

03 August 2017

Tupras

2Q17: The only way is up

- Tupras posts impressive results in 2Q17:** Tupras posted EBITDA of TL1.5bn (up 134% y/y, UNLU&Co: TL1.3bn, cons: TL1.3bn) and net income of TL1.5bn (UNLU&Co: TL0.8bn, cons: TL1.0bn) in 2Q17. Key highlights of the quarter were: i) elevated CUR of 117%, ii) highest ever 2Q net refining margin of USD7.8/bbl (up 50% y/y), iii) strict cost control with OPEX (USD/bbl) down 13% y/y, iv) higher-than-expected net other income, v) lower-than-expected financial expenses, and vi) TL176m deferred tax income.
- Net refining margin guidance upped by USD1.25/bbl:** Following the strong performance in 1H, Tupras' management revised up its full-year Med-Complex refining margin expectation by USD0.25/bbl to USD4.25-4.75/bbl (1H17: USD5.41/bbl, UNLU&Co: USD5.25/bbl). More importantly, the management now foresees its net refining margin to materialise in the range of USD7.0-7.5/bbl in 2017 (1H17: USD8.21/bbl, UNLU&Co: USD8.0/bbl). We note that the previous guidance was USD5.75-6.25/bbl.
- Lifting our 2017E EPS by 25%:** Following the stronger-than-expected 2Q17 performance, we revise up our 2017E EBITDA forecast by 6% to TL5.7bn from TL5.4bn. As the bottom-line beat was much stronger, we increase our full-year net income projection by 25% to TL4.0bn from TL3.2bn.
- We are now >40% ahead of the consensus on 2017E EPS:** After having revised our estimates, we are 32% and 46% ahead of consensus for 2017 EBITDA and EPS forecasts, respectively. Tupras was subject to notable earnings revisions since October 2016 (30% on EBITDA and 43% on EPS). Despite that, we believe the Street is still behind the curve and needs to upgrade its earnings estimates further.
- Increasing TP to TL128/sh; Buy maintained:** We use the DCF method (10.5% RFR, 5.5% ERP, 0.75x beta, 12.25% COD, 4% terminal growth rate) to value Tupras. As our revised price target still implies 18% upside potential, we maintain our Buy recommendation. The key drivers behind the target price revision are: i) incorporating stronger-than-expected 1H17 results, and ii) pencilling in a higher CUR into our entire forecast horizon.

On our revised numbers, Tupras trades at 5.3x 2017E EV/EBITDA and 6.7x 2017E P/E multiples while offering 12% FCF and 13% dividend yields. We believe these levels are sufficiently attractive to support our positive stance on the stock, despite the strong rally ytd. Tupras remains our top-pick within the commodity space and the solid results confirm/increase our conviction. Crude oil price fluctuations, weaker refining margins, rising competition, and TL appreciation represent downside risks to our estimates for Tupras.

Key forecasts	2014A	2015A	2016A	2017E	2018E	2019E
Revenue (TLm)	39,723	36,893	34,855	52,950	61,830	68,477
EBITDA (TLm)	789	3,785	3,192	5,693	5,631	5,097
Net Income (TLm)	1,459	2,550	1,793	4,009	3,503	2,908
DPS (TL)	1.6	0.0	6.5	6.2	14.5	13.1
Dividend Yield (%)	3.3	0.0	9.6	7.9	13.4	12.1
PE (x)	7.7	8.6	7.1	6.7	7.7	9.3
EV/EBITDA (x)	8.9	7.4	6.5	5.3	5.7	6.2

Source: Company financials, UNLU & Co estimates

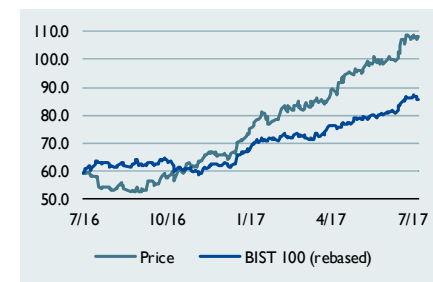
Recommendation: **BUY** Maintained

Target Price: TL 128.0

*Stock ratings are relative to the relevant country benchmark.
Target price is for 12 months
Produced by: UNLU & Co

Share data	
RIC	TUPRS.IS
Sector	Commodities
Price (02 Aug 2017)	TL 108.00
Market cap. (TLm)	27,045
Enterprise value (TLm)	32,937
Market cap. (USDm)	7,663
Enterprise value (USDm)	9,333
Avg. daily trade value (USDm)	23.72
Free float (%)	49

Price relative to BIST 100



Historical performance relative to BIST 100 (%)			
Performance over	1M	3M	12M
Absolute (%)	6.7	22.4	81.8
Relative (%)	0.6	8.4	29.4

Source: BIST 100, UNLU & Co Research

The price relative chart measures performance against the Turkey BIST 100 which closed at 106,525 on 02 Aug 2017

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Valuation and risks

Buy maintained, with TL128.0/sh TP

We use the DCF method (10.5% risk-free rate, 5.5% equity risk premium, 0.75x beta, 12.25% cost of debt, and 4% terminal growth rate) to reach our 12-month target price for Tupras. Note that we discount nominal TL cash flows with the appropriate TL-based WACC. The risk-free rate assumption is based on the average yield on 10-year Turkish lira bond rates. We use a 4% terminal growth rate, which is lower than our long-term nominal GDP growth rate assumption, in order to factor in the company's capacity constraints.

We raise our target price for Tupras by 8%, to TL128.0/share from TL119.0, with this report. The key drivers behind the increase are i) stronger-than-expected regional refining margins, ii) higher CUR, and iii) incorporating stronger-than-expected 2Q17 results. As our revised price target implies an upside potential of 18%, we maintain our Buy recommendation on Tupras.

Figure 1: Tupras DCF valuation (TLm)

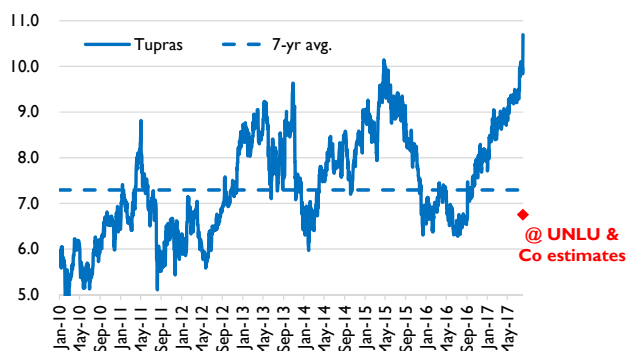
Tupras DCF Analysis											
(TL m)	2016	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E
Revenues	34,855	52,950	61,830	68,477	77,128	86,184	93,078	100,464	107,981	114,676	121,790
- growth	-6%	52%	17%	11%	13%	12%	8%	8%	7%	6%	6%
EBITDA	3,192	5,693	5,631	5,097	4,854	4,540	5,829	7,224	8,127	7,490	6,767
- growth	-16%	78%	-1%	-9%	-5%	-6%	28%	24%	12%	-8%	-10%
- margin	9.2%	10.8%	9.1%	7.4%	6.3%	5.3%	6.3%	7.2%	7.5%	6.5%	5.6%
Taxes	(531)	(1,021)	(993)	(871)	(806)	(726)	(967)	(1,228)	(1,389)	(1,241)	(1,074)
Change in working capital	977	(95)	144	156	155	165	241	(261)	(253)	(176)	(208)
Capex	(879)	(1,264)	(1,066)	(1,135)	(1,203)	(1,269)	(1,333)	(1,399)	(1,466)	(1,538)	(1,612)
Free cash flow	2,759	3,313	3,716	3,247	3,000	2,709	3,769	4,337	5,019	4,536	3,873
Risk-free rate	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%
Beta	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Equity risk premium	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
Cost of equity	14.7%	14.7%	14.7%	14.7%	14.7%	14.7%	14.7%	14.7%	14.7%	14.7%	14.7%
Cost of debt	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%
Tax rate	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
Debt ratio	38.9%	31.9%	34.0%	32.4%	30.4%	30.3%	27.8%	27.1%	24.7%	26.6%	26.7%
WACC	12.8%	13.1%	13.0%	13.1%	13.2%	13.2%	13.3%	13.3%	13.5%	13.4%	13.4%
Discount factor		1.00	1.13	1.28	1.45	1.64	1.85	2.10	2.38	2.70	3.06
PV of Free cash flow		3,313	3,288	2,541	2,074	1,655	2,032	2,063	2,105	1,678	1,264
EV 2017-2026											22,013
Terminal value											14,046
EV total											36,059
+ 40% stake in Opet											1,115
- Net debt											7,641
Target mcap (TL m)											31,999
Current mcap (TL m)											27,045
Upside / (downside)											18%
Current price (TL)											108.0
Target price (TL)											128.0

Tupras' multiples and profitability indicators											
	2016	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E
FCF Yield	10.2%	12.2%	13.7%	12.0%	11.1%	10.0%	13.9%	16.0%	18.6%	16.8%	14.3%
Dividend Yield	6.0%	5.8%	13.4%	12.1%	10.1%	9.0%	8.1%	11.3%	14.9%	17.2%	15.2%
ROAE	21.9%	41.6%	30.5%	24.3%	20.9%	17.9%	23.0%	26.9%	27.7%	22.9%	18.7%
ROIC	14.5%	27.4%	24.5%	20.1%	17.5%	14.9%	18.9%	22.7%	24.0%	20.2%	16.5%
EV/EBIT	12.1	6.0	6.2	7.3	8.0	9.0	6.6	5.1	4.5	5.1	6.1
EV/EBITDA	10.0	5.3	5.7	6.2	6.6	7.2	5.5	4.3	3.8	4.2	4.8
P/B	3.3	2.4	2.3	2.2	2.1	2.0	1.8	1.6	1.4	1.4	1.3
P/E	15.1	6.7	7.7	9.3	10.4	11.6	8.3	6.3	5.4	6.2	7.3

Source: Company data, UNLU & Co analysis and estimates, Bloomberg Finance LP

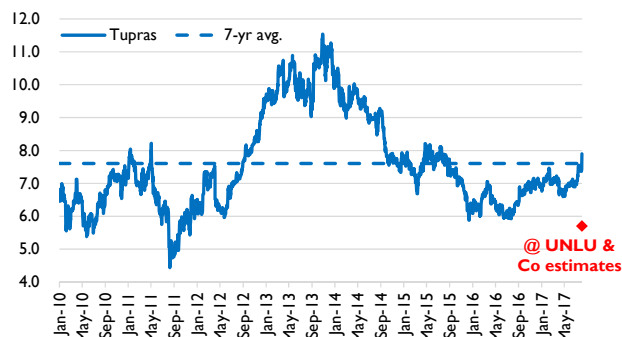
On our forecasts, Tupras is trading at 2017E multiples of 6.7x on P/E and 5.3x on EV/EBITDA. Compared to mid-cycle averages, the current multiples imply decent upside potential.

Figure 2: Tupras one-year-fwd P/E multiple



Source: Bloomberg Finance LP

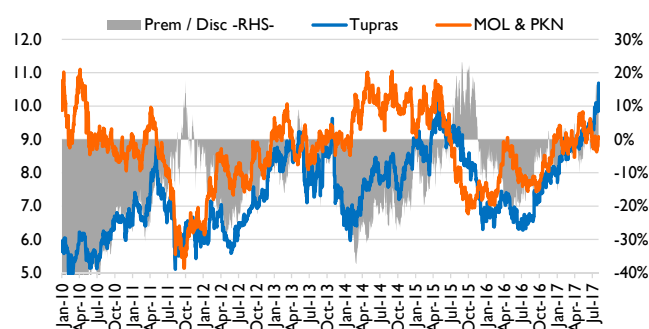
Figure 3: Tupras one-year-fwd EV/EBITDA multiple



Source: Bloomberg Finance LP

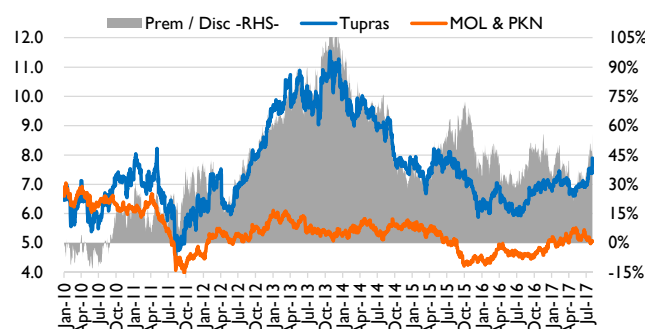
Tupras tends to trade at a premium to its peers on EV/EBITDA multiples, due to its higher FCF generation capability, together with higher ROE, ROIC and dividend yield. As we expect these metrics to improve in the coming years, we think the company's multiples should continue to trade at a premium. On P/E, however, Tupras has been trading in line with PKN and MOL, which we see as the best benchmarks within the refining space. We believe the argument for an EV/EBITDA multiple premium is also valid for P/E, and that Tupras should in fact trade at a premium vs its peers.

Figure 4: Tupras historical P/E multiple vs peer group



Source: Bloomberg Finance LP

Figure 5: Tupras historical EV/EBITDA multiple vs peer group



Source: Bloomberg Finance LP

Risks

We believe that refining capacity in Turkey and the region and refining trends and margins – represent the most significant downside risks to our valuation. A company-specific downside risk is the competitive landscape if more than one refinery is built in Turkey. Currently, SOCAR is in the process of building a 10m ton refinery in Petkim's Aliaga complex, which is scheduled to be operational by 2019.

Although there is a weak relationship between crude prices and refining margins, Tupras' profitability is highly dependent on the level of crude prices. EBITDA generation is also largely dependent on the price differential between diesel, gasoline, jet-fuel and other derivatives, such as fuel oil.

The Competition Board fined Tupras, together with its petroleum distribution company Opet, in 2014 for abusing its dominant market position in the Oil & Gas sector. The potential for similar fines being imposed constitutes another important risk for the company, in our view.

Companies Mentioned (Price as of 1 Aug 2017)
 Tupras (TUPRS.IS, BUY, TP TL128.0)

Disclosure Appendix

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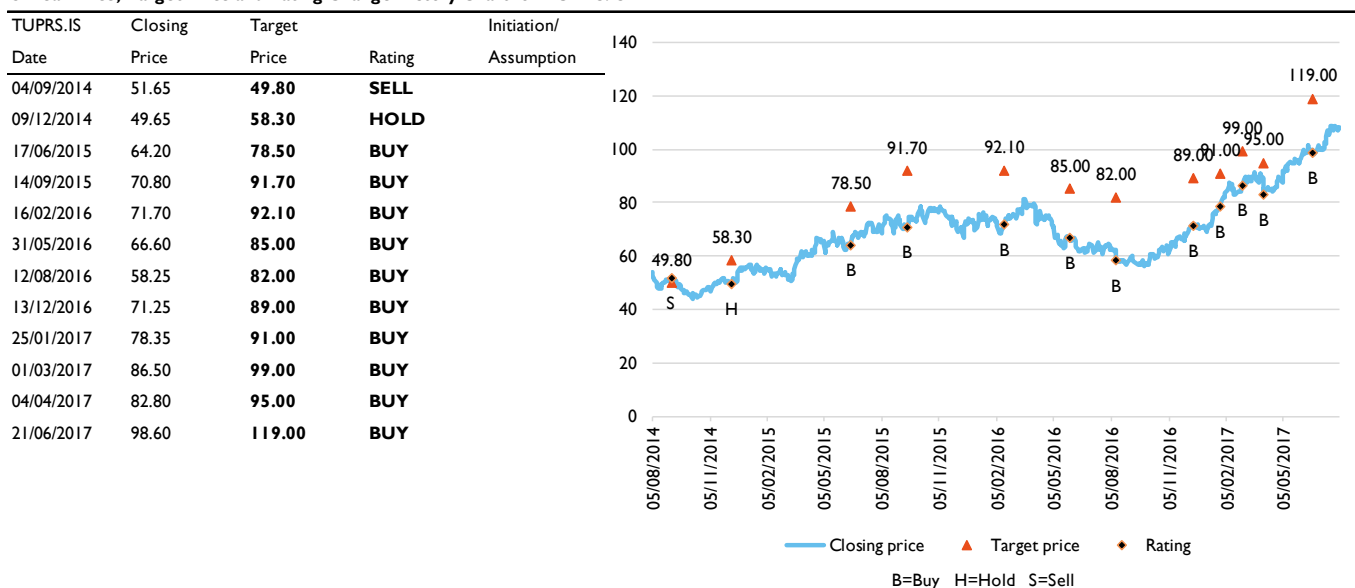
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3-Year Price, Target Price and Rating Change History Chart for TUPRS.IS



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