion, leading to 29% YoY revenue growth in TRY terms with a 1.4% EBITDA margin. Also, besides the current USD1.15bn backlog, our conservative estimates point to a USD560mn contribution from project extensions and new tenders, with a USD1.1bn backlog at the end of this year.

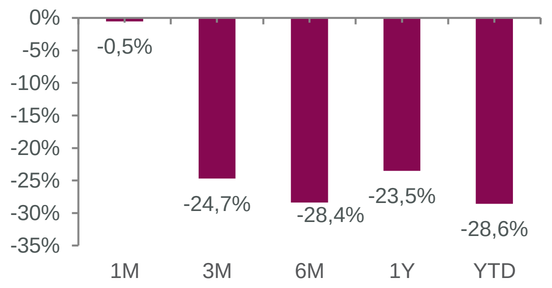
Margins back to normal in the chemical segment: In 2022, natural gas prices reached historical highs especially in Eastern Europe on the back of the conflict between Russia and Ukraine, and fertilizer prices soared to sky-high levels. During 1H22, prices of raw materials used in fertilizers increased by 140% on average compared to 1H21 to reach new peaks. From 2H22, a halting of fertilizing activities due to drought conditions in Turkey and expectations for lower prices in the coming period on falling energy prices led to a normalization in fertilizer prices and margins, and the company's EBITDA margin in the chemical segment declined from 17.6% to 13.8%. According to the World Bank data, fertilizer prices (DAP and Potassium Chloride) remained relatively flat in 1Q23, except for urea where prices tumbled by 49% compared to their 2022 average in Eastern Europe. In line with the narrowing gap between raw material and unit prices, we estimate a 12.8% EBITDA margin for 2023. In our projection, we forecast a 20% decline in unit sales prices to average USD 490/ton for the rest of the year. Accordingly, our forecasts point to sales volumes of 1.9mn tons, up 14% YoY with revenue of TRY21.3bn, also up 20% YoY in 2023. We forecast an EBITDA margin of 13.0%-13.5% throughout the projection horizon.

Cheap valuation but headwinds in sight: Although the current valuation implies attractive multiples of 2.8x EV/EBITDA and 3.6x P/E, we believe the depressed operating profitability in the chemical segment and the fiercely competitive environment in the contracting business casts a shadow over the outlook. Hence, we calculate a TRY16.4bn NAV on a 30% holding discount. Contrary to our conservative stance towards the stock, a potential increase in operating profitability along with the new awarded projects may support the share price performance and offer opportunities in the near future.

Stock data

Bloomberg / Reuters	TKFEN TI / TKFEN.IS
Mcap (US$mn)	654.5
EV (US$mn)	590.4
Avg. Trd. Vol. (US$mn)	36.3
Free float	48%

Relative Performance to BIST100



Key Data (TRYmn)	2021	2022	2023F	2024F
Revenues	16.223	30.668	38.383	49.641
Growth	*38%*	*89%*	*25%*	*29%*
EBITDA	728	3.410	3.569	5.007
Growth	*59%*	*368%*	*5%*	*40%*
Net Profit	1.121	3.467	3.480	4.276
Growth	-	*209%*	*0%*	*23%*
P/E (x)	5,4	2,9	3,6	2,9
EV/EBITDA (x)	6,0	2,6	2,8	1,8
P/BV (x)	0,8	1,0	1,0	0,8
FCF yield (%)	7%	-11%	10%	13%
Div. yield (%)	0%	3%	8%	8%

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Figure 1 – Summary financials & key metrics (TRYmn)

Income statement	2020	2021	2022	2023F	2024F
Revenues	**11.730**	**16.223**	**30.668**	**38.383**	**49.641**
Gross profit	**914**	**1.280**	**3.610**	**4.978**	**6.645**
EBITDA	**459**	**728**	**3.410**	**3.569**	**5.007**
Depreciation	315	431	601	663	825
EBIT	**83**	**216**	**1.885**	**2.779**	**4.009**
Net other income	-143	-775	-458	-573	-741
Income from investing activities	4	389	657	947	1.035
Net financial income	225	1.218	224	312	223
Profit from associates	60	81	923	128	173
PBT	**229**	**1.129**	**3.232**	**3.592**	**4.698**
Taxes	-297	-300	217	-136	-453
Minority interest	-7	-10	-19	-24	-31
Net income	**-60**	**1.121**	**3.467**	**3.480**	**4.276**

Balance sheet	2020	2021	2022	2023F	2024F
Current assets	**9.013**	**15.407**	**22.403**	**30.114**	**37.508**
Cash equivalents	3.259	5.064	4.152	7.171	8.036
Trade receivables	2.039	2.814	4.152	5.197	6.721
Inventories	2.034	3.952	7.931	9.791	12.602
Other current assets	1.682	3.577	6.169	7.955	10.149
Non-current assets	**4.904**	**6.506**	**9.784**	**12.231**	**14.374**
Tangibles	2.577	3.442	4.455	4.872	5.445
Intangibles	44	55	58	89	121
Other non-current assets	2.283	3.010	5.271	7.270	8.808
Total assets	**13.917**	**21.914**	**32.187**	**42.345**	**51.883**
Current liabilities	**7.475**	**13.073**	**18.288**	**23.753**	**29.207**
Short-term loans	2.086	3.177	2.724	3.405	3.640
Trade payables	3.418	6.833	10.566	13.044	16.790
Other current liabilities	1.971	3.064	4.997	7.303	8.777
Non-current liabilities	**632**	**1.115**	**3.309**	**5.586**	**6.468**
Long-term loans	273	325	1.997	3.618	4.008
Other non-current liabilities	359	790	1.312	1.968	2.460
Minority Interest	**81**	**130**	**161**	**137**	**107**
Shareholders' equity	**5.811**	**7.725**	**10.590**	**13.007**	**16.208**
Total liabilities and equity	**13.917**	**21.914**	**32.187**	**42.345**	**51.883**

Key metrics	2020	2021	2022	2023F	2024F
Growth					
Revenue growth	-20%	38%	89%	25%	29%
EBITDA growth	-76%	59%	368%	5%	40%
Net income growth	-104%	-1964%	209%	0%	23%
Profitability					
Gross Margin	8%	8%	12%	13%	13%
EBITDA margin	4%	4%	11%	9%	10%
Net margin	-1%	7%	11%	9%	9%
Return on assets (ROA)	0%	6%	13%	9%	9%
Return on equity (ROE)	-1%	17%	38%	29%	29%
Return on cap. emp. (ROCE)	-1%	18%	37%	34%	34%
Leverage					
Net Debt	-983	-1.614	-1.199	-2.625	-3.484
Net debt / Equity	-0,2	-0,2	-0,1	-0,2	-0,2
Net debt / EBITDA	-2,1	-2,2	-0,4	-0,7	-0,7
EBIT Interest coverage	0,7	1,4	4,6	7,2	8,9
Efficiency					
Total asset turnover	0,8	0,7	1,0	0,9	1,0
Equity turnover	2,0	2,1	2,9	3,0	3,1
WC/Sales	6%	0%	5%	5%	5%
Opex/Sales	7,1%	6,6%	5,6%	5,7%	5,3%

Cash flow	2020	2021	2022	2023F	2024F
EBITDA	459	728	3.410	3.569	5.007
Change in working capital	-583	720	-1.583	-426	-590
Taxes	-297	-300	217	-136	-453
Capital expenditure	-568	-556	-905	-1.777	-2.278
Adjustment	-1.351	-195	-2.244	0	0
FCFF	-2.339	397	-1.106	1.231	1.686

QNB Finansinvest vs Consensus	2023F			2024F		
	Estimate	Cons.	Deviation	Estimate	Cons.	Deviation
Revenues	38.383	33.483	15%	49.641	39.146	27%
EBITDA	3.569	3.409	5%	5.007	3.751	33%
Net Income	3.480	2.985	17%	4.276	3.298	30%

Source: QNBFI Estimates

Valuation

We base our contracting and chemical segment valuation on DCF analysis. As for the marine segment, we assume 8.0x EV/EBITDA and derive our valuation.

- In our DCF models, we assume a 18% risk-free rate and 6.0% equity risk premium with 1.0x stock beta. Accordingly, we calculate a WACC of 20.2% for the following couple of years.
- We implement 30% holding discount into our model and calculate TRY 16.4bn NAV in total. We reach a 12-month target price of TRY44.34/share, indicating 31% upside potential.
- On our 2023 earnings forecasts, the stock trades at an EV/EBITDA of 2.8x and P/E of 3.6x.
- As for 2024 prospective earnings, the company trades at an EV/EBITDA of 1.8x and P/E of 2.9x.

Figure 9 – NAV Analysis

Branch	Market Cap. (TRYmn)	Holding's Share (%)	Holding's Share (TRYmn)	Share in NAV (%)	Valuation Method	12M Target MCAP (TRYmn)
Contracting	100	100%	100	0%	DCF	124
Fertilizer	12.453	100%	12.453	59%	DCF	15.442
AKMGY	2.799	10%	293	1%	Market Cap.	363
Real Estate	5.508	100%	5.508	26%	Fair Market Value; 25% discount	4.131
Socar Polymer	5840	10%	584	3%	Book Value	579
Marine (Terminal)	2.254	100%	2.254	11%	EV/EBITDA 8.0x	2.795
Total			**21.193**			**23.435**
Current NAV / 12M Target NAV			**21.193**			**23.435**
Conglomerate discount			*30%*			*30%*
Current 12M Target MCAP			**14.835**			**16.405**
12M Target Price (TRY/share)						**44,34**
Upside Potential (%)						**31%**

Source: QNBFI Estimates

QNB Finansinvest Rating System

We employ a relative scale in our rating system (i.e. Market **Outperform, Neutral, Underperform**) in order to better present relative value propositions and more actively pursue long vs. short ideas at the BIST. The relevant benchmark is the broader Turkish stock market, using the BIST-100 index as a basis. The ratings also incorporate a certain degree of relativity within the analyst's own stock coverage universe due to asymmetric return expectations among the industries under our BIST coverage. The rating system combines analysts' views on a stock relative to the sectors under coverage, and the sector call relative to the market, together providing a view on the stock relative to the market.

Individual ratings reflect the expected performance of the stock relative to the broader market over the next 6 to 12 months. The assessment of expected performance includes a function of near-term company fundamentals, industry outlook, confidence in earnings estimates and valuation, and other factors.

An essential element of our rating methodology involves benchmarking a 12-month expected return against the cost of equity. We set a required rate of return for each stock, calculated from our risk-free rate and equity risk premium assumptions. The price target for a stock represents the value that the stock is expected to reach or sustain over the performance horizon of 12 months, according to the view of the analyst.

We have separated the stocks under our coverage into two groups, mainly with respect to their liquidity (market cap, free float market cap and historical average daily trading volume) as small-cap stocks exhibit different risk/return characteristics to more-liquid large-caps. For the purposes of the relative stock rating, however, stocks within each group will be considered on an unweighted basis with regard to their market capitalization.

For a stock to be assigned an **Outperform** rating, the implied return *must* exceed the required rate of return by at least 5 percentage points over the next 12 months for our larger-cap stock coverage, or by 10 percentage points for the small-cap group. For a stock to be assigned an **Underperform** rating, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months. Stocks between these bands will be classified as **Neutral**.

When the potential upside of an *average* stock in our coverage exceeds its required rate of return (i.e. the market upside exceeding the implied average cost of capital), a greater number of stocks would fall into the aforementioned Outperform (Buy) category, illustrating the significance of the "relative return" concept (vis-à-vis absolute return) in picking better investment ideas with a positive alpha. The same holds true when the potential upside of an *average* stock in our coverage falls short of its required rate of return.

In this regard, as a supplemental methodology, we rank the stocks in our coverage according to their notional target price with respect to their current market price, and then categorise the top group (approximately 40-50% of the companies under coverage) as Outperform, the next 40-50% as Neutral and the lowest 10-20% (and no less than 10%) as Underperform.

It should be noted that the expected returns on some stocks may at times fall outside the relevant ranges of the applicable respective rating category because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges are permitted but becomes subject to review.

Also note that the analyst's short-term view may occasionally diverge from the stock's longer-term fundamental rating.

Outperform. We expect the stock to outperform the BIST-100 over the next 6 to 12 months.

Neutral (Market Perform). We expect the stock to broadly perform in line with the BIST-100 index over the next 6 to 12 months. (Although we would normally have a neutral assessment of stocks in this category, if a stock has gone through a period of market underperformance, it would be an indication that the stock may be expected to improve its performance relative to market averages in the coming period, and vice versa).

Underperform. We expect the stock to underperform the BIST-100 over the next 6 to 12 months.

N/R. Not Rated.

U/R. Under Review.

Analyst Certification

The following analysts hereby certify that the views expressed in this research report accurately reflect their own personal views regarding the securities and issuers referred to therein and that no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report: **E.Yağmur Avcı.**

Unless otherwise stated, the individuals listed on the cover page of this report are research analysts.

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