TURKISH EQUITIES / COMPANY UPDATE

Erdemir

11 March 2024

Neutral
(Upgraded from Underperform)

Close Price: TRY45.90
12M Target Price: TRY53.00
Upside Potential: 15%

A demanding valuation despite a steelier outlook

We are upgrading our rating for Erdemir from Underperform to Neutral with a revised target price of TRY53.00/share, implying 15% upside potential. The stock has underperformed the BIST-100 Index by 39% since our downgrade to "Underperform" on 7th March 2023. Although the pricing environment and cash spreads remain weak in the industry, we are highly optimistic for the remainder of the year given the recovery in confidence indices on expected rate cuts in 2H24 and our expectation of a solid rebound in the Chinese market where demand in 2023 is estimated to have been 6.4% below its 2020 level. We currently assume a rise of around 5% YoY in steel prices with an EBITDA/tonne of USD110 in 2024 vs. USD87 in 4Q23, reaching its historical average of USD130/tonne in 2H24. With our forecast of a normalized total volume without the negative impact of the earthquake at the Isdemir factory in 2023, we calculate growth of 48% in EBITDA and 174% in net income for 2024 in USD-terms. Despite healthy earnings momentum, the stock trades at an EV/EBITDA of 7.2x and a P/E of 10.8x based on 2024 prospective earnings, implying an average of 14% premium to its historical average and 12% to its global peers. Although we find the valuation demanding, we justify a Neutral rating for the stock after its sharp underperformance, in anticipation of a reversal in industry dynamics and its relatively defensive prospects given its 1) USD-friendly operations, 2) robust sales performance with its cost advantage over its peers and 3) the buy-back program which it has initiated.

Global steel industry approaching the end its down-cycle: Despite our positive view of the steel industry for 2024, we are yet to observe much in the way of strength where we calculate cash spreads hovering around 11% lower than their 2023 average levels. We currently forecast that 1H24 EBITDA/tonne levels will be broadly similar to 4Q23 levels for our steel coverage while assume some normalization of spreads for 2H24 in line with their historical averages on our on-going expectation for a healthy recovery as in 3Q20 after Covid-19 when China quickly re-opened its economy, ushering in an up-cycle for the steel industry in the following 24-months.

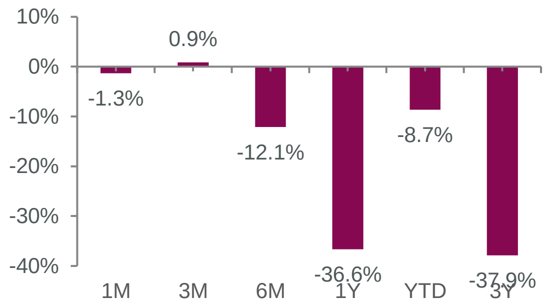
Long investment cycle compromising balance sheet health: Compounding its ongoing USD2.5bn investment cycle between 2019-2023, Erdemir announced its new zero-carbon investment cycle for the long-term, where the company plans USD450mn in annual capex over the next 7 years in the process to be net zero by 2050. We currently assume USD 1.0bn capex for 2024 and USD450mn for the coming 3 years given the highly unpredictable returns of potential projects and uncertainty surrounding upcoming trends, technology and demand. We expect the company's net debt position to peak at USD1.9bn in 2024 with a net debt/EBITDA ratio of 2.0x (in USD-terms) – a level we find healthy in its capex cycle with calculated average EBITDA generation of USD1.3bn over the last 10 years. However, contrasting with its net cash position between 2016-2021 and the 0.4x net debt/EBITDA level of its peers, its levered balance sheet in the near future may limit the potential of a re-rating of multiples on its enhancing green growth prospects.

Demanding valuation: We initially assume an improvement in the EBITDA/tonne in the second half of 2024 for Erdemir as we factor in an incremental improvement from the USD90/tonne in 1H24 to USD130/tonne in 2H24. This implies 48% growth in EBITDA and 174% in net income for 2024 in USD-terms vs. our expectation of a cumulative contraction in both figures for our coverage universe. Accordingly, despite its demanding valuation on its short term multiples, we have a Neutral rating for the stock following its sharp underperformance, as we think its defensive prospects and initiated buy-back program will cushion any further pressure on the stock performance.

Stock Data

Bloomberg / Reuters	EREGL TI / EREGL.IS
Mcap (US$mn)	5,042
EV (US$mn)	6466.4
Avg. Trd. Vol. (US$mn)	177.6
Free float	48%

Relative Performance to BIST100



Key Data (TRYmn)	2022	2023	2024F	2025F
Revenues	127783	147900	297336	379201
Growth	*87%*	*16%*	*101%*	*28%*
EBITDA	26655	15573	35712	52387
Growth	*1%*	*-42%*	*129%*	*47%*
Net Profit	18005	4033	17093	29078
Growth	*16%*	*-78%*	*324%*	*70%*
P/E (x)	6.8	29.7	10.8	7.6
EV/EBITDA (x)	5.0	9.9	7.2	5.7
P/BV (x)	1.1	1.1	1.2	1.2
FCF yield (%)	n.m.	n.m.	n.m.	6.6%
Div. yield (%)	12.3%	0.0%	1.0%	7.4%

Analyst
Can Alagoz
+90 212 336 7273
can.alagoz@qnbfi.com

Figure 1 – Summary financials & key metrics (TRYmn)

Income statement	2020	2021	2022	2023	2024F	2025F
Revenues	**32,048**	**68,227**	**127,783**	**147,900**	**297,336**	**379,201**
Gross profit	**5,925**	**25,516**	**25,539**	**14,242**	**30,980**	**47,745**
EBITDA	**6,665**	**26,468**	**26,655**	**15,573**	**35,712**	**52,387**
Depreciation	1,525	2,052	3,494	5,373	10,265	11,700
EBIT	**5,140**	**24,416**	**23,161**	**10,201**	**25,447**	**40,687**
Net other income	433	456	409	3,134	2,651	2,706
Income from investing activities	0	0	1	1	1	1
Net financial income	11	-949	-1,539	-4,390	-5,914	-5,593
Profit from associates	8	-6	73	78	121	145
PBT	**5,592**	**23,916**	**22,105**	**9,024**	**22,306**	**37,946**
Taxes	-2,148	-7,838	-3,459	-4,508	-4,461	-7,589
Minority interest	-201	-551	-648	-296	-751	-1,278
Net income	**3,309**	**15,527**	**18,005**	**4,033**	**17,093**	**29,078**

Balance sheet	2020	2021	2022	2023	2024F	2025F
Current assets	**28,507**	**65,694**	**80,656**	**134,518**	**248,976**	**323,163**
Cash equivalents	13,542	23,190	15,186	24,073	47,950	73,092
Trade receivables	3,828	11,414	15,602	20,353	39,156	49,937
Inventories	10,107	28,960	44,152	67,277	128,299	159,657
Other current assets	1,031	2,130	5,715	22,815	33,571	40,476
Non-current assets	**29,487**	**60,749**	**94,237**	**175,515**	**290,925**	**359,481**
Tangibles	26,062	51,025	80,716	147,415	250,005	308,669
Intangibles	411	3,689	4,953	7,553	11,177	13,799
Other non-current assets	3,014	6,035	8,568	20,547	29,744	37,012
Total assets	**57,994**	**126,442**	**174,894**	**310,033**	**539,901**	**682,644**
Current liabilities	**9,434**	**23,477**	**35,909**	**89,292**	**127,353**	**154,734**
Short-term loans	3,786	9,716	21,172	56,761	66,873	79,891
Trade payables	3,767	6,733	11,228	23,427	44,676	55,596
Other current liabilities	1,882	7,029	3,508	9,104	15,804	19,247
Non-current liabilities	**7,438**	**18,417**	**20,323**	**29,213**	**106,893**	**134,749**
Long-term loans	2,813	6,961	8,408	10,980	67,730	87,962
Other non-current liabilities	4,625	11,457	11,914	18,233	39,163	46,786
Minority Interest	**1,312**	**2,255**	**3,017**	**5,337**	**11,468**	**13,700**
Shareholders' equity	**39,809**	**82,293**	**115,645**	**186,191**	**294,187**	**379,461**
Total liabilities and equity	**57,994**	**126,442**	**174,894**	**310,033**	**539,901**	**682,644**

Key metrics	2020	2021	2022	2023	2024F	2025F
Growth						
Revenue growth	17%	113%	87%	16%	101%	28%
EBITDA growth	22%	297%	1%	-42%	129%	47%
Net income growth	0%	369%	16%	-78%	324%	70%
Profitability						
Gross Margin	18.5%	37.4%	20.0%	9.6%	10.4%	12.6%
EBITDA margin	20.8%	38.8%	20.9%	10.5%	12.0%	13.8%
Net margin	10.3%	22.8%	14.1%	2.7%	5.7%	7.7%
Return on assets (ROA)	6.3%	16.8%	12.0%	1.7%	4.0%	4.8%
Return on equity (ROE)	9.4%	25.4%	18.2%	2.7%	7.1%	8.6%
Return on cap. emp.(ROCE)	6.1%	12.3%	8.9%	1.4%	5.8%	7.7%
Leverage						
Net Debt	-6,944	-6,513	14,394	43,668	86,653	94,761
Net debt / Equity	-0.2	-0.1	0.1	0.2	0.3	0.2
Net debt / EBITDA	-1.0	-0.2	0.5	2.8	2.4	1.8
EBIT Interest coverage	-26.3	-86.3	60.6	3.9	7.4	13.1
Efficiency						
Total asset turnover	0.6	0.5	0.7	0.5	0.6	0.6
Equity turnover	0.8	0.8	1.1	0.8	1.0	1.0
WC/Sales	32%	128%	65%	48%	49%	41%
Opex/Sales	2.4%	1.6%	1.9%	2.7%	1.9%	1.9%

Cash flow	2020	2021	2022	2023	2024F	2025F
EBITDA	6,665.3	26,467.8	26,654.5	15,573.5	35,711.9	52,387.3
Change in working capital	2,237.4	-14,453.5	-4,063.8	4,147.2	-23,453.9	-6,179.0
Taxes (EBIT x 20%)	-1,000.9	-4,883.2	-4,632.1	-2,055.5	-5,089.4	-8,137.5
Capital expenditure	-1,983.7	-3,839.8	-11,345.1	-22,765.1	-36,780.0	-19,665.5
Adjustment	-1,721.9	-5,095.3	-10,085.7	-9,162.1	0.0	0.0
FCFF	4,196.1	-1,803.9	-3,472.2	-14,262.0	-29,611.4	18,405.3

QNB Finansinvest vs Consensus		2024F			2025E	
	Estimate	Cons.	Deviation	Estimate	Cons.	Deviation
Revenues	297,336	231,028	29%	379,201	271,921	39%
EBITDA	35,712	37,464	-5%	52,387	53,426	-2%
Net Income	17,093	15,175	13%	29,078	24,500	19%

Source: QNBFI Estimates

INVESTMENT THEME

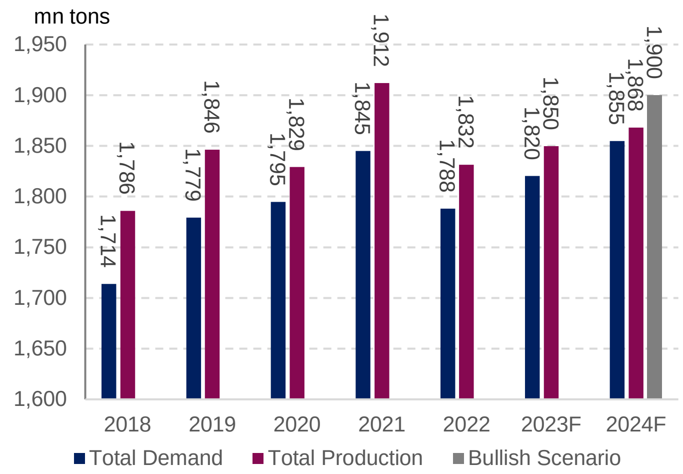
We are upgrading our rating for Erdemir from Underperform to Neutral while revising up our target price from TRY36.50/share to TRY53.00/share - suggesting a mere 15% upside potential. Erdemir's operational performance has been depressed both by the weak global pricing environment with conversation costs being elevated due to higher energy and personnel costs and negative impact of the earthquake which hit the production volume of Isdemir complex in 1H23. Accordingly, the company experienced another EBITDA contraction in 2023, with EBITDA down 60% after having already declined by 45% in 2022 in USD-terms. We do not currently see any substantial improvement in profitability dynamics despite normalized volumes, keeping us conservative for 1H24. On the other hand, we maintain a positive view for the second half of the year with strengthening demand dynamics and potential rate cuts in developed economies expected to end the two year long down cycle in the industry. We therefore assume more normalized cash spreads for 2H24, leading to growth of 48% in EBITDA and 174% in net income for 2024 in USD-terms. Despite our expectation of healthy earning momentum in 2024, the stock trades at an EV/EBITDA of 7.2x and a P/E of 10.8x based on 2024 prospective earnings, implying an average 14% premium to its historical average and 12% to global peers. The stock underperformed the BIST-100 Index by 39% since we downgraded our recommendation for the stock to "Underperform" on 7th March 2023. Although we still find the current multiples demanding compared to its historical average and do not expect any re-rating in the multiples on its relatively levered balance sheet amidst an ongoing investment cycle, we now find a Neutral rating more justified for the stock on our expectation that the industry outlook will bottom out, its defensive prospects on its USD-friendly operational matrices and a robust sales performance thanks to its cost advantage over its domestic peers and the recently initiated buy-back program, which may cushion any pressure on the stock performance in the near-term.

No end in sight for the down-cycle yet: 2023 was challenging year for the global steel industry as the activities of steel using sectors continued to cool sharply while appetite for investments and consumption was also weak on higher financing costs in an environment of uncertainty over global growth. In addition, the negative developments in China's real estate market and the localised but on-going restrictions at the beginning of the year cast a long shadow over the industrial outlook. Accordingly, following its sharp deterioration between 2Q22 to 2Q23, there was sustainable recovery in the steel industry in the following quarters of 2023.

On a regional basis, demand in the Asia Pacific region was weak again as in 2022, with total production up by just 1.1% compared to the previous year with China dominating almost 50% of the total market. The weakest region was Europe, where total production was down by 7.6%. The combination of hiked interest rates and higher energy costs took a heavy toll on manufacturing activity, with the sluggish recovery in the auto production being a key reason behind the weakness in the market. Accordingly, after a fall of 7.8% in 2022, steel demand is forecasted to have ended 2023 another 5.1% lower. In the US, despite its economy's resilience in the face of high interest rates, total steel demand was negatively affected by weak residential construction activities and a slowing trend in investments being taken as part of the Infrastructure Law and Inflation Reduction Act (IRA), despite a post pandemic recovery in the auto industry. Accordingly, following a 2.6% decline, total steel demand in the US is forecasted to contract by another 1.1% in 2023. The only region to exhibit robust growth was emerging economies excluding China, with developing Asia resilient to global headwinds. Accordingly, demand in emerging economies is estimated to have grown by 4.1% in 2023 with India leading the growth in overall demand with an estimated 8.6% growth in 2023 on top of the 9.3% growth in 2022, with Türkiye another driver of growth in the global industry, with an estimated 17.2% recovery in total demand, mainly supported by earthquake related construction activities.

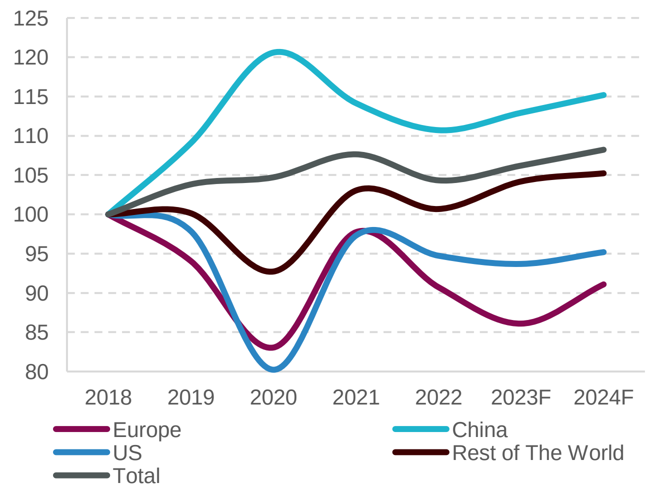
All in all, latest reports suggest that total global steel demand is forecasted to grow by 1.8% in 2023, once again supported by resilient demand dynamics in emerging economies. Looking to 2024, current forecasts point to 1.9% growth in global demand with 5.8% growth in Europe, 1.6% in the United States and 4.8% in emerging economies excluding China. On top of a projected technical rebound in Europe and a bright outlook for emerging economies, China will have a pivotal impact on the global steel demand outlook for 2024 again, with current projections assuming fairly weak demand, as in 2023, which was still 6.4% lower than its 2020 level. A recovery in demand in China to its 2020 level would be calculated to result in 4.4% demand growth for the global industry, vs. the current forecast of 1.9% for 2024.

Figure 2– Global Steel Production and Consumption



Source: World Steel Association, QNBFI Estimates

Figure 3– Regional Steel Demand Growth (Indexed to 100)



Source: Bloomberg

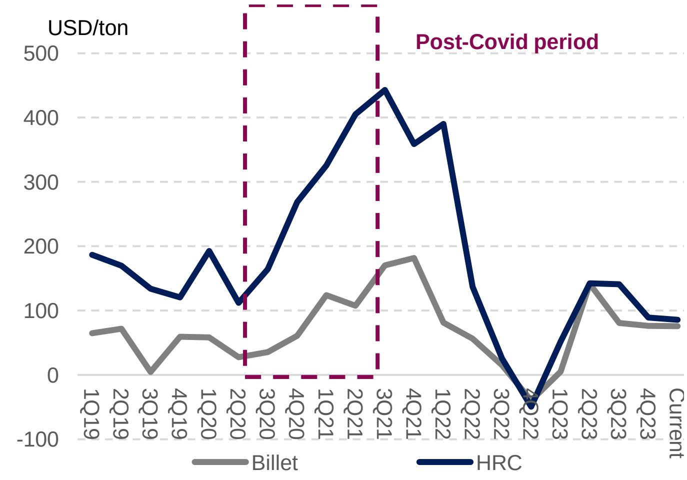
In terms of pricing, both HRC and billet prices were down by an average of 20% in the last quarter of 2023 compared to their 2022 average. Compounding the relatively weak demand conditions, Russia's dumped prices in alternative markets was another reason of weak pricing, as Europe banned imports of rolled, semi-finished steel products in October 2022 with a granted grace period for shipping some goods through 1 October 2024.

The pricing environment remains weak with expectations pointing to a mere 1.9% demand growth for 2024 as uncertainty over demand growth in China currently implying a feeble 2.0% growth in the region in 2024 – a far cry from the post-pandemic average growth levels around 10.0%. On the other hand, the current inventory levels in the ports are on course to hover around 12.0% lower than their 5-year historical averages while initial announcement from regional producers suggest a solid reversal in order books.

We find the current market environment very similar to the post-Covid period when the lockdowns led to a 4.1% decline in steel production in the rest of the world (excluding China) in 2020, while China posted a 1.6% rise in production, leading to a super-cycle to the industry where prices rose by an average of 117% in the following 24 months to reach record high levels, while cash spreads also soared to record highs.

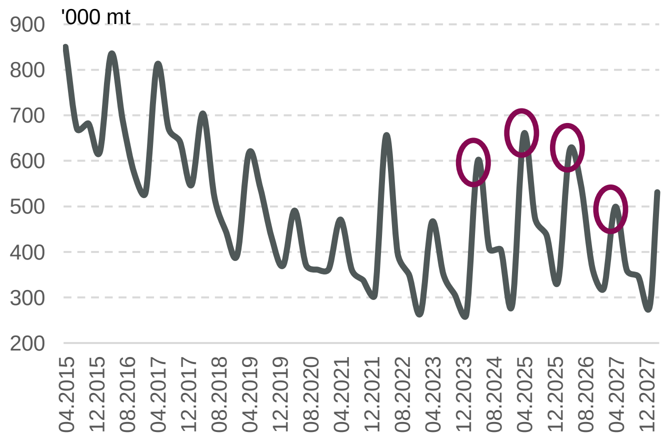
In contrast with the dynamics of the post-Covid period, we are now much more optimistic when it comes to long steel products as the investments and growth drivers are likely to be dominated by construction and real estate industry – comprising almost 27% of the economy in total. Interest rates have already been lowered to record-low levels and further easing measures on both monetary and fiscal policies are likely to be announced in order to accelerate economic activity, with the economy forecasted to grow by 5.0% in 2024.

Figure 4–BoF Steel Making Cash Profit (USD/tonne)



Source: Bloomberg, QNBFI Estimates

Figure 5– China Total Steel Inventory Level

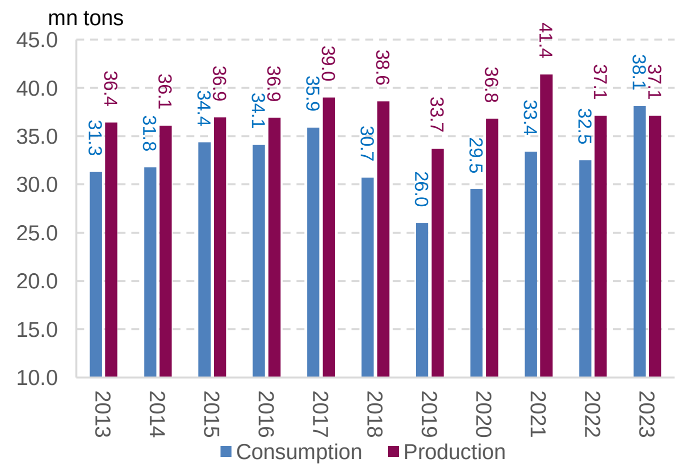


Source: Bloomberg

Brighter conditions in the domestic market: In contrast with global trends, Türkiye's total steel consumption was up by 17.2% YoY in 2023 with production almost unchanged compared to the previous year. Imports surged by 15.5% and exports were down by 30.9% YoY as producers scrambled to meet domestic demand, while production was negatively impacted by the earthquake, which also had an upward impact on demand figures. Both flat and long-steel demand reached a record high of 19.5mn tonnes for flat steel and 18.6mn tonnes for long products, exceeding the previous record levels of 17.6mn tonnes for flat steel and 18.3mn tonnes for long products set in 2017.

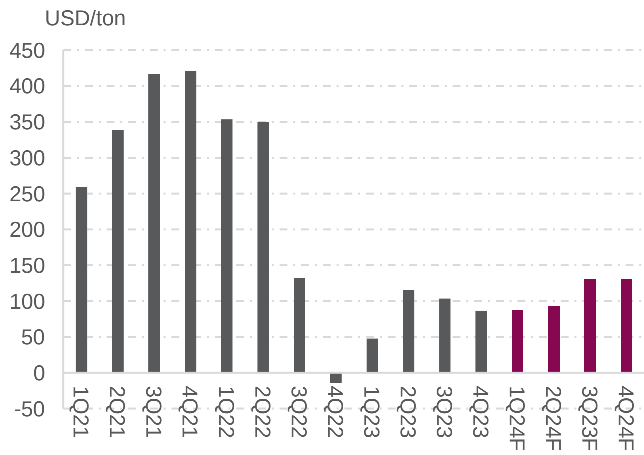
In terms of profitability, cash spreads dipped to historic lows between 3Q22-1Q23 after hitting record highs in 3Q21. The recovery in the three quarters after 1Q23 did not find enough support on weakening demand environment in China and negative news-flow on real estate developers in the region. We do not currently expect a substantial improvement in either cash spreads or prices, with cash spreads calculated to hover around 42% lower than their historical average and 11% lower than their 2023 average. However, we expect a rally in product prices and cash spreads in the weeks following the end of Lunar Holiday at the end of February. Our main assumption for the steel industry is for a mere 5.0% YoY recovery in product prices in line with the rise in the raw material prices, indicating that cash spreads will reach their historical average levels in the second half of the year.

Figure 6–Türkiye: Steel Demand and Consumption



Source: Bloomberg, QNBFI Estimates

Figure 7– Erdemir: EBITDA/ton Generation



Source: Bloomberg, QNBFI Calculations

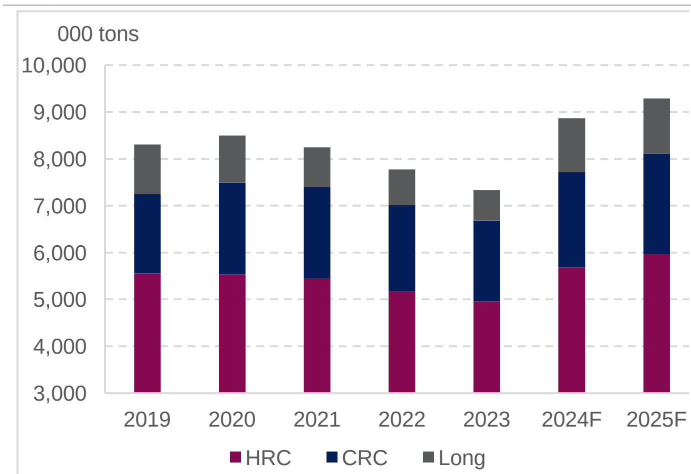
Erdemir on course for 48% EBITDA growth in 2024 in USD-terms: Despite the tragic earthquakes which struck the south east of Türkiye, Erdemir's total production was down 5.5% in 2023 compared to its 2022 level as production at its Isdemir factory was halted for more than two months, which also had a negative impact on Türkiye's total steel production, given its share of 13.4% in total steel production.

For the first half of 2024, we think that solid steel demand growth is likely to be driven by long-steel products given our expectation that the strength in the construction industry will be maintained. However, we are somewhat concerned that domestic flat steel demand could falter on the back of cooling industrial activity amid higher financing costs and a weak economic outlook in key export markets, such as Europe. On the other hand, we are more optimistic for the second half of the year with global interest rate cuts likely to pave the way for a revival in manufacturing activity globally, while re-stocking activities in an environment of rising prices could also lead to a healthier pricing environment for the steel producers.

Erdemir recorded an EBITDA/tonne of USD87 in 4Q23, vs. its historical average of around USD130 and the USD103/tonne in the previous quarter. Apart from the weakness in the cash spreads, rising conversion costs on higher energy costs and personnel costs also played a significant role in the weakness in the profitability matrices, especially in the second half of 2023, while cost increases in Turkish Lira related conversion costs exceeded the depreciation of the Turkish Lira.

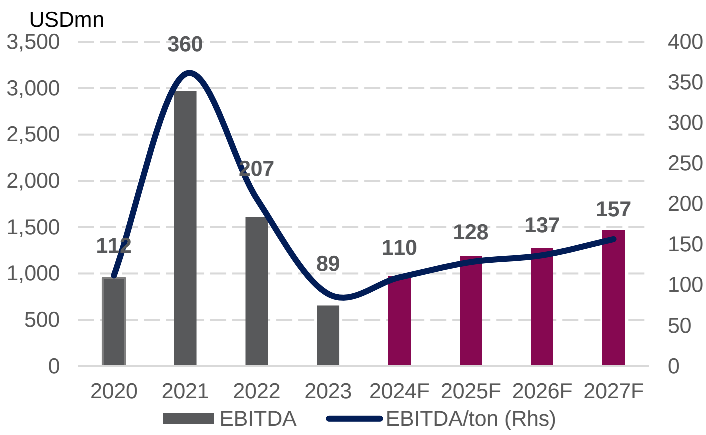
We currently calculate a largely stable EBITDA/tonne for 1Q24 while our calculations suggest a similar trend, at least for the beginning of 2Q24 considering Erdemir's 2-3 month advance order book. However, we are convinced that there will be a reversal in steel prices in the near-future, and accordingly assume a 5.0% YoY recovery in steel prices for the full year on average, while cash steel making costs have already risen by 12.8% since 2Q23. This suggests a full year EBITDA/tonne of USD110 for the full year, with our projections incorporating normalized levels of USD130/tonne for the second half. This implies 48% EBITDA growth for the full year.

Figure 8– Erdemir: Sales Volume



Source: Bloomberg, QNBFI Estimates

Figure 9– Erdemir: EBITDA and EBITDA/Tonne Generation



Source: Bloomberg, QNBFI Estimates

Balance sheet being levered, but still at healthy levels: With the investment plan announced after the release of its 2018YE financial statements, Erdemir entered a new investment cycle after the 2015-2018 period of light capex, when the annual capex averaged USD195mn. In addition to these investment plans, the company unveiled plans for two more capacity investments at the beginning of August 2019. In the first announcement, the company set out plans to construct a new blast furnace with a capacity of 3,000m^3 in Isdemir, instead of relining its third Blast Furnace with 1,850m^3. The company then announced that it would construct a new blast furnace instead of relining the second Blast Furnace at its Eregli complex. Work on most of these plans has been completed and the complexes are close to being more cost efficient with a higher production capacity. Furthermore, the company's mining unit, Ermaden, announced that it had found intense mineralization in the Bingol-Avnil site, with a total of 250-300mn tonnes of reserves at the end of 2022. Accordingly, the company decided to establish a pelletizing plant with an annual production capacity of 3.0mn tons while its self-sufficiency in pellet is forecasted to increase from 25-30% to 80-85% with a capex budget of USD550mn and the complex is forecasted to be operational as of 2027. Accordingly, the company's annual capex level incrementally increased from an average annual of USD195mn between 2015-2018 to almost USD1.0bn as of 2023, with a further USD1.0bn in capex forecasted for 2024.

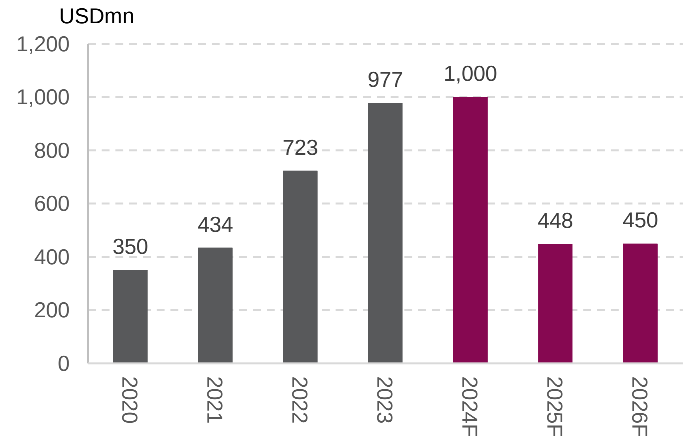
Last but not least, in early 2024, the company also announced its Net Zero Carbon Roadmap to contribute to Türkiye's target of net zero emissions by 2053. Accordingly, the company aims to reduce carbon emissions by 25% per tonne by 2030, by 40% per tonne by 2040 (compared to the base year of 2022) and to achieve net zero emissions by 2050. In this regard, the company is committed to undertaking a transformational investment of USD3.2bn in both complexes by the end of 2030. These projects include the installation of a Solar Power Plant (SPP) with an annual electricity generation capacity of 1,710,000 MWh and two construction of Electric Arc Furnaces with a capacity of 2.5mn tonnes at the Isdemir complex and 1.4mn tonnes at the Erdemir complex with plans for further investments in DRI technology and bio-mass energy in the medium term. For the foreseeable future, a total investment budget of USD3.2mn is forecasted to be made over the next 7 years with annual capex of around USD450mn.

We welcome the company's zero-carbon plans and investments, which are becoming an obligation for the near-future, although the required steps are not generally being followed by other players in the local market, which will be subject to the EU carbon adjustment mechanism by the end of 2025. The European Union is the main export market for Türkiye's steel industry, accounting for 31.0% in exports, corresponding to 13.4% of total production.

As Türkiye is a net flat steel importer, where total production only meets 80% of total demand based on the historical figures, Erdemir's main market has always been the domestic market, where it enjoys a cost advantage over domestic competitors as the sole BoF based flat steel producer, so export revenues comprise only around 10% of total sales volume. However, we deem these early steps to become a zero-carbon industrial company to be highly valuable both for its corporate governance and its presence in the investor community, as these steps are increasingly being sought by investors.

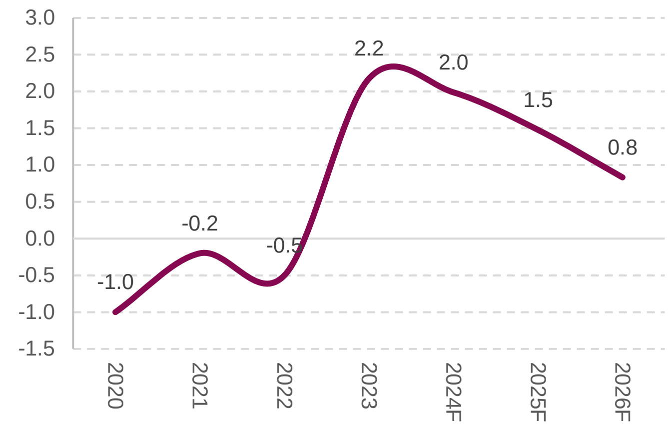
As of 2023YE, Erdemir had a net debt position of USD1.4bn with a net debt/EBITDA ratio of 2.2x. With our projection of USD1.0bn in capex in 2024 and USD971mn in EBITDA generation, we forecast the net debt to reach USD1.9bn with a net debt/EBITDA ratio of 2.0x before declining to 1.5x in 2025 and improving further thereafter based on our projections, where we maintain our terminal EBITDA/tonne assumption of around USD130, excluding the positive impact of pelleting complex, where we assume an annual contribution of USD22/tonne by 2027, and a USD7/tonne terminal EBITDA contribution from Kumas.

Figure 10–Erdemir: Capex Projection



Source: QNBFI Estimates

Figure 11– Erdemir: Net Debt/EBITDA (x)

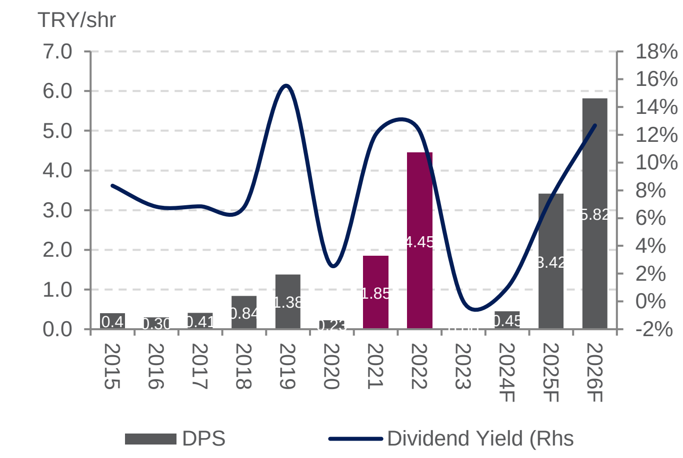


Source: QNBFI Estimates

Dividend payments possible even in the investment cycle: Based on our incorporation of USD1.0bn in capex for 2024 and around USD450mn in capex for the next 3 years, we calculate 163% YoY growth in Erdemir's net income in 2024 with a CAGR of 22% between 2024-2027 in USD-terms. Erdemir can be considered as a generous dividend payer; even in the 2010-2015 investment period, it provided an average 73% dividend pay-out ratio. The company has again been in a new investment cycle since 2019 with the capex budget hovering near its peak levels. The management is sticking to its dividend strategy but considering its projected net debt/EBITDA level of 2.0x, we doubt that the pay-out levels will be as high as the 90% levels seen in the recent past. The company announced that it would distribute a cash dividend from its 2023 earnings with a pay-out ratio of 42% based on IFRS figures. Considering the one-off earthquake impact, we do not consider the 2024 pay-out ratio indicative for the coming years, and conservatively plug in a 70% pay-out ratio for the coming years. We have some concerns even on these levels, considering that any down cycle dynamics may end with lower pay-out ratios for the valuation horizon. Based on our projections, we calculate a DPS of TRY3.42 from 2024 earnings implying a 7.4% dividend yield based on the latest close. In the following year, we calculate a DPS of TRY5.82 with an 12.7% dividend yield.

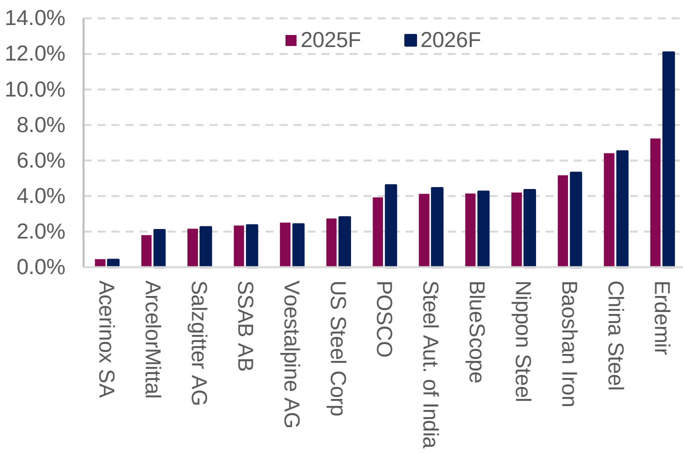
Erdemir's historical dividend yield has averaged 10.3% over the last 5 years, excluding 2023. Although our forecast for 2025 is lower than its historical average, we would reiterate that this is the highest level among global peers, as it has mostly been in recent history.

Figure 12–Erdemir: DPS and Dividend Yield Assumptions



Source: QNBFI Estimates

Figure 13– Erdemir Dividend Yield Comparison



Source: Bloomberg, QNBFI Estimates

Valuation

We base our valuation on a 70-30 weighting of the results derived from the extrapolation of DCF and multiple valuation methodology, and find a 12-month target value of USD5,281mn. We attach a higher weight to DCF valuation to reflect the contribution of the company's current investments and potential contribution of the pelletizing investment by 2027.

- Our USD-denominated DCF model is based on a 11.2% WACC and a beta of 1.0x. Meanwhile, we assume a risk free rate of 7.5% and an equity risk premium of 5.0%.
- We incorporate USD550mn in capex for the pelletizing investment into our model, and assume the investment will yield an annual positive contribution of USD200mn by 2H26.
- We do not incorporate any contribution from the company's zero-carbon investments into our model given the highly unpredictable returns of potential projects given the uncertainty surrounding upcoming trends, technology and the demand environment.
- Based on our 2024 earnings forecasts, Erdemir trades at an EV/EBITDA of 7.2x and a P/E of 10.8x, implying 27% premium and 2% discount to international peers, respectively. Based on 2025 earnings forecasts, the stock trades at an EV/EBITDA of 5.7x and P/E of 7.6x.

Figure 14 – DCF Analysis

USDmn	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F
Revenues	8,084	8,630	8,834	9,043	9,258	9,443	9,817	10,014	10,214	10,418
Revenue Growth	*30%*	*7%*	*2%*	*2%*	*2%*	*2%*	*4%*	*2%*	*2%*	*2%*
EBIT	692	926	977	1145	1184	1150	1144	1168	1176	1198
EBITDA	971	1192	1275	1466	1504	1471	1465	1488	1497	1518
EBITDA Margin	*12.0%*	*13.8%*	*14.4%*	*16.2%*	*16.2%*	*15.6%*	*14.9%*	*14.9%*	*14.7%*	*14.6%*
Taxes	-138	-185	-195	-229	-237	-230	-229	-234	-235	-240
Inc./dec. in W/C	-638	-141	-62	-62	-62	-62	-62	-62	-62	-62
Capex	-1000	-448	-450	-446	-320	-323	-326	-359	-395	-399
FCF	**-805**	**419**	**568**	**729**	**885**	**855**	**847**	**834**	**804**	**818**
WACC	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%
PV of FCFs	**3050**									
Terminal Growth Rate	2%									
Terminal Value	9071									
PV of TV	**3375**									
Value of Firm	6425									
Net Debt	1424									
Participations	0									
Equity Value	**5001**									

Source: QNBFI Estimates,

Figure 15 – Peer Analysis

	Mcap (USDmn)	P/E 24 (x)	P/E 25 (x)	EV/EBITDA 24 (x)	EV/EBITDA 25 (x)
EUROPE					
Acerinox SA	2,572	6.9	6.2	4.2	3.8
ArcelorMittal	21,631	5.5	4.9	3.6	3.4
Salzgitter AG	1,498	6.5	5.9	2.8	2.8
Voestalpine AG	4,737	8.8	8.3	3.9	3.9
ASIA					
POSCO	27,856	15.7	12.7	6.1	5.5
Steel Authority of India	6,741	23.2	16.6	8.3	7.1
BlueScope Steel Ltd	6,250	10.4	10.6	4.6	4.8
Nippon Steel& Sum	23,958	7.6	7.2	6.3	5.9
Baoshan Iron& Steel	20,587	13.2	11.3	5.8	5.4
China Steel Corp	11,981	39.4	24.2	15.9	11.5
AMERICA					
US Steel Corp	10,685	14.9	13.2	6.3	5.7
Usinas Siderurgicas	2,638	11.8	9.4	5.4	4.4
Cia Siderurgica	4,434	n.m.	9.4	4.5	4.4
Average		11.1	10.0	5.6	5.1
Erdemir	5,042	10.8	7.6	7.2	5.7
Discount/Premium		-2%	-24%	27%	13%

Source: Bloomberg, QNBFI Estimates

QNB Finansinvest Rating System

We employ a relative scale in our rating system (i.e. Market **Outperform, Neutral, Underperform**) in order to better present relative value propositions and more actively pursue long vs. short ideas at the BIST. The relevant benchmark is the broader Turkish stock market, using the BIST-100 index as a basis. The ratings also incorporate a certain degree of relativity within the analyst's own stock coverage universe due to asymmetric return expectations among the industries under our BIST coverage. The rating system combines analysts' views on a stock relative to the sectors under coverage, and the sector call relative to the market, together providing a view on the stock relative to the market.

Individual ratings reflect the expected performance of the stock relative to the broader market over the next 6 to 12 months. The assessment of expected performance includes a function of near-term company fundamentals, industry outlook, confidence in earnings estimates and valuation, and other factors.

An essential element of our rating methodology involves benchmarking a 12-month expected return against the cost of equity. We set a required rate of return for each stock, calculated from our risk-free rate and equity risk premium assumptions. The price target for a stock represents the value that the stock is expected to reach or sustain over the performance horizon of 12 months, according to the view of the analyst.

We have separated the stocks under our coverage into two groups, mainly with respect to their liquidity (market cap, free float market cap and historical average daily trading volume) as small-cap stocks exhibit different risk/return characteristics to more-liquid large-caps. For the purposes of the relative stock rating, however, stocks within each group will be considered on an unweighted basis with regard to their market capitalization.

For a stock to be assigned an **Outperform** rating, the implied return *must* exceed the required rate of return by at least 5 percentage points over the next 12 months for our larger-cap stock coverage, or by 10 percentage points for the small-cap group. For a stock to be assigned an **Underperform** rating, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months. Stocks between these bands will be classified as **Neutral**.

When the potential upside of an *average* stock in our coverage exceeds its required rate of return (i.e. the market upside exceeding the implied average cost of capital), a greater number of stocks would fall into the aforementioned Outperform (Buy) category, illustrating the significance of the "relative return" concept (vis-à-vis absolute return) in picking better investment ideas with a positive alpha. The same holds true when the potential upside of an *average* stock in our coverage falls short of its required rate of return.

In this regard, as a supplemental methodology, we rank the stocks in our coverage according to their notional target price with respect to their current market price, and then categorise the top group (approximately 40-50% of the companies under coverage) as Outperform, the next 40-50% as Neutral and the lowest 10-20% (and no less than 10%) as Underperform.

It should be noted that the expected returns on some stocks may at times fall outside the relevant ranges of the applicable respective rating category because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges are permitted but becomes subject to review.

Also note that the analyst's short-term view may occasionally diverge from the stock's longer-term fundamental rating.

Outperform. We expect the stock to outperform the BIST-100 over the next 6 to 12 months.

Neutral (Market Perform). We expect the stock to broadly perform in line with the BIST-100 index over the next 6 to 12 months. (Although we would normally have a neutral assessment of stocks in this category, if a stock has gone through a period of market underperformance, it would be an indication that the stock may be expected to improve its performance relative to market averages in the coming period, and vice versa).

Underperform. We expect the stock to underperform the BIST-100 over the next 6 to 12 months.

N/R. Not Rated.

U/R. Under Review.

Analyst Certification

The following analysts hereby certify that the views expressed in this research report accurately reflect their own personal views regarding the securities and issuers referred to therein and that no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report: **Can Alagöz.**

Unless otherwise stated, the individuals listed on the cover page of this report are research analysts.

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