Katmerciler

The Promise of Growth

We visited Katmerciler to discuss the company's current operations and prospects regarding its investments in the defence industry. Katmerciler is the leader of the domestic on-vehicle equipment sector in Turkey with an annual production capacity of 1,300 vehicles. Buoyed by the success of its water-cannon vehicles (TOMA), Katmerciler has invested in the defence industry with a new plant in Ankara and developed three armoured personnel carriers (APCs), which are in strong demand from the Turkish Military and Police Force, for use in the fight against terror. The new plant will initially have an annual production capacity of 250 vehicles which will gradually increase to 1000-1,500 vehicles. Katmerciler has already bid in the APC tenders held by the Undersecretariat of the Defence Industry and is expecting a positive outcome, while the Company is evaluating export opportunities and preparing for new tenders in Turkey along with developments of new armoured vehicles. Katmerciler is also establishing a JV with the prominent Limak Holding to exploit further opportunities in the defence industry. With on-vehicle equipment orders set to recover from last year's weak base and prospective defence industry orders, Katmerciler is forecast to generate TRY400-420mn of revenues in 2017 (up from TRY145mn in 2016).

- **Leading the domestic on-vehicle equipment sector:** Katmerciler is the leader of Turkey's highly fragmented on-vehicle equipment sector, with a 30 year presence in the sector. Production is carried out on the 31,000sqm Cigli facility which has an annual production capacity of 1,300 vehicles. Clients are predominantly public institutions and Katmerciler receives orders through direct participation in tenders or subcontracting to truck producers. The Company also exports to over 50 countries, with exports comprising approximately 60% of revenues.
- **A strong foray into the defense industry:** Katmerciler invested in defence industry with the production of armoured excavators, construction equipment and 4x4 personnel carriers. The Company invested USD2mn in a new facility in Ankara where it will produce defence equipment, and the facility was commissioned in August 2016. The Company seeks to benefit from Turkey's increasing demand for armoured vehicles given the terror threats both in Turkey and neighbouring countries, and also seeks export opportunities in the region. Katmerciler recently entered an agreement with Limak Holding to establish a JV to co-evaluate opportunities in the defence industry and the initial focus of the JV will likely be the applications of ceramic-fortified armour.
- **Poised to benefit from its investments:** Katmerciler has received around USD17mn of orders for its armoured excavators and construction equipment in the last year and is now pursuing new tenders to sell its new 4x4 armoured personnel carriers in Turkey and export markets. With such prospects, the management expects revenues to exceed TRY400mn in 2017 (from TRY145mn in 2016) and gradually increase thereafter. The Company is also working on new vehicles such as 6x6 and 8x8 tactical armoured vehicles and mine clearance vehicles, which may bring additional orders to the company.

2 May 2017

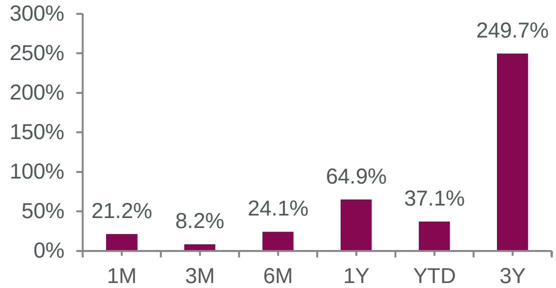
N/R

Close Price: TRY12.16
12M Target Price: N/A
Upside Potential: N/A

Stock data

Bloomberg / Reuters	KATMR TI / KATMR.IS
Mcap (US$mn)	86
EV (US$mn)	130
Avg. Trd. Vol. (US$mn)	4.9
Free float	36%

Relative Performance to BIST100



Key Data (TRYmn)	2013	2014	2015	2016
Revenues	146	170	311	145
Growth	*-4%*	*16%*	*83%*	*-53%*
EBITDA	13.7	15.2	43.9	28.8
Growth	*-2%*	*11%*	*188%*	*-34%*
Net Profit	-8.2	9.3	18.6	9.6
Growth	*n.m.*	*n.m.*	*100%*	*-48%*
P/E (x)	n.m.	7.1	5.6	31.7*
EV/EBITDA (x)	15.3	11.6	4.4	14.9*
P/BV (x)	4.0	1.6	1.7	4.2*
FCF yield (%)	-55%	79%	15%	-26%
Div. yield (%)	4%	0%	0%	0%

**Based on current market valuation*

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Figure 1 – Summary financials & key metrics (TRYmn)

Income statement	2013	2014	2015	2016
Revenues	**146**	**170**	**311**	**145**
Gross profit	**35**	**34**	**74**	**56**
EBITDA	**14**	**15**	**44**	**29**
Depreciation	-133	-155	-267	-116
EBIT	**146**	**170**	**311**	**145**
Net other income	-138	-165	-309	-135
Income from investing activities	14	15	44	29
Net financial income	-30	-11	-22	-26
Profit from associates	0	0	0	0
PBT	**-8**	**9**	**24**	**12**
Taxes	0	0	-5	-2
Minority interest	0	0	0	0
Net income	**-8**	**9**	**19**	**10**

Balance sheet	2013	2014	2015	2016
Current assets	**202**	**170**	**177**	**224**
Cash equivalents	6	7	17	7
Trade receivables	92	63	76	99
Inventories	83	78	60	92
Other current assets	22	22	24	25
Non-current assets	**35**	**42**	**51**	**69**
Tangibles	0	0	0	0
Intangibles	25	27	33	43
Other non-current assets	10	15	18	26
Total assets	**237**	**212**	**229**	**293**
Current liabilities	**165**	**115**	**111**	**159**
Short-term loans	105	45	55	113
Trade payables	35	36	46	36
Other current liabilities	26	34	11	10
Non-current liabilities	**41**	**54**	**55**	**62**
Long-term loans	37	48	48	52
Other non-current liabilities	4	6	7	10
Minority Interest	**3**	**3**	**0**	**0**
Shareholders' equity	**28**	**40**	**63**	**72**
Total liabilities and equity	**237**	**212**	**229**	**293**

Key metrics	2013	2014	2015	2016
Growth				
Revenue growth	-4%	16%	83%	-53%
EBITDA growth	-2%	11%	188%	-34%
Net income growth	-181%	-213%	100%	-48%
Profitability				
Gross Margin	24.0%	19.9%	23.8%	39.0%
EBITDA margin	9.4%	9.0%	14.1%	19.9%
Net margin	-5.6%	5.5%	6.0%	6.6%
Return on assets (ROA)	-4.2%	4.1%	8.4%	3.7%
Return on equity (ROE)	-24.6%	27.3%	36.2%	14.2%
Return on cap. emp. (ROCE)	-5.0%	7.4%	12.6%	4.2%
Leverage				
Net Debt	135	86	85	158
Net debt / Equity	4.8	2.1	1.4	2.2
Net debt / EBITDA	9.9	5.7	1.9	5.5
EBIT Interest coverage	2.0	4.4	2.2	3.2
Efficiency				
Total asset turnover	0.6	0.8	1.4	0.5
Equity turnover	5.2	4.2	5.0	2.0
WC/Sales	95%	62%	29%	108%
Opex/Sales	15.4%	11.6%	10.2%	20.5%

Cash flow	2013	2014	2015	2016
EBITDA	14	15	44	29
Change in working capital	-70	35	15	-66
Taxes (EBIT x 20%)	-3	-3	-9	-6
Capital expenditure	0	-3	-6	-16
Adjustment	-2	8	-28	-21
FCFF	-61	52	16	-80

Source: Katmerciler, QNB Finansinvest

INVESTMENT THEME

The leader of the domestic on-vehicle equipment sector

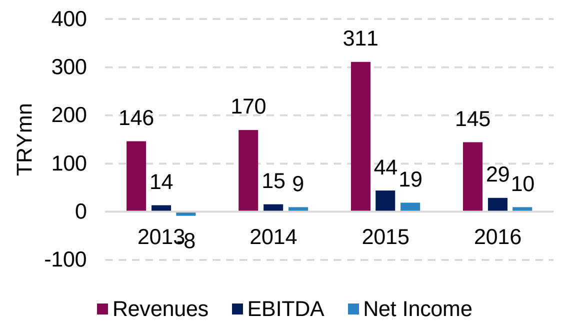
Established in 1985, Katmerciler boasts more than 30 years of experience in the on-vehicle equipment sector. Katmerciler has the leading market share in this highly fragmented sector in Turkey. The other players are mainly small enterprises. The company delivers turnkey solutions for its customers and carries out production at its 31,000sqm facility in Cigli, Izmir (with an enclosed area of 17,000sqm) with an annual production capacity of 1,300 vehicles. The products are tailor-made for each customer's needs and hence almost all of the company's products are different from each other. The Company's main product range includes fire engines, environmental vehicles, transportation vehicles, construction special vehicles and special products. The clients are predominantly but not exclusively public institutions such as municipalities and government departments. Accordingly, the sales are contract-based and all vehicles in production are pre-ordered. Katmerciler receives orders either through government/ private sector tenders or subcontracting to truck producers. The Company is also the largest exporter in its sector and has realized exports to more than 50 countries – exports comprise an average 60% share of sales.

Figure 2 – Katmerciler equipment sales progression

Equipment sales volume	2014	2015	2016
Compression Garbage Tool	125	358	202
TOMA (Anti-riot vehicle)	88	155	5
Water tanker	114	132	70
Fire truck	58	98	67
Dump truck box	362	75	62
Road Sweeper	9	53	27
Fuel Tanker	20	44	77
Sewage Vehicle	93	40	34
Canal jetting vehicle	10	17	-
Others	138	294	105
Total	**1017**	**1266**	**649**

Source: Katmerciler, QNB Finansinvest

Figure 3 – Katmerciler recent financial performance



Source: Katmerciler, Rasyonet

A concerted advance into the armoured vehicles segment

Katmerciler has been present in the defence sector with the production of water cannon vehicles (TOMA) since 2010 and more recently with armoured excavators and construction equipment. Buoyed by the success of these vehicles, the Company decided to increase its presence in the defence industry with the production of armoured vehicles. To this end, Katmerciler established a new facility in Ankara with a capex of USD2mn. The facility was opened in August 2016 and currently commands an annual production capacity of 250 vehicles. The Company has been investing TRY10mn for the second phase of this facility and will invest another TRY10mn to gradually increase the production capacity to 1000-1,500 vehicles by 2019. Katmerciler obtained the Facility Security Clearance Certificate for its Ankara facility in 2015, certifying that the facility complies with NATO security rules and regulations. This certificate will allow the Company to participate in defence industry tenders both in Turkey and abroad.

Katmerciler has developed three armoured vehicles – the 'Khan', the 'Hizir' and the 'Nefer'. The Khan is a light armored personnel carrier and has a seating capacity for eight personnel – this vehicle competes with Otokar's light armoured tactical vehicle, the Ural. The Hizir is a tactical wheeled heavy armoured vehicle with a seating capacity of nine personnel – this vehicle competes with the 'Cobra' produced by Otokar and the 'Ejder Yalcin', which is made by Nurol. The 'Nefer' is a Jeep-driven armoured vehicle which is lighter and has better manoeuvring capabilities than most tactical armoured vehicles. The armour for this vehicle was built with fortified ceramic and it has no competitors – we think it offers good potential for use in military and police forces. Katmerciler sees massive potential in fortified ceramic with extended use in military and police vehicles and buildings.

Figure 4 – Katmerciler armoured vehicle portfolio

KHAN 4x4 Armoured Personnel Carrier

Hizir 4x4 Tactical Wheeled Armoured Vehicle

Nefer 4x4 Armoured Command and Patrol Vehicle

Remote-controlled Armored Excavator

Armoured Construction Equipment

Riot Control Vehicle

Source: Katmerciler

A surging need for armoured vehicles

Katmerciler has signed three contracts for armoured vehicles so far in 2017, with a cumulated contract award of USD13mn. These contracts include armoured excavators and pick-up trucks for the needs of Turkish Police and Military forces. With Turkey's increasing need for security and defence both inside Turkey and abroad, we expect an increase in demand for armoured vehicles from the Police force and the Turkish Military. Given the terror threats and cross-border operations, Turkey currently needs armoured versions of personnel carriers, tactical wheeled vehicles, excavators, ambulances, pick-up trucks and police vehicles.

Katmerciler pursuing opportunities both at home and abroad

Having developed three armoured vehicles, Katmerciler is now pursuing tenders and opportunities to sell its products both in Turkey and in export markets. The company has not yet received any orders for its existing portfolio (except for the armoured construction equipment and pick-up trucks) as the product portfolio has recently been completed and related tenders still continuing. Katmerciler has bid in the APC tenders held by Undersecretariat of Defense and expects a positive outcome while the Company should be a competitive contender for upcoming tenders. With the proven track record of Turkey's armored vehicle producers, there has been also increasing interest and demand for these vehicles from Middle Eastern and African countries and Katmerciler is pursuing these opportunities. The Company is also currently developing 6x6 and 8x8 armoured vehicles that will allow it to enter new segments which is also asked by the Undersecretariat of Defence. Katmerciler currently has an annual production capacity of 250 armoured tactical vehicles, although this figure is expected to dip during the ramp-up phase of the new facility. Going forward, the production capacity is planned to gradually increase to 1,000-1,500 vehicles in the coming years.

Establishing a JV with the prominent Limak Holding

In late January, Katmerciler announced that it has signed a non-disclosure agreement with Limak Holding to evaluate opportunities in the defence industry. In mid-March, Katmerciler announced that it had initiated work on setting up a JV named LIKA Savunma Sanayi ve Ticaret A.S. The shareholder structure has not yet been disclosed, but our understanding is that Katmerciler would be a minority in the JV while the shareholding would reach 50% with the Katmerci family's stake – the other 50% stake would be owned by Limak Holding.

Established in 1976, Limak Holding has interests in the tourism, cement, energy, infrastructure, airport management and operations, port management, food and aviation sectors. Limak Holding is one of Turkey's biggest business groups and generated TRY12bn of revenues in 2016 with a revenue target of TRY15bn for 2017. Limak Holding will not only inject capital to the JV but will also pave the way for LIKA as well as Katmerciler to enter new countries where the Holding is actively doing business.

There are a wealth of opportunities for LIKA in the defence industry. While Katmerciler will continue to focus on the armoured vehicles business, LIKA will work on different projects. Although the scope of its business is not yet clear, our understanding is that the JV will initially focus on ceramic-fortified armouring. Ceramic armour is lighter and offers the same ballistic resistance as steel armour and, accordingly, presents opportunities for use in a wide variety of products including armoured vehicles, tanks, bulletproof vests and buildings. The JV is also interested in the production of engines, axles and transmission systems, and has plans to co-operate with other defense companies in Turkey.

Shareholder structure and registered shares

Katmerciler is controlled by the Katmerci family with a total holding of 61.7%, while 36.3% of shares float freely on the Borsa Istanbul.

Family members also assume seats in the management. Ismail Katmerci is the Chairman of the Board, Mehmet Katmerci is the Deputy Chairman, General Manager and President of the Executive Committee, and Furkan Katmerci is the Deputy President of the Executive Committee.

Ismail Katmerci had registered 6 million shares (24% of the total shares) on the Borsa Istanbul for possible sale with one year, and this period will expire in May 2017. Although a re-registration poses a risk to the stock, we would not expect the sale of the shares in the near future considering the Company's multiple growth prospects.

Figure 5 – Katmerciler shareholder structure

Shareholder	Stake	Management Duty
Ismail Katmerci	46.11%	Chairman of the Board
Havva Katmerci	4.40%	-
Mehmet Katmerci	4.40%	Deputy Chairman, General Manager and President of the Executive Committee
Ayse Nur Cobanoglu	4.40%	-
Furkan Katmerci	4.40%	Deputy President of the Executive Committee
Free Float	36.29%	-
	100%	

Source: Katmerciler

Poised to reap the fruits of investments

The Turkish Government is planning to increase the share of defence spending in GDP from the current 1.6-1.7% to 2% amid a rising need for security and defence amid multiple terror threats within the country and in the surrounding region. The Turkish Government is also placing a special emphasis on domestic procurement in the defence industry, presenting a wealth of opportunities for local firms. To capitalize on this opportunity, Katmerciler has been ramping up its investments in the defence industry and is now poised to reap the fruits of its investments.

Katmerciler targets c.TRY400mn revenue generation in 2017 (from TRY145mn in 2016) thanks to the award of potential contracts for its armoured vehicles and an acceleration in its on-vehicle equipment orders. The Company has bid for EUR600mn of projects in defense industry and is expecting to be awarded the contracts. Going forward, the Company has ambitious growth plans and targets to reach EUR300mn of revenues within the next 4-5 years with the rising contribution of defence industry sales. Given the number of projects in hand and lack of visibility of their impact on the financial statements, we think it would be very difficult at this stage to conduct an accurate valuation to the company or compare trading multiples. However, for instructive purposes we have provided trading multiples for Katmerciler according to varying revenue and EBITDA assumptions, to at least provide some perspective of the relative valuation.

Figure 6 – Trading multiples according to different revenue and EBITDA assumptions

2017F EV/EBITDA

EBITDA Margin	Revenues (TRYmn) 200	300	400	500
12%	16.7	12.9	10.9	9.8
14%	14.4	11.0	9.4	8.4
15%	13.4	10.3	8.7	7.8
16%	12.6	9.7	8.2	7.3

2018F EV/EBITDA

EBITDA Margin	Revenues (TRYmn) 300	400	500	600
12%	12.9	10.9	9.8	9.0
14%	11.0	9.4	8.4	7.7
15%	10.3	8.7	7.8	7.2
16%	9.7	8.2	7.3	6.8

2017F P/E

EBITDA Margin	Revenues (TRYmn) 200	300	400	500
12%	26.5	19.7	15.7	13.1
14%	20.7	15.1	11.8	9.7
15%	18.7	13.5	10.5	8.6
16%	17.0	12.2	9.5	7.7

2018F P/E

EBITDA Margin	Revenues (TRYmn) 300	400	500	600
12%	18.7	15.1	12.6	10.8
14%	14.4	11.4	9.5	8.1
15%	13.0	10.2	8.4	7.2
16%	11.8	9.2	7.6	6.4

Source: QNB Finansinvest

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: **Özgür Uçur.**

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

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