TURKISH EQUITIES / COMPANY UPDATE

Kardemir

On the rails…

We are maintaining our Outperform rating for Kardemir with a new TP of TRY44.50/share for the D-type shares, suggesting 78% upside potential. The steel industry has languished in a long down cycle since the end of 2022 while short-term recoveries failed to get off the ground within this period, mostly on negative news-flows from the stressed Chinese property industry. With increasing positivity following the long-awaited announcement of a rescue plan for the industry, we think we are approaching the end of the down-cycle while the steel prices in the region have risen by 10.2% on average since the end of September'24. For Kardemir, we expect a sustainable recovery in EBITDA/tonne from USD31 in 2Q24 to around USD80 in 4Q24, combined with 13.6% HoH volume growth in 2H24. For 2025, we forecast an additional 5% rise in steel prices, suggesting a recovery in the EBITDA/tonne from USD60 in 2024 to USD110 in 2025, on the assumption of a diminishing negative impact of inflation accounting on our expectation for normalized inflation pattern. The stock trades at an EV/EBITDA of 2.7x and P/E based of 5.1x based on our 2025 forecasts, implying 41% and 40% discounts to its global peers and a 43% discount to its historical average. Given 1) imminent operational earnings momentum on a quarterly basis, 2) an unleveraged balance sheet with a net cash position by the end of 2024, 3) a brighter outlook for the industry and 4) accelerating rail sales – suggesting a sustainable USD15 improvement in the EBITDA/ton for the Company based on our scenario analysis, we deem the discounted valuation a good entry point to play on a revival in the steel industry.

Approaching the end of the down-cycle: The PBoC finally initiated a rescue plan for the property industry in late September. Although the amount of the official bailout package not yet been announced, the general expectation is for a 200bn Yuan cash package for the industry while debt swaps with local governments may reach 5 trillion Yuan, with these steps expected to be announced in the coming weeks. The initial reaction to the PBoC's steps has been a 10.2% surge in steel prices on average, which are nevertheless still hovering around 16% lower than their historical average levels. The last time we were in such a down cycle when the steel making cash spread was so far below its historical average and even negative, as seen since 3Q23, was in the 2Q15-2Q17 period, which gave way to a 35% jump in the steel prices over the next year while cash spreads improved to USD165/tonne (currently USD8/tonne). Along with a declining trend in steel inventories in the ports on a weekly basis, we think we are approaching the end of the down-cycle in the industry, with improving global growth prospects on rate hikes also supporting this argument.

The worst is over: Kardemir's EBITDA/tonne declined to USD89 in 1Q24 and USD31 in 2Q24 vs. a historical average of USD110. As well as the weak outlook for the steel industry, the inflation accounting impact on the EBITDA/tonne level was also behind our calculation of a USD28/tonne figure. With a declining cost base and slight recovery in domestic prices, we calculate a recovery in the Company's EBITDA/tonne to USD80 by 4Q24 and USD110 for 2025, back in line with its historical average, on our assumption of steel prices being 5% higher on average, implying an 87.1% improvement in EBITDA generation in USD-terms.

Highly discounted on its normalized figures: The stock trades at an EV/EBITDA of 2.7x and P/E of 5.1x based on our 2025 forecasts, implying an average 43.1% discount to its historical average. Although the bottom-line is likely to be under pressure from non-cash FX-losses in 3Q24, the Company is on the verge of building up operational earnings momentum, and with its healthy balance sheet, more constructive industrial outlook and rising sustainable operational earnings prospects, we maintain our Outperform rating for the stock and find the current levels deeply discounted for playing for a revival in the steel industry.

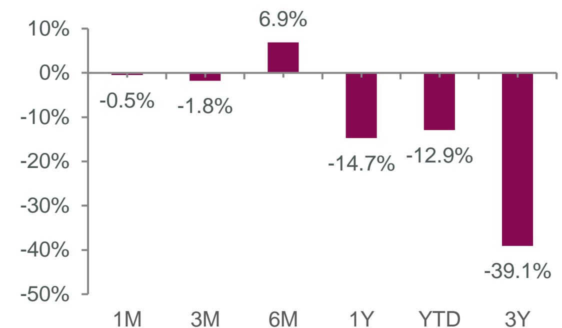
31 October 2024

Outperform
(Maintained)

Close Price: TRY 24.94
12M Target Price: TRY44.50
Upside Potential: 78%

Stock data	
Bloomberg / Reuters	KRDMD TI / KRDMD.IS
Mcap (US$mn)	569
EV (US$mn)	568.3
Avg. Trd. Vol. (US$mn)	32.5
Free float	89%

Relative Performance to BIST100



Key Data (TRYmn)	2023	R. 2023	2024E	R. 2024	2025E
Revenues	51,621	59,387	58,177	72,721	79,091
Growth	*-5%*		*-2%*		*9%*
EBITDA	3,210	3,693	4,947	6,184	12,056
Growth	*-37%*		*34%*		*95%*
Net Profit	1,588	1,827	-1,884	-2,355	6,232
Growth	*43%*				
P/E (x)	15.4				5.1
EV/EBITDA (x)	6.8		5.5		2.7
P/BV (x)	0.7		0.6		0.5
FCF yield (%)	9%		20%		12%
Div. yield (%)	0.6%		0.0%		0.0%

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

Figure 1 – Summary financials & key metrics (TRYmn)

Income Statement (TLmn)	2022	2023	Restated 2023	2024E	Restated 2024E	2025E
Revenues	**54,168**	**51,621**	**59,387**	**58,177**	**72,721**	**79,091**
Gross Profit	**4,177**	**2,189**	**2,519**	**3,751**	**4,689**	**10,601**
EBITDA	**5,105**	**3,210**	**3,693**	**4,947**	**6,184**	**12,056**
Depreciation	1,506	1,623	**1,867**	2,267	**2,834**	2,911
EBIT	**3,599**	**1,587**	**1,826**	**2,680**	**3,350**	**9,145**
Net other income	-1,249	-4,628	**-5,324**	-1,344	**-1,680**	646
Income from investing activities	417	52	**60**	57	**72**	9
Net financial income	504	3,057	**3,517**	-1,413	**-1,766**	-2,009
Profit from associates	18	42	**48**	0	**0**	0
PBT	**3,289**	**111**	**127**	**-19**	**-24**	**7,790**
Taxes Paid	-2,181	1,477	**1,700**	-1,865	**-2,331**	-1,558
Minority Interest	0	0	**0**	0	**0**	0
Net Profit/(Loss)	**1,108**	**1,588**	**1,827**	**-1,884**	**-2,355**	**6,232**

Balance Sheet (TLmn)	2022	2023	Restated 2023	2024E	Restated 2024E	2025E
Current assets	**30,693**	**31,451**	**36,012**	**35,206**	**43,722**	**52,229**
Cash equivalents	3,116	5,933	6,655	3,185	3,697	14,409
Trade receivables	6,907	6,432	7,400	4,996	6,244	5,971
Inventories	16,724	15,321	17,626	19,529	24,412	23,345
Other current assets	3,945	3,765	4,331	7,496	9,370	8,503
Non-current assets	**34,953**	**43,346**	**49,867**	**43,926**	**54,908**	**49,583**
Tangibles	34,499	42,789	49,227	43,252	54,065	48,812
Intangibles	168	235	270	248	310	279
Other non-current assets	286	322	370	426	533	492
Total assets	**65,646**	**74,797**	**85,879**	**79,132**	**98,630**	**101,812**
Current liabilities	**22,199**	**23,981**	**27,589**	**24,459**	**30,574**	**24,487**
Short-term loans	3,250	2,252	2,591	1,962	2,452	1,058
Trade payables	12,617	13,514	15,547	16,846	21,057	18,640
Other current liabilities	6,332	8,215	9,451	5,651	7,064	4,789
Non-current liabilities	**6,841**	**4,859**	**5,590**	**6,173**	**7,716**	**8,108**
Long-term financial loans	846	496	571	497	621	1,774
Other non-current liabilities	5,995	4,363	5,019	5,676	7,095	6,334
Minority Interest	0	0	0	0	0	0
Shareholders' Equity	**36,606**	**45,957**	**52,700**	**48,500**	**60,340**	**69,217**
Total liabilities and equity	**65,646**	**74,797**	**85,879**	**79,132**	**98,630**	**101,812**

Key metrics	2022	2023	Restated 2023	2024E	Restated 2024E	2025E
Growth						
Revenue growth	267%	-5%	-2%	13%	9%	36%
EBITDA growth	4%	-37%	34%	54%	95%	144%
Net income growth	-71%	43%	n.m.	n.m.	n.m.	n.m.
Profitability						
Gross Margin	7.7%	4.2%	4.2%	6.4%	6.4%	13.4%
EBITDA margin	9.4%	6.2%	6.2%	8.5%	8.5%	15.2%
Net margin	2.0%	3.1%	3.1%	n.m.	n.m.	7.9%
Return on assets (ROA)	2.5%	2.3%	2.4%	-2.4%	-2.7%	6.7%
Return on equity (ROE)	4.8%	3.8%	4.1%	-3.8%	-4.4%	10.5%
Return on cap. emp. (ROCE)	4.9%	4.0%	4.2%	-4.1%	-4.5%	11.3%
Leverage						
Net Debt	979	-3,187	-3,666	-729	-911	-11,579
Net debt / Equity	0.0	-0.1	-0.1	0.0	0.0	-0.2
Net debt / EBITDA	0.2	-1.0	-1.0	-0.1	-0.1	-1.0
EBIT Interest coverage	-15.6	-7.6	-5.7	-7.9	-7.9	-7.7
Efficiency						
Total asset turnover	0.8	0.7	0.7	0.7	0.7	0.8
Equity turnover	1.5	1.1	1.1	1.2	1.2	1.1
WC/Sales	18%	13%	13%	13%	13%	15%
Opex/Sales	1.1%	1.2%	1.2%	1.8%	1.8%	1.8%

Cash Flow (TLmn)	2022	2023	Restated 2023	2024E	Restated 2024	2025E
EBITDA	5,105	3,210	3,693	4,947	6,184	12,056
Change in working capital	-9,465	5,474	6,297	2,537	2,919	-2,309
Taxes	-900	-397	-457	-1,865	-2,145	-1,558
Capital Expenditures	-1,594	-1,448	-1,666	-1,095	-1,260	-3,038
Adjustment	-2,514	-3,670	-4,222	1,195	1,375	0
FCFF	-9,368	3,169	3,646	5,719	6,579	5,151

QNB Invest vs Consensus	2024F			2025F		
	Deviation	Estimate	Cons.	Deviation	Estimate	Cons.
Revenues	9%	58,177	53,484	34%	79,091	58,921
EBITDA	-7%	4,947	5,332	53%	12,056	7,863
Net Income	4%	-1,884	-1,807	366%	6,232	1,338

Source: QNBI Calculations

INVESTMENT THEME

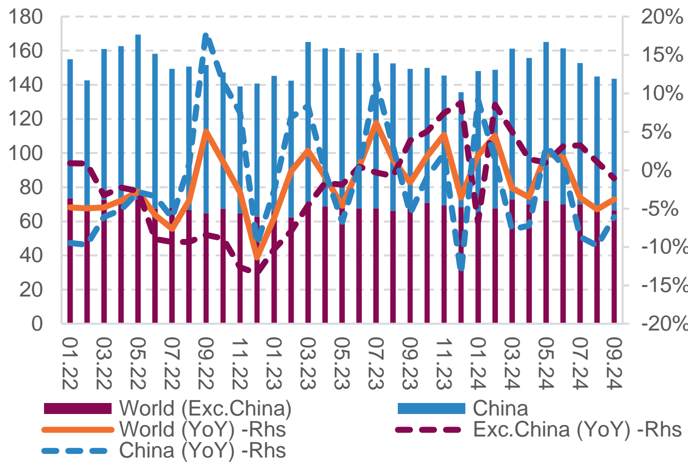
We are maintaining our Outperform rating for Kardemir (D-type shares) with a new TP of TRY44.50/share, suggesting 78% upside potential. The steel industry has languished in long-drawn out down cycle since the end of the super cycle period which has followed the Covid era of 2021 and 2022, when the industry's profitability reached record high levels. Although we have observed some strength within this period, the sustainability of recoveries has proven limited as demand in China deteriorated amid weak growth dynamics stemming from the real estate industry under stressed. By the end of September, some prices started to increase in China following the Central Bank's long-awaited announcement of a rescue plan for the property industry while further steps will be clearer in the coming weeks. Accordingly, steel prices in the region have jumped by 10.2%, taking prices to 14.7% above the lows recorded earlier this year, although remaining 16% below their historical average. The last time we were in such a down cycle with a steel making cash spread this far below the historical average, or even negative as has been seen since 3Q23, was in the 2Q15-2Q17 period, which gave way to a 35% surge in steel prices over the following year while cash spreads improved to USD165/tonne vs. the current level of a negative USD8/tonne. While the current downcycle has already lasted for two more quarters than the previous down cycle, current news flows offers hope of a healthy recovery for the coming period. Looking at Kardemir specifically, the Company's EBITDA/tonne has languished at USD89 in 1Q24 and USD31 in 2Q24, vs. a historical average of USD110, squeezed by both lower cash spreads and the negative impact of inflation accounting. Current cash spreads now point to an EBITDA/tonne of USD90/tonne on the back of a declining cost base and slight recovery in prices, where we forecast a further improvement on the back of rising prices in China. Accordingly, we calculate a steady improvement in EBITDA generation in the coming quarters, with EBITDA/tonne reaching USD110 for 2025, up 87% YoY in USD-based nominal terms, while the negative impact of inflation accounting on EBITDA is likely to be limited given our expectation of a depreciation in the Lira against the USD in line with the inflation trend for 2025. Last but not least, the Company has already started to export profitable rail product, offering further upside over its normalized EBITDA/tonne in the coming period. This upside would be around USD15/tonne based on a scenario with a 35-65% share of rail and profile production in its profile-rail mill, and USD35/tonne in a scenario of 50-50% (vs. the current 11-89%). The stock trades at an EV/EBITDA of 2.7x and P/E of 5.1x based on our 2025 forecasts, implying 41% and 40% discounts to global peers and average 43% discount to its historical average. With the operational earnings expected to gather momentum on a quarterly basis, its unleveraged balance sheet with a USD1mn net cash position as of 6M24 - which is forecasted to strengthen by the end of 2024 - and a brighter outlook for the industry, we raise our target price and maintain our Outperform rating for the stock given its discounted valuation.

The end of the down-cycle is finally in sight: At the beginning of the year, global steel demand had been forecasted to decline by 1.7% following two consecutive years of contraction, after having reached a record high in 2021. However, the much hoped for recovery in the manufacturing industry failed to materialize with a downturn in second quarter of 2024 amid continued weakness in the construction industry with interest rates remaining high as central banks delayed easing steps, preferring to adopt a wait-and-see approach. Accordingly, global production as of 9M24 remains 1.9% down YoY and demand is now forecasted to decline by 0.9% to 1.7bn tonnes for the full year. In regional terms, although China is mainly behind the contraction, commanding around 50% of the total market where the demand is forecasted to end the year with decline of 3%, demand in developed countries is also forecasted to decline by around 2%.

Basically, the failure of the steel industry to recover since the beginning of the year can be attributed to 1) delayed interest rate cuts from central banks, leading to downward revisions in global growth forecasts for 2024, except in the US, and 2) increasing pessimism over China's economic outlook amid concerns over the crisis in the country's property sector, which contributes around 14% to its entire GDP and which had peaked at 25-30% of GDP in 2018-19 when considered together related industries, also corresponding to around 70% of China's steel demand.

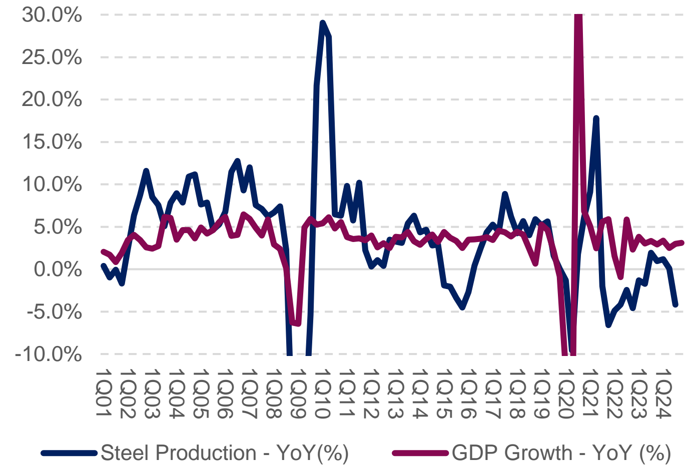
Regarding the rate cuts, the major central banks have finally got around to rate cuts, which are expected to continue in 2025, suggesting a solid GDP outlook for 2025. Among the regions, growth in Europe - comprising almost 10% of the steel industry - is likely to be more apparent with the region forecast to grow by 1.6% vs. the 0.7% growth forecasted in 2024. In the US, although current forecasts suggest 1.8% YoY GDP growth for 2025 on top of the healthy 2.6% growth in 2024, further upside is highly likely given the accelerating AI infrastructure investments while further growth may be driven by increasing domestic industrial production depending on the outcome of the Presidential elections, with some expectations of 2.3% growth for 2025. For the rest of the world, although the geopolitical risks remain high, there is a consensus for 4.3% growth in emerging markets vs. the 3.9% growth forecasted in 2024, driven by a strengthening economic outlook in Eastern Europe, the Asia Pacific and South America as the monetary easing cycle of major central banks supports growth in terms of liquidity flows into the regions.

Figure 2– Global Steel Production Figures on Monthly Basis (mn tonnes)



Source: World Steel Association

Figure 3– World Steel Production and GDP Growth



Source: Bloomberg, World Steel Association, QNBI Calculations

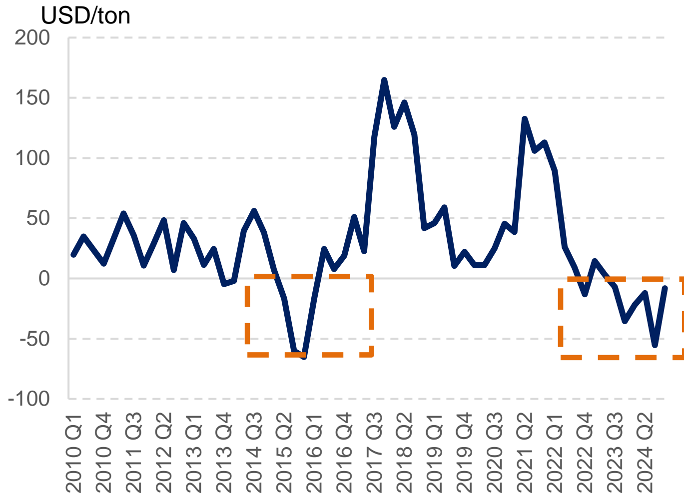
As well as driving the global market, China could also present the main roadblock to global growth and steel demand going forward. Although Chinese authorities have been announcing various regulations to support the property industry, including bailout plans for stressed real estate developers since the end of 2021, concerns over the outlook of the industry have not diminished with housing sales having slumped by 18% YoY in first eight months of 2024 while property investments were also declined by 10.2% on top of the 10.0% and 9.6% declines in 2023, respectively.

In late September, the Central Bank finally initiated a rescue plan for property industry as it announced that it would cut outstanding mortgage rates for individual borrowers by around 0.5 pp while the minimum down-payment ratio on second home purchases would be lowered from 25% to 15%. Additionally, homeowners will be able to renegotiate terms with their current lenders and be able to refinance with different banks. Last but not least, the PBOC will ramp up its re-lending program for state-owned firms to acquire unsold properties, providing 100% of the principal of bank loans, up from 60% previously. Over the last two weeks, further details have been officially been revealed on the plan to raise the bond issue limit to help local authorities support the industry, both on the purchase of idle properties and to support the new purchases. The final amount of the bail-out plan has not yet been announced yet but the general expectation is for a cash package for the industry in the order of 200bn Yuan, while debt swaps with local governments could reach as much as 5 trillion Yuan. The steps are expected to be announced in the coming weeks.

The initial reaction to the PBOC's move has been a 10.2% jump in steel prices in China, taking prices 14.7% off their lows this year but still around 16.0% lower than their historical average, while spreads over iron ore – the main feedstock for the steel industry (given that China is dominated with BoFs, which have a share of around 85%) – are also 15% lower.

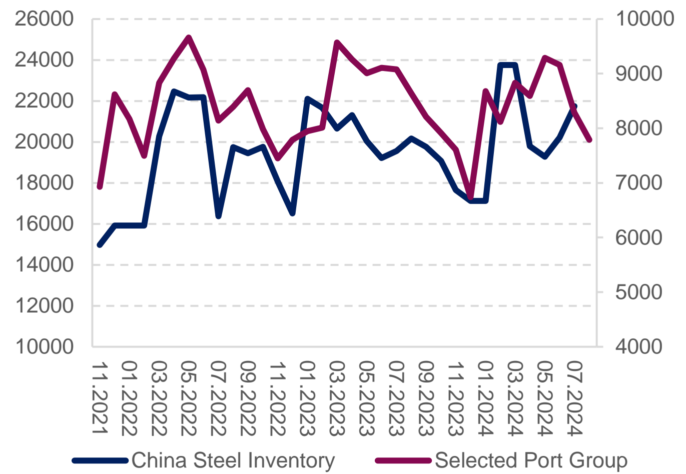
The last time we were in such a down cycle where the steel making cash spread was so far below its historical average and even turned negative (as it has since 3Q23) was in the 2Q15-2Q17 period, which gave way to a 35% rise in the steel prices over the next year while the cash spread improved to USD165/tonne vs. its current negative spread of USD8/tonne. There is some news flow suggesting we are emerging from the current down cycle, which has already dragged on for two additional quarters, with a healthy recovery on the horizon. Additionally, our calculation for the weekly steel inventory in the most important steel ports - comprising nearly 45% of the total inventory level - suggests an ongoing decline in inventory levels after the official monthly figure announced for July, implying a re-stocking period for the industry.

Figure 4– China BoF Cash Spread (USD/tonne)



Source: Bloomberg, QNBI Calculations

Figure 5– China Steel Inventories (x1,000 tonnes)



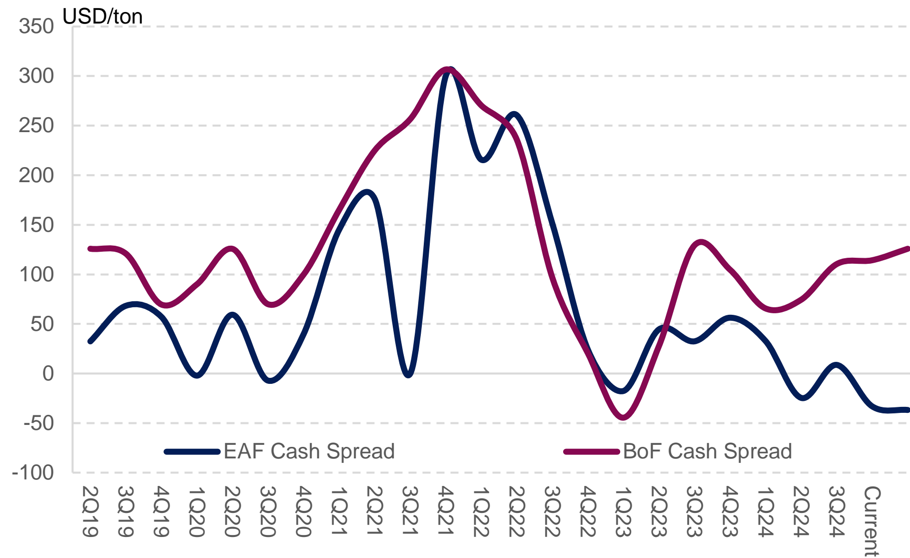
Source: Bloomberg, QNBI Calculations

Strength in the domestic market is apparent, but profitability is the main concern: Türkiye's steel demand surged to record high level of 38.1mn tons in 2023. In addition to meeting demand in areas of re-construction which had been negatively affected by the tragic earthquakes to strike Türkiye's south east, the ongoing momentum in industrial production also supported demand. Imports increased from 14.8mn tonnes to 17.1mn tonnes while production level was largely stable, given that the area affected by the earthquake was home to around 30% of Türkiye's total steel industry. In 9M24, production improved from 24.5mn tonnes to 27.9mn tonnes while consumption declined on softening economic activity with the monetary tightening steps taken by the Central Bank and rising cost bases as the USD/TRY exchange rate held firm, limiting the competitiveness of domestically produced steel when compared to imports. In detail, demand for long steel - mostly used in the construction industry - declined by 3.9%, compared to a 5.3% decline in demand for flat steel in 8M24, leading a cumulative decline of 4.6%. On the other hand, export volumes surged by 39% to 8.9mn tonnes, hence the growth in production at a time when demand was declining.

Profitability has been feeble, in line with the global trend. The weighted average cash spread of steel production - calculated based on the share of BoF and EAF capacities - in 1Q24 was at its lowest levels since 4Q22 on a quarterly basis, and 83.2% below its historical average. Despite some recovery in profitability given a much steeper decline in the cost base compared to steel prices, average cash spreads are still 62.8% lower than their historical average levels.

A recovery in prices in China has started to be observed in both Europe and Türkiye, with a recovery apparent for BoF producers which have seen a much steeper fall in their cost base (18% compared to 2023YE) vs. the stable trend for EAF producers, since prices of coking coal, the main source of energy for BoF producers, are now 34.2% down from their 2023YE level, while electricity prices, the main source of energy for EAF producers, are virtually unchanged in USD terms. Accordingly, recovering steel prices point to much promising more outlook for BOF producers, which comprise around 25% of the total capacity in Türkiye, with this improvement likely to become apparent in the 4Q24 and 1Q25 financials due to lag effect amid higher duration of the order book for BoF producers. We also think the ongoing momentum in steel prices is likely to support re-stocking activities in the coming period while the anti-dumping activities – placed for HRC and also expected to be placed for wire rod – may support the domestic prices further in the coming period.

Figure 6 – Türkiye Cash Spreads (USD/tonne)



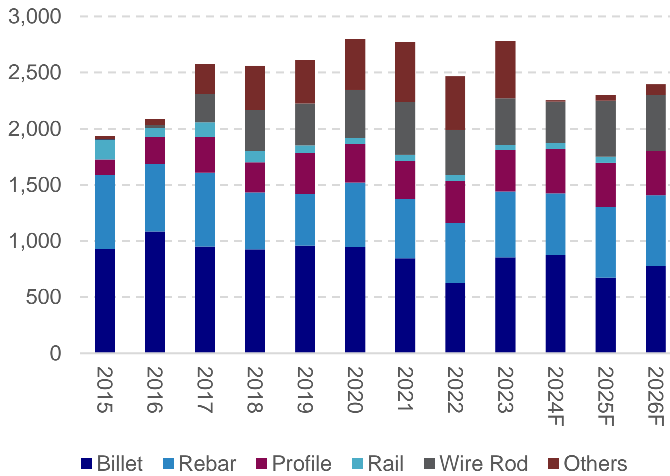
Source: QNBI Calculations

Kardemir: The worst is over for operating performance: Kardemir's sales volume surprisingly declined by 2.5% YoY in 1H24 amid weakening demand conditions in the domestic market while the festive holiday also had a negative impact on domestic demand. Profitability declined on tightened cash spreads amid depressed sales prices with its EBITDA/tonne declining to USD89 in 1Q24 and USD31 in 2Q24, vs. a historical average of USD110. Apart from the weak backdrop in the steel industry, the inflation accounting impact on EBITDA level was around USD29.1mn in 1H24 – USD28/ton– based on our calculation as the indexation of inventories has a larger impact on the operational figures for companies with higher inventory in days.

With steel-making costs for BOF producers now 7.9% lower than at the end of 1H24, on top of a 10.7% decline in 1H24 compared to 2023YE, prospects for the coming quarters are brighter, while we believe the negative impact of the inventory revaluation on EBITDA is likely to ease amid a limited revaluation effect and a declining base effect from inflation indexation. Accordingly, we calculate an increase in the EBITDA/tonne from USD31 to USD43 in 3Q24 with further improvements likely in 4Q to USD80/tonne on rising sales prices, with billet sales prices now 3.8% higher than the 9M24-end level. We also expect a further improvement on the back of rising prices in China.

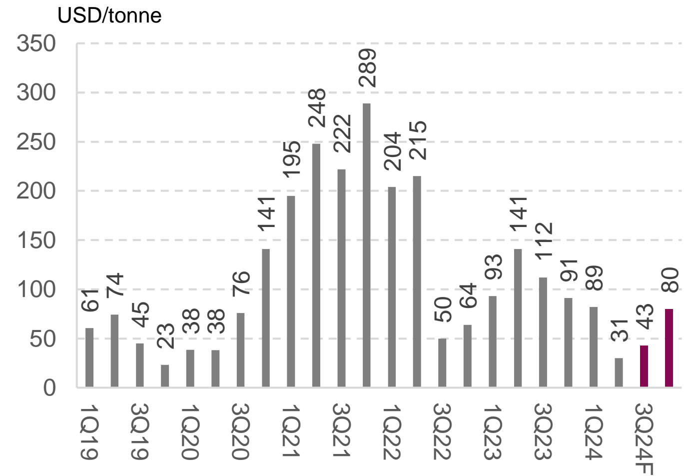
For 2025, although current cash spreads point to EBITDA/tonne of around USD90, we assume another 5% rise in the domestic steel prices and iron ore prices, while the negative impact of inflation accounting on EBITDA will diminish further on our expectation of a similar devaluation in the TRY against USD in line with inflation. Accordingly, we calculate an 87.1% improvement in EBITDA generation in USD-terms based on a similar sales mix assumption and a conservative assumption of a 2% increase in total sales volumes.

Figure 7– Kardemir Sales Mix (x1,000 tonnes)



Source: The Company, QNBI Estimates

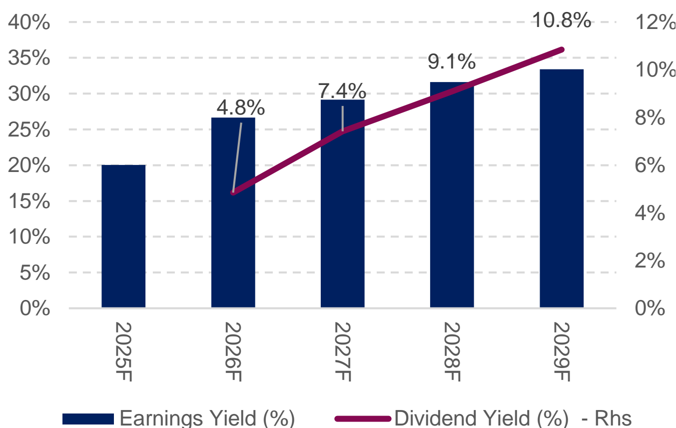
Figure 8– Kardemir: EBITDA/tonne Generation



Source: QNBI Calculations and Estimates

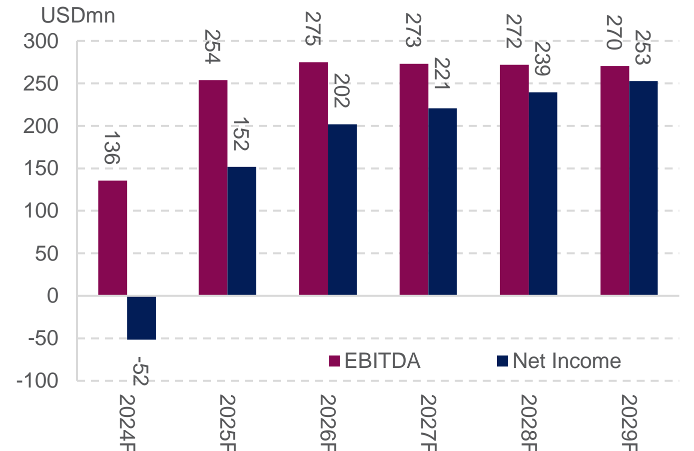
Bottom-line may gain momentum on lower FX-losses and tax expenses in 2025: Kardemir's bottom-line was squeezed by FX-losses in 1H24 on its short FX-position of USD438mn and EUR57.5mn, resulting from its working capital structure, leading to a total of TRY1.8bn in FX-losses in 1H24 despite its cash flow hedging mechanism that had cushioned the impact of FX-losses on the bottom-line in the previous years. We think the relatively limited impact of this mechanism on the bottom-line was mostly driven by the strength of the TRY against the USD throughout the year, given our year-end TRY/USD forecast of TRY42.00 vs. our current assumption of 36.50, translating into 21.7% depreciation of the TRY against USD for the full year vs. our previous assumption of 40%. Given the nature of the mechanism, the positive deviation in the exchange rate assumption may have had a negative impact on FX-losses, although any calculation with limited information would be misleading. Another important factor would have been the losses on deferred tax assets, with the company posting a net of TRY829mn in tax expenses during 1H24, including TRY414mn of deferred tax expenses. The expenses on deferred tax assets resulted from inflation accounting adjustments, which are highly unpredictable. Although we currently expect further losses in 3Q24, given our year-end inflation expectation of 25.0% in 2025 (compared to 43.5% for the 2024 full year), we are likely to see a more limited inflation accounting impact on the financials, with the bottom-line performance (and the operating performance) being more visible. Accordingly, we calculate TRY6.2bn in net income generation for 2025, implying a 20% earnings yield, comparing to 12.8% for BIST-100.

Figure 9 – Kardemir: Earnings and Dividend Yields (%)



Source: QNBI Estimates

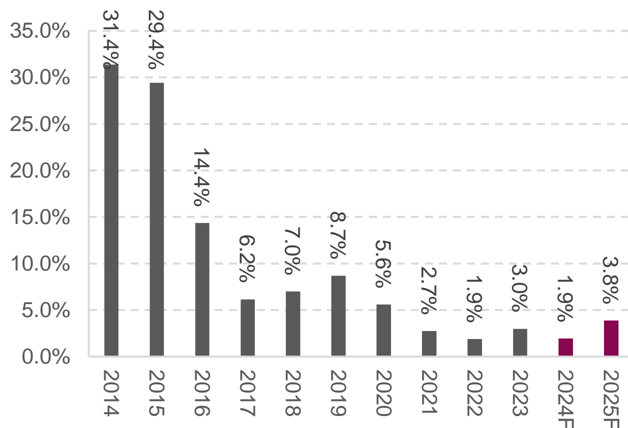
Figure 10 – Kardemir: EBITDA and Net Income Projection



Source: QNBI Estimates

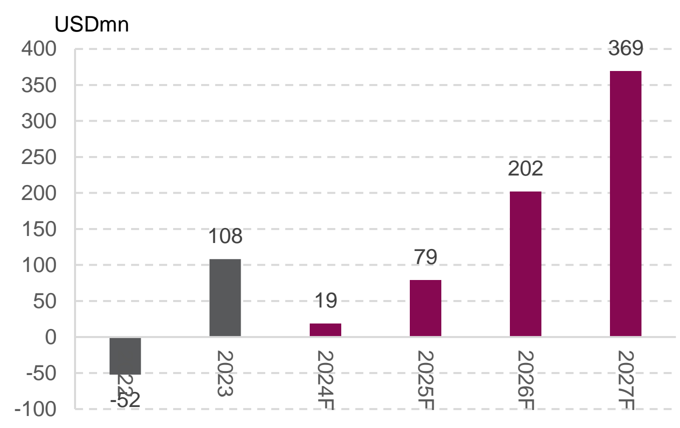
A healthy balance sheet in a high interest rate environment: Kardemir held a net cash position of USD1mn at the end of 1H24, having declined from USD107mn at the end of 1Q24. Despite a limited capex amount of USD8.3mn for the quarter, an increase of USD122.3mn in the working capital need led to a decline in the net cash level. We forecast a 13.6% HoH increase in the company's sales volume in 2H24 against a backdrop of falling raw material costs. This would suggest a recovery in the working capital need for the coming quarters, and along with strengthening operational performance, we calculate an improvement in the company's net cash position by the end of 2024, although we have not assumed any improvement on the working capital front for the sake of adopting a conservative approach. Kardemir is not currently in a heavy capex period; the Company's target of increasing its liquid steel production to 3.0mn tonnes does not require any heavy capex, while the sizing blocking technology investment, which is approaching completion, suggests more profitable product sales from its wire rod mill. Although the Company may step up its investments to reduce carbon emissions, no official plan has yet been announced on this front. Accordingly, we assume a mere USD65mn in capex for 2025, implying a net cash level of USD79mn for the end of 2025, but any unforeseen investments in green projects or potential initiatives regarding logistics could limit cash accumulation.

Figure 11 –Kardemir: Capex / Sales Ratio (%)



Source: QNBI Calculations and Estimates

Figure 12 – Kardemir: Net Cash Projection



Source: QNBI Calculations and Estimates

Railway exports offer exciting prospects: Kardemir's rail-profile mill has a production capacity of 450,000 tonnes while related products comprise 17.5% of its total sales volume. Although these two product types are milled at the same complex, rail product sales are much more profitable than profile sales, with the price spread between two having averaged around USD330/tonne, while profile production accounted for 89.4% of the Company's production in 1H24.

Türkiye has been investing heavily in its transportation industry, with around USD250bn of investments between 2003-2022. In terms of the breakdown, 60.7% of this investment has been directed to roads followed by 20.7% in rail, corresponding to USD51.7bn. Strategically, Türkiye has been placing a high level of importance on railway investments, with the target increasing the number of passengers carried by rail from 19.5mn to 270mn over the next 30 years while aiming for growth in freight carried by rail from 30mn tonnes to 448mn tonnes. This growth plan is mostly in line with the global trends on low carbon emission targets, with road transportation comprising 71.7% of carbon emissions in the transport industry compared to just 1.8% for rail transportation. In other words, road transportation carbon emissions are around 24 times higher than carbon emissions from rail transportation.

According to the latest projections published by the Ministry of Transport and Infrastructure, Türkiye aims to expand the national railway network from 13,919km as of 2023 to 17,235km by 2025, with approximately 3,800km of new railway lines currently under construction according to the latest statements with studies for 5,800 km of new lines having been completed with and research and project development work ongoing for an additional 5,000 km of lines. In the longer term, Türkiye plans to expand its railway network length to 28,590 km by 2053.

According to International Union of Railways, 98-130 tonnes of rail is required per kilometre of new track, implying around annual of 72,000-95,000 tonnes of rail needs without any potential modernization investments within the targets, noting that engineering details may result in high deviations in the calculated figure and actual need, as previous statements had claimed that the annual rail demand in Türkiye was around 150,000 tons. Despite Kardemir's overcapacity, as the sole rail producer in Türkiye, the country reportedly needed to import 41,600 tonnes of railway steel in 2023. In line with the company's strategy to increase the share of rail production in total and the importance being attached to local production at a national level while lowering total imports, we think that rail import volumes may decline in the coming period, which would be replaced by Kardemir's products. In addition, the recent rail export sales hint at a further increase in the share of rail steel in total production.

Railway rail sells at a price which is, on average, USD330/tonne higher than profile products and USD517/tonne higher than billet. Kardemir sold 44,000 tonnes of railway steel in 2023, compared to 368,000 tonnes of profile steel. Based on our scenario analysis based on sales volumes of 150,000 of railway steel – in line with Türkiye's normalized annual need – instead of profile, we calculate USD32mn of potential upside over our normalized EBITDA forecast, implying an improvement of around USD15/tonne in the sustainable EBITDA/tonne level. In a scenario with a 50-50 share, this would surge to an improvement of USD35/tonne, or USD54mn in overall EBITDA generation. These two scenarios imply 20% and 34% upside challenges to our DCF model under our conservative approach which assumes sales volume of around 2.4mn tonnes over the projection horizon which is highly conservative amid the management's target of increasing its liquid steel production to 3.0mn tons.

Valuation

We base our valuation on an 50-50 weighting of the results derived from the extrapolation of DCF and multiple valuation methodology, and derive a 12-month target value of USD1,391mn, implying 78% upside potential.

- Our USD-denominated DCF model is based on a 12.6% WACC and a beta of 1.2x. Meanwhile, we assume a risk-free rate of 7.5% and an equity risk premium of 5.5%.
- We use our USD-based nominal forecasts in our DCF model as the company's inflation accounting included financials are not indicative of its cash generation ability on the indexation and inventory revaluation, as was also the case in 2024 in such a high inflation environment. Accordingly, our forecasts for IFRS figures differ slightly from the figures in our DCF model.
- Kardemir D-type shares represent 68.44% of the capital. However, they only control one seat in the BoD compared to the four seats held by A-type shareholders and two seats by B-type shareholders. Although these shares historically constituted 56% (a 12% discount) of the total market capitalization, over the last couple of years, the discount has narrowed. Accordingly, we do not incorporate any discount for its limited seat representation compared to other type of shares
- Our multiple analysis is based on a 50-50 blend of P/E and the EV/EBITDA multiples. On our 2025 earnings forecasts, Kardemir trades at a P/E of 5.1x and EV/EBITDA of 2.7x suggesting an average 41% discount to its international peers. Based on 2026 prospective earnings, Kardemir currently trades at a P/E of 3.8x and an EV/EBITDA of 2.1x, implying 47% and 53% discounts to international peers, respectively. We use 80-20% weightings for 2025 and 2026 on multiple analysis valuation due to high cyclicality of the industry that longer-term projections are highly sensitive to the industrial cycles.

Figure 13 – Valuation Summary

Method	Weights	USDmn
DCF-Driven 12M Target Value	50%	1628
Peers Analysis Implied Value	50%	1153
12-Month Target Value		1391
12-Month Target Price (USD)		**1.2**
12-Month Target Price (TRY)		**44.5**

Source: QNBI Estimates

QNB INVEST

Figure 14 – DCF Tables

USDmn	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F
Revenues	1,594	1,692	1,900	1,937	1,974	2,012	2,051	2,091	2,131	2,172
Revenue Growth	*-28%*	*6%*	*12%*	*2%*	*2%*	*2%*	*2%*	*2%*	*2%*	*2%*
EBIT	73	191	212	209	205	202	198	198	202	204
EBITDA	136	254	275	273	272	270	267	269	272	274
EBITDA Margin	*8.5%*	*15.0%*	*14.5%*	*14.1%*	*13.8%*	*13.4%*	*13.0%*	*12.8%*	*12.8%*	*12.6%*
Taxes	-18	-48	-47	-46	-45	-44	-44	-44	-44	-45
Inc./dec. in W/C	70	-49	-31	-4	-3	-3	-4	-4	-4	-4
Capex	-30	-65	-70	-70	-70	-70	-70	-70	-70	-70
FCF	**157**	**91**	**127**	**154**	**153**	**153**	**150**	**151**	**154**	**156**
WACC	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%
PV of FCFs	**914**									
Terminal Growth Rate	2%									
Terminal Value	1428									
PV of TV	**512**									
Value of Firm	1426									
Net Debt	-1									
Participations	0									
Equity Value	**1427**									

Source: QNBI Estimates

Figure 15 – Peer Analysis

		P/E (x)		EV/EBITDA (x)	
	Mcap	**2025**	**2026**	**2025**	**2026**
EUROPE					
Acerinox SA	2,860	6.9	5.9	3.7	4.0
ArcelorMittal	28,389	5.4	4.6	3.6	3.4
Salzgitter AG	2,652	4.7	3.4	2.5	3.4
Voestalpine AG	6,855	7.0	5.9	3.3	3.2
ASIA					
POSCO	21,579	11.4	10.1	5.4	5.2
Steel Authority of India	4,424	10.7	8.4	6.2	5.5
BlueScope Steel Ltd	6,366	10.8	9.6	4.6	4.3
Nippon Steel& Sumitomo Metal Corp	22,018	5.6	5.0	5.2	4.2
Baoshan Iron& Steel	21,926	8.4	9.4	5.9	6.9
AMERICA					
US Steel Corp	7,109	14.1	10.6	6.3	4.4
Average		8.5	7.3	4.7	4.4
Kardemir		5.1	3.8	2.7	2.1
Discount/Premium		**-40%**	**-47%**	**-41%**	**-53%**

Source: Bloomberg, QNBI Estimates

QNB Invest 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.

QNB INVEST

Disclaimer

All information given in this document has been obtained from sources believed to be reliable, and while QNB INVEST has taken reasonable care in verifying the accuracy and completeness of the information presented herein, it cannot be held responsible for any errors, omissions or for consequences arising from the use of such information. The investment information, commentary and advice contained within this document does not constitute investment advisory activity or any solicitation to buy or sell the securities mentioned herein. Investment advisory services are provided by authorized institutions to persons and entities privately by considering their risk and return preferences, while the commentary and advice included in this document is of a general nature and therefore may not be appropriate for your financial situation or your risk and return preferences. As such, investment decisions based only on the information herein may not produce results that fit your expectations. The affiliates, officers, partners and employees, including persons involved in the preparation or issuance of this material may have a direct or indirect position in any security mentioned in this report.