



# GNAM Investment Competition

Koc University

Top Investment Idea – Turkish Airlines (THYAO)

Date : 31.10.2015

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# Turkish Airlines - Key Take-Outs

**Beneficial oil price and FX positioning, structural and geopolitical competitive advantage to peers, boosted traffic momentum in 2015 Q3 and trading at a discount to global peers; makes Turkish Airlines highly attractive**

- Lower oil price with limited hedging and FX positioning
- Relatively lower unit cost and geopolitical location of Istanbul being a natural
- Potentially strong Q3 results with traffic boost and margin recovery
- Being traded at a discount to global and regional peers

12-m rating	BUY
12-m price target	TRY 11.40
Current price	TRY 8.61
Upside	32%



# Turkish Airlines - Key Take-Outs

## Year to Date Relative Stock Price vs. BIST100



Source: GoogleFinance, MarketWatch

## Stock Info

**TL8.61** ↑

Change **+0.31 +3.73%**  
Volume **29.64m**  
Oct 30, 2015, 5:39 p.m.  
Quotes are delayed by 20 min

Previous close **TL 8.30**  
Day low **TL8.24** Day high **TL8.61**  
Open: 8.27

52 week low **TL7.08** 52 week high **TL10.45**  
Market cap **TL11.45B**  
Average volume **29.28M**

- Analyst recommendations have become more optimistic about the stock recently

1-5 Linear Scale	Current	1 Month Ago	2 Month Ago	3 Month Ago
(1) BUY	6	5	5	5
(2) OUTPERFORM	12	12	12	12
(3) HOLD	4	6	6	6
(4) UNDERPERFORM	0	0	0	0
(5) SELL	0	0	0	0
No Opinion	0	0	0	0
Source: Reuters				

# Turkish Airlines – Company Overview

Established in 1933, Turkish Airlines' main fields of activity are all types of domestic and international passenger and cargo air transportation. As for the shareholding structure of the Company; 50.88% are publicly traded and 49.12% by the Prime Ministry Privatization Administration.



Turkish Airlines flies to 264 destinations; 45 domestic and 219 international.

Over the previous year, number of passengers increased by 13.3% from 48.3 million in 2013 to 54.7 million in 2014.





# Macro Outlook - Turkey

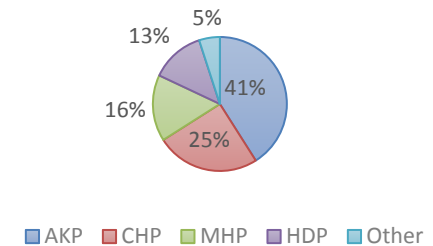
## Tomorrow there is an election. Will this time be different?

- Following unsuccessful efforts to form a coalition government after the 7 June elections, Turkey is heading for another round of elections on November 1st, tomorrow

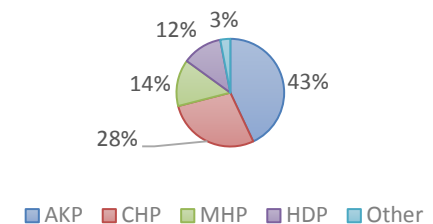
**We expect 3 main scenarios which can come out from elections.**

1. AKP gets enough seats to form a majority government [ Possibility : 30% ]
2. AKP fails to get enough seats for parliamentary majority, and coalition talks will be successful. High likely to result in an AKP – CHP government. [ Possibility : 60% ]
3. There will be no party with enough seats in the parliament to govern on its own and coalition talks will be unsuccessful resulting in an ongoing political chaos. [ Possibility : 10% ]

June 7th Election Results



Nov 1st Election- Consensus Poll



# Macro Outlook - Turkey

- Recent stock market pricing behavior also indicates that financial markets believe in a coalition government between AKP and CHP after tomorrow's election.
- Upcoming FED rate hike is a clear risk to Turkish equities which are not guarded against the depreciation of Turkish Lira; however THYAO is one of the long in FX companies listed in BIST for whom depreciation of TRY is a positive catalyst
- **We expect a relief rally in Turkish equities, especially in long FX ones, after the form of a functioning government also given the 14% underperformance of MSCI Turkey versus MSCI EM this year in USD terms.**



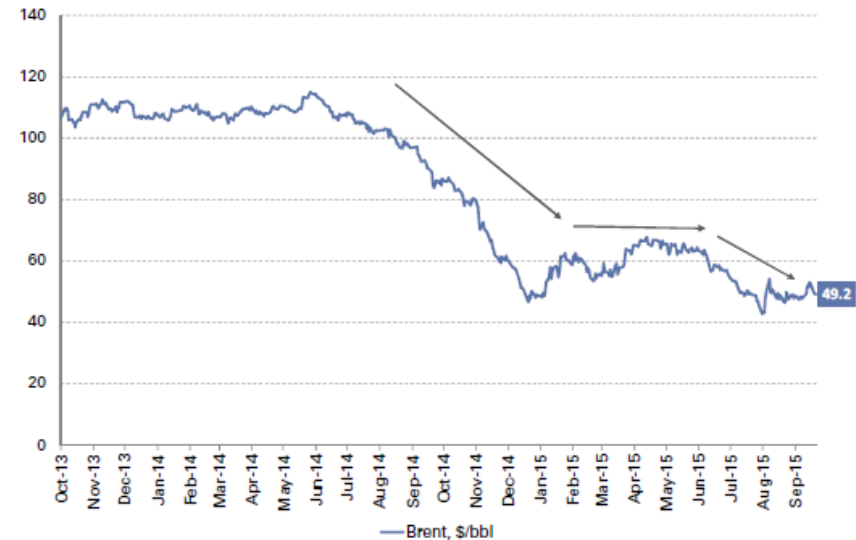
# Why to Fly with Turkish Airlines ?

Persistent weakness in **oil prices** with relatively lower hedging and long FX positioning creates a significant upside catalyst for THYAO.

- Fuel cost, the largest cost item, constitutes 35-40% of the company's total expenses
- Oil Prices declined by 60% to \$48/bbl from \$115/bbl
- According to Citibank calculations, each US\$1/bbl drop in fuel prices increases THYAO's EBIT by 6.8% on average in US\$ terms

Exhibit 20: The recent oil price movement is supportive for both THY and PGS

Brent, US\$/bbl



Source: Datastream.

Figure 29. Oil price estimates

Source: Citi Research

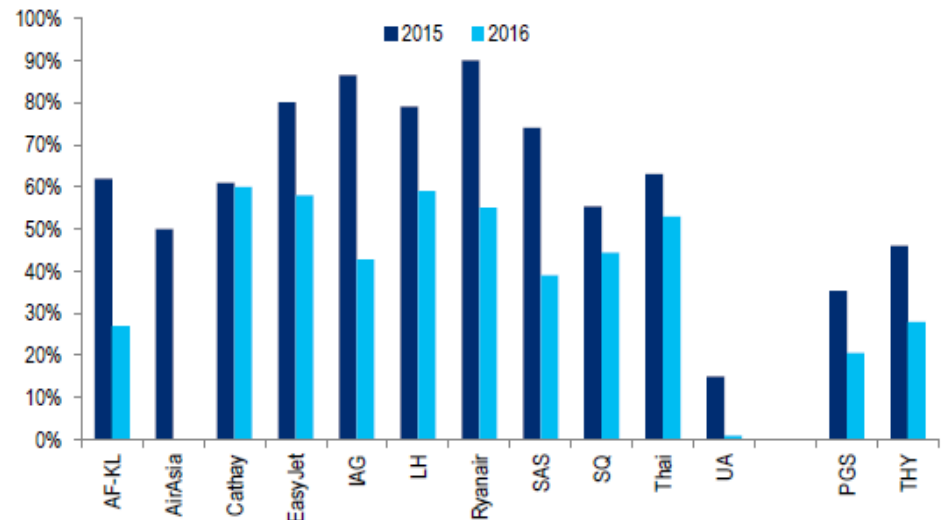
Brent (US\$/barrel)	2015E	2016E	2017E	2018E	2019E
Citi (A)	53.00	53.00	65.00	73.00	75.00

# Why to Fly with Turkish Airlines ?

## Hedging Ratio

- THYAO's oil hedging ratio is relatively lower for both 2015 and 2016 compared to its peers.
- Major global airlines' oil hedging ratio is 61% average for 2015 and 39% average for 2016 whereas THYAO's oil hedging ratio are respectively 46% and 28%.
- Spot market price is lower than hedged oil prices for THYAO, \$48 vs. \$75

Figure 28. Oil hedging ratio of selected airlines



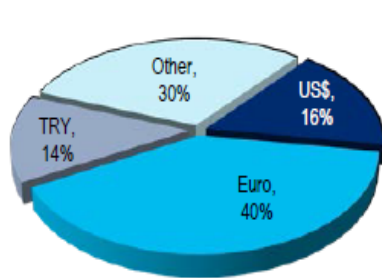
Source: Citi Research, Company reports. Estimated average hedge ratio over one year period.



# Why to Fly with Turkish Airlines ?

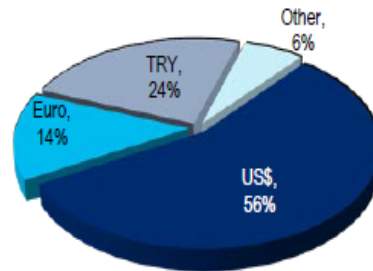
## Well-Spread Currency Revenue and Cost Structure

Figure 41. THY revenue breakdown, 2014



Source: Citi Research, Company annual reports

Figure 42. THY total cost breakdown, 2014



Source: Citi Research, Company annual reports

- THYAO has gained advantage with weakening TRY since it is long in FX

- Company is in safe side especially nowadays where FX structure is very unpredictable and volatile thanks to well-spread profit base

Exhibit 22: Weaker TRY supports THY's margins but is negative for PGS's profitability  
TRY/USD



Source: Datastream.



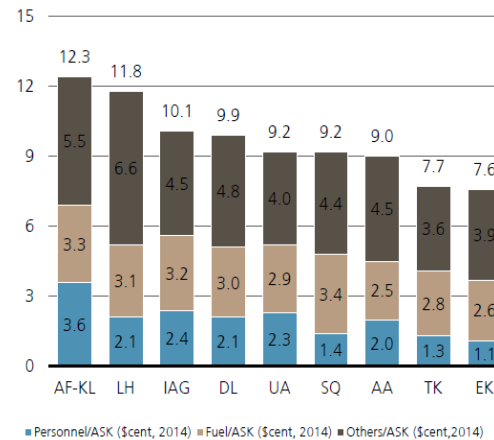
# Why to Fly with Turkish Airlines ?

## Strong Cost Competitiveness

THYAO's CASK is 2<sup>nd</sup> lowest globally with \$7.7cent where average of global peers (excl. THYAO) is \$9.9cent

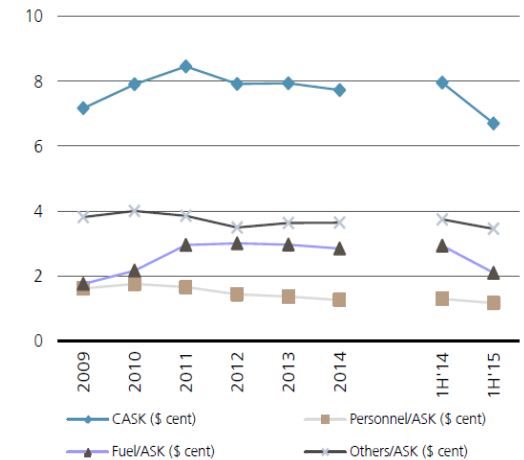
- There has been 15.9% yoy and 8.4% yoy drop in THYAO CASK and ex-fuel CASK in 1H15
- Paying salaries in TRY, which has depreciated by 27% against USD since 2015, further helps THYAO's CASK to become relatively lower compared to global peers

Figure 12: THYAO is very cost competitive when compared to some of the global peers



Source: Company data

Figure 13: THYAO has shown solid cost discipline with unit costs more or less flat over the past 5 years



Source: Company data

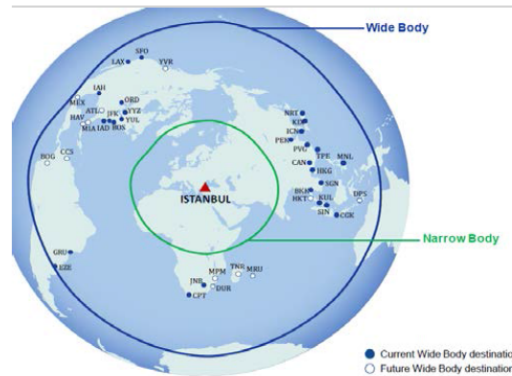


# Why to Fly with Turkish Airlines ?

## Istanbul – Natural Hub

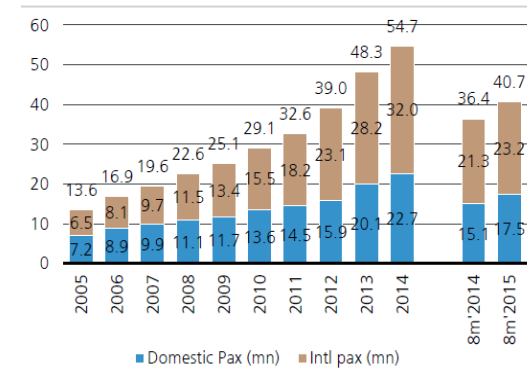
Both point-to-point and international-to-international transfer passenger traffic has become one of the most important contributors to Turkey's passenger traffic growth thanks to Istanbul's location as a major hub

Figure 10: Istanbul's (Hub for THYAO) geographic location has been a key driver behind its emergence as a global transit hub.



Source: Company data

Figure 11: This is clearly reflected in THYAO's passenger traffic growth over the past decade and we expect this trend to continue albeit at a slower pace



Source: Company data

### ISTANBUL NEW AIRPORT

About Istanbul New Airport

- 150 million** passenger capacity
- 271** aircraft capacity
- 6** runways
- 181** passenger bridges

Istanbul New Airport, scheduled to open and start providing services in 2017, will add a strong momentum to the growth trend in Turkey's civil aviation sector that continues for the last 12 years. This giant project that will carry Turkish Airlines into future, will also turn Istanbul, which already is a natural hub due to its geographical position, into one of the world's largest aviation centers.

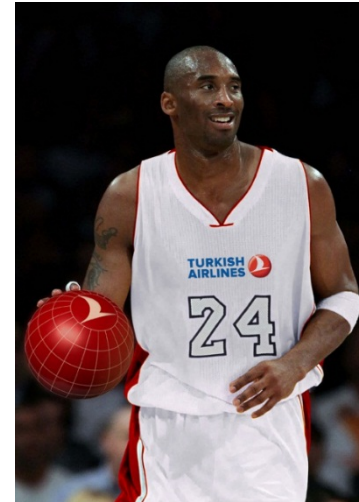
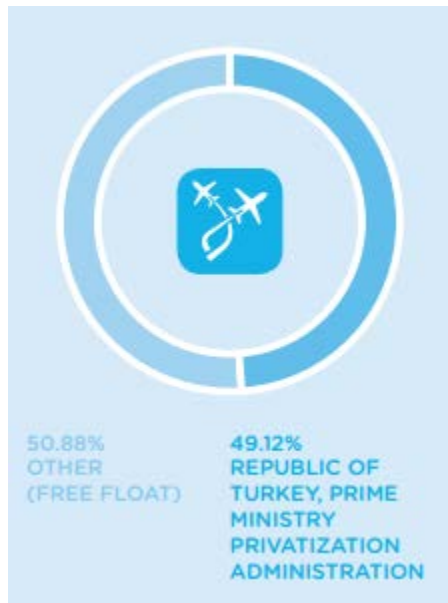
- The tender for Istanbul's new airport was completed in May 2013
- Excessive support by the government for the completion of new airport
- Completion Date : 29 October 2017



# Why to Fly with Turkish Airlines ?

## Brand Power and Ownership Structure

- Global sponsorship agreements
- Touching billions of people



- Government support behind
- Further capacity growth with 3rd airport project

# Why to Fly with Turkish Airlines ?

## Strong 3Q15 Actuals

- Potentially strong Q3 results with traffic boost and margin recovery will be near-future catalysts for THYAO once Q3 results are announced
- At passenger traffic which is one of the key measures of the business, 3Q15 growth vs 3Q14 is more than double of 1H15 growth vs 1H14

Passenger Traffic (m)				
Year	1H15	July	August	Sep
2015	28.5	5.9	6.3	5.8
2014	26.3	4.7	5.4	5.0
Actual growth	8.50%	25.53%	16.67%	16.00%

# Valuation

DCF summary (\$ m)	
WACC	8.2%
Terminal growth rate	3%
NPV of 10-years DCF	-3230
NPV of Terminal value	13766
Enterprise value	10536
Net debt	5229
Equity value	5307
12-m Equity value	5888
USD/TRY	2.99
# of shares	1380
<b>Target share price (TRY)</b>	<b>12.76</b>

2015E	P/E	EV/EBIT	EV/EBITDAR	EV/Sales	EV/IC
Nominal (US\$m)	805	650	2,043	10,679	18,059
Target multiple (x)*	10.6	20.0	7.2	1.1	1.4
Target EV			14,653	12,250	26,126
Adj.net debt**		9,785	9,785	9,785	9,785
<b>Target Value</b>	<b>8,535</b>	<b>3,228</b>	<b>4,867</b>	<b>2,465</b>	<b>16,340</b>
US\$/TRY exchange rate	2.99	2.99	2.99	2.99	2.99
<b>Target Value (TL)</b>	<b>25,523</b>	<b>9,652</b>	<b>14,555</b>	<b>7,372</b>	<b>48,864</b>
Shares (m)	1,380	1,380	1,380	1,380	1,380
<b>Target value per share (TL)</b>	<b>18.50</b>	<b>7.00</b>	<b>10.50</b>	<b>5.30</b>	<b>35.40</b>

Methodology	Target price (TRY)	Weight
DCF	12.76	40%
Peer multiple	10.50	60%
<b>Final weighted target</b>	<b>11.40</b>	
<b>Upside potential</b>	<b>32%</b>	

**BUY!**



***Thank you...***



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## Turk Hava Yolları (Turkish Airlines) - THYAO

Beneficial oil price and FX positioning, structural and geopolitical competitive advantage to peers, boosted traffic momentum in 2015 Q3 and trading at a discount to global peers; makes Turkish Airlines highly attractive

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Day low Day high

TL8.24 TL8.61

Open: 8.27

52 week low 52 week high

TL7.08 TL10.45

Market cap TL11.45B

Average volume 29.28M

### Analysts' Suggestions

1-5 Linear Scale	Current	1 Month Ago	2 Month Ago	3 Month Ago
(1) BUY	6	5	5	5
(2) OUTPERFORM	12	12	12	12
(3) HOLD	4	6	6	6
(4) UNDERPERFORM	0	0	0	0
(5) SELL	0	0	0	0
No Opinion	0	0	0	0

Source: Reuters

31 October 2015

Authors: Görkem Türk, Ahmet Polat, Yiğitcan Öztürk, Kürşad Yamaç, Arda Çolak, Selçuk Tosun



## **KEY TAKE-OUTS**

### **Lower oil price with limited hedging and FX positioning provides a significant advantage to THYAO.**

Oil prices, the largest cost segment of THY (35-40% of total cost base), have declined by 60% to \$48/bbl from \$115/bbl between June-December 2014 and it still remains in the same levels. THY's oil price hedging ratio is relatively lower than its peers for both 2015 and 2016, respectively 46% vs 61% and 28% and 39%, where the hedged oil prices are higher than spot market price. Hence, the recent oil prices are even more supportive for THYAO in comparison to global peers. In FX positioning, THYAO's revenue and cost breakdown is well-spread mainly between EUR, USD and TRY which lowers the risk of solely depending on single currency, in other words the risk of FX volatility. Additionally, Turkish Airlines is effectively short in TRY with respect to EUR and USD when revenue and cost breakdown is analyzed. Therefore, current level of weak TRY and its further potential to weaken supports THYAO's margins.

### **Relatively lower unit cost and geopolitical location of Istanbul being a natural hub gives THYAO an unbeatable competitive edge.**

THYAO is very cost-competitive in CASK (cost of available seat-km) compared to its global peers. For 2014, THYAO's CASK is 2<sup>nd</sup> lowest globally with \$7.7cent where average of global peers (excl. THYAO) is \$9.9cent. Furthermore, this cost advantage will be better in 2015E and 2016E figures since THYAO has been showing effective cost management and paying personnel salaries in TRY which has weakened with respect to hard currencies. In addition to cost advantage, THYAO has geopolitical competitive advantage thanks to its settlement. Istanbul has become a global transit hub enabling strong transfer passenger traffic which has a huge growth potential thanks to Istanbul's 3<sup>rd</sup> airport project which will be THYAO's new major hub.

### **Potentially strong Q3 results with traffic boost and margin recovery on top of being traded at a discount to global and regional peers creates an upside potential for THYAO.**

Q3 is the most important quarter for Turkish Airlines which has historically accounted for c.45% of full year EBITDA. 3Q15 traffic is actualized as 18 million passengers which is 20% higher than 3Q14. Given 8.5% growth of 1H15 vs 1H14, 3Q15 traffic result seems like a very good catalyst for the stock. In Q3, traffic momentum and better load rate vs 1H15 will increase the positive impact of oil price difference with 3Q14; hence EBITDAR margin of 3Q15 will be better from both 3Q14 and 1H15. In addition to traffic boost and EBITDAR margin recovery, THYAO is now trading at a discount to its own history and to peers. THYAO's 2015E adjusted EV/EBITDAR is 5.8x while global average (excl. THYAO) is 7.2x and EM average is 6.8x. These peer multiples constitutes a favorable valuation and upside potential for THYAO.

### **Who is Turkish Airlines?**

Turkish national flag carrier Turkish Airlines was founded in 1933. As of February 2015, it operates scheduled services to 280 destinations in Europe, Asia, Africa, and the Americas, making it the largest carrier in the world by number of countries it fly and 4th largest carrier by number of total destinations. THYAO has been a member of the Star Alliance network since 1 April 2008. Today, the government owns 49.1% of the company, while the remaining 50.9% is free float. With its fleet of 249 aircraft and over 23,600 employees, passenger revenues comprise 87% of total revenues of Turkish Airlines. In terms of geographical breakdown, c33% of passenger revenues are from Europe and 14% from Turkey, with the Middle East at c13%. According to AEA (Association of European Airlines) data, Turkish Airline increased its market share to 14.6% successfully and has taken second place among European carriers.

## **MACRO OUTLOOK – TURKEY**

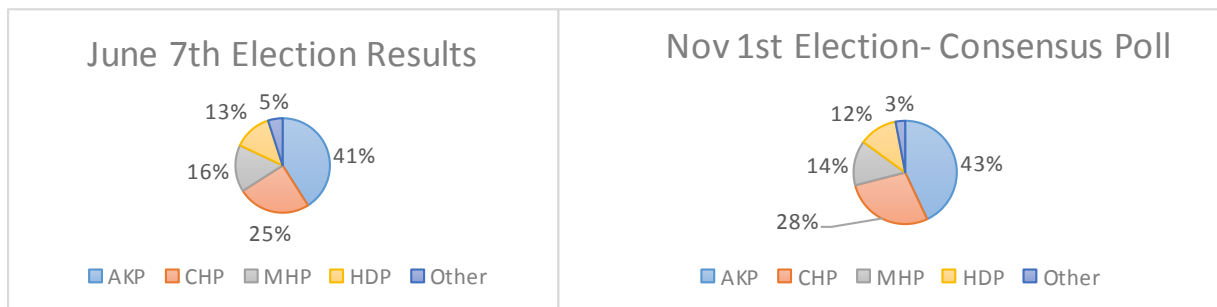
### **Tomorrow there is an election. Will this time be different?**

Following unsuccessful efforts to form a coalition government after the 7 June elections, Turkey is heading for another round of elections on 1 November. The political stalemate is prompted by the fact that the Justice and Development Party (AKP) lost its majority in Parliament in the June election for the first time since the party's foundation in 2002. Despite the troubles for the Turkish economy, economic issues have taken a less prominent role this year. The ongoing political uncertainty in Turkey has contributed to the weakness seen in economic sentiment indicators. According to the recent polls, elections are likely to end with another parliament where four parties will be represented. With AKP again failing to regain a majority, the challenging political environment is likely to pursue. In our view, a coalition government is likely in such a situation, potentially consisting of AKP and CHP.

### **We expect 3 main scenarios which can come out from elections.**

1. AKP gets enough seats to form a majority government [Possibility: 30%]
2. AKP fails to get enough seats for parliamentary majority, and coalition talks will be successful. High likely to result in an AKP – CHP government. [Possibility: 60%]
3. There will be no party with enough seats in the parliament to govern on its own and coalition talks will be unsuccessful resulting in an ongoing political chaos. [Possibility: 10%]

Current survey results are consistent with that no party would be able to govern alone and thus with our Scenario #2 or Scenario #3.



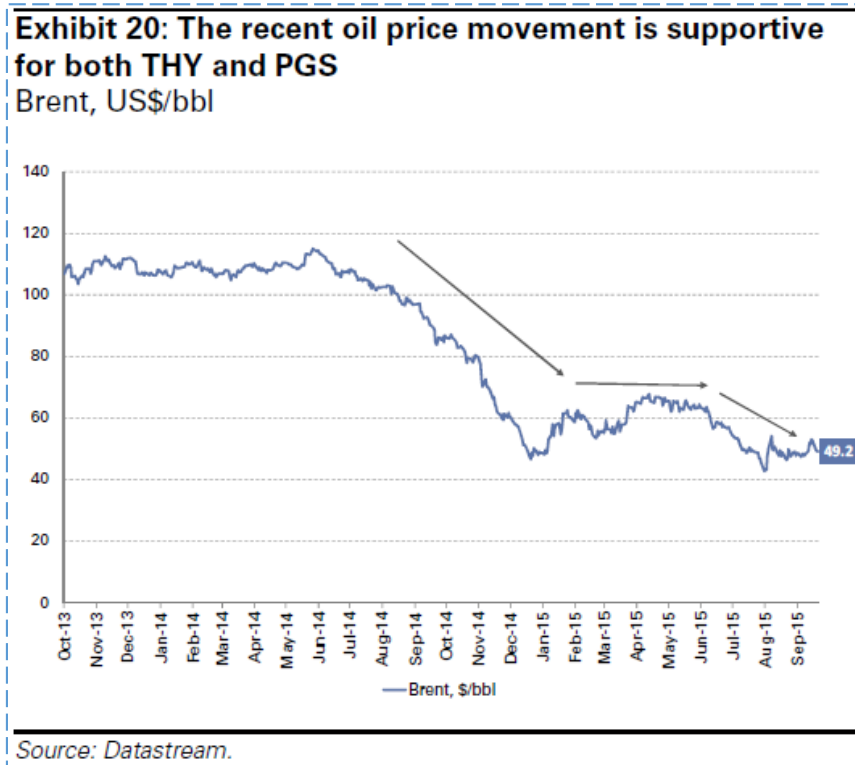
We believe that coalition talks will not be similar to 7 June as political parties are under pressure to overcome the political stalemate and form a coalition. The latest indications from the two main political parties, AKP and CHP, present an increased willingness to compromise and we see this scenario as the most logical coalition outcome. Recent stock market pricing behavior also indicates that financial markets believe in a coalition government between AKP and CHP after tomorrow's election.

**We expect a relief rally in Turkish equities, especially in long FX ones, after the form of a functioning government also given the 14% underperformance of MSCI Turkey versus MSCI EM this year in USD terms.** Any normalization of the recent political chaos after the elections should support this relief rally in equities. Apart from the uncertainty around the new elections scheduled for 1 November, further appreciation of USD driven by upcoming FED rate hike is a clear risk to Turkish equities which are not guarded against the depreciation of Turkish Lira; however THYAO is one of the long in FX companies listed in BIST for whom depreciation of TRY is a positive catalyst. Based on our expectation of a relief rally under our base scenarios, we recommend being long and high beta in Turkish equities. Hence, we think Turkish Banks and companies like Turkish Airlines can benefit from a risk-reversal trade given the attractive valuations.

## WHY TO FLY WITH THYAO? HERE WE GO!

**Persistent weakness in oil prices with relatively lower hedging and long FX positioning creates a significant upside catalyst for THYAO.**

Fuel cost, the largest cost item, constitutes 35-40% of the company's total expenses enabling a significant movement in oil price to put pressure on THYAO's profitability. If we analyze the oil prices, between June-December 2014, it has declined by 60% to \$48/bbl from \$115/bbl. Then, it increased and reached to \$c.60/bbl levels. However; with the recent Brent move, oil prices have come down back to the levels touched earlier this year i.e. \$c.50/bbl in 3Q15 vs \$62 at the end of 2Q15. Significant decrease in oil prices after June 2014 provides benefit to THYAO. According to Citibank calculations, each US\$1/bbl drop in fuel prices increases THYAO's EBIT by 6.8% on average in US\$ terms. This benefit seems to be long-lasting catalyst since Citi oil price estimates for 2015E, 2016E and 2017E are respectively 53\$, 53\$ and 67\$. These estimates does not change much in other resources' estimates.



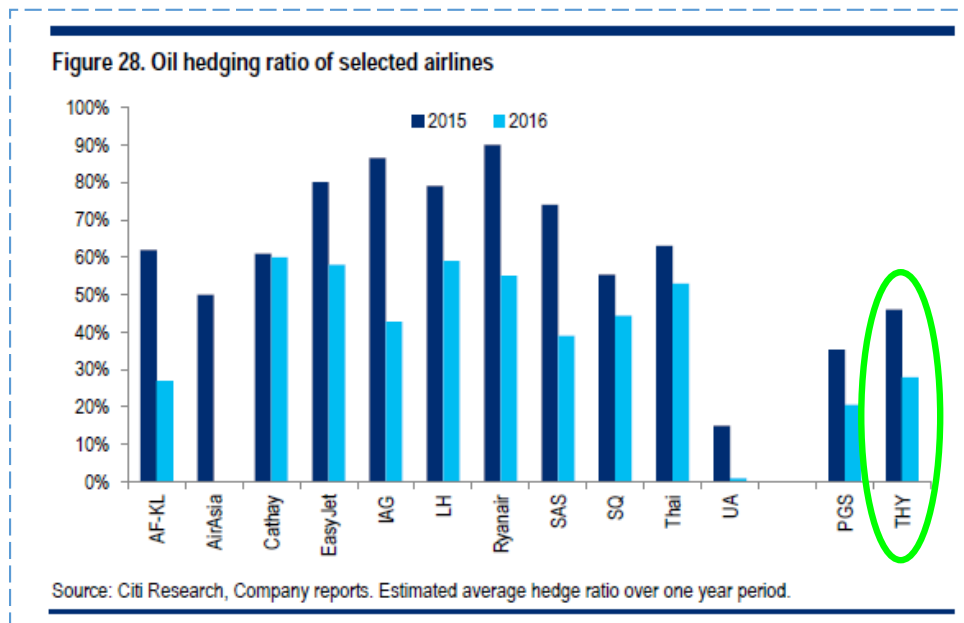
**Figure 29. Oil price estimates**

Source: Citi Research

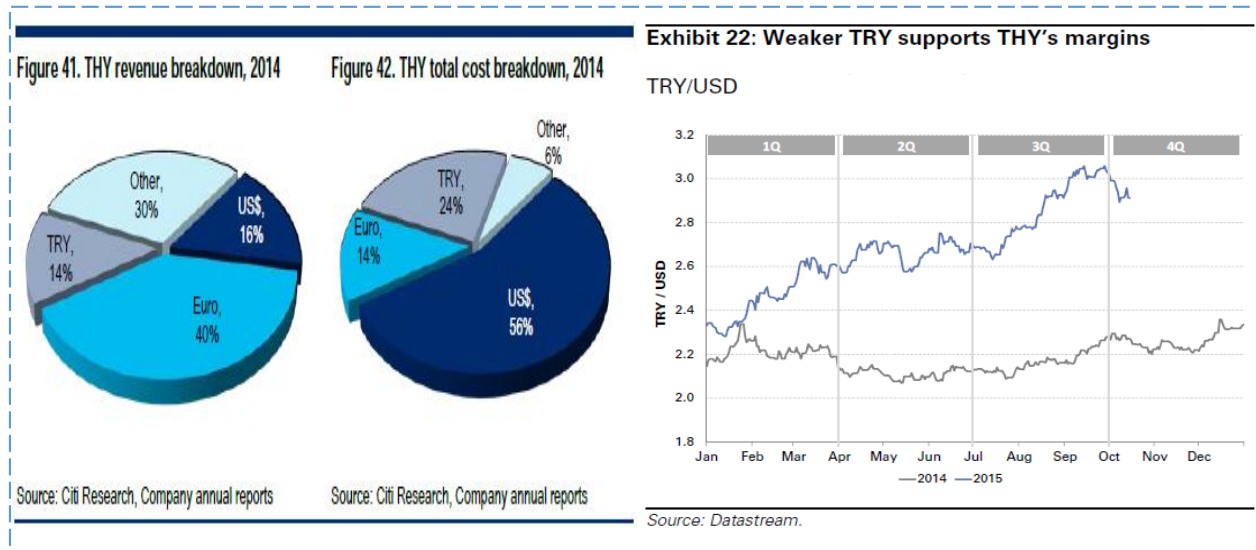
Brent (US\$/barrel)	2015E	2016E	2017E	2018E	2019E
Citi (A)	53.00	53.00	65.00	73.00	75.00

Another competitive advantage for THYAO is oil hedging ratio. THYAO's oil hedging ratio is relatively lower for both 2015 and 2016 compared to its peers. Major global airlines' oil hedging ratio is 61% average for 2015 and 39% average for 2016 whereas THYAO's oil hedging ratio are respectively 46% and 28%. Since spot market price is lower than hedged oil prices for THYAO, \$48 vs. \$75, current oil prices are more

supportive for THYAO compared to its global peers. THYAO will enjoy more and more if persistent weakness in oil prices continues or even weaken further.



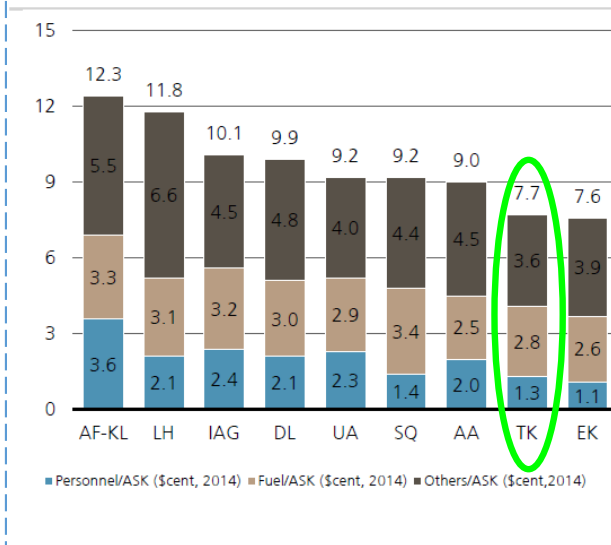
On the currency side, THYAO has well-spread and more favorable revenue and cost structure against weak TRY. 40% of THYAO's revenues are Euro-denominated, followed by 16% exposure to US\$ and 14% exposure to TRY. As functional currency of fuel purchases is US\$, majority of the expenses (56%) are US\$ denominated. TRY and Euro are the other currencies that have the largest share in THYAO's total expenses with 24% and 14% share, respectively. In general, THYAO's profit structure does not merely depending on single currency which puts the company to safe side especially nowadays where FX structure is very unpredictable and volatile. Additionally, THYAO is effectively short in TRY which has depreciated vs USD by 27% since the beginning of the year and by 25% in Q3. In other words, THYAO has been benefiting from recently weakening TRY and will continue to do so.



**Strong cost-competitiveness and Istanbul’s wonderful position as a natural hub make THYAO an unbeatable flight carrier.**

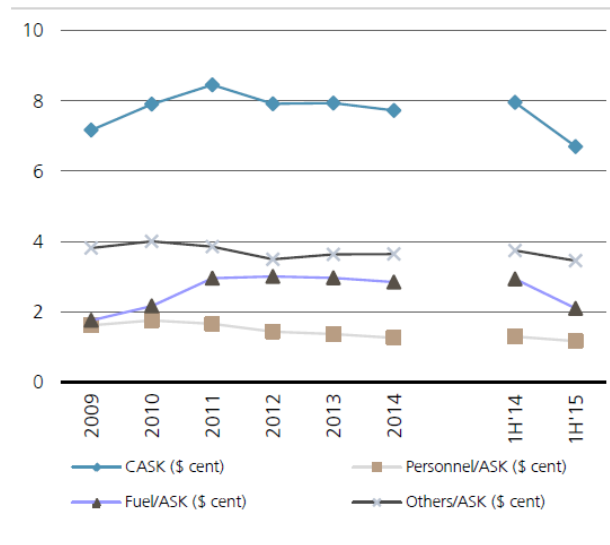
THYAO has done a very good job in solid cost management making THYAO a very cost-efficient airline company. Thanks to solid cost management, THYAO’s CASK is 2<sup>nd</sup> lowest globally with \$7.7cent where average of global peers (excl. THYAO) is \$9.9cent. In addition to low fuel prices accounting for 35-40% of THYAO’s cost base, company continuously decreased its ex-fuel cost base supporting margins and market share so that per unit costs remained largely flat over the past five years. Hence; there has been 15.9% yoy and 8.4% yoy drop in THYAO CASK and ex-fuel CASK in 1H15. Apart from that, paying salaries in TRY, which has depreciated by 27% against USD since 2015, further helps THYAO’s CASK to become relatively lower compared to global peers.

**Figure 12: THYAO is very cost competitive when compared to some of the global peers**



Source: Company data

**Figure 13: THYAO has shown solid cost discipline with unit costs more or less flat over the past 5 years**

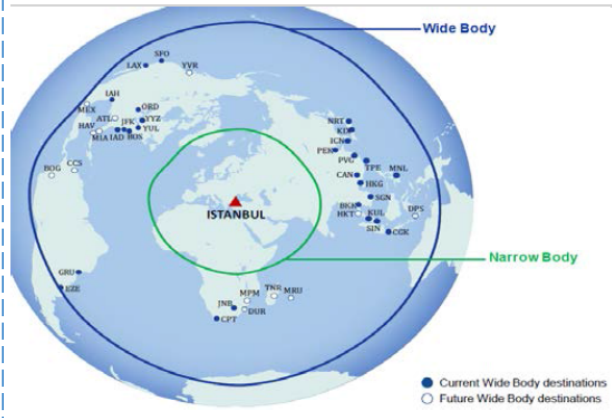


Source: Company data

Besides THYAO benefitting from strong cost management, it enjoys perfect geopolitical location of Istanbul being a natural hub. Istanbul’s geopolitical location has become a vital competitive edge and has been the key pillar for THYAO’s emergence as a global carrier. Both point-to-point and international-to-international transfer passenger traffic has become one of the most important contributors to Turkey’s passenger traffic growth thanks to Istanbul’s location as a major hub. In addition to Istanbul, being a global transit hub enabling strong transfer passenger traffic, government’s supportive approach to the aviation industry (introducing cash support for airlines expanding their fleets), will continue to boost traffic growth. The tender for Istanbul’s new airport was completed in May 2013 and in accordance with the tender documentation, the winning consortium agreed to start the construction work in six months. Recently, the credit loan agreement of the project has just been approved and signed 2 weeks ago. President Recep Tayyip Erdogan announced the completion date of the first phase of the project (90mn-passenger capacity, 680K sqm terminal, 4mn sqm apron, 88 aircraft bridges, eight taxiways, three independent runways and all other service buildings) as of 29 October 2017. We believe that no matter which political

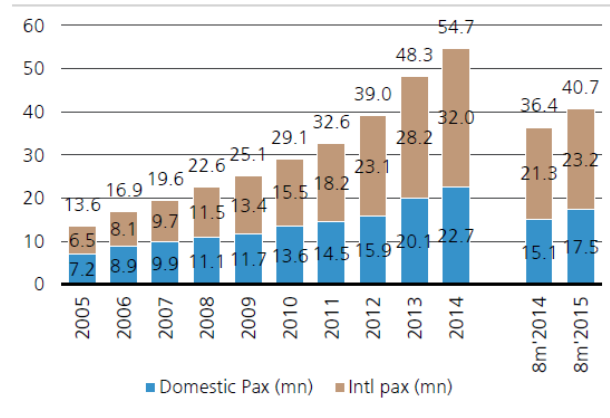
party comes as government, it will push THYAO further in terms of capacity expansions with the project start-up.

**Figure 10: Istanbul's (Hub for THYAO) geographic location has been a key driver behind its emergence as a global transit hub.**



Source: Company data

**Figure 11: This is clearly reflected in THYAO's passenger traffic growth over the past decade and we expect this trend to continue albeit at a slower pace**



Source: Company data

**We believe government will push THYAO further in terms of capacity expansions due to the fact that 49.1% of THYAO is owned by government and the rest is publicly traded.**

This shareholder structure will give government financing and continuous ease of doing business support to THYAO for both capacity expansions and brand power as a global carrier. To strengthen brand perception, THYAO has become the official carrier of Europe's leading soccer clubs such as FC Barcelona, Manchester United F.C., Borussia Dortmund, Galatasaray, Olympique de Marseille, Aston Villa, FK Sarajevo, Hannover 96 and A.S. Roma. The airline has also made sponsorship and promotion deals with renowned athletes and actors, including Lionel Messi, Kobe Bryant, Caroline Wozniacki, Kevin Costner, Wayne Rooney and Didier Drogba. Furthermore, the company is the primary sponsor of the Turkish Airlines Euroleague since 2010 and was among the sponsors of the 2010 FIBA World Championship. With the help of these remarkable sponsorships and deals, THYAO touches billion of people in the world.

**Potentially strong Q3 results with traffic boost and margin recovery will be near-future catalysts for THYAO once Q3 results are announced.** After a hard year-half, THYAO came back with positive results it actualized during Q3. At passenger traffic which is one of the key measures of the business, 3Q15 growth vs 3Q14 is more than double of 1H15 growth vs 1H14. Monthly growth rates of Q3 and 1H15 can be found in the table below.

Passenger Traffic (m)				
Year	1H15	July	August	Sep
2015	28.5	5.9	6.3	5.8
2014	26.3	4.7	5.4	5.0
Actual growth	8.50%	25.53%	16.67%	16.00%

## VALUATION

**12-month target price for THYAO is derived as 11.40 TL which gives 32% upside potential, therefore we rate the stock as Buy.** In valuation, we used the sum of the parts (SOTP) methodology where 40% comes from DCF valuation and 60% comes from peer multiple comparison. We put lower emphasis on DCF because, in this case, it is very sensitive to oil prices which is very hard to forecast long-term and risk-free bond rates are currently affected by FED's unpredictable interest rate hike and upcoming elections. In DCF, we used USD cash-flow instead of TRY. While calculating COE to reach WACC, we took risk-free rate as 5.45% which is the yield of 2034-maturity USD-bond issued by Turkish government. We used such methodology because we believe that 2-years bond interest rates can be over-affected by near-term risks, especially under current circumstances created by FED and upcoming elections. With 2034-maturity bond and USD cash flow, we tried to make our valuation more realistic and reasonable since 2034 is the longest-maturity USD-bond that Turkish government issued and all currencies are assumed parity in infinity according to the fundamental economic theory. We took beta as 1.1 since aviation is riskier than general industry by heavily depending on oil prices and we took equity risk premium as standard 5%. With these inputs, our WACC is calculated as 8.2% and we used 3% as terminal/horizon growth rate after 10 years. At the end of DCF valuation, Value of Operations is assumed to be equal to Enterprise Value since there is not any unused land or asset outside of core business. Additionally, Equity value calculated at year-0 is forwarded 12-m with COE (10.95%) to reach share target price. The summary of DCF valuation methodology for THYAO can be found in table below. Peer multiple comparison and SOTP valuation is on next page.

DCF summary (\$ m)	
WACC	8.2%
Terminal growth rate	3%
NPV of 10-years DCF	-3230
NPV of Terminal value	13766
Enterprise value	10536
Net debt	5229
Equity value	5307
12-m Equity value	5888
USD/TRY	2.99
# of shares	1380
<b>Target share price (TRY)</b>	<b>12.76</b>

For peer multiple comparison, EV/EBITDAR is the key multiple we used in valuation since leasing and rent expenses have a big effect on financials of aviation sector. In our 2015E target EV/EBITDAR multiple valuation, we used adjusted EV (net debt-adjusted with capitalized 2015 operational lease expenses of 7x operational leasing expenses) and adjusted EBITDAR (EBIT adjusted with total leasing expenses and depreciation for the period). We used a 7.2x target multiple, which is the average of EV/EBITDAR multiple of the company's global peer group.

2015E	P/E	EV/EBIT	EV/EBITDAR	EV/Sales	EV/IC
Nominal (US\$m)	805	650	2,043	10,679	18,059
Target multiple (x)*	10.6	20.0	7.2	1.1	1.4
Target EV			14,653	12,250	26,126
Adj.net debt**		9,785	9,785	9,785	9,785
Target Value	8,535	3,228	4,867	2,465	16,340
US\$/TRY exchange rate	2.99	2.99	2.99	2.99	2.99
Target Value (TL)	25,523	9,652	14,555	7,372	48,864
Shares (m)	1,380	1,380	1,380	1,380	1,380
Target value per share (TL)	18.50	7.00	10.50	5.30	35.40

Source: Citi Research, Company presentation. \*Average multiples of 26 global flag carriers. \*\* Net debt is adjusted with capitalized 2015 operational leases (7 times 2015 operational and 55% wet leasing expenses) and US\$429mn worth fair value of subsidiaries (50% of Turkish Ground Services, 25% market value of Turkish Do&Co, 50% target value of Turkish Opet, 50% target value of Sun Express).

THYAO's target share price coming from DCF methodology and peer multiple comparison are respectively 12.76 TL and 10.50 TL. 12-month weighted-average SOTP target price is derived as 11.40 TL which gives 32% upside potential and rates the stock as Buy. The summary of SOTP for THYAO can be found in table below.

Methodology	Target price (TRY)	Weight
DCF	12.76	40%
Peer multiple	10.50	60%
<b>Final weighted target</b>	<b>11.40</b>	
<b>Upside potential</b>	<b>32%</b>	

**Disclosures:** This report is written for the purposes of application to GNAM Investment Competition organized by Yale University Investment Management Club. All of the calculations and assumptions are in line with the authors' (whose names can be found in the first page) thoughts. Authors will not accept any responsibility for the market investments and circumstances done directly by referencing this document.

**Appendix (next page):** Actuals and future estimates of financial statements of Turkish Airlines.



<b>Profit &amp; Loss (TLm)</b>	<b>2013</b>	<b>2014</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>	<b>Valuation ratios</b>	<b>2013</b>	<b>2014</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
Sales revenue	18,777	24,158	31,934	32,426	35,573	PE (x)	17.3	6.5	18.1	30.8	33.2
Cost of sales	-15,305	-19,813	-25,596	-25,740	-27,518	PB (x)	1.7	1.3	3.3	2.7	3.4
Gross profit	3,472	4,345	6,338	6,686	8,055	EV/EBITDA (x)	na	6.8	6.1	7.2	6.3
Gross Margin (%)	18.5	18.0	19.8	20.6	22.6	FCF yield (%)	17.4	13.4	3.0	7.0	7.2
<b>EBITDA (Adj)</b>	<b>2,670</b>	<b>3,312</b>	<b>4,737</b>	<b>4,669</b>	<b>5,389</b>	Dividend yield (%)	0	0	0	0	0
EBITDA Margin (Adj) (%)	14.2	13.7	14.8	14.4	15.2	Payout ratio (%)	0	0	0	0	0
Depreciation	-1,580	-2,028	-2,792	-2,726	-2,609	ROE (%)	na	22.6	21.5	9.2	9.2
Amortisation	0	0	0	0	0	<b>Cashflow (TLm)</b>	<b>2013</b>	<b>2014</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
<b>EBIT (Adj)</b>	<b>1,090</b>	<b>1,284</b>	<b>1,944</b>	<b>1,943</b>	<b>2,781</b>	EBITDA	2,670	3,312	4,737	4,669	5,389
EBIT Margin (Adj) (%)	5.8	5.3	6.1	6.0	7.8	Working capital	545	-535	-54	863	304
Net interest	-370	742	810	-484	-1,131	Other	-73	-102	-2,749	-1,126	-2,180
Associates	109	161	136	143	124	<b>Operating cashflow</b>	<b>3,142</b>	<b>2,676</b>	<b>1,934</b>	<b>4,406</b>	<b>3,513</b>
Non-op/Except	136	74	499	480	381	Capex	-1,097	-1,096	-643	-1,649	-604
<b>Pre-tax profit</b>	<b>965</b>	<b>2,261</b>	<b>3,389</b>	<b>2,082</b>	<b>2,154</b>	Net acq/disposals	0	0	0	0	0
Tax	-283	-442	-983	-812	-939	Other	-561	114	100	305	482
Extraord./Min.Int./Pref.div.	0	0	0	0	0	<b>Investing cashflow</b>	<b>-1,659</b>	<b>-983</b>	<b>-542</b>	<b>-1,343</b>	<b>-122</b>
<b>Reported net profit</b>	<b>683</b>	<b>1,819</b>	<b>2,406</b>	<b>1,270</b>	<b>1,216</b>	Dividends paid	0	0	0	0	0
Net Margin (%)	3.6	7.5	7.5	3.9	3.4	<b>Financing cashflow</b>	<b>-1,471</b>	<b>-1,527</b>	<b>-2,071</b>	<b>-4,403</b>	<b>-4,052</b>
Core NPAT	683	1,819	2,406	1,270	1,216	<b>Net change in cash</b>	<b>12</b>	<b>167</b>	<b>-679</b>	<b>-1,341</b>	<b>-661</b>
<b>Per share data</b>	<b>2013</b>	<b>2014</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>	<b>Free cashflow to s/holders</b>	<b>2,045</b>	<b>1,580</b>	<b>1,292</b>	<b>2,757</b>	<b>2,909</b>
Reported EPS (TL)	0.49	1.32	0.47	0.28	0.26	<b>Valuation Ratio</b>	<b>2013</b>	<b>2014</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
Core EPS (TL)	0.49	1.32	0.47	0.28	0.26	EV/EBITDAR	6.5	7.2	5.8	5.8	5.3
DPS (TL)	0	0	0	0	0						
CFPS (TL)	2.28	1.94	0.38	0.96	0.74						
FCFPS (TL)	1.48	1.14	0.25	0.60	0.62						
BVPS (TL)	5.05	6.63	2.59	3.15	2.52						
Wtd avg ord shares (m)	1,380	1,380	5,110	4,585	4,721						
Wtd avg diluted shares (m)	1,380	1,380	5,110	4,585	4,721						
<b>Balance Sheet (TLm)</b>	<b>2013</b>	<b>2014</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>						
Cash & cash equiv.	1,382	1,674	3,142	2,713	2,375						
Accounts receivables	1,148	1,057	1,737	1,588	1,687						
Inventory	342	452	485	475	502						
Net fixed & other tangibles	20,297	24,508	42,002	42,805	42,876						
Goodwill & intangibles	104	194	253	227	234						
Financial & other assets	2,130	3,989	5,575	5,089	5,378						
<b>Total assets</b>	<b>25,402</b>	<b>31,876</b>	<b>53,194</b>	<b>52,897</b>	<b>53,050</b>						
Accounts payable	1,451	1,539	1,947	1,906	2,011						
Short-term debt	1,188	1,421	2,314	2,133	2,206						
Long-term debt	10,364	12,334	23,863	22,538	23,407						
Provisions & other liab	5,436	7,428	11,832	11,887	13,546						
<b>Total liabilities</b>	<b>18,440</b>	<b>22,721</b>	<b>39,956</b>	<b>38,463</b>	<b>41,170</b>						
Shareholders' equity	6,962	9,154	13,238	14,434	11,880						
Minority interests	0	0	0	0	0						
<b>Total equity</b>	<b>6,962</b>	<b>9,154</b>	<b>13,238</b>	<b>14,434</b>	<b>11,880</b>						
<b>Net debt (Adj)</b>	<b>10,171</b>	<b>12,081</b>	<b>23,035</b>	<b>21,958</b>	<b>23,238</b>						
Net debt to equity (Adj) (%)	146.1	132.0	174.0	152.1	195.6						

## **Garanti Bank – GARAN**

Established in 1946, Garanti is Turkey's second largest private bank by total assets of USD 99.9 billion. Garanti's core banking activities include retail, corporate, commercial, SME and payment systems. Garanti shares continuously outperformed the market since 2004. 10-year return of USD 100 in Garanti was 2.4x compared to BIST 100 Index 1.5x and BIST Banks Index 1.3x. Garanti has been continuously widening its short FX position (almost fully hedged with swaps) year to date, increasing the FX portion of its liabilities and TL portion of its assets. This helped the bank to support its NIM by 40bps in 1H15 in a period of rising deposit costs, though it also elevated its swap costs, which are recorded as trading losses under the P&L. Nevertheless, the bank's swap adjusted NIM of 4.4% is well above its peer average of 3.6%. Garanti took a selective lending strategy in 1H15, expanding in TL denominated business banking loans, which reprice more rapidly, have better loan yields and are relatively well-collateralized. Garanti Bank's below sector duration gap also suggests that the anticipated improvement in loan-deposit spreads will take place earlier for Garanti than its peers. Thanks to a 20bps expected improvement in its NIM and a strong NPL collection performance, Garanti is expected to record an above sector 13% RoAE in 2015. Analysts expect the bank's RoE to improve above 15% in 2016 thanks to improving fee growth and normalizing opex and general provision expenses.

## **Aselsan - ASELS**

Aselsan was established in 1975 for meeting the communication tool requirements of Turkish Armed Forces. Currently Aselsan is Turkey's leading defence electronics company. Turkish Armed Forces Foundation holds 84,6% of the company while 15,3% is on free float. With increase of sales, investments for R&D, and increase on exports, Aselsan shows prospect to achieve their targets. Aselsan expected to have %16-20 percent increase on revenues and have 120 million TL investment in 2015. Even though current P/BV seems high, with projects in Aselsan's pipeline, even higher prices are expected on Aselsan shares. Aselsan also enjoys high USD & EUR rates since the company makes sales on FX but spends mostly with TL, which leads to no FX pressure. The company established a new facility in Ankara Golbasi, will be used for ground, air, sea, and space radar technology development and UAV's. There are different upcoming projects for Aselsan, including serial production of Altay Tank, long range observation radar development, serial production of low and medium altitude air defense system, and long range air defense rocket system development. Aselsan expanded to 3 more export markets in 2014, and reached to 60 countries. In 2015, export sales are expected to increase and help the EBITDA increase of company. Along with these, Turkey's military spendings are expected to remain high and this will result in more profitable business for Aselsan. Additionally, further government investments are expected to be done in Aselsan after recent terrorist attacks in Turkey.

## **Is REIT - ISGYO**

ISGYO (Is REIT) is a real estate investment company which was established in 1999 by the strategic partnership of Isbank (Isbank is Turkey's biggest private bank established in 1924). İş REIT is one of the leading firms in the sector with its solid portfolio and financial structure. İş REIT possesses a diversified portfolio covering various elements including land, offices, shoppingmalls, hotels and projects. Within this scope, the Company maintains its stable growth target by capitalizing on all investment opportunities and thus enriching its portfolio. The main reason behind the upside opportunity of IS Reit is that they have solid rent income in US dollars from retail business companies. Currently, Is REIT has c60% of its revenue coming from rental assets, of which c40% are FX denominated (USD 34%, EUR 5%). This bodes well given the sharp depreciation in TRY vs USD. In addition to current portfolio, projects under development would increase the rental income by 50% (\$76 mn) in early 2016. These projects also include some residential

projects which has an expected total revenue of \$ 700 mn until 2018. With these future projects and current-solid financial structure, estimated EBITDA has potential to increase up to 90% and net profits would be increased by 145% in 2016. Based on a 5.5% equity risk premium, an 9.5% risk-free rate and a 0.8 beta, WACC of 13.3% is calculated With the help of DCF valuation the target price is TRY 2.00 which has an upside target of 34 % from the current price of TRY 1.50.

### **Coca Cola Bottlers - CCOLA**

Coca-Cola İçecek / Bottlers (CCI) is the fifth-largest bottler in the Coca-Cola System in terms of sales volume. CCI produces, distributes and sells sparkling and still beverages of The Coca-Cola Company (TCCC) across Turkey, Pakistan, Kazakhstan, Azerbaijan, Kyrgyzstan, Turkmenistan, Jordan, Iraq, Syria and Tajikistan. CCI employs over 10,000 people and has a total of 25 plants, offering a wide range of beverages to a consumer base of more than 380 million people. CCI has historically traded at a 3-year average premium of 37% to its peer bottlers but the recent slide in the stock price means the stock now trades at 20% discount. The stock is down by 22% since the Q2 volume announcement on 9th July and also because of weaker currency in most parts of its operational geography but especially in Turkey. We expect a strong 3Q15 performance in Turkey since both weather conditions and consumer sentiment (summer period and both religious periods were in Q3 this year) will help the company to post better sales numbers vis a vis 3Q14, considering the low base and improved operating profitability in 2Q15. The valuation for Coca Cola İçecek on DCF and peer group analysis is assigned as equal weightings to each. While the DCF valuation yields a target market capitalization of TL14,752mn, other Coca Cola bottlers' multiples suggest a target equity value of TL11,002mn. Weighted target market capitalization is computed as TL12,877mn, leading to a 12-mth target share price of TL50.6 per share with 47% upside potential.