

## Tupras

Reduce 2014 earnings estimate and PT following fine of TRY412m from Turkish Competition Authority

We cut 2014E net income (adj) by 47% as we incorporate TRY412m of fines from the Turkish Competition Authority (TCA) assuming the company has to pay this fine in full in 2014. We now forecast 2014 net income (Adj.) of TRY465m (from TRY877m). Following the reduction to earnings estimates, our reduced Dec14 PT is TRY51.6m (from TRY53.3). We await more details from TCA on the fine but we remain concerned about some macro uncertainty in the near term (*see note*). On valuation, post 2014E earnings cut, Tupras shares now trade on 23x and 7.2x for '14/15e adjusted P/E vs its global peer average 11.5x/10.5x.

- TRY412m fine from TCA and other ongoing investigations.** Last week, Tupras was fined TRY412m by TCA (Bloomberg and other sources). The investigation was initially launched in July 2012 to determine whether Tupras misused its dominant position in the Turkish market during the 2008 world financial crisis. Separately, in 2013, Turkish tax authorities raided Tupras in an investigation into claims regarding counterfeit fuel products. However, in our view, comments from the Turkish energy minister in Sep13 stating 'samples' were clean reduced the risk of a potentially meaningful fine but the results of other technical inspections are still pending.
- Sensitivity to PT to a potential fine due to ongoing investigations.** Our analysis suggests PT would reduce by about 1% for every TRY100m of potential fine.
- Lower DPS for 2014E.** Following reduction in 2014 earning estimates, now we forecast 2014 DPS of TRY1.8 (from TRY3.25), implying dividend yield of 4.2%. We maintain our 2015 DPS forecast of TRY4, implying dividend yield of 9.4%. **The trailing 12m yield of >7.5% is the 2nd highest in the BIST-30.**
- Key risks:** higher than expected depreciation in TRY, lower than expected refinery margins, any meaningful fine from ongoing investigations, lower than expected discount between Brent and heavy crude benchmarks, delays/increase in costs for RUP.

### Tupras Turkiye Petrol Rafinerileri AS (TUPRS.IS;TUPRS TI)

FYE Dec	2011A	2012A	2013E	2014E (Prev)	2014E (Curr)
Adj. EPS FY (TL)	4.96	5.82	2.54	3.50	1.86
Revenue FY (TL mn)	40,747	47,033	41,367	43,087	43,087
EBIT FY (TL mn)	1,984	1,079	667	882	882
EV/EBITDA FY	5.3	8.7	15.5	11.8	11.9
P/E (x) FY	8.7	7.4	17.0	12.3	23.2
EV/Revenue FY	0.3	0.2	0.3	0.3	0.3
Div Yield FY	9.1%	9.0%	5.8%	7.6%	4.2%
EBITDA FY (TL mn)	2,233	1,349	909	1,187	1,187

Source: Company data, Bloomberg, J.P. Morgan estimates.

## Overweight

TUPRS.IS, TUPRS TI

Price: TL43.01

▼ **Price Target: TL51.60**  
Previous: TL53.30

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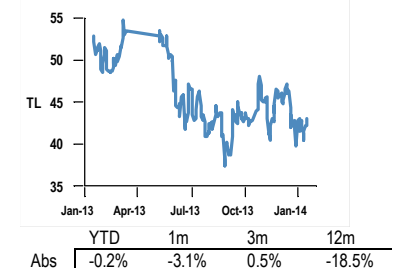
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### Price Performance



### Company Data

Price (TL)	43.01
Date Of Price	17 Jan 14
Price Target (TL)	51.60
Price Target End Date	31-Dec-14
52-week Range (TL)	56.25-36.50
Market Cap (TL bn)	10.77
Shares O/S (mn)	250

See page 6 for analyst certification and important disclosures, including non-US analyst disclosures.

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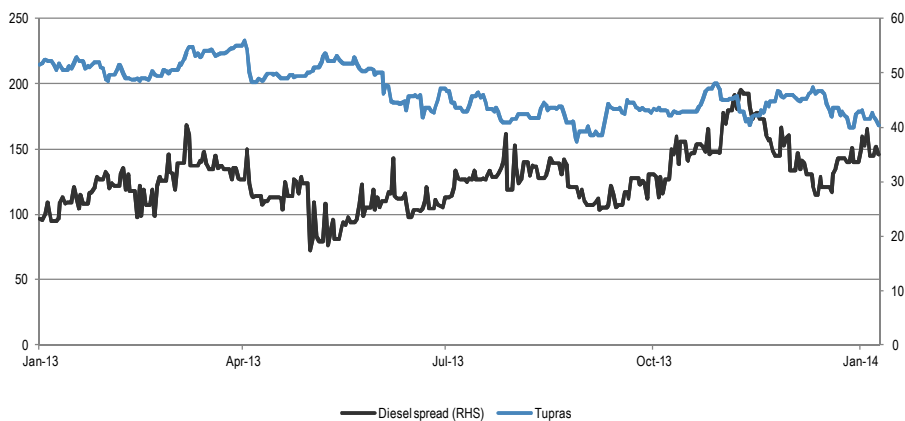
## Financials

Table 1: Tupras: sensitivity of PT to any potential fine from ongoing investigations

Potential Fine (TRYm)	% Change to PT	New Dec 13 PT
100	-1%	51.2
200	-2%	50.8
300	-2%	50.4
400	-3%	50.0
500	-4%	49.6
600	-5%	49.2
700	-5%	48.8
800	-6%	48.4

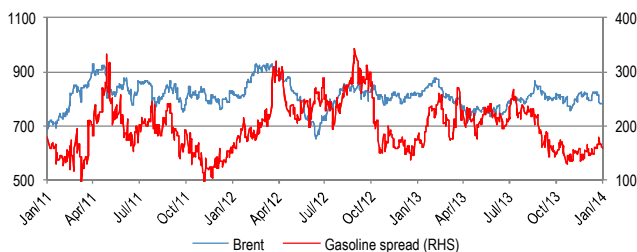
Source: J.P. Morgan estimates.

Figure 1: Tupras share price vs Diesel spread



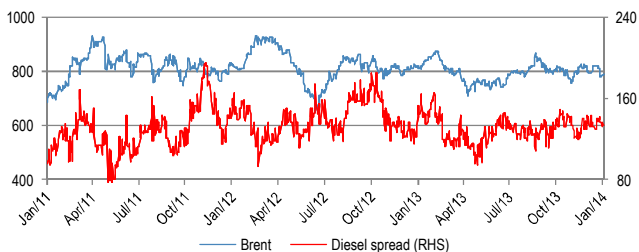
Source: Bloomberg and J.P. Morgan.

Figure 2: Brent vs gasoline spread (\$/t)



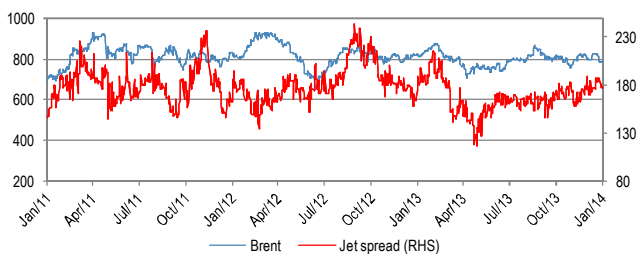
Source: Bloomberg and J.P. Morgan estimates.

Figure 3: Brent vs diesel spread (\$/t)



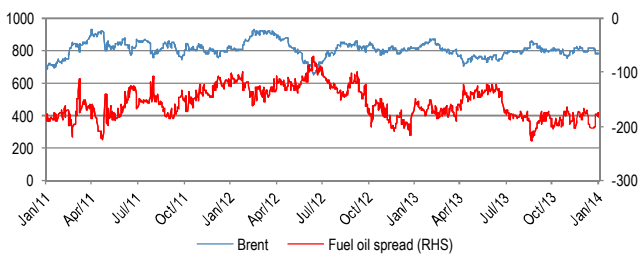
Source: Bloomberg and J.P. Morgan estimates.

Figure 4: Brent vs jet fuel spread (\$/t)



Source: Bloomberg and J.P. Morgan estimates.

Figure 5: Brent vs fuel oil spread (\$/t)



Source: Bloomberg and J.P. Morgan estimates.

Table 2: Tupras- DCF based Dec14 price target of TRY51.6

DCF calculations		
	Fair value Per share TRY	
Tupras EV	17,417	69.6
Net (debt)/cash (14E)	(5,155)	-20.6
Pension deficit & others	(238)	-0.9
Associates	900	3.6
<b>Implied equity value</b>	<b>12,924</b>	<b>51.6</b>

DCF assumptions summary

Terminal growth	3.0%
Terminal NOPAT margin	3.3%
WACC	12.0%

WACC analysis

Cost of equity	13.2
Cost of debt	9.2
Cost of capital	12.0

	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	Terminal
Sales	43,153	44,773	47,034	49,412	51,915	54,549	57,322	60,268	63,366	66,623	70,021	72,121
NOPAT	705	1,462	1,501	1,579	1,661	1,747	1,838	2,013	2,116	2,225	2,339	2,409
Capex	-2,000	-500	-350	-300	-300	-300	-300	-300	-300	-300	-300	-300
Depreciation	305	450	448	420	414	407	397	353	333	300	300	300
Working Capital requirement	-100	-500	-50	-20	-10	-10	-10	-5	-5	-5	-5	-5
<b>Unlevered FCF (pre-restructuring)</b>	<b>-1,089</b>	<b>912</b>	<b>1,549</b>	<b>1,679</b>	<b>1,765</b>	<b>1,844</b>	<b>1,926</b>	<b>2,061</b>	<b>2,145</b>	<b>2,220</b>	<b>2,334</b>	<b>2,404</b>
PV of FCF	9,739											
PV of Residual Value (FCF)	7,678											
<b>Theoretical EV</b>	<b>17,417</b>											

Source: J.P. Morgan estimates.

Table 3: Tupras-profit and loss statement

TRYm

P&L (TRYm)	2010	2011	2012	2013E	2014E	2015E
Sales (net)	26183	40747	47033	41367	43087	44708
Cost of sales (-)	-24384	-38158	-45102	-39866	-41453	-42291
Service income(net)	53	59	66	60	66	66
GROSS PROFIT	1852	2648	1996	1561	1699	2482
% margin	7.1%	6.5%	4.2%	3.8%	3.9%	5.5%
Marketing, selling & distribution expenses (-)	-251	-287	-336	-191	-194	-201
General administrative expenses (-)	-395	-448	-518	-437	-437	-437
Research & development expenses (-)	-9	-4	-12	-16	-16	-16
Other operating income	66	101	48	150	50	0
Other operating expenses (-)	-234	-26	-99	-400	-220	0
OPERATING PROFIT/ (LOSS)	1029	1984	1079	667	882	1827
% margin	3.9%	4.9%	2.3%	1.6%	2.0%	4.1%
Income /(loss) from investments accounted by equity method	-1	5	11	100	103	106
Net financial charges	-99	-447	280	-120	-90	-75
PROFIT BEFORE TAXATION	929	1543	1371	647	895	1859
Income Tax expense	-188	-298	96	938	371	-372
-Tax expense for the period	-193	-258	-249	-12	-18	-372
-Deferred tax income	5	-39	345	949	389	
Provision for fines					-412	
PROFIT FOR THE PERIOD	742	1245	1467	1585	854	1487
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	748	1251	1466	1585	854	1487
Earnings per share	2.98	4.98	5.8	6.3	3.4	5.9
<b>Net profit (adj.)</b>				<b>635</b>	<b>465</b>	<b>1487</b>
<b>EPS (adj.)</b>				<b>2.5</b>	<b>1.9</b>	<b>5.9</b>

Source: Company reports and J.P. Morgan estimates.

## Investment Thesis, Valuation and Risks

### Tupras (*Overweight; Price Target: TL51.60*)

#### **Investment Thesis**

Tupras is independent and the sole refiner in Turkey with a throughput of 28.1m tons and Nelson Complexity index of 7.25. The company serves about 65% of the energy deficient Turkish refined product demand and generates >20% revenues from exports.

We are OW on Tupras. We forecast gross margins to improve more than 150bps by 2016E post RUP. With the 'strategic' project status awarded by the Central government of Turkey to RUP, we expect potential increase in dividends in 2015e as the company benefits from a lower tax rate of 2% vs 20% previously. In addition, RUP was awarded tax incentive of 30% under 'large scale investment' project but with 'strategic' project status Tupras will benefit from a 50% tax incentive. On valuation, Tupras shares trade on 23x and 7.2x for '14/15e adjusted P/E vs its global peer average 11.5x/10.5x. We forecast Tupras's dividend yield to increase from 4.2% to 9.5% from 2013-15e.

#### **Valuation**

We derive our Dec14 PT of TRY51.6 using a DCF approach. Our key assumptions are a terminal growth rate of 3% and weighted average cost of capital of 11.5%.

#### **Risks to Rating and Price Target**

The primary downside risks to our rating and price target include:

- lower than expected product prices and refining margins
- Decreasing discount between Brent and heavy crude oil benchmarks
- Execution risk/cost overrun for RUP and other investment projects.
- Meaningful fine from ongoing investigations
- Lower than expected refined products demand growth

## Tupras: Summary of Financials

Profit and Loss Statement						Cash flow statement					
TL in millions, year end Dec	FY11	FY12	FY13E	FY14E	FY15E	TL in millions, year end Dec	FY11	FY12	FY13E	FY14E	FY15E
Revenues	40,747	47,033	41,367	43,087	44,708	EBIT	1,984	1,079	667	882	1,827
% Change Y/Y	55.6%	15.4%	(12.0%)	4.2%	3.8%	Depreciation & amortization	249	270	242	305	450
Gross Margin (%)	6.5%	4.2%	3.8%	3.9%	5.6%	Change in working capital	(4,135)	1,589	100	(100)	(500)
EBITDA (pre - restructuring)	2,233	1,349	909	1,187	2,278	Taxes	-	-	-	-	-
% Change Y/Y	78.6%	(39.6%)	(32.6%)	30.6%	91.9%	Cash flow from operations	(2,670)	2,819	1,015	715	1,835
EBITDA Margin (%)	5.5%	2.9%	2.2%	2.8%	5.1%	Capex	(699)	(2,330)	(2,300)	(2,000)	(500)
EBIT (pre - restructuring)	1,984	1,079	667	882	1,827	Acquisitions/disposals	23	29	0	0	0
% Change Y/Y	92.8%	(45.6%)	(38.2%)	32.2%	107.2%	Net Interest	(447)	280	(120)	(90)	(75)
EBIT Margin	4.9%	2.3%	1.6%	2.0%	4.1%	Free cash flow	(3,370)	489	(1,285)	(1,285)	1,335
Net Interest	(447)	280	(120)	(90)	(75)	Equity raised/repaid	-	-	-	-	-
Earnings before tax (reported)	1,543	1,371	647	895	1,859	Debt Raised/repaid	(1,523)	2,394	2,000	1,500	0
% change Y/Y	66.0%	(11.1%)	(52.8%)	38.3%	107.7%	Other	(121)	(150)	0	0	0
Tax	(298)	96	938	371	(372)	Dividends paid	0	(985)	(964)	(626)	(451)
Reported tax rate (%)	19.3%	7.0%	144.9%	41.5%	20.0%	Beginning cash	5,613	844	3,249	3,000	2,589
Net Income Rep	1,242	1,459	635	465	1,487	Ending cash	1,244	3,249	3,000	2,589	3,473
% change Y/Y	68.4%	17.5%	(56.4%)	(26.8%)	219.8%	DPS	3.93	3.85	2.50	1.80	4.00
Shares Outstanding	250	250	250	250	250						
Reported EPS	4.96	5.82	2.54	1.86	5.94						
Adjusted EPS	4.96	5.82	2.54	1.86	5.94						
Balance sheet						Ratio Analysis					
TL in millions, year end Dec	FY11	FY12	FY13E	FY14E	FY15E	TL in millions, year end Dec	FY11	FY12	FY13E	FY14E	FY15E
Cash and cash equivalent	1,243	3,249	3,000	2,589	3,473	Net debt	1,104	995	3,244	5,155	4,271
Accounts Receivables	3,544	2,084	2,068	2,154	2,235	EV	11,832	11,755	14,124	14,124	14,124
Inventories	3,659	3,124	3,269	3,316	3,383	EV/Sales	0.3	0.2	0.3	0.3	0.3
Others	618	489	606	606	606	EV/EBITDA	5.3	8.7	15.5	11.9	6.2
Current assets	9,065	8,946	8,944	8,666	9,698	EV/EBIT	6.0	10.9	21.2	16.0	7.7
LT investments	107	798	798	798	798	P/E (adjusted EPS)	8.7	7.4	17.0	23.2	7.2
Net fixed assets	4,089	5,846	7,444	9,139	9,189	FCF yield	(31.3%)	4.5%	(11.9%)	(11.9%)	12.4%
Total assets	14,758	16,464	18,160	19,577	20,659	Dividend per share	3.93	3.85	2.50	1.80	4.00
						Dividend Yield	9.1%	9.0%	5.8%	4.2%	9.3%
Liabilities						EPS growth	67.7%	17.5%	(56.4%)	(26.8%)	219.8%
ST loans	929	552	552	552	552	Net debt /EBITDA	49.5%	73.8%	356.9%	434.3%	187.5%
Payables	5,548	5,064	4,964	4,740	4,918	Interest coverage (x)	4.4	(3.8)	5.6	9.8	24.4
Others	1,909	2,268	2,225	2,225	2,225	Net debt to Total Capital	20.0%	16.9%	40.7%	51.4%	42.5%
Total current liabilities	8,386	7,885	7,741	7,517	7,695	Net debt to equity	25.1%	20.4%	68.6%	105.9%	74.0%
Long term debt	1,212	3,540	5,540	7,040	7,040	ROCE	23.6%	12.6%	(3.0%)	4.4%	11.2%
Other liabilities	755	151	150	150	150						
Total liabilities	10,352	11,575	13,431	14,707	14,885						
Shareholders' equity	4,406	4,890	4,729	4,870	5,774						
Total Liabilities and Shareholder Equity	14,758	16,464	18,160	19,577	20,659						

Source: Company reports and J.P. Morgan estimates.

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Tupras (TUPRS.IS, TUPRS TI) Price Chart



Date	Rating	Share Price (TL)	Price Target (TL)
10-May-07	N	21.43	40.00
13-May-07	OW	22.30	40.00
18-Oct-07	OW	23.65	--
23-Sep-09	OW	24.70	30.30
16-Nov-09	OW	27.25	34.10
18-Nov-11	N	38.20	34.10
21-May-13	UW	51.75	48.00
12-Jun-13	N	44.70	48.00
05-Nov-13	OW	45.30	55.00
15-Jan-14	OW	42.90	53.30

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
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