TURKEY
e.research@burgansecurities.com
+90 212 317 2727

August 12, 2016

2Q16 EARNINGS REVIEW

TUPRAS (TUPRS TI)

# Weak margins prompt earnings miss

## BUY (L/T) MARKETPERFORM (S/T)

| | | | |
|---|---|---|---|
| Current Price (TRL) | 62.45 | Target Price (TRL) | 80.0 (Prev:85.0) |
| Market Cap (TRL / US$ mn) | 15,639 / 5,280 | 12M Abs / Rel Return (%) | -9 / -10 |
| P/E (2016E) | 12.5x | EV/EBITDA (2016E) | 8.9x |

| (TRLmn) | 2Q16 | 2Q15 | yoy Δ | Burgan Estimate | Consensus |
|---|---|---|---|---|---|
| Revenues | 8,453 | 10,601 | -20% | 9,193 | 8,346 |
| EBITDA | 633 | 1,050 | -40% | 854 | 735 |
| *EBITDA Margin* | *7.5%* | *9.9%* | *-2.4 pp* | *12.0%* | *8.8%* |
| Net Earnings | 331 | 710 | -53% | 560 | 453 |

### 2Q16 Results at a Glance

- **Impact of weaker cracks once again exceeds estimates -** Tupras posted TRL331mn net profit for 2Q16, much weaker than both consensus (TRL453mn) and our estimate (TRL560mn). The earnings miss was attributable mainly to a more pronounced negative impact from crack margins, with lower revenues and gross margin leading to a softer operating performance. EBITDA of TRL633mn remained short of both consensus (TRL735mn) and our estimate (TRL854mn).

- **Management lowers FY16 net refining margin guidance by US$1.0/bbl -** Management revised down its net refining margin guidance by US$1/bbl to US$4.5-5.0/bbl, compared to Med Complex margin expectation of US$3.5-4.0/bbl, in line with our estimate of US$4.8/bbl, which we revise down by US$0.2/bbl. Management kept the rest of its guidance unchanged.

### Our View

- **Disappointing set of results; 2016 now a lost year -** The qoq recovery fell short of our expectations. And with dismal crack margins in July and August so far, 3Q16 does not seem any different, either. We slash our FY16 EBITDA estimate from TRL3.08bn to TRL2.5bn, and net earnings from TRL1.6bn to TRL1.2bn. 2016 multiples now seem unattractive with our revised estimates. Nevertheless, assuming conservative crack margins in 2017 and beyond, the stock would be cheap for the L/T. Hence, while our L/T rating remains a BUY, we **cut our S/T rating from OUTPERFORM to MARKETPERFORM -** considering likely weakness in the near term - and slash our TP from TRL85 to TRL80. A rebound in the share price would require a reversal in crack margins, whose timing seems difficult to guess, in our view.

### Comments

- **Volumes in line; revenues lower on weaker price ratios -** Sales volumes grew 5% yoy to 7.7mn tonnes, in line with our estimate, while CUR was realised at 95%, down from 99% a year ago. Sales to the domestic market (84% in 2Q16 vs. 74% in 2Q15) rose, thanks to stronger middle distillate demand, particularly in diesel. Domestic volumes were up by 19%, while export contracted by 35%. Weak Med FOB price ratios, which Tupras applies for domestic pricing, had a more severe negative impact on revenues, which were 8% shy of our estimate. Gasoline and diesel prices were c.27% lower yoy in US$, around 5% weaker than our estimate. Middle distillate yield recovered from 45% in 1Q16 to 51% in 2Q16, as RUP became fully on line.

- **Weaker inventory gains than estimated -** Inventory gains totalled US$117mn, lagging our US$166mn estimate. There was a gradual increase in oil prices in the quarter, which helped Tupras to completely erase 1Q16's US$22mn inventory loss. Assuming steady oil prices at current US$46/bbl, Tupras would incur a minor inventory loss in 3Q16.

- **Refining margins remain anaemic; weakness in diesel cracks persists in 3Q16 -** Net refining margin of US$5.2/bbl was even slightly above our estimate of US$4.5/bbl, while being well below last year's US$7.5/bbl. Benchmark Med margin, meanwhile, stood at US$3.2/bbl, down from US$4.9/bbl a year ago. Diesel cracks rebounded from the lows in 1Q16 slightly to US$8.6/bbl, still well below last year's US$15/bbl levels, due to persisting demand weakness and supply glut driven by independent Chinese producers. The diesel crack margin remains at around US$7-8/bbl levels despite peak summer months, at the lowest levels since the global crisis period of 2008. Management thinks current price levels are exceptionally low and temporary, and that margins should normalise in the coming quarters.

Murat Ignebekcili
murat.ignebekcili@burgansecurities.com
+90 212 317 2761

- **Non-operational items broadly in line -** Net other and financial expenses totalled TRL152mn vs. our TRL139mn estimate, while subsidiary income of TRL54mn exceeded our TRL25mn estimate. A higher effective tax also contributed around TRL50mn to the divergence versus our estimate in net income.

**Tupras - Announced Financials (IFRS Basis; TRLmn)**

| *Income Statement* | *1H16* | *1H15* | *YoY Δ* | *2Q16* | *2Q15* | *YoY Δ* | *1Q16* | *QoQ Δ* |
|---|---|---|---|---|---|---|---|---|
| **Net Sales** | ***14,645*** | ***17,549*** | **-17%** | ***8,453*** | ***10,601*** | **-20%** | ***6,191*** | **37%** |
| COGS | -13,512 | -15,925 | -15% | -7,728 | -9,472 | -18% | -5,701 | 36% |
| **Gross Profit** | **1,132** | **1,624** | **-30%** | **725** | **1,129** | **-36%** | **491** | **48%** |
| Operating Exp. | -455 | -364 | 25% | -228 | -192 | 19% | -227 | 1% |
| **Operating Profit** | **678** | **1,261** | **-46%** | **497** | **938** | **-47%** | **264** | **88%** |
| **EBITDA** | **947** | **1,446** | **-34%** | **633** | **1,050** | **-40%** | **398** | **59%** |
| Net Other Income | 89 | -287 | n.m. | -4 | -68 | -94% | 10 | n.m. |
| Net Gain from Investments | -0 | 0 | n.m. | 0 | 0 | n.m. | -0 | n.m. |
| Income from Associates | 69 | 9 | n.m. | 54 | 32 | 68% | 15 | 266% |
| Net Financial Exp | -341 | -303 | 13% | -148 | -192 | -23% | -192 | -23% |
| Taxes | -76 | 311 | n.m. | -64 | 4 | n.m. | -13 | n.m. |
| Discont. Operations | 0 | 0 | n.m. | 0 | 0 | n.m. | 0 | n.m. |
| Minority Interest | -9 | -6 | 38% | -4 | -3 | 42% | -4 | 7% |
| **Net Profit** | **409** | **985** | **-58%** | **331** | **710** | **-53%** | **79** | **n.m.** |
| **Margins** | | | | | | | | |
| *Gross* | *7.7%* | *9.3%* | *-1.5 pp* | *8.6%* | *10.7%* | *-2.1 pp* | *7.9%* | *0.7 pp* |
| ***EBITDA*** | ***6.5%*** | ***8.2%*** | ***-1.8 pp*** | ***7.5%*** | ***9.9%*** | ***-2.4 pp*** | ***6.4%*** | ***1.0 pp*** |
| *Operating* | *4.6%* | *7.2%* | *-2.6 pp* | *5.9%* | *8.8%* | *-3.0 pp* | *4.3%* | *1.6 pp* |
| *Eff. Tax Rate* | *17.9%* | *n.m.* | *n.m.* | *18.5%* | *n.m.* | *n.m.* | *15.7%* | *2.8 pp* |
| ***Net*** | ***2.8%*** | ***5.6%*** | ***-2.8 pp*** | ***3.9%*** | ***6.7%*** | ***-2.8 pp*** | ***1.3%*** | ***2.6 pp*** |
| *Balance Sheet* | *1H16* | *1H15* | *YoY Δ* | *2Q16* | *2Q15* | *YoY Δ* | *1Q16* | *QoQ Δ* |
| Cash & Mkt. Sec. | 4,600 | 2,787 | 65% | 4,600 | 2,787 | 65% | 4,638 | -1% |
| Fin. Debt | 11,518 | 9,710 | 19% | 11,518 | 9,710 | 19% | 11,035 | 4% |
| **Net Debt** | **6,918** | **6,923** | **0%** | **6,918** | **6,923** | **0%** | **6,397** | **8%** |
| Accounts Rec. | 2,595 | 1,690 | 54% | 2,595 | 1,690 | 54% | 1,955 | 33% |
| Inventories | 2,582 | 2,783 | -7% | 2,582 | 2,783 | -7% | 2,225 | 16% |
| Accounts Payable | 4,837 | 4,528 | 7% | 4,837 | 4,528 | 7% | 3,441 | 41% |
| LT Assets | 16,868 | 16,095 | 5% | 16,868 | 16,095 | 5% | 16,750 | 1% |
| LT Liabilities | 8,300 | 8,557 | -3% | 8,300 | 8,557 | -3% | 8,527 | -3% |
| **Total Assets** | **27,279** | **24,341** | **12%** | **27,279** | **24,341** | **12%** | **26,158** | **4%** |
| **Equity (Cont. Int.)** | **7,233** | **6,919** | **5%** | **7,233** | **6,919** | **5%** | **8,467** | **-15%** |
| *Cash Flow Statement* | *1H16* | *1H15* | *YoY Δ* | *2Q16* | *2Q15* | *YoY Δ* | *1Q16* | *QoQ Δ* |
| Free Cash Flow | 1,618 | -1,976 | n.m. | 1,455 | -430 | n.m. | 163 | n.m. |
| Net Cash from Operations | 1,990 | -1,467 | n.m. | 1,606 | -240 | n.m. | 384 | n.m. |
| Net Cash from Investments | -373 | -509 | -27% | -151 | -190 | -20% | -222 | -32% |
| **Financial Ratios** | *1H16* | *1H15* | *YoY Δ* | *2Q16* | *2Q15* | *YoY Δ* | *1Q16* | *QoQ Δ* |
| Debt/Equity | 159.2% | 140.3% | 18.9 pp | 159.2% | 140.3% | 18.9 pp | 130.3% | 22% |
| Receivable Days | 32 | 17 | 15 | 56 | 29 | 27 | 29 | 4 |
| Inventory Days | 35 | 32 | 3 | 61 | 53 | 8 | 36 | -1 |
| Payable Days | 65 | 51 | 14 | 114 | 87 | 27 | 55 | 10 |
| Net Work. Cap. Days | 2 | -2 | 4 | 3 | -4 | 7 | 9 | -7 |

*Source: Burgan Research, The Company*

# Burgan Securities - Equity Rating System

## 12-month Rating:

**Our 12-month rating system comprises the following designations: BUY (B), HOLD (H), SELL (S).** The absolute upside to target value implied by the current market capitalisation is the main determinant of our rating system. Valuation tools employed most frequently are Discounted Cash Flow (DCF) and international peer group comparison, though other metrics such as historical relative valuation, price to book, return on equity, replacement value are also used wherever appropriate. Our analysts set the fair/target values with a 12-month investment horizon. Comparing the upside in a specific stock with the market's upside (determined through the aggregate upside of our coverage based on free float Mcaps), in addition to taking other yardsticks into consideration, analysts recommend BUY (B), HOLD (H), SELL (S) based on their 12-month total return views.

## Sector Rating

Our investment horizon for industry ratings is again 12 months. This rating gives an indication as to how the analyst sees that particular industry for the next 12-month period in terms of growth, profitability, pricing power, competitive dynamics etc. The rating in this category thus reflects our analyst's assessment of the conjunctural outlook for the industry, without involving any specific benchmarks. The ratings employed are **Overweight (OW), Neutral (N), Underweight (UW).**

**Overweight (OW):** Due to improving sector related fundamentals and/or attractive valuations, the sector index is expected to perform better than the BIST-100 in the next 12-months

**Neutral (N):** The sector index is expected to perform in line with the BIST-100 in the next 12-months

**Underweight (UW):** Due to worsening sector related fundamentals and/or expensive valuations, the sector index is expected to perform worse than the BIST-100 in the next 12-months

## Short-term Rating:

Our short-term rating system comprises the following designations: OUTPERFORM (OP), MARKETPERFORM (MP), UNDERPERFORM (UP). Considering possible triggers, catalysts, and/or company, sector & market views, we rate the stocks as:

| S/T Stock Rating Summary | Relative Return |
|---|---|
| **Outperform (OP)** | >=10% |
| **Marketperform (MP)** | <+10% & >-10% |
| **Underperform (UP)** | <=-10% |

**Outperform (OP):** If 3-month total return is expected to exceed the BIST-100 (sector index if specified) by more than 10%

**Marketperform (MP):** If 3-month total return is expected to be in line (+/- 10%) with the BIST-100 (Peerperform if sector index is specified)

**Underperform (UP):** If 3-month total return is expected to be below the BIST-100 (sector index if specified) by more than 10%

*To have a more balanced distribution of ratings, Burgan Securities has requested that analysts maintain* ***at least 20% of their ratings as Underperform*** *and* ***no more than 25% as Outperform****, subject to change depending on market conditions.*

## Other Qualifiers Utilised:

**NR**: Not Rated

**NC:** Not Covered

**UR:** Under Review

## Market Call

Our equity **market call** has an investment horizon of 3-12 months. **Our market calls are** BUY, NEUTRAL, SELL.

Eski Buyukdere Cad.
Güney Plaza
No: 13 Maslak, Istanbul
Tel: +90 212 317 2727
Fax: +90 212 317 2726
info@burgansecurities.com

Burgan Securities is a prominent investment firm active in the fields of brokerage, corporate finance and asset management in Turkish capital markets. Our firm, a member of Burgan Group, one of the leading financial institutions of Kuwait, caters to the entirety of domestic/international retail/institutional investor spectrum. Supporting our corporate finance and institutional sales activities is a highly qualified research team that offers premium quality and timely research products covering a broad array of sectors and companies. Our corporate finance activities comprise mergers and acquisitions, as well as private and public equity and debt transactions. Our new product development activities are centred around derivative products, along with online trading platforms for retail clients.

**Burgan Securities' goal is to be the investment firm of choice in Turkey through exemplary service and product quality, with a view to becoming a regional player.**

**INSTITUTIONAL SALES** (sales@burgansecurities.com)

| | | | |
|---|---|---|---|
| Tolga Atac | Head of Sales & Trading | tolga.atac@burgansecurities.com | +90 212 317 2770 |
| Can Yazgan | Head of Sales | can.yazgan@burgansecurities.com | +90 212 317 2757 |
| Canan Uras | Sales & Trading | canan.uras@burgansecurities.com | +90 212 317 2825 |
| Aysegul Yilmaz | Sales & Trading | aysegul.yilmaz@burgansecurities.com | +90 212 317 2759 |
| Burak Demircioglu | Sales & Trading | burak.demircioglu@burgansecurities.com | +90 212 317 2765 |

**RESEARCH**

| | | | |
|---|---|---|---|
| Nergis Kasabali | Head of Research | nergis.kasabali@burgansecurities.com | +90 212 317 2753 |
| Lolita Haleva | Editor | lolita.haleva@burgansecurities.com | +90 212 317 2704 |

**Equity Research** (e.research@burgansecurities.com)

| | | | |
|---|---|---|---|
| Duygun Kutucu, CFA | Banking & Insurance | duygun.kutucu@burgansecurities.com | +90 212 317 2784 |
| Burak Isyar, CFA | Aviation & Consumers | burak.isyar@burgansecurities.com | +90 212 317 2709 |
| Murat Ignebekcili | Industrials & Telecom | murat.ignebekcili@burgansecurities.com | +90 212 317 2761 |
| Ismail Ozer | Quantitative Analysis | ismail.ozer@burgansecurities.com | +90 212 317 2705 |
| Nuray Apari | Database Manager | nuray.apari@burgansecurities.com | +90 212 317 2707 |
| Ozge Uysaler | Assistant Associate | ozge.uysaler@burgansecurities.com | +90 212 317 2832 |

**Macroeconomic Research** (m.research@burgansecurities.com)

| | | | |
|---|---|---|---|
| Asli Savranoglu | Chief Economist | asli.savranoglu@burgansecurities.com | +90 212 317 2866 |