Aug 3, 2021

TURKEY– Energy

Naturelgaz

Market leadership priced in

Initiating with a HOLD recommendation. We are initiating Turkey's biggest CNG supplier Naturelgaz with a Hold recommendation. While the shares are down by 6% since its listing in April 2021, we cannot justify a Buy rating with higher risk free rate and equity risk premium. Based on a DCF valuation, we set our 12-month price target (PT) at TL8.20 which implies 2% upside.

A growing share in a highly cyclical market. Accounting for just 1.4% share in the c. 48bn m3 Turkish natural gas consumption, transportable natural gas industry caters mostly to industry, construction and long-haul transportation. Since 2018, it has shrunk by 15% in volumes with the conclusion of big projects such as Istanbul airport and Izmir highway as well as a weak economy. Against this backdrop, compressed natural gas (CNG) has been gaining market share against Liquefied Natural Gas (LNG) which has long dominated the transportable natural gas industry as lower operating costs, environmental and security concerns gain importance, in line with the global trends. At the end of 2020, CNG makes up 30%+ of transportable natural gas market.

Naturelgaz a committed player. In 2020, Naturelgaz accounted for 72% of the CNG sales volumes, and was the largest player with nearly 25% share in the overall transportable natural gas industry. Following the acquisition of SOCAR LNG in late 2020, the company should see its market share exceed 80% in 2021. The acquisition also gave Naturelgaz access to LNG market with a small 1.15% share. The company currently operates 13 bulk CNG plants, 9 auto-CNG stations, 56k+ CNG cylinders and 341-strong vehicle fleet nationwide.

Consolidating position in bulk CNG, growth in city gas and auto gas. Naturelgaz plans to utilise its IPO proceeds for further capacity additions in bulk gas, expand to profitable and less cyclical residential heating city gas, and auto gas. In line with this strategy, Naturelgaz recently made a partnership with Petrol Ofisi, a large operator of petrol stations, to sell CNG at new 12 locations. The company will continue to consider inorganic growth as well as international partnership to exploit CNG production at oil wells although the latter has been under consideration for many years.

Improving cash generation over years. Based on limited historical financial data we have, it seems Naturelgaz has improved its profitability since 2017, posting a 26%+ gross margin and a positive net income since 2019. It buys most of it natural gas from BOTAS, the state monopoly, applying a mark-up to BOTAS's prices. At the end of 2020, the company posted an EBITDA margin of 21% and a net income of 19.9% which was boosted by one-off goodwill due to acquisition. We expect profit margin to normalize to 10.2% in 2021E. Management guidance for maintenance capex is around 4% of sales with additional 1-2% outflow for working capital.

Relatively poor growth prospects. Naturelgaz enjoys a dominant position in transportable natural gas space, but the industry's growth prospects are stagnant with little change expected in the future. A significant pick up in road constructions may improve earnings, and eventually revive interest in the stock. But for now, we think the valuation is not attractive with 3% dividend yield on our 2021 estimates vs. 7% offered by LPG distributor AYGAZ.

NTGAZ	2018	2019	2020	2021E	2022E	2023E
Net Income (TL mn)	-32	30	90	76	114	140
Revenue (TL mn)	250	433	453	742	1,006	1,164
EBITDA (TL mn)	39	99	96	142	202	235
Net Debt/EBITDA (x)	2.86	0.82	1.09	-0.27	-0.41	-0.51

Source: Company data, INFO RESEARCH estimates

HOLD

Price: TL8.02

Price Target: TL8.20

Company Data

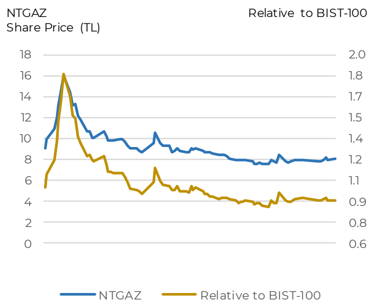
Stock Ticker	NTGAZ
Stock Rating	HOLD
Price Target	8.20
Up/downside to PT	2%
Share Price	8.02
12-week range (TL)	9.89 -7.60
No.of shares (mn)	115
Free Float	30%
MCAP (TL mn)	922
MCAP (USD mn)	110
Net Debt (TL mn)	-26
3M ADV (USD mn)	3
3M ADV/FF MCAP (%)	10.3%

Valuation

	2020	21E	22E	23E
P/E (x)	10.2	12.2	8.1	6.6
EV/EBITDA (x)	9.4	6.4	4.5	3.8
EV/Sales (x)	2.0	1.2	0.9	0.8
Div. yield (%)	4%	3%	7%	9%

Source: INFO RESEARCH estimates

Price Performance



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For analyst certification and other important disclosures, refer to the Disclosure Section, located at the end of this report.

Exhibit 1. Financial Summary

Income Statement

(TL mn)	2020	2021E	2022E	2023E
Net Sales	453	742	1,006	1,164
Cost of Sales	-334	-555	-752	-870
Gross profit (loss)	119	187	253	293
Operating Expenses	-51	-79	-92	-101
Core EBIT	69	108	161	193
Inc.& Exp. from Other Operations	-1	-4	-1	-2
Reported EBIT	68	105	160	191
Financial Income/Expenses	-33	-30	-12	-9
Other income	55	0	0	1
PBT from continuing operations	90	76	148	182
Tax on Continuing Operations	0	0	-34	-42
Profit from continuing operations	90	76	114	140
Net Profit	90	76	114	140
EBITDA	96	142	202	235

Balance Sheet

(TL mn)	2020	2021E	2022E	2023E
Cash and Marketable Securities	9	106	128	158
ST Trade and Related Receivables	84	109	148	172
Inventories	12	19	26	30
Other Short-Term Assets	12	20	27	32
Fixed Assets	278	289	304	323
Intangible Assets	5	5	6	6
LT Receivables	0	0	0	0
Other Long-Term Assets	1	1	1	1
TOTAL ASSETS	402	551	641	721
ST Financial Payables	81	48	32	23
ST Trade and Other Payables	47	71	96	111
Other Short-Term Liabilities	2	3	4	4
LT Financial Payables	33	20	14	14
LT Trade and Other Payables	0	0	0	0
Other Long-Term Liabilities	5	9	12	14
Equity	234	400	484	556
Minority Interest	0	0	0	0
Other Liabilities and Equity Items	0	0	0	0
TOTAL LIABILITIES AND S.HOLDERS' EQUITY	402	551	641	721

Cash Flow Statement

(TL mn)	2020	2021E	2022E	2023E
Earnings before Adjustments	90	76	114	140
Depreciation and Amortization	28	33	41	42
Other Adjustments	-23	0	0	0
Changes in Working Capital	-6	-15	-27	-16
Cash Flow from Operating Activities	80	97	131	168
Investing Cash Flow	-49	-30	-41	-47
Capital Expenditures (CapEx)	-18	-30	-40	-47
Cash from Other Invesment Operations	-31	0	0	0
Financing Cash Flow	-32	30	-68	-93
Changes in Financial Debt	-9	-48	-24	-9
Net Cash from Capital Increase /(Decrease)	0	123	0	0
Dividends Paid	0	-32	-30	-68
Cash from Other Financing Operations	-23	-12	-14	-16

Financial Analysis

	2020	2021E	2022E	2023E
Growth (%)				
Sales	4.6	63.7	35.5	15.7
EBIT	-3.1	57.9	48.9	19.4
EBITDA	-2.8	47.2	42.6	16.4
Net Profit	202.7	-16.2	50.7	23.0
Margins (%)				
Gross Margin	26.3	25.2	25.2	25.2
EBITDA Margin	21.2	19.1	20.1	20.2
EBIT Margin	15.1	14.6	16.0	16.6
Net Margin	19.9	10.2	11.3	12.0
Efficiency				
Receivables Days	54	54	54	54
Inventory Days	13	13	13	13
Payables Days	47	47	47	47
Opex/Net Sales (%)	11.2	10.6	9.1	8.6
Profitability (%)				
ROA	22.5	13.7	17.8	19.4
ROE	38.6	18.9	23.5	25.2
ROCE	25.2	25.2	31.7	33.0
Leverage (x)				
Asset/Equity	1.72	1.38	1.32	1.30
Net Debt/Equity	0.45	-0.09	-0.17	-0.22
Net Debt/EBITDA	1.09	-0.27	-0.41	-0.51

Key Operating Indicators

	2020	2021E	2022E	2023E
Transportable Gas Market (mn m3)	698	775	798	822
CNG Market (mn m3)	237	271	287	304
CNG Share(%)	34	35	36	37
Naturel Gaz				
Total Sales (mn sm3)	174	232	248	265
Market Share (%)	25	30	31	32
Naturelgaz CNG Market Share (%)	72	82	83	84
Implied price				
CNG+LNG (TL per sm3)	2.6	3.2	4.0	4.3
BOTAS CNG Prices (TL per m3)	1.5	1.7	2.3	2.6

Key macro assumptions

	2020	2021E	2022E	2023E
GDP growth, real	1.8%	6.0%	3.0%	3.0%
CPI	14.6%	15.0%	12.0%	12.0%
USDTL, ave	7.01	8.81	9.69	10.66
USDTL, eop	7.42	9.27	10.20	11.22

Source: Company data, INFO RESEARCH estimates

Valuation & Risks

We are using a DCF valuation utilising our free cash flows to firm (FCFF) to set our price target for NTGAZ. Our valuation assumptions are as the followings:

1) Equity risk premium as 7% ;

2) Risk free rate which is 18%.

3) Stock beta of 1.23, based on trading from the IPO date.

4) Terminal growth rate of 7.1%

5) Working capital as 1-2% of the revenues.

6) CAPEX as 4% of the revenues.

7) We expand the fair equity value by cost of equity to reach at our 12m PT.

Exhibit 2. NTGAZ DCF Valuation

TL mn	2020A	2021E	2022E	2023E	2024E	2025E	2026E
Revenues	453	742	1,006	1,164	1,292	1,403	1,560
Growth rate	*5%*	*64%*	*35%*	*16%*	*11%*	*9%*	*11%*
EBITDA	96	142	202	235	261	283	315
EBITDA margin	*21.2%*	*19.1%*	*20.1%*	*20.2%*	*20.2%*	*20.2%*	*20.2%*
EBIT	69	108	161	193	216	236	264
+ Depreciation & amortisation	28	33	41	42	45	48	51
- Capex	-18	-30	-40	-47	-52	-56	-62
Capex /Revenues	*-4%*	*-4%*	*-4%*	*-4%*	*-4%*	*-4%*	*-4%*
- Change in working capital	-6	-15	-27	-16	-13	-11	-16
Change in WC/Revenues	*-1%*	*-2%*	*-3%*	*-1%*	*-1%*	*-1%*	*-1%*
- Taxes	-15	0	-37	-44	-50	-54	-61
- Other	0	0	0	0	0	0	0
Free cash flow to firm (FCFF)	57	97	98	128	147	162	176
Discount factor		0.91	0.73	0.58	0.47	0.37	0.30
Discounted cash flow for projected period	415	88	71	75	68	60	52
Discounted cash flow for perpetuity	311						
Enterprise value	726						
- Adjusted 2020A net debt	-18						
- Minority interest	0						
+ Participations	0						
Equity value	745						
Implied Fair Value (TL)	6.50						
COE	27%						
12m Price Target (PT)	**8.20**						
Potential upside	2%						

WACC	
Risk free rate	18.0%
Beta	1.23
Equity risk premium	7.0%
Cost of equity	26.6%
Cost of debt, after tax	11.6%
Capitalisation rate	10.0%
Weighed average cost of capital	25.1%
Terminal growth rate	7.1%

Source: Company data, INFO RESEARCH estimates

Risks

Natural gas sales and distribution licenses are directly dependent on the Turkish government. Any law amendments about natural gas sales may affect the company's businesses. Increase in the price of natural gas due to taxes, or raw material price increase or additional costs to fossil fuels because of environmental concerns may cause lower demand by the customers. If any kind of incentive is given to other energy resources that rivals with natural gas, could again result with lower demand as well as the improvements in the pipeline infrastructure.

Exhibit 3. Peer multiples

RT TICKER	Company Name	Country	MCAP (USD mn)	P/E 2021E	P/E 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/SALES 2021E	EV/SALES 2022E	Dividend Yield 2021E	Dividend Yield 2022E
TGN:BS	S.N.T.G.N. Transgaz S.A.	Romania	773	30.9	38.3	11.9	11.4	3.4	3.4	1.6%	3.4%
5209:MY	Gas Malaysia Bhd	Malaysia	807	15.3	15.0	9.1	8.6	0.6	0.5	5.6%	0.5%
WP:TH	Wp Energy Pcl	Thailand	77	12.5	9.9	3.7	3.6	0.2	0.2	3.7%	0.2%
1430:HK	Suchuang Gas Corporation Ltd	Hong Kong	228	7.3	5.1	4.4	3.0	0.7	0.6	5.3%	0.6%
AYGAZ:IS	Aygaz	Turkey	518	11.6	8.8	9.4	8.8	0.5	0.4	7%	0%
	Median			12.5	9.9	9.1	8.6	0.6	0.5	5%	1%
NTGAZ:IS	Naturelgaz	Turkey	109	12.2	8.1	6.4	4.5	1.2	0.9	3%	7%
				-2%	-18%	-30%	-48%	106%	66%	-38%	1266%

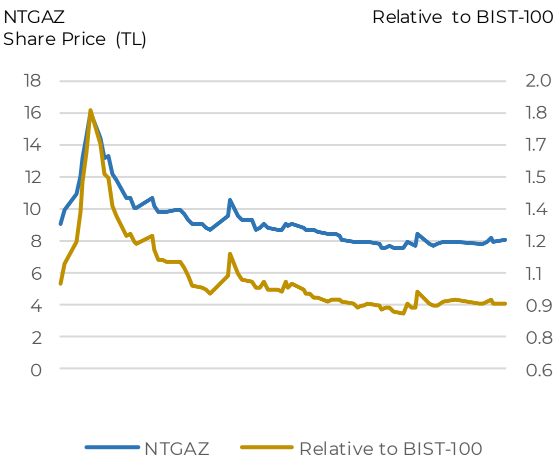
Source: Factset via EquityRT, INFO RESEARCH estimates

Exhibit 4. Share price performance

	Absolute Return in Local Currency YTD	1M	3M	12M	Relative Return in Local Currency YTD	1M	3M	12M
S.N.T.G.N. Transgaz S.A.	-1.1	-2.9	-4.1	-0.7	-18.3	-2.9	-8.4	-29.5
Gas Malaysia Bhd	1.8	-0.4	-0.2	2.6	9.5	0.9	5.6	8.8
Wp Energy Pcl	18.0	-2.8	-0.9	4.0	11.3	0.4	2.0	-11.1
Suchuang Gas Corporation Ltd	-1.7	-2.0	-0.7	-42.4	1.7	7.4	8.4	-45.9
Aygaz	2.4	9.2	5.7	18.8	8.6	6.3	6.0	-3.9
Naturelgaz		4.9	-18.3			2.1	-18.0	

Source: EquityRT

Exhibit 5. Share price performance



Source: EquityRT

Industry overview

Steady market with potential for increased consumption. Turkish natural gas consumption fluctuated between 37-54 bn m^3 in the last decade, closing 2020 with 48 bn m^3 consumption. Almost all of natural gas is imported, mainly from Russia, Azerbaijan and Iran, although Turkish explorations in the Black Sea promises some 540bn m^3 of reserves according to Dünya Daily. This could possibly enter the market earliest by 2023. With the availability of cheaper domestic natural gas and the switch to a relatively cleaner source of energy, we think natural gas usage in Turkey may increase.

Transportable natural gas a small part of market. Natural gas is predominantly distributed through the pipelines, but around 1.5% of the demand is met by transportable natural gas in locations where pipelines are not feasible. In the last three years, the transportable natural gas market shrunk by nearly 15% to 695 mn m^3 in 2020, which was faster than the overall 7% drop in consumption of natural gas due to a weak economy. The completion of major projects such as new Istanbul airport as well as expansion of pipelines were a factor according to management.

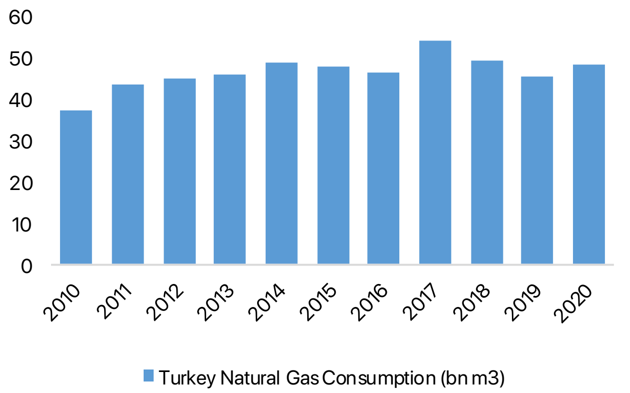
Increasing share for CNG. Accounting for 66% of the market, the Liquefied Natural Gas (LNG) is the dominant consumption form of transportable natural gas in Turkey. However its alternative Compressed Natural Gas (CNG) has been gaining a bigger share, mirroring global trends. The increase in demand for alternative fuels and environmental concerns help to drive take up of CNG alongside with the increased infrastructure investments in capacity. Overall, CNG is safer and cheaper in production costs compared to LNG, but requires expensive upfront infrastructure investments. Additionally, LNG is primarily available in western Turkey where it is imported through sea terminals while CNG can be pulled directly from pipelines across Turkey. In the last decade, CNG consumption increased by a CAGR of 18% to 235 m $m^{3.}$

Players of the sector. Naturelgaz is the market leader of the transportable natural gas market with close to 30% share. It is followed by OMV and Ipragaz which operate solely in LNG segment, with 16.5% and 16.0% share, respectively. In fact, Naturelgaz is the dominant player in CNG with over 80% share, after the acquisition of SOCAR LNG in 2020. The remainder of the CNG companies are smaller companies focused on reselling and distribution.

BOTAŞ is the domestic monopoly. Turkey procures 34% of natural gas from Russia mainly through the government pipeline monopoly BOTAS. The price of imported natural gas is not made public, but it is benchmarked to Brent oil prices with an approximately 9 month lag. However, it is usually very difficult to predict BOTAS prices changes given the currency fluctuations and its other considerations. On our rather simple calculations, we estimate that the 2021 natural gas prices in Turkey will need to be increased by a further 15% in the light of 39% hike in Brent price and 15% TL depreciation. At its last adjustment on July, BOTAS increased the natural gas prices by 20%.

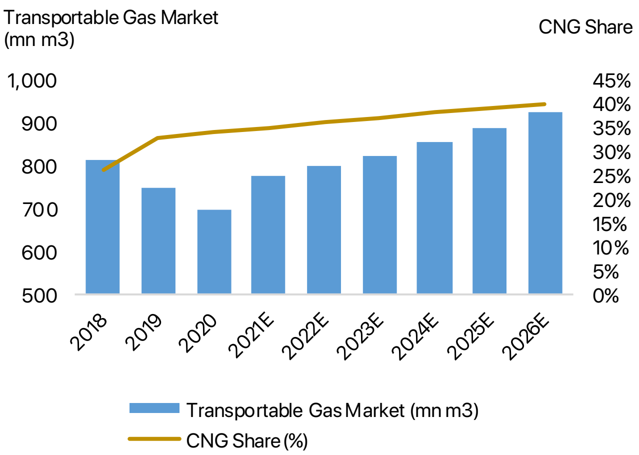
A seasonal industry. Transportable natural gas is mainly used by construction industry during road construction as the heating fuel for asphalt as well as in agriculture. In the Blacksea region, tea producers utilise CNG for drying tea. In addition, it is used for building heating in public institutions. Called city gas, the private gas distribution companies also utilise it for residence heating in cities where pipelines are not available. Finally, it is also used as automobile fuel though a small network of stations. The demand for CNG and LNG tends to be pretty seasonal: for CNG, the demand peaks in Q2 and Q3 because of the high demand from road builders and the tea industry. This is somewhat offset with city gas demand during winter months.

Exhibit 6. Turkish Natural Gas Consumption (bn m3)



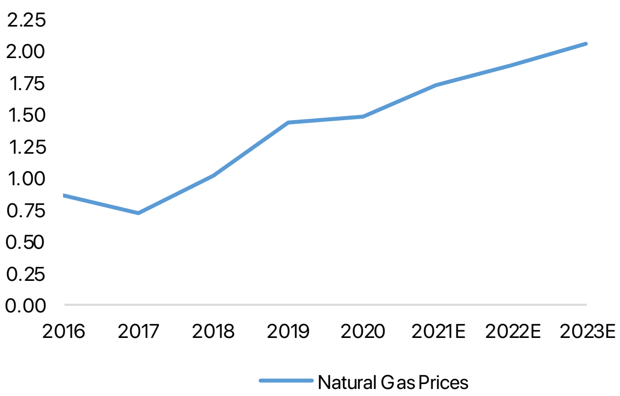
Source: Company Data

Exhibit 7. Transportable Natural Gas Market and CNG's Share



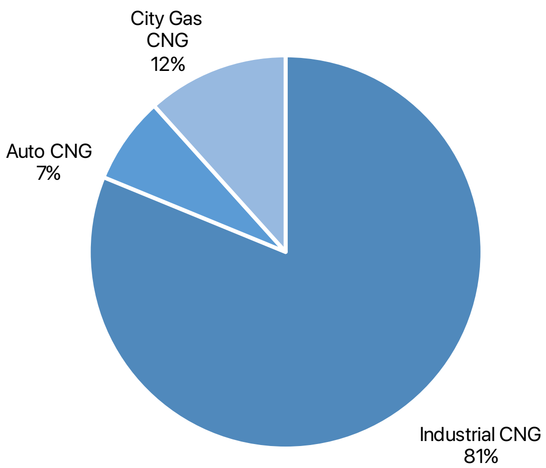
Source: Company Data

Exhibit 8. Natural Gas Prices (TL/m3)



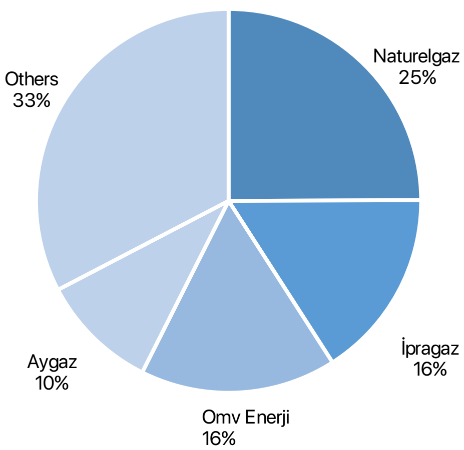
Source: BOTAŞ, INFO Research Estimates

Exhibit 9. CNG Usage by Product in Turkey



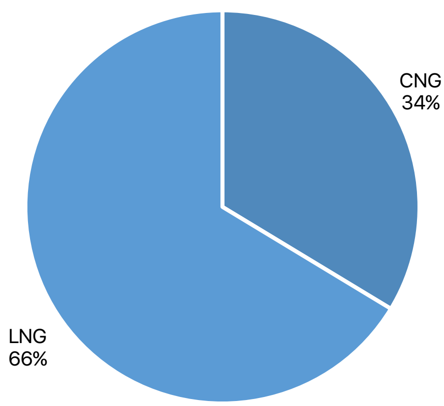
Source: Company Data

Exhibit 10. Transportable Natural Gas Market Shares



Source: Company Data

Exhibit 11. CNG and LNG Share in Transportable Market (2020)



Source: Company Data

Naturelgaz Overview

Naturelgaz was established in 2004 by Çalık Group and Goldenberg Family focusing on the transportable natural gas market. It is the market leader in transportable natural gas with over 25% market share, and the dominant CNG provider in CNG with over 80% in that segment. The company generated TL453mn in revenues in 2020, and employs over 120 people.

Global Yatırım Holding became the main shareholder of the company in 2012. In April 2021, Naturel Gaz became a public company after 30% of its share were listed through a combination of capital increase and shareholder sale. The company plans to use the IPO proceeds for capacity increase, inorganic growth, overseas investments and deleveraging post its Socar LNG acquisition.

Market leader in CNG. Naturelgaz generates nearly all of its revenues from CNG with a very small contribution from LNG market. Its biggest business segment is bulk gas which contributes nearly 80% of revenues followed by city gas and auto gas with 15% and 4% share, respectively. The company cemented its strong position in transportable natural gas by its 2020 acquisition of SOCAR LNG which added nearly 10% to its CNG market share. The acquisition also gave Naturelgaz a 1.5% market share and a beachhead in the 460mn m3 LNG market which is the bigger part of transportable natural gas market.

Nation wide infrastructure. Transportable natural gas market requires high upfront investments in the form of storage and decompression facilities and a tanker truck fleet to transport the gas. After the acquisition of SOCAR LNG, Naturelgaz now operates 13 bulk CNG plants, 9 auto-CNG stations, 56,650 CNG cylinders and 341 vehicles. In the LNG market, the acquisition brought in 44 LNG tanks and 6 tank trucks.

Strategy to grow in bulk CNG, auto and LNG. The acquisition of SOCAR LNG is supportive of Naturelgaz's plans to consolidate its position in bulk CNG, break into LNG market and develop an auto CNG station network in critical routes of heavy duty vehicle transportation routes. Recently, Naturelgaz made a partnership with Petrol Ofisi, a large operator of petrol stations, to sell CNG at new 12 locations. In 2020, auto CNG market size in the transportable natural gas market is 2.4%, and Naturelgaz accounts for about a third of it. The auto gas accounts for 3% of the revenues and we expect this to be 4% with the acquisition.

City Gas is highly profitable and tackles seasonality. Generating around 15% of revenues, Naturelgaz also provides CNG to cities that are not on a pipeline network though gas distribution companies. This helps to smooth out demand which tends to peak in Q2 and Q3 in the bulk CNG segments. The business line also tends to be most profitable business line generating as much as 61% of gross profit in 1Q21 against a 39% revenue share in the same period. Naturel Gaz currently sells in 51 different districts reaching a population of 1.1m.

BOTAS main supplier. Acquiring most of its gas from BOTAS though annual contracts, Naturelgaz adds system usage fee and taxes to BOTAS prices to determine the price of the CNG it sells. There is an additional mark-up depending on the distribution costs and the customer. Based on available financial data, Naturelgaz's average spread was USD 0.17 per m^3 in the last three years.

Improving gross margins. In 2020, Naturelgaz posted a gross profit of TL119m with an implied margin of 26% which was broadly flat yoy. That said, gross margin has generally been going up since 2017 which was just 10% at the time. Meanwhile, 2020 EBITDA margin was slightly down yoy to 21% due to marketing and personnel costs.

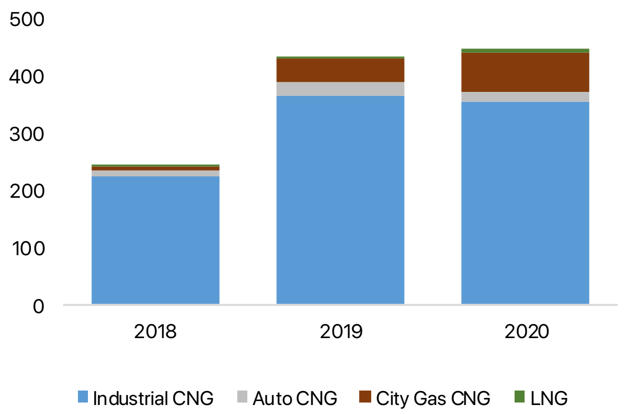
One-off impact on net margins due to goodwill. Despite a flattish EBIT yoy, Naturelgaz posted a big jump in net income to TL90m in 2020 as the company recognized TL55m of positive goodwill as a result of its SOCAR LNG acquisition. Consequently, its net profit margin shot to nearly 20% compared to 6.9% in 2019. Before 2019, the company was not turning a profit based on the limited historical data we have.

Maintenance capex at 4% of sales. The industry requires high upfront infrastructure investments and operates at rather low utilisation rates. According to management, the maintenance capex requirements are around 4% of sales annually. The acquisition of SOCAR LNG upped working capital requirements temporarily, but we expect it to decline to around 1% of sales in the medium term. After raising TL123m as part of its IPO, Naturelgaz now has a net cash of TL 26m as of 1Q21.

Exhibit 12. 9 Refuelling Points of Naturelgaz without Petrol Ofisi Agreement

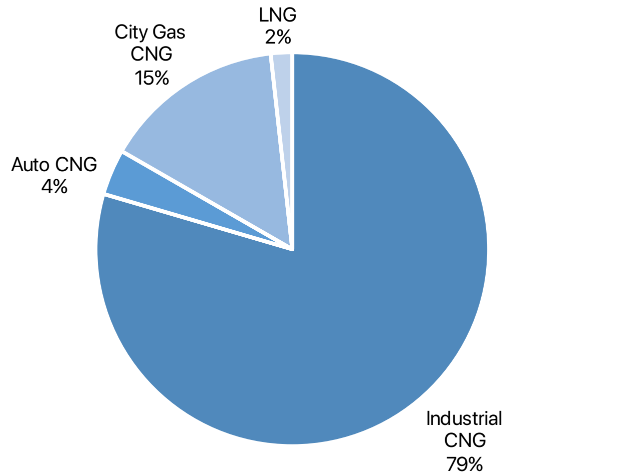
Source: Company Data

Exhibit 13. Sales Breakdown in Years (mn TL)



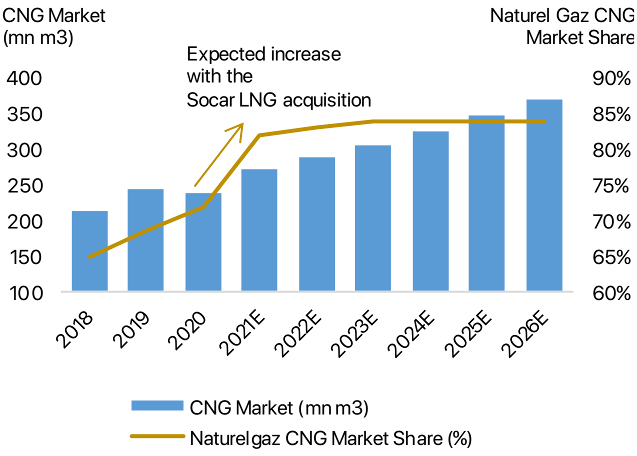
Source: Company Data, INFO Research Estimates

Exhibit 14. 2020 Sales Breakdown



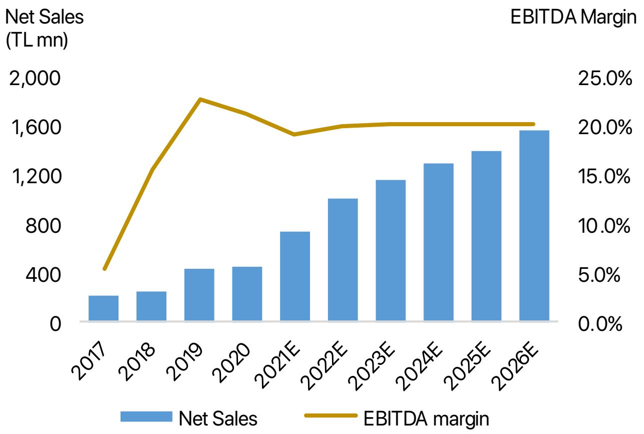
Source: Company Data

Exhibit 15. Sales breakdown in years (mn TL)



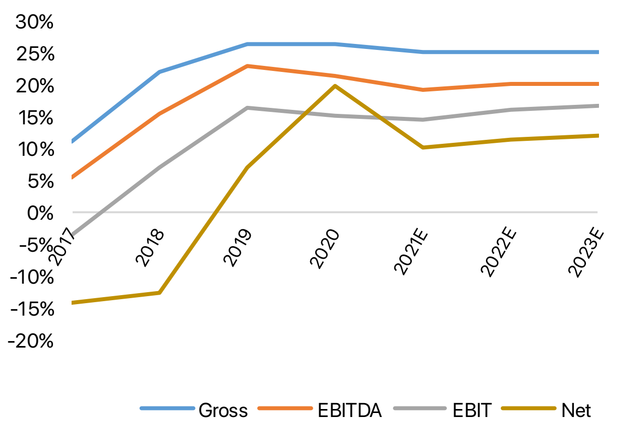
Source: Company Data

Exhibit 16. Net Sales and EBITDA Margin



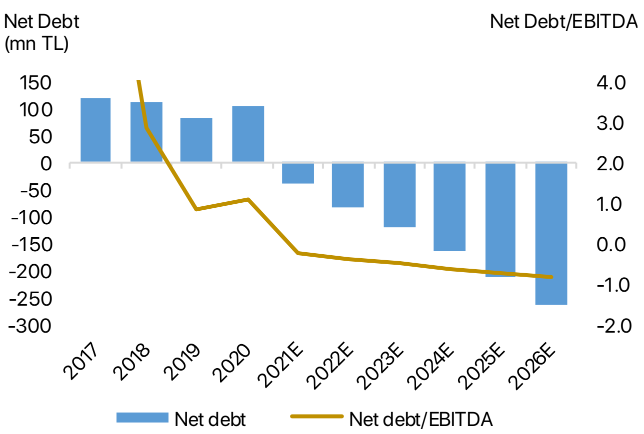
Source: Company Data, INFO Research Estimates

Exhibit 17. Margin Evolution



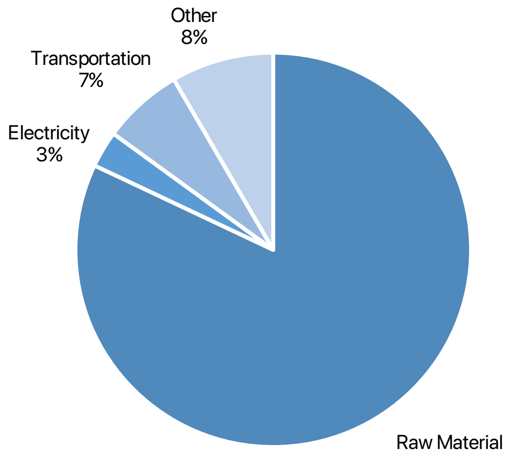
Source: Company Data, INFO Research Estimates

Exhibit 18. Net Debt and Leverage



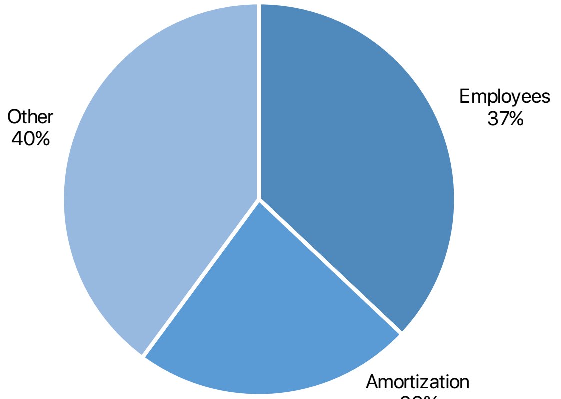
Source: Company Data, INFO Research Estimates

Exhibit 19. COGS Breakdown of 2020



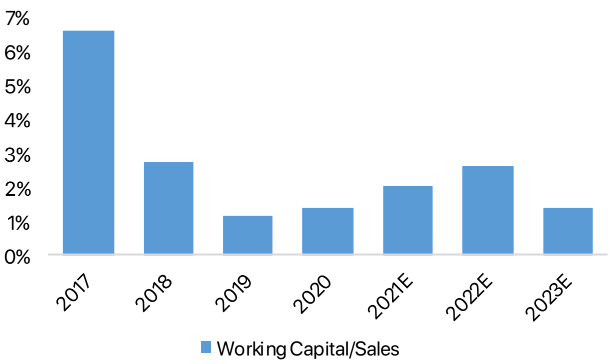
Source: Company Data

Exhibit 20. OPEX Breakdown of 2020



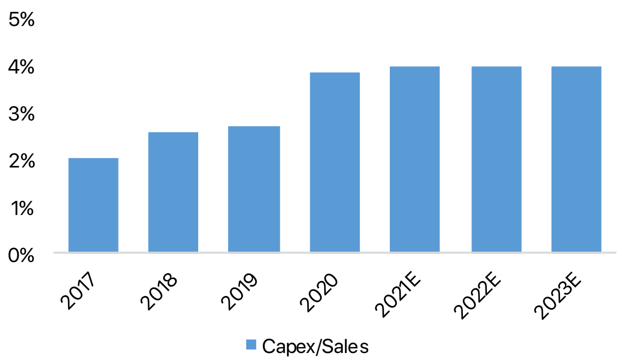
Source: Company Data

Exhibit 21. Working Capital as % of Sales



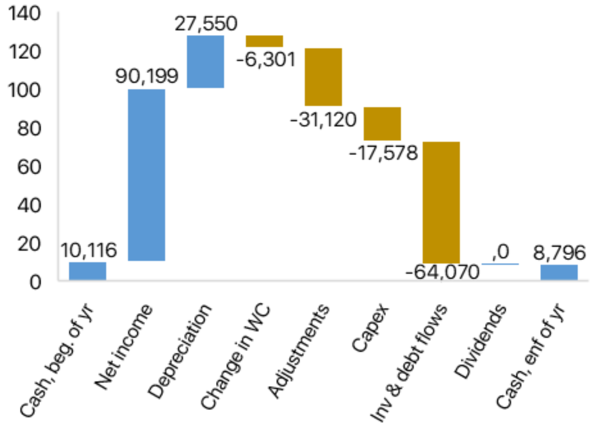
Source: Company Data, INFO Research Estimates

Exhibit 22. Capex as % of Sales



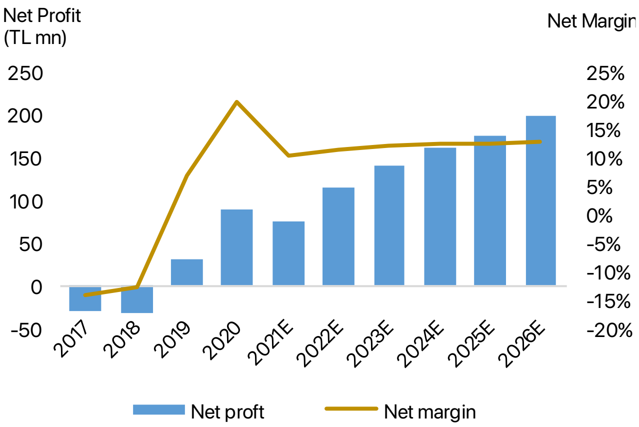
Source: Company Data, INFO Research Estimates

Exhibit 23. 2020 Cash Flow Summary (TL mn)



Source: Company Data, INFO Research Estimates

Exhibit 24. Net Profit (TL mn) and Net Margin



Source: Company Data, INFO Research Estimates

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Rating Methodology:

We employ Discounted Cash Flow (DCF) model and peer multiple analysis to derive at our target prices. Our recommendation methodology is as follows:

Buy: If Target Price is 5 percentage points higher than the estimated Cost of Equity

Hold: If Target Price is within -5 and 5 percentage points of the estimated Cost of Equity

Sell: If Target Price is lower than 5 percentage points of the estimated Cost of Equity

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

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