

# Turkish Airlines

10 March 2010

## Brightest star in the Star Alliance

Airlines		Current price	TRY 5.35*	Buy
Turkey		Fair value	TRY 6.90	Rating maintained
<b>Performance over</b>	<b>1M</b> <b>3M</b> <b>12M</b>	<b>TRY m</b>	<b>2008A</b> <b>2009F</b> <b>2010F</b> <b>2011F</b>	
<b>Absolute %</b>	4% -7% 391%	<b>Revenues</b>	6,123.2 6,884.4 8,265.3 10,559.9	
<b>Rel. ISE-100 %</b>	1% -12% 114%	<b>EBITDAR</b>	1,174.5 1,650.0 1,838.1 2,315.8	
<b>12M Hi/Lo</b>	TRY 5.80 / 1.07	<b>EBITDAR margin</b>	19.2% 24.0% 22.2% 21.9%	
<b>Reuters</b>	THYAO.IS	<b>EBIT</b>	633.3 885.3 917.5 1,175.0	
<b>Bloomberg</b>	THYAO TI	<b>Net income</b>	1,134.2 675.9 778.0 953.1	
<b>Market cap</b>	TRY 4,681m	<b>EPS</b>	6.48 0.77 0.89 1.09	
<b>Next corporate event</b>		<b>EV/Sales</b>	1.36 1.21 1.01 0.79	
4Q09 Financial results announcement		<b>EV/EBITDAR</b>	7.10 5.05 4.53 3.60	
<b>TRY / €</b>		<b>P/E</b>	4.13 6.93 6.02 4.91	
2.0845		<i>Source: Company data, KBC Securities</i>		

We remain bullish on Turkish Airlines (THY) due to the positive outlook for passenger growth. We have revised our earnings estimates and valuation upwards to reflect improving operational profitability and downward revisions in our oil forecasts for 2010-2011 (revised to \$75 and \$82 from \$82 and \$95). We believe THY offers a good entry point after underperforming the ISE-100 index by 12% in the last three months. We have raised our EBITDAR forecasts by 4.9% to TRY 1.65bn (+40.5% y/y) for 2009, 0.2% to TRY 1.84bn (+11.4% y/y) for 2010 and 11.0% to TRY 2.32bn (26.0% y/y) for 2011. Also factoring-in a lower discount rate, our fair value estimate is up 31.4% to TRY 6.90 per share, implying 29% upside.

*\*Priced at COB 9 March 2010*

### Recommendation maintained

- Superior growth prospects:** THY's air traffic data for January indicated a strong 26% rebound in passenger numbers (pax) versus a 6.4% rise in global pax. We expect pax to rise 16.5% to 29.2m in 2010 and 19.6% to 35.0m in 2011 thanks to THY's geographical expansion, increasing flight frequencies and growing capacity. However, our generous growth target remains below THY's aggressive guidance of 30m total pax for 2010.
- Rising brand recognition:** THY is investing in its global brand image to support growth in international passengers, which is expected to be the main driver of pax growth. We expect THY's sponsorship of leading soccer (Barcelona & Manchester United) and basketball clubs (Maroussi) will make a significant contribution in the firm's profile and help to attract more passengers from the European market.
- Operations in top health:** We expect PLF to improve by 50bp to 71.5% in 2010, supported by a 10% increase in RPK. Geographical expansion will play a key role in RPK growth, as THY's total destinations will rise to 169 with the addition of 13 destinations in 2010. Using the advantageous location of Istanbul as a hub, THY is managing to capture market share in international passenger transit.
- Cost efficiency:** THY's efficient cost structure allows competitive pricing and better profitability versus peers. With 5.1 € cent operating cost/ASK, 1.18 € cent personnel cost/ASK and 1.2 € cent fuel expense/ASK, THY has one of the most efficient cost structures among European airlines. Benefiting from its young fleet, THY's fuel consumption has fallen 9.5% to 3.48 litres/100 ASK since 2005.
- Attractive valuation:** On a 2010F EV/EBITDA of 6.21x, THY trades at a deep 33.1% discount to global peers, despite outperforming the ISE-100 by 114% in the last 12 months. We believe THY deserves to trade at a lower discount considering its ambitious growth strategy and superior operational efficiency that allowed THY to post a 24.6% EBITDAR margin compared to the 7.7% average of European airlines in 9M09.

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Stock rating	Definition
BUY	Expected total return (including dividends) of 10% or more over a 6-month period
HOLD	Expected total return (including dividends) of between -10% and +10% over a 6-month period
SELL	Expected total return (including dividends) of -10% or worse over a 6-month period

Due to external factors and in exceptional cases, KBC Securities allows the use of ratings such as Accept the Offer, Black Out, No Recommendation or Suspended.

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Stock rating	% of covered universe	% of covered universe with investment banking relationship during last year
BUY	52.27%	0.00%
HOLD	29.55%	0.00%
SELL	18.18%	0.00%

Turkish Airlines is the dominant airline company in Turkey.

The price target for Turkish Airlines is based on following parameters: Discounted Cash Flow (DCF).

The risks which may impede the achievement of our price target are: regulatory tightening, increase in competition, shareholder dispute, shareholder stake sale, material increase in capital expenditures, higher energy prices and risks to tourism.

Any reference made to a DCF valuation for Turkish Airlines is based on the following parameters: a forecast period from 2010 until 2019, a perpetual growth rate of 7.1% and an average WACC of 14.1%.

Below is an overview of the stock ratings and target price history in the last 12 months for the stock described in this report.

Date	Rating	Target price
10 March 2010	Buy	TRY 6.90
15 October 2009	Buy	TRY 5.25
27 August 2009	Buy	TRY 3.80
24 June 2009	Hold	TRY 2.18

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