

## NET HOLDING

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### Key Takeaways from Analyst Meeting

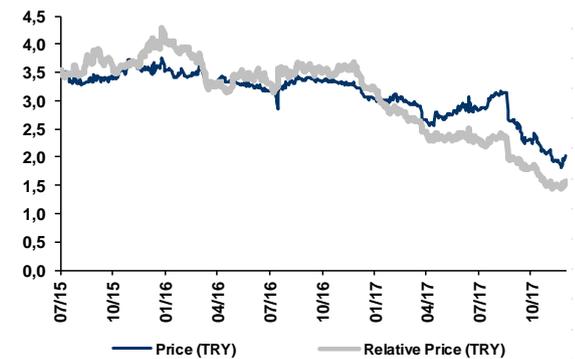
**Company Overview.** With Merit brand, Net Holding is the leader casino operator and hotel chain in Turkish Republic of Northern Cyprus (TRNC) with five casinos and six 5-star hotels located in Kyrenia, Nicosia and Famagusta. Merit had 40% share in gaming market and 36% share in total 5-star bed capacity in Northern Cyprus and it is the only company operating as a casino chain. In addition to TRNC, Merit also entered Balkans market in 2016 and currently operates 5 casinos in Croatia and Montenegro while planning to open three more in Bulgaria, Macedonia and Croatia in 2018. Net Holding also had a strong real estate portfolio, 11.7mn sqm in Turkey, 2.5mn sqm in Northern Cyprus and 0.3mn sqm land in Baku-Azerbaijan.

**Strong growth and financial outlook.** In 2013 and 2014, Merit opened three new casino hotels in Kyrenia and became the leader casino operator in TRNC. New casinos were the main driver of growth as the company had registered an 18.7% revenue CAGR and 21.6% EBITDA CAGR in USD terms within 2013-2017E. Following the aggressive growth in TRNC, Net Holding focused on growth in Balkans and entered the market in 2016. Low cost and Capex growth model in Balkans support the expansion while the company has also been seeking opportunities in other Balkan countries. In that sense, the company foresees 16% and 9% consolidated revenue growth in USD-terms for 2018 and 2019, respectively. On the other hand, increasing traffic and diversifying client base in TRNC continue to support profitability, while the company also expects improvement in profitability at new casinos as these reach maturity, which is around two years in this business.

**Compelling valuation multiples with short-term catalysts.** Based on company's guidance (EBITDA: USD60mn 2017 and USD81mn 2018; Net Debt: USD65mn in 2017 and 2018) and our adjustment for the buyback shares (158mn), we calculate 4.7x 2017E EV/EBITDA and 3.5x 2018E EV/EBITDA multiples. The company also makes real estate revaluations through independent appraisal companies every two years with an upcoming one in 4Q17, which may boost the bottom-line thanks to one-off revaluation gains. Additionally, 4Q is the seasonally strongest quarter due to recognition of revenues stemming from the provided credit to casino customers in 3Q and the company's 2017 guidance implies c. 17% y/y EBITDA growth in USD terms in 4Q17.

IFRS TRYmn	2012	2013	2014	2015	2016
Sales	107	195	308	403	472
EBITDA	-12	30	74	97	168
Net income	76	150	23	66	-24
EPS reported (TRY)	0,21	0,41	0,06	0,18	-0,07
DPS (TRY)	0,19	0,00	0,00	0,00	0,00
P/E (x)	8,1	5,8	42,5	18,8	nm
EV/EBITDA (x)	nm	38,6	14,2	12,3	7,4
Div. yield (%)	8,1%	0,0%	0,0%	0,0%	0,0%
ROE (%)	35,6%	28,8%	25,4%	24,1%	-12,3%

Stock Data	6 December 2017			
Current price	TRY2,03			
Current Mcap	TRY1.145	mn/US\$297mn		
Bloomberg Ticker	NTHOL TI			
Number of outstanding shares (mn)	564			
High / Low Price Range (12M)	3,23/1,82			
3-m Average Daily Turnover (\$ mn)	2,0			
Price Performance (%)	1M	3M	6M	YtD
Return	-5,4	-27,5	-32,6	-33,4
Relative to BIST100	-0,9	-25,2	-37,8	-50,6



Source: Bloomberg, YKY Research

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**Cyprus Operations:** Despite the negative headwinds on tourism sector in 2016, Net Holding was able to manage these risks thanks to its well-diversified client base and increased its EBITDA\* (including other income/expense from the operations) to USD52.5mn in 2016 from USD50mn in 2015. In 9M17, Northern Cyprus (TRNC) operations' EBITDA jumped by 58% to TRY137.2mn (USD38.6mn) from TRY86.8mn (USD28.6mn). The company foresees USD62mn EBITDA in 2017 as the 4Q's are the strongest quarters due to the shift of revenues stemming from the provided credit to casino customers in 3Q's (9M16: USD28.6mn, 2016: USD52.5mn). The company expects this strong trend to continue and do not anticipate a major competition as barriers-to-entry for the casino market in TRNC is high due to TRNC market's high Capex model. Accordingly, finding the adequate location, plot size for hotel & casino constructions and harder qualifications for licensing indicates nearly USD1bn Capex with five years of construction period. Additionally, Merit's chain casino structure offers a unique proposition as the casino's all slot machines are connected, which forms the largest ever slot jackpot pool (Mega Jackpot) with the largest awards, which attract the casino players. Lastly, although Merit dominates the TRNC's casino market with 40% market share, the company also has one more casino license for Merit Royal Premium Hotel that could be utilized in the mid-term.

**Table 1: EBITDA Breakdown (9M17)**

Segments (TRY mn)	9M17	9M16
Northern Cyprus	137,2	86,8
Montenegro	15,9	1,5
Croatia	-11,0	-0,2
Other + Eliminations	-28,0	-22,1
<b>Total</b>	<b>114,1</b>	<b>66,0</b>

Source: Net Holding Investor Presentation

**International Operations:** After Northern Cyprus (TRNC), the company decided to enter the Balkan market and opened 5 new casinos in Croatia and Montenegro in 2016 and 2017. The company plans to add three more casinos in Svilengrad –Bulgaria (1H18), Skopje – Macedonia (2H18) and Zagreb – Croatia (2H18). Especially, expectations on the prospects of Svilengrad are very high due to its location; it is very close to both Turkey and Greece borders and only 2.5 hours from Istanbul by car. Within the context of expansion in Balkans, the company also targets Slovenia, Serbia, Bosnia & Herzegovina, Albania and Ukraine markets while there is not a concrete decision for these markets at this stage.

In Balkans operations, contrary to TRNC market, the company is able to open casinos with lower Capex. The company does not build a hotel for the casino and rents a casino space from the hotel owner for 5+5 years, while the second five year term is optional based on the company's approval. The company has an USD5mn Capex limit per casino and further Capex is subject to both Board and key shareholders' approval. In general, casinos such as Croatia generate negative EBITDA in their opening year due to high OPEX. Meanwhile, if the casino generates negative EBITDA for two years, the company shut downs the casino and transfers the equipment for the next target casino. Based on the company's guidance, if the company closes a casino, it pays a 6-months rent of forfeit fee to the hotel.

Although the company's growth strategy in Balkans seems aggressive, management said that annual Capex will be limited at USD20mn thanks to the low cost and Capex structure of casino openings in the region. Similar to Capex limit in casino openings, higher than USD20mn Capex per annum is subject to both board and key shareholders' approval.

**Currency Impact:** Although Turkish visitors had a 47% share in total, 77% of total revenues are denominated in hard currency. Accordingly, USD denominated revenues had 62% share, Euro had 11% share and GBP has 4% share in casino revenues and weak TRY supports Net Holding's operating performance. The main reason of this structure is that live games are played with hard currency and live games revenue constitute 75% of the casino revenues, while slots have 25% share, which could be played with TRY. On the other hand, Net Holding has a net short FX position of TRY101.1mn as of 9M17 (EUR46.4mn short position, USD 19.5mn long position and GBP 0.9mn long position), which puts pressure on the bottom-line during TRY weakness.

**Real Estate Portfolio:** Net Holding also had a strong real estate portfolio, 11.7mn sqm in Turkey, 2.5mn sqm in Turkish Republic of Northern Cyprus and 0.3mn sqm land in Baku-Azerbaijan. Accordingly, total value is TRY2.03bn (USD526.7mn – based on yesterday's USD/TRY close) as of 9M17. The company also makes real estate revaluations through independent appraisal companies every two years with an upcoming one in 4Q17, which may boost the bottom-line thanks to the one-off revaluation gains.

**Table 2: Net Holding's Properties**

Categories	Net Book Value (TRY mn)	Net Book Value (USD mn)
Turkey Land	68,7	17,8
Cyprus Land	308,8	80,0
Turkey Real Estate	117,6	30,4
Cyprus Real Estate	1367,5	354,1
Azerbaijan Land + Real Estate	171,9	44,5
<b>Total</b>	<b>2034,5</b>	<b>526,7</b>

Source: Net Holding Investor Presentation

We also should note that, the company has a land of 1k hectares, 10 minutes away from Gulluk region and 5 minutes from Bodrum International Airport by car. This land is not recorded on balance sheet, as the land is under a revenue sharing agreement with a local developer since 2007 that entitles Net Holding to

19% revenues of the total project. On the other hand, three options regarding the agreement are;

- i. If the developer exercises his call option, it can buy Net Holding's stake for USD300mn
- ii. If developer sells land to third parties with Net Holding's consent, 60% proceeds goes to Net Group
- iii. If developer defaults on contract, Net Holding records back the land on its balance sheet at market value without any compensation to developer.

Although there is no concrete development on Bodrum project, it will continue to be a potential value for Net Holding in the long term

**Net Turizm Merger and Recent Corporate Actions:** Net Holding completed the merger process with its subsidiary Net Turizm (NTTUR TI) on October, 2017. Starting with 4Q17 results, financials will be simplified due to the elimination of cross-holding structure. During this process, one of the major shareholders, Pine River sold its c. 21.3% stake due to the liquidation of one its Asian funds, according to the company management. Most of these shares are bought by Tibuk Family and the company through a share buyback program. Last week, Net Holding announced that the BoD decided to not to sell these shares until 2019. The company also added that BoD plans to sell buyback shares to institutional investors at the wholesale market after 2019. Recall that the company purchased c.158mn shares (28.02% stake). Management also told that cancellation of these shares through capital decrease could still be an option after 2019.

We should note that Pine River still has 42.4mn shares with a 7.52% stake.

**Projections:** Net Holding expects 16% USD-based growth with revenues reaching to USD227mn in 2018. On the other hand, the company foresees 35% and 16% EBITDA growth in 2018 and 2019 reaching to USD81mn and USD94mn, respectively. In addition to growth, new casino openings may generate negative EBITDA in their first year like Croatia and expect these casinos to turn positive, which is the main reason behind the company's EBITDA jump estimate in Balkans.

**Table 3: Net Holding's Financials Forecasts**

Forecasts (mn USD)	2017	2018	2019
Cyprus	62	67	70
Balkans	10	28	38
Holding level and others	-12	-13	-14
<b>Total EBITDA</b>	<b>60</b>	<b>81</b>	<b>94</b>
<b>Revenues</b>	<b>195</b>	<b>227</b>	<b>245</b>
EBITDA Margin	30,8%	35,7%	38,4%

Source: Net Holding

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