

# Alarko Holding

**OUTPERFORM**

Current price: TRY4.52  
12-mo T.Price: TRY5.60

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## Financing completed for Karabiga

- **Cenal secured a US\$765mn loan for the Karabiga project.** Cenal, the 50%-50% JV between Alarko Holding and Cengiz Group, secured a US\$765mn loan with a 12 year maturity for its 1,320MW coal-fired power plant project (Karabiga, Canakkale/Turkey). Denizbank, Halkbank, Finansbank and Ziraat Bank contributed equally to the loan package. It had been reported that Cenal had signed a EUR180mn EPC agreement with Alstom regarding the engineering and equipment supply for the power plant on 29<sup>th</sup> September. An initial US\$200mn loan for the US\$1.2bn power plant project had previously been secured in 2Q13. The project, which is expected to enter operation in 2018, constitutes 20% of Alarko's target NAV, according to our forecasts.

- **In our view, the completion of financing would convince investors regarding the feasibility of the project.** Following the news, we have revised down our holding discount from 50% to 40%. As a result, we have revised up our 12-month target price to TRY5.60 per share (from TRY4.65) and upgraded our rating from Neutral to Outperform. The shares have underperformed the BIST-100 Index by 16% in the last 6 months, mainly due to the uncertainty surrounding the Karabiga project as well as concerns regarding the contracting segment.

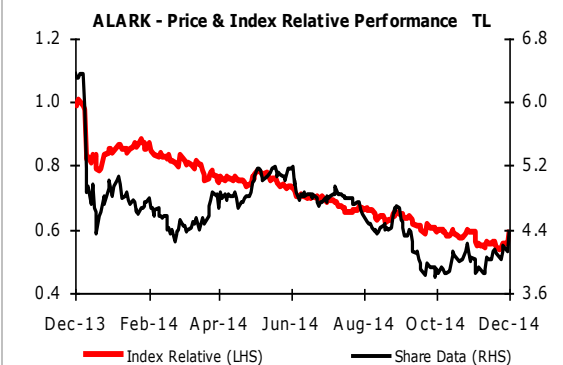
- **Potential contracting projects could be a short-term catalyst.** Alarko's latest backlog is US\$298mn. Any positive developments in the TANAP project (composed of 3 lots with total size of US\$1.5-2bn), Qatar mega reservoir project (composed of 5 stages with a total size of US\$4.5bn-5bn), Baltic urea plant project (US\$250mn), Ethylene cracker and PE plant project (US\$300-500mn) or Moscow refinery modernization project (US\$300mn) would serve as short-term catalysts for the shares.

- **Risks.** Despite clauses in the contracting agreements regarding the projects in Kazakhstan, we may observe some fluctuations in Alarko's operating margins depending on when and if the compensation for the Kazakh Tenge devaluation is forthcoming. Furthermore, any possible court ruling against the environmental permit for Karabiga may result in a delay in construction activities. However, we would not expect this to have a major impact on our valuation, considering the previous two cases (i.e. the time between the cancellation of environmental permit and the company receiving a new permit).

### Stock Data

Ticker (Reuters, Bloomberg)	ALARK.IS, ALARK.TI
Market Cap. (TLmn)	1,010
Number of Shares (000)	223,467
Free Float	28%
Daily Vol. (3 Month, TRY thou)	9.7
Solo Net Cash (2014/09, TRYmn)	165
BIST-100 Index (TL)	84,126 / 37,216

Stock data is as of 09 December 2014



### Stock Performance

	1W	1M	3M	1Y
TL	9.7%	12.4%	0.7%	-28.2%
Index Rel.*	10.7%	3.9%	-4.9%	-37.9%

\* vs. BIST Total Return Index

### Forecasts (TLmn)

	2013	2014F	2015F	2016F
Net Sales	1,261	891	724	795
Net Profit	184	6	82	109
P/B	0.9	0.9	0.8	0.7
P/E	5.5	n.m.	12.3	9.3

### Shareholding Structure

Alaton Family	35.37%
Garih Family	33.23%
Other	3.25%
Free Float	28.15%

## **INVESTMENT THEME**

Alarko Holding announced that Cenal, the 50%-50% JV between Alarko and Cengiz Group, had secured a US\$765mn loan for the Karabiga project. The company shares have underperformed the BIST-100 Index by 16% in the last 6 months, mainly due to the uncertainty surrounding the Karabiga project (stemming from the legal appeals against the project's environmental permits and, accordingly, the extended negotiations for the financing) in addition to concerns over the contracting segment (negative impact from the devaluation of the Kazakh Tenge, write-offs of receivables for the completed and cancelled projects, and the lack of project additions to the backlog). In our view, the completion of financing would convince investors regarding the feasibility of the project. Following the news, we revised down our conservative holding discount from 50% to 40% and revised up our 12-month target price to TRY5.60 per share (from TRY4.65) while upgrading our rating to Outperform (from Neutral). Furthermore, any positive developments regarding the TANAP project could serve as a short-term catalyst for the company shares.

**Cenal secured a US\$765mn loan for Karabiga project.** Cenal, the 50%-50% JV between Alarko Holding and Cengiz Group, secured a US\$765mn loan with 12 years maturity for its 1,320MW coal-fired power plant project (Karabiga, Canakkale/Turkey). Denizbank, Halkbank, Finansbank and Ziraat Bank equally contributed to the loan package. According to previous press reports, Cenal had signed a EUR180mn EPC agreement with Alstom regarding the engineering and equipment supply for the power plant on 29 September, 2014. An initial US\$200mn loan for the US\$1.2bn power plant project had previously been secured in 2Q13. The project, which is expected to enter operation in 2018, constitutes 20% of Alarko's target NAV, according to our estimates.

Note that the negotiations for the financing of the power plant had been extended due to the legal appeals lodged against the award of the environmental permit for the project. The court had ruled to cancel the environmental permit twice (the first time being in September 2013 and the second time in May 2014 after the company received revised environmental permit in December 2013). Finally, the Ministry for the Environment had approved the revised environmental impact assessment (EIA) in October 2014, which paved the way for the finalization of financing negotiations for the US\$765mn loan package. Although preparations for the project had continued during the valid environmental permit periods, there were concerns surrounding the feasibility of the project due to the ongoing legal cases. However, the completion of financing negotiations for the project will reassure investors of the project's feasibility.

**Following the news, we have trimmed our conservative holding discount from 50% to 40%.** Our sum-of-the-parts valuation yields a 12-month TP of TL5.60 per share. We value Alsim, Alcen, Altek, and Cenal on a DCF basis (risk free rate of 5.70% and risk premium of 5% in US\$ terms). We have utilized the Mcap of listed Alarko REIT and Alarko Carrier, the NAV of Alarko Konut and the book value of Alfarm and Attas. In our valuation of Mos Alarko, we employed a rental yield of 9%. Meanwhile, we apply a 40% holding discount in the valuation of Alarko Holding.

Alarko Holding – Valuation							
Company	Business	Valuation method	Equity Value (US\$ mn)	Stake	Alarko's stake	% of NAV	
Alsim	Contracting	DCF	199	100%	199	23%	
Alarko REIT	Land Development	Mcap	93	51%	48	5%	
Alarko Konut (Prev: Alarko Deyaar)	Land Development	NAV	40	100%	40	5%	
Mos Alarko	Real Estate	Rent yield @9%	39	50%	19	2%	
Alcen	Elect. Dist.	DCF	375	50%	188	22%	
Altek	Elect. Gen.	DCF	46	100%	46	5%	
Cenal	Elect. Gen. (Karabiga)	DCF	347	50%	174	20%	
Alarko Carrier	Industry & Trade	Mcap	169	43%	73	8%	
Alfarm	Sea Food	BV	4	50%	2	0%	
Attas	Tourism	BV	9	100%	9	1%	
Holding only net cash (US\$ mn)					72	8%	
12M Target NAV					868		
12M Target Mcap (NAV@40% holding discount, US\$m)					521		
Target Mcap (TL mn)					1,250		
12m TP (TL per share)					5.60		
Upside					24%		

Source: Ak Investment estimates

**Potential contracting projects may serve as a short-term catalyst.** Alarko's latest backlog stands at US\$298mn. The projects below will serve as a short term catalyst for the shares. We forecast US\$200mn of revenue and a 6.0% EBITDA margin for the contracting segment in 2015. Any positive developments regarding potential projects might bring new upside to our forecasts.

- The TANAP pipeline project is composed of 3 lots with a total estimated size of US\$1.5-2bn. Alarko is waiting the results of the tender held on 6<sup>th</sup> November, to be announced by the end of 2014. Furthermore, there will be a 4th lot of the same project with an estimated average size of US\$500mn. However no details have been announced regarding the schedule.
- Qatar mega reservoir and pumping station project: The total size of the project is US\$4.5bn-US\$5bn, composed of 5 stages. The company had bid for the tender on 18<sup>th</sup> September and is awaiting the announcement of the results.
- Baltic urea plant construction project (Russia): The Alarko - Ustay Construction (equal weight) JV had bid in the tender with a project size of US\$250mn on 25<sup>th</sup> September and is awaiting the announcement of the results.
- Ethylene cracker and PE plant project (TACE) in Turkmenistan: The total estimated size of the project is US\$300-500mn. Alarko bid for the tender on 15<sup>th</sup> October and is awaiting the announcement of the results.
- The modernization project for the Moscow refinery: The Alarko - Ustay Construction (equal weight) JV had bid for the tender with a project size of US\$300mn on 27<sup>th</sup> November, and is awaiting the announcement of the results.
- The JV between Alarko-Tecnimont S.p.A. is among the prequalified bidders for the construction of the compressor and measurement stations for the TANAP. It is currently estimated that there will be two stations (with a total project size of

US\$800mn – US\$1,000mn) to be constructed. However, no details have been announced as to whether the project will be split into two parts.

Alarko Holding – Backlog (US\$mn)							
Projects	Partners	Location	Contract Size	Alarko Portion	Completion	Construction Period	Backlog (US\$ mn)
Taksim-Yenikapi Subway Proj.	Alarko-Hyundai	Istanbul	280	53%	99.4%	2007-14	1
Levent - Ayazaga Subway Proj.	Alarko-Makyol	Istanbul	447	50%	98.0%	2008-14	5
Levent - Hisarustu Subway Proj.	Alarko-Makyol	Istanbul	132	50%	81.1%	2012-14	12
Ankara Subway Proj.	Alarko-Ansaldo	Ankara	304	47%	98.8%	2011-14	2
Bozshakol Copper Ore Plant Proj.	Alarko	Kazakhstan	490	100%	97.6%	2011-14	12
Taldykol Sewer Pond (3rd stage)	Alarko	Kazakhstan	98	100%	1.0%	2012-15	97
Taldykol Sewer Pond (4th stage)	Alarko	Kazakhstan	48	99.40%	81.2%	2012-15	9
Taldykol Sewer Pond (5th stage)	Alarko	Kazakhstan	142	100%	12.2%	2013-17	125
Aktau-Manasha Highway- LOT 1	Alarko	Kazakhstan	40	100%	60.3%	2012-14	16
Aktau-Manasha Highway- LOT 2	Alarko	Kazakhstan	40	100%	79.5%	2012-14	8
Aktau-Manasha Highway- LOT 3	Alarko	Kazakhstan	35	100%	87.2%	2012-14	5
Aktau-Manasha Highway- LOT 4	Alarko	Kazakhstan	39	100%	81.4%	2012-15	7
<b>Total</b>							<b>298</b>

Source: Alarko

**A weak 2014 operating performance due to one-offs.** The company's 2014 operating performance was weaker than expected, mainly due to write-offs regarding receivables of the completed and cancelled projects in Ukraine, Morocco, and Kazakhstan (Aktogay and Bozshakol projects). We have revised down our 4Q14 estimates slightly, mainly due to the potential negative impact from the Bozshakol project (Kazakhstan). Our 2015 forecasts conservatively assume US\$200mn in revenue for the contracting segment and an EBITDA margin of 6% (compared to the management guidance of a 9-12% margin).

The majority (93%) of the company's latest backlog of US\$298mn is composed of contracting projects in Kazakhstan. The devaluation of the Kazakh Tenge has hit the company's operating margins. Despite clauses in the contracting agreements protecting the company from any weakness in the Kazakh Tenge, it may take some time for the company to obtain compensation. In our view, our conservative EBITDA margin forecast largely takes account of the temporary weakness in operating margins in the contracting segment.

Furthermore, the company's Karakuz (76MW) hydro power plant project is expected to enter operation in 1H15, and we expect it to be up and running by July 2015. An earlier than expected start of operations may pose an upside challenge to our forecasts.

Revisions to forecasts						
TL mn	Previous		New		Consensus	
	2014F	2015F	2014F	2015F	2014F	2015F
Revenues	892	700	891	724	917	901
Net profit	12	82	6	82	53	95

Source: Ak Investment Forecasts, Bloomberg

**Alarko is among the bidders for thermal power plant privatization tenders.** The Privatization Administration announced that there were 4 bidders for the privatization tenders of Orhaneli (210MW) & Tuncbilek (365MW) lignite fired power plants (i.e. power plant asset sales and transfer of operating rights for the related lignite mines) yesterday.

These are Alarko, Bereket Enerji, Konya Seker, and Celikler Taahhut. Although the date for auction has not been announced yet, considering the previous cases we think that it would be held in 2-3 weeks following the collection of bids. Note that Alarko is also interested in the privatization tender for Soma B (990MW) lignite fired power plant (i.e. power plant asset sale), the bidding deadline of which is 19/12/2014. Any positive news regarding the tender could be a short-term catalyst for the company shares.

**Al-Riva Project remains an upside challenge.** The Court of Appeals ruled in favour of Alarko Holding regarding the rectification of a previous court decision (the 3rd and final stage of the legal case) in the Al-Riva Project case. On the back of the agreement signed in 1995 between the Celaloglu Family and Alarko Holding, Alarko Holding reserves the right to obtain 40% of the net profit of the company (i.e. Al-Riva Arazi Degerlendirme). Note that the company owns a plot of land with a total area of 3.5mn sqm in Riva (Istanbul). Fair values in the Riva region range between US\$180-US\$400 per sqm. Hence, according to our estimates, the total value of Alarko's Riva plot stands at around US\$1bn. The Al-Riva Project remains as an upside challenge for our valuation.

As the legal stage is completed, we think the negotiations between Alarko Holding and the Celaloglu Family for developing the project may start shortly. However, as no details have been provided on the issue, we refrain from including the potential project in our valuation, and prefer to treat it as an upside challenge.

**Other risks.** Despite clauses in the contracting agreements regarding the projects in Kazakhstan, we may observe fluctuations in Alarko's operating margins depending on when and if the compensation regarding Kazakh Tenge devaluation is forthcoming. Furthermore, any possible court ruling against the environmental permit of Karabiga may result in a delay in construction activity. However, we do not expect it to have a major impact on our valuation considering the previous two cases (i.e. the time between the cancellation of the environmental permit and the company being awarded a new one).

## Alarko Summary Financials (IFRS, TRYmn)

Income Statement	2013	2014F	2015F	2016F	Balance Sheet	2013	2014F	2015F	2016F
<b>Net Sales</b>	<b>1,261</b>	<b>891</b>	<b>724</b>	<b>795</b>	Current Assets	1,281	1,267	1,129	1,268
Cost of Goods Sold	-1,083	-895	-610	-646	<i>Cash &amp; Equivalents</i>	586	606	512	633
<b>Gross Profit</b>	<b>179</b>	<b>-4</b>	<b>114</b>	<b>149</b>	<i>Inventory</i>	330	236	192	211
Operating Expenses	-99	-131	-117	-123	<i>Trade Receivables</i>	196	257	257	257
<b>EBIT</b>	<b>80</b>	<b>-135</b>	<b>-3</b>	<b>27</b>	L/T Assets	1,332	1,225	1,399	1,355
<b>EBITDA</b>	<b>149</b>	<b>-84</b>	<b>51</b>	<b>85</b>	<i>Tangible Assets</i>	685	526	587	650
Net Financ. Inc/Exp	-15	8	-6	-6	<i>Intangible Assets</i>	25	25	25	25
Net Other Inc/Exp	179	146	112	109	<b>TOTAL ASSETS</b>	<b>2,620</b>	<b>2,492</b>	<b>2,528</b>	<b>2,623</b>
<b>Profit before Tax</b>	<b>244</b>	<b>19</b>	<b>104</b>	<b>130</b>	S/T Liabilities	828	702	666	671
Taxes	-35	-3	-12	-14	<i>Financial Debt</i>	100	95	95	95
Minority Interest	-25	-10	-10	-8	<i>Trade Payables</i>	201	111	76	80
<b>Net Profit</b>	<b>184</b>	<b>6</b>	<b>82</b>	<b>109</b>	L/T Liabilities	478	486	466	446
<b>Nominal Gr. (YoY)</b>	<b>2013</b>	<b>2014F</b>	<b>2015F</b>	<b>2016F</b>	<i>Financial Debt</i>	166	221	201	181
Net Sales	136%	-29%	-19%	10%	Shareholders' Equity	1,184	1,167	1,249	1,352
EBITDA	280%	-156%	n.m.	65%	Minority Interest	129	137	147	154
Net Profit	146%	-97%	n.m.	33%	<b>TOT.LIA.&amp;SH.EQU.</b>	<b>2,620</b>	<b>2,492</b>	<b>2,528</b>	<b>2,623</b>
<b>Margins</b>	<b>2013</b>	<b>2014F</b>	<b>2015F</b>	<b>2016F</b>					
Gross Profit	14.2%	-0.4%	15.8%	18.8%	<b>Key Metrics</b>	<b>2013</b>	<b>2014F</b>	<b>2015F</b>	<b>2016F</b>
EBIT	6.3%	-15.1%	-0.4%	3.4%	W.Capital days	51	145	206	194
EBITDA	11.8%	-9.4%	7.1%	10.7%	Capex/sales	25%	10%	13%	12%
Net margin	14.6%	0.7%	11.3%	13.7%	Net debt (TLmn)	-320	-290	-216	-356
					Net debt / equity	-0.27	-0.25	-0.17	-0.26
					Net Debt / EBITDA	-2.32	3.65	-4.91	-3.37
<b>Cash Flow Statement</b>	<b>2013</b>	<b>2014F</b>	<b>2015F</b>	<b>2016F</b>	ROA (%)	8%	0%	3%	4%
Profit before tax	244	6	82	109	ROIC (%)	9%	-12%	0%	7%
Depreciation	69	51	55	59	ROE (%)	16.9%	0.5%	6.8%	8.4%
Changes in WC	58	-75	9	-14	Dividend payout (%)	17.6%	8.2%	7.0%	7.0%
<b>Operating Cash Flow</b>	<b>297</b>	<b>-76</b>	<b>88</b>	<b>96</b>	Dividend yield (%)	1.1%	1.5%	0.0%	0.6%
Capex	-312	-87	-93	-98	Effect.tax rate (%)	14%	15%	12%	10%
Change in debts	127	51	-20	-20					
Dividends paid	-13	-15	0	-6	<b>Valuation</b>	<b>2013</b>	<b>2014F</b>	<b>2015F</b>	<b>2016F</b>
Other	-41	138	-5	-3	EV/Sales	0.7	1.0	1.3	1.0
<b>Financing Cash Flow</b>	<b>58</b>	<b>10</b>	<b>-31</b>	<b>-30</b>	EV/EBITDA	5.8	n.m.	18.3	9.5
Cash-beginning of per.	322	379	390	359	PE	5.5	n.m.	12.3	9.3
Cash-end of period	<b>379</b>	<b>390</b>	<b>359</b>	<b>329</b>	FCF yield (%)	-4%	-1%	1%	1%

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