

## Net Holding (NTHOL, Not Rated)

### A resilient business with potential triggers

#### Company in brief:

Net Holding was founded in 1981 and has been listed on the Borsa Istanbul (BIST) since 1989 with the ticker “NTHOL.” Net Holding’s average daily trading volume was more than USD2.0mn in November 2017. The company is managed by the Tibuk family (30%) and institutional investors represent 27% of the company. The company’s Treasury shares are 29%, while 15% is free float.

| Share Price | 12M Target Price | Potential Return | Recommendation |
|-------------|------------------|------------------|----------------|
| TL1.94      | -                | -                | -              |

| Stock Market Data             | 05.12.2017                                                                                                          |              |               | Financials and Ratios | 2013  | 2014  | 2015  | 2016  |
|-------------------------------|---------------------------------------------------------------------------------------------------------------------|--------------|---------------|-----------------------|-------|-------|-------|-------|
| <b>Bloomberg/Reuters:</b>     | <b>NTHOL.TI / NTHOL.IS</b>                                                                                          |              |               | Net Sales (TLmn)      | 195   | 308   | 403   | 479   |
| Mcap (TLmn)                   | 1,094                                                                                                               |              |               | YoY                   | 82%   | 58%   | 31%   | 19%   |
| Mcap (US\$m)                  | 283                                                                                                                 |              |               | EBITDA (TLmn)         | 30    | 74    | 97    | 119   |
| EV (TLmn)                     | 1,290                                                                                                               |              |               | YoY                   | -362% | 145%  | 31%   | 22%   |
| Net Debt (TLmn - 3Q17)        | 196                                                                                                                 |              |               | Net Profit (TLmn)     | 150   | 23    | 66    | -24   |
| <b>Rel. Performance:</b>      | <b>1 mth</b>                                                                                                        | <b>3 mth</b> | <b>12 mth</b> | YoY                   | 98%   | n.m.  | n.m.  | -137% |
| 12M Range (TL):               | -1%                                                                                                                 | -25%         | -58%          | EBITDA Margin         | 15.6% | 24.1% | 24.1% | 24.8% |
| Av. Daily Vol. (US\$m) 3 mth: | 1.82 / 3.23                                                                                                         |              |               | P/E (x)               | 7.3   | 47.9  | 16.6  | n.m.  |
| YTD TL Return:                | -36%                                                                                                                |              |               | EV/EBITDA (x)         | 42.6  | 17.4  | 13.3  | 10.9  |
| Beta (2 year, weekly)         | 0.49                                                                                                                |              |               | EV/Sales (x)          | 6.63  | 4.18  | 3.20  | 2.70  |
| Weight in BIST-100            | -                                                                                                                   |              |               | EPS (TL)              | 0.27  | 0.04  | 0.12  | -0.04 |
| Shares Outstanding (mn):      | 564                                                                                                                 |              |               | DPS (TL)              | 0.14  | 0.00  | 0.00  | 0.42  |
| Foreign Own. in Free Float :  | Current                                                                                                             | 12M ago      |               | Div. Yield            | 7.2%  | 0.0%  | 0.0%  | 21.6% |
|                               | 23.9%                                                                                                               | 58.7%        |               |                       |       |       |       |       |
| <b>Shareholders:</b>          | Tibuk Family 29.7%, Treasury shares 28.8%, Pine River 7.5%, Foreign institutional investors 19.2%, Free Float 14.8% |              |               |                       |       |       |       |       |

- Net Holding operates under the Merit brand with six hotels and five casinos in Northern Cyprus, three casinos in Montenegro and two casinos in Croatia. The company will open one new casino in Bulgaria, Macedonia and Croatia each in 2018.
- The company operates a 35k sqm casino area with 486 live tables and 4,390 slot machines. Its hotel portfolio has 4,305 beds in total. Net Holding’s Merit casino chain is the only casino chain in Northern Cyprus with a 40% share in the gaming market.
- Net Holding’s core business is gaming, yet it also has a real estate portfolio to be sold. Net Holding has 11.7mn sqm of land in Turkey, 2.5mn sqm in Northern Cyprus and 0.3mn sqm in Baku, Azerbaijan. All of its real estate will be revalued in 4Q17 with expectations of value increases, especially for Northern Cyprus. Its 10mn sqm plot in Bodrum is not included in its revaluation and is not shown on its balance sheet. According to the presentation, all the real estate had a book value of USD572mn as of 9M17.

#### A glance at Net Holding’s Proporties

| Categories                    | Net Book Value (USDmn) |
|-------------------------------|------------------------|
| Turkey Land                   | 19.3                   |
| Cyprus Land                   | 86.8                   |
| Turkey Real Estate            | 33.1                   |
| Cyprus Real Estate            | 384.3                  |
| Azerbaijan Land & Real Estate | 48.3                   |
| <b>Total</b>                  | <b>571.7</b>           |

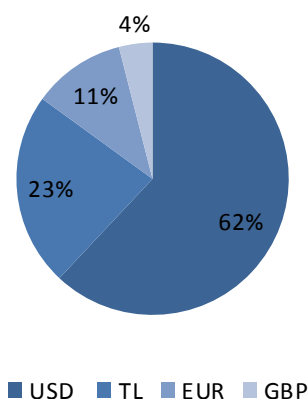
Source: The company

- Furthermore, the company is in an exclusive venture agreement with Scientific Games in 26 neighboring countries to develop, acquire and operate lottery concessions.

**Operations**

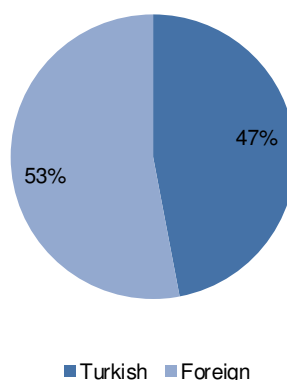
- **Merger creates synergy:**
  - Net Holding merged its operations with Net Turizm (NTTUR TI) in October 2017 to simplify its shareholder structure.
  - After the merger, the company is now fully focused on its core operations.
  - The completion of the long-awaited merger with Net Turizm has eliminated cross holdings and has simplified the corporate structure.
- **Resilient profitability recorded in 2016:** Despite all the adverse conditions in the tourism sector in 2016, the company’s solid business activity in Northern Cyprus generated a strong c.USD52mn EBITDA, which is expected to rise to USD60mn in 2017.
- **Shielded against the depreciation of the TL:** As 77% of its revenue generation is in hard currency (mainly USD ), the rapid devaluation of the TL vs. the USD has had no effect on the company’s EBITDA generation.
- **Not vulnerable to political developments creating negative sentiment:**
  - The failed coup attempt on July 15, 2016 in Turkey led to a massive drop in consumer confidence, consumer spending and restricted travel outside of Turkey, yet had no effect on the company’s EBITDA as Turkish visitors still made up 47% of the visitors.
  - Recall than the earlier downing of a Russian jet by Turkey had already resulted in a massive drop in Russian arrivals to Turkey, but had no effect on the company’s EBITDA as 53% of the visitors were foreigners and the company has a well-diversified base that is not dependent on one single nationality.

**Revenue distribution by Currency (2016)**



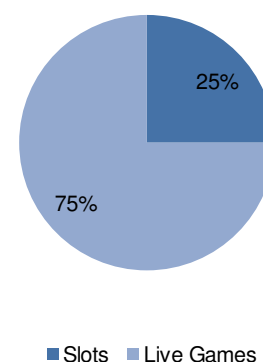
Source: The company

**Visitors Nationality (2016)**



Source: The company

**Casino revenues split**



Source: The company

- **Unrivaled player in Northern Cyprus:** Merit remains the island’s only hotel and casino chain. A new entrant to the casino market in Northern Cyprus would have difficulty in finding an adequate location and plot size for hotel & casino construction and would have to invest close to USD1bn and spend five years in construction to match the size of Merit’s operations on the island. The company spent a minimum of USD100mn for each of its Northern Cyprus casino licenses as each license on the island is granted on the basis of building a brand new hotel that has to meet strict governmental requirements.

- **4Q17 results are likely to be strong:** Since the company collects its credit sales in the casino business once every two-three months, the high season of its 3Q operations is actually reflected in 4Q. The company also re-evaluates its real estate portfolio in 4Q17 (happens once every two years), which is likely to boost 4Q17 bottom line through one-off revaluation gains. Thus, we expect its 4Q17 financials to be strong from top to bottom.

#### Future expectations:

**Expansion to the Balkans:** The company's expansion plan to the Balkans has been defined as very flexible and requiring a low capex. With its European licenses, the company is able to rapidly assess whether a casino is generating a positive EBITDA. If it is not, the casino is closed and the company moves on to its next target. Net Holding's business plan also aims to increase the frequency of Merit customers' visits to Merit casinos by adding new venues to its existing Northern Cyprus portfolio. Net Holding chooses a five-star hotel that best fits the standards of its Merit brand and rents a casino space from the hotel owner for 5 +5=10 years total. The second five-year phase is conditional on the company's one-way approval and an exit right at any moment by the company with a six-month rent penalty. The capex for each casino for the Balkans' expansion has a limit of USD5mn and further spending is subject to both its board and key shareholders' approval. If any casino in the Balkans has a two-year losing streak that casino is shut down and the equipment is transferred to a new targeted casino operation.

**Bodrum Plot (a USD300mn monetization opportunity – not on the B/S):** According to the company presentation, the plot is 1,000 hectares just outside the town of Gulluk on Turkey's Aegean coast, five minutes' drive from Milas International Airport and 30 minutes from the town of Bodrum. The property has been under a revenue sharing agreement with a local developer "Agaoglu" since 2007 that entitles Net Holding to 19% of the project's revenues with a deadline to finish construction until June 2013. The deadline has clearly elapsed. Due to the type of contract, the title of the property has been passed to the developer and the asset (plus attached revenue sharing deal) cannot yet be seen in Net Holding's accounts.

Three routes of monetization remain available per established judiciary practice and the agreement between the parties:

- The developer can exercise his call option and buy out Net Holding's shares in this project at USD300mn.
- The developer can sell to a third party with Net Holding's consent with 60% of the proceeds going to the Net Group.
- The developer can default on the contract. Net Holding would receive back the land in its balance sheet at a new market value without any compensation to the developer.

According to latest newflow, a local developer together with a Chinese group have visited the plot and have signed a preliminary protocol to develop a project. Therefore, we may see some developments in the coming months.

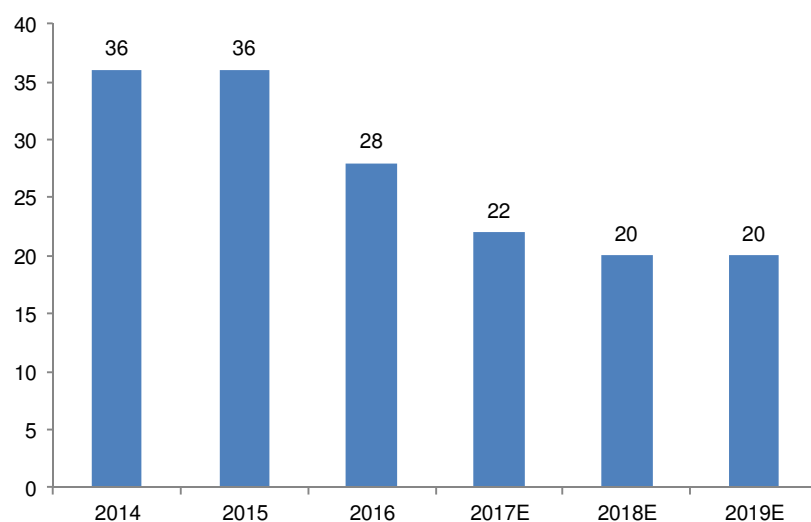
#### Credit Note

**Fitch has recently rated NTHOL as B with Outlook stable:** According to Fitch, the 'B' rating reflects Net Holding's sustainable business model, which has shown resilience over the past years despite the sharp depreciation of the TL alongside its deleveraging capacity by 2020 after a planned sizeable investment phase with adequate financial flexibility. The Stable Outlook reflects the expectation that Net Holding's resilience should continue over the next few years as it plans to improve its geographic diversification into new regions via a different asset-light operating model, helping to broaden its scale through successful strategy execution when the planned investment starts generating additional revenues. Fitch believes that the company will achieve TL800mn in revenues in 2019 (vs. TL472mn in 2016) and a 33% EBITDA margin vs. 27% in 2016.

### Other Issues

- **A dividend payment might be on the table in the coming years as the majority of the capex has been left behind:** Given no major capex requirement in its expansion to the Balkans, the company foresees a USD20mn capex for 2018 and 2019 each. Annual maintenance capex is around USD6-7mn according to the management. Thus, there might be a dividend payment in the coming years.

Capex Guidance (USDmn)



Source: The company

- **Reunification of Cyprus:** There is the long-lasting issue of the reunification of Cyprus (Northern Cyprus and Southern Cyprus). Northern Cyprus is only recognized by Turkey. If peace talks between the parties are successfully concluded, this could be very positive for Net Holding as Northern Cyprus will be open to direct flights, meaning a substantial increase in visitors to its casinos and hotels.
- **Pine River Capital Management share sales:** According to the announcements, Pine River Capital Management has liquidated one of its Asian Funds which had been holding Net Holding equities. Pine River's stake in Net Holding has now fallen to 7.5% from 28.8%. The stake sold by Pine River was actually purchased by the company as part of its buy-back program.
- **Treasury shares of 29% of capital not to be sold in the market:** The company officially announced that Treasury shares will not be sold until January 1, 2019. Subsequently, Net Holding may consider selling its shares to institutional investors via a block sale. Cancellation of the Treasury shares is also among the options.

### Company targets:

As depicted below, the company targets to close 2017 with USD195mn in revenues, a USD60mn EBITDA and around a USD65mn net debt. For 2018, the figures are expected to be 227mn in revenues and a USD81mn EBITDA, while those of 2019 are USD245mn and USD94mn, respectively. Accordingly, after adjusting for the USD82mn Treasury shares, we calculate a 2017E/18E EV/EBITDA of 4.5x and 3.5x, respectively, at a huge discount compared to peers. Given the different revenue mix among industry players, we think that a peer comparison is not definitive.

| Company Targets (USDmn) | 2017         | 2018         | 2019         |
|-------------------------|--------------|--------------|--------------|
| <b>Total EBITDA</b>     | <b>60</b>    | <b>81</b>    | <b>94</b>    |
| Cyprus                  | 62           | 67           | 70           |
| Balkans                 | 10           | 28           | 38           |
| Holding & Others        | -12          | -13          | -14          |
| <b>Sales</b>            | <b>195</b>   | <b>227</b>   | <b>245</b>   |
| <b>EBITDA margin</b>    | <b>30.8%</b> | <b>35.7%</b> | <b>38.4%</b> |

Source: The company

## APPENDIX I — Peer Comparison

| Company                                          | Country       | MCAP (EURmn) | EV/EBITDA   |             | EBITDA margin |            |
|--------------------------------------------------|---------------|--------------|-------------|-------------|---------------|------------|
|                                                  |               |              | 2017        | 2018        | 2017          | 2018       |
| Las Vegas Sands Corp                             | UNITED STATES | 46,412       | 14.1        | 13.9        | 36%           | 35%        |
| Wynn Resorts Ltd                                 | UNITED STATES | 13,857       | 14.2        | 13.1        | 27%           | 28%        |
| MGM China Holdings Ltd                           | MACAU         | 8,620        | 22.6        | 16.1        | 27%           | 25%        |
| Wynn Macau Ltd                                   | MACAU         | 12,453       | 17.4        | 15.2        | 23%           | 24%        |
| Melco Resorts And Entertainment Philippines Corp | PHILIPPINES   | 694          | 7.3         | 6.5         | 23%           | 24%        |
| Bloomberry Resorts Corp                          | PHILIPPINES   | 1,914        | 9.7         | 8.7         | 35%           | 36%        |
| <b>Mcap Adjusted Average</b>                     |               |              | <b>15.3</b> | <b>14.0</b> | <b>31%</b>    | <b>31%</b> |
| NTHOL multiples                                  |               |              | 4.50        | 3.30        | 31%           | 36%        |
| Discount/Premium                                 |               |              | -71%        | -76%        | -1%           | 4%         |

Source: Bloomberg, Garanti Securities, the company

## APPENDIX II — 3Q17 Financials

| Net Holding Summary Financials<br>(mn TL) |              |              |             |              |              |              |              |               | Change        |             |  |
|-------------------------------------------|--------------|--------------|-------------|--------------|--------------|--------------|--------------|---------------|---------------|-------------|--|
|                                           | 3Q16         | 4Q16         | 1Q17        | 2Q17         | 3Q17         | 9M16         | 9M17         | 3Q17/3Q16     | 3Q17/2Q17     | 9M17/9M16   |  |
| <b>Net Sales</b>                          | <b>121</b>   | <b>166</b>   | <b>90</b>   | <b>152</b>   | <b>185</b>   | <b>306</b>   | <b>428</b>   | <b>53%</b>    | <b>22%</b>    | <b>40%</b>  |  |
| <b>Gross Profit</b>                       | <b>38</b>    | <b>95</b>    | <b>4</b>    | <b>56</b>    | <b>72</b>    | <b>91</b>    | <b>133</b>   | <b>91%</b>    | <b>29%</b>    | <b>46%</b>  |  |
| <b>Operating Profit</b>                   | <b>9</b>     | <b>51</b>    | <b>-26</b>  | <b>23</b>    | <b>37</b>    | <b>6</b>     | <b>34</b>    | <b>311%</b>   | <b>62%</b>    | <b>428%</b> |  |
| <b>EBITDA</b>                             | <b>25</b>    | <b>67</b>    | <b>-9</b>   | <b>40</b>    | <b>55</b>    | <b>52</b>    | <b>86</b>    | <b>116%</b>   | <b>37%</b>    | <b>65%</b>  |  |
| Net Other Income/Expense                  | 1            | 7            | 2           | 7            | 7            | 4            | 16           | 507%          | n.m.          | 304%        |  |
| Financial Inc./ Exp. (net)                | -9           | -18          | -19         | -16          | -23          | -25          | -58          | n.m.          | n.m.          | n.m.        |  |
| PROFIT BEFORE TAX FROM                    | 2            | 40           | -43         | 14           | 23           | -11          | -6           | 889%          | 60%           | n.m.        |  |
| Tax                                       | 2            | -38          | 5           | 5            | -6           | 6            | 4            | n.m.          | n.m.          | -24%        |  |
| Minority Interests                        | 2            | 13           | -7          | 4            | -1           | 7            | -4           | n.m.          | n.m.          | n.m.        |  |
| <b>Net Income</b>                         | <b>2</b>     | <b>-11</b>   | <b>-30</b>  | <b>13</b>    | <b>18</b>    | <b>-14</b>   | <b>2</b>     | <b>1028%</b>  | <b>42%</b>    | <b>n.m.</b> |  |
| Net Cash                                  | -99          | -114         | -103        | -157         | -196         | -99          | -196         |               |               |             |  |
| Working Capital                           | -98          | -129         | -116        | -164         | -152         | -98          | -152         |               |               |             |  |
| Shareholders Equity                       | 2,041        | 2,110        | 2,081       | 2,096        | 2,071        | 2,041        | 2,071        |               |               |             |  |
| <b>Ratios</b>                             |              |              |             |              |              |              |              |               |               |             |  |
| Gross Margin                              | 31.3%        | 57.0%        | 5.0%        | 36.9%        | <b>39.0%</b> | 29.7%        | 31.0%        | 7.7 pp        | 2.1 pp        | 1.3 pp      |  |
| Operating Margin                          | 7.3%         | 30.7%        | n.m.        | 14.8%        | <b>19.7%</b> | 2.1%         | 7.8%         | 12.4 pp       | 4.9 pp        | 5.8 pp      |  |
| <b>EBITDA Margin</b>                      | <b>20.9%</b> | <b>40.0%</b> | <b>n.m.</b> | <b>26.2%</b> | <b>29.5%</b> | <b>17.1%</b> | <b>20.1%</b> | <b>8.6 pp</b> | <b>3.2 pp</b> | <b>3 pp</b> |  |
| Net Profit Margin                         | 1.3%         | n.m.         | n.m.        | 8.4%         | <b>9.8%</b>  | n.m.         | 0.4%         | 8.5 pp        | 1.4 pp        | n.m.        |  |

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OUTPERFORM (OP)      The stock's return is expected to exceed the return of the BIST-100 over the next 12 months.

MARKET PERFORM (MP)      The stock's return is expected to be in line with the BIST-100 over the next 12 months.

UNDERPERFORM (UP)      The stock's return is expected to fall below the return of the BIST-100 over the next 12 months.

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