

# Turkish Airlines (THYAO.IS)

Strong positioning, geared to leisure travel recovery; reiterate Buy

Buy

THYAO.IS 12m Price Target: **TRY18.20** Price: **TRY13.94** Upside: **30.6%**

We revise our estimates for Turkish Airlines (THY). Reflecting more upbeat expectations from management post stronger than expected FY20 results (clean EBITDA c.20% ahead of company-compiled consensus expectations), our revenue and EBITDA forecasts increase by c.11%/15% on average over 2021-23.

**Our 12-month price target increases by c.11% to TRY18.2, implying >25% upside. We reiterate our Buy rating. We see improving monthly pax numbers from 2Q21 and a pick-up in summer bookings as a catalyst for share price performance, driven by a favourable base effect, easing restrictions on mobility, and increasing vaccination roll-outs globally.**

We see THY as a key beneficiary of recovery in leisure travel, particularly in Europe, with a large share of short-haul destinations in the region. We expect ASK to reach 67% of 2019's level in 2021, in line with management expectations. Given THY's structural advantage, with a relatively large share of local currency costs, strong cargo operations (+60% yoy in FY20) and strict cost controls that we believe can be partially sustained longer term, we expect profitability to remain resilient. While leverage remains an investor concern, driven by lease liabilities relating to fleet expansion that is making THY one of the youngest fleets in Europe, we note significant operating leverage that should drive leverage ratios lower on recovering traffic, driving absolute profitability higher. We expect net debt/EBITDA to fall from 11x in 2020 to 4.7x by 2024E, broadly in line with the company's historical average.

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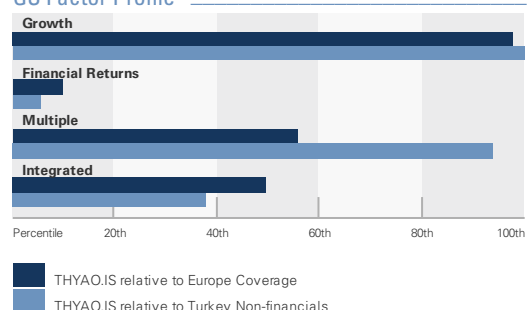
## Key Data

Market cap: TRY22.3bn / \$2.9bn  
Enterprise value: TRY142.2bn / \$18.6bn  
3m ADTV: TRY1.4bn / \$187.3mn  
Turkey  
Turkey Non-financials  
M&A Rank: 3  
Leases incl. in net debt & EV?: Yes

## GS Forecast

	12/20	12/21E	12/22E	12/23E
<b>Revenue (\$ mn) New</b>	<b>6,734.0</b>	<b>9,621.8</b>	<b>12,455.8</b>	<b>14,038.6</b>
Revenue (\$ mn) Old	6,720.4	8,565.3	10,893.0	13,231.6
EBIT (\$ mn)	(307.0)	139.1	534.9	744.7
<b>EPS (\$ New)</b>	<b>(0.52)</b>	<b>0.01</b>	<b>0.28</b>	<b>0.43</b>
EPS (\$ Old)	(0.52)	(0.00)	0.15	0.42
P/E (X)	NM	NM	6.5	4.3
Dividend yield (%)	0.0	0.0	0.0	0.0
CROCI (%)	5.6	6.2	7.4	7.9
N debt/EBITDA (ex lease,X)	9.8	7.4	5.5	4.7
	<b>12/20</b>	<b>3/21E</b>	<b>6/21E</b>	<b>9/21E</b>
EPS (\$)	(0.03)	(0.15)	0.02	0.06

## GS Factor Profile



Source: Company data, Goldman Sachs Research estimates.  
See disclosures for details.

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Buy

## Turkish Airlines (THYAO.IS)

Rating since Dec 8, 2020

## Ratios &amp; Valuation

	12/20	12/21E	12/22E	12/23E
EV/sales (X)	2.6	1.9	1.4	1.2
EV/EBITDAR (X)	12.9	9.9	7.3	6.2
EV/EBITDA (excl. leases) (X)	11.6	8.9	6.6	5.6
EV/EBIT (X)	NM	132.2	32.7	22.5
P/E (X)	NM	NM	6.5	4.3
Dividend yield (%)	0.0	0.0	0.0	0.0
EV/GCI (X)	0.6	0.6	0.6	0.5
CROCI (%)	5.6	6.2	7.4	7.9
ROIC (%)	(1.5)	0.7	2.4	3.4
ROA (%)	(2.6)	1.2	2.7	3.5
Days inventory outst, sales	16.1	13.1	9.7	7.6
Asset turnover (X)	0.4	0.5	0.6	0.7
Capex/D&A (%)	51.8	68.4	64.7	70.0
Net debt/equity (excl. leases) (%)	246.1	257.6	226.6	195.3
EBIT interest cover (X)	(1.1)	0.3	1.3	1.9
FCF cover of dividends (X)	—	—	—	—

## Growth &amp; Margins (%)

	12/20	12/21E	12/22E	12/23E
Total revenue growth	(49.1)	42.9	29.5	12.7
EBITDA growth	(43.3)	38.0	29.2	12.2
EBIT growth	(135.6)	145.3	284.5	39.2
Net inc. growth	(206.1)	101.4	NM	52.7
EPS growth	(206.1)	101.4	3,617.8	52.7
DPS growth	NM	NM	NM	NM

## Price Performance



Source: FactSet. Price as of 18 Mar 2021 close.

## Income Statement (\$ mn)

	12/20	12/21E	12/22E	12/23E
Total revenue	6,734.0	9,621.8	12,455.8	14,038.6
Total operating expenses	(5,605.0)	(7,909.8)	(10,318.1)	(11,640.8)
R&D	0.0	0.0	0.0	0.0
Other operating inc./exp.)	223.0	153.9	274.0	308.8
<b>EBITDA</b>	<b>1,352.0</b>	<b>1,866.0</b>	<b>2,411.7</b>	<b>2,706.6</b>
Depreciation & amortisation	(1,659.0)	(1,726.9)	(1,876.8)	(1,961.9)
<b>EBIT</b>	<b>(307.0)</b>	<b>139.1</b>	<b>534.9</b>	<b>744.7</b>
Net interest inc./exp.)	(195.0)	(316.7)	(315.8)	(301.4)
Income/(loss) from associates	83.0	136.2	174.6	212.3
Profit/(loss) on disposals	—	—	—	—
Total other net	(507.0)	50.0	100.0	100.0
<b>Pre-tax profit</b>	<b>(926.0)</b>	<b>8.6</b>	<b>493.7</b>	<b>755.6</b>
Provision for taxes	90.0	3.5	(46.1)	(72.1)
Minority interest	—	—	—	—
Preferred dividends	—	—	—	—
<b>Net inc. (pre-exceptionals)</b>	<b>(836.0)</b>	<b>12.0</b>	<b>447.6</b>	<b>683.5</b>
Post-tax exceptionals	—	—	—	—
<b>Net inc. (post-exceptionals)</b>	<b>(836.0)</b>	<b>12.0</b>	<b>447.6</b>	<b>683.5</b>
<b>EPS (basic, pre-exception) (\$)</b>	<b>(0.52)</b>	<b>0.01</b>	<b>0.28</b>	<b>0.43</b>
<b>EPS (basic, post-exception) (\$)</b>	<b>(0.52)</b>	<b>0.01</b>	<b>0.28</b>	<b>0.43</b>
Wtd avg shares out. (basic) (mn)	1,597.0	1,597.0	1,597.0	1,597.0
Tax rate (%)	9.7	(40.3)	9.3	9.5
Common dividends declared	0.0	0.0	0.0	0.0
DPS (\$)	—	—	—	—

## Balance Sheet (\$ mn)

	12/20	12/21E	12/22E	12/23E
Cash & cash equivalents	1,829.0	1,829.0	1,829.0	1,829.0
Accounts receivable	637.0	577.3	498.2	561.5
Inventory	305.0	384.9	274.0	308.8
Other current assets	1,407.0	1,748.3	1,731.3	1,636.3
<b>Total current assets</b>	<b>4,178.0</b>	<b>4,539.5</b>	<b>4,332.5</b>	<b>4,335.7</b>
Net PP&E	18,922.0	19,901.2	19,788.7	19,834.4
Net intangibles	101.0	79.9	58.7	37.6
Total investments	331.0	371.0	446.0	546.0
Other long-term assets	1,998.0	2,053.1	2,126.3	2,201.3
<b>Total assets</b>	<b>25,530.0</b>	<b>26,944.6</b>	<b>26,752.3</b>	<b>26,954.9</b>
Accounts payable	861.0	1,154.6	1,121.0	1,193.3
Long-term debt	4,169.0	3,754.9	3,702.5	3,660.6
Short-term lease liabilities	272.0	284.3	258.7	235.5
Other current liabilities	1,152.0	1,539.5	1,743.8	1,825.0
<b>Total current liabilities</b>	<b>6,454.0</b>	<b>6,733.4</b>	<b>6,826.0</b>	<b>6,914.4</b>
Long-term debt	10,909.7	11,971.7	11,366.1	10,912.0
Long-term lease liabilities	1,350.3	1,411.5	1,284.5	1,169.4
Other long-term liabilities	1,433.0	1,433.0	1,433.0	1,433.0
<b>Total long-term liabilities</b>	<b>13,693.0</b>	<b>14,816.2</b>	<b>14,083.6</b>	<b>13,514.4</b>
<b>Total liabilities</b>	<b>20,147.0</b>	<b>21,549.6</b>	<b>20,909.6</b>	<b>20,428.8</b>
Preferred shares	—	—	—	—
<b>Total common equity</b>	<b>5,382.0</b>	<b>5,394.0</b>	<b>5,841.7</b>	<b>6,525.1</b>
Minority interest	1.0	1.0	1.0	1.0
<b>Total liabilities &amp; equity</b>	<b>25,530.0</b>	<b>26,944.6</b>	<b>26,752.3</b>	<b>26,954.9</b>
<b>Capital employed</b>	<b>20,461.7</b>	<b>21,121.7</b>	<b>20,911.2</b>	<b>21,098.7</b>
Adj for unfunded pensions & GW	—	—	—	—

## Cash Flow (\$ mn)

	12/20	12/21E	12/22E	12/23E
Net income	(836.0)	12.0	447.6	683.5
D&A add-back	1,659.0	1,726.9	1,876.8	1,961.9
Minority interest add-back	—	—	—	—
Net (inc)/dec working capital	(1,173.0)	374.7	450.9	225.3
Other operating cash flow	531.0	(186.2)	(274.6)	(312.3)
<b>Cash flow from operations</b>	<b>181.0</b>	<b>1,927.4</b>	<b>2,500.7</b>	<b>2,558.4</b>
Capital expenditures	(860.0)	(1,181.5)	(1,213.8)	(1,373.4)
Acquisitions	—	—	—	—
Divestitures	14.0	44.5	77.5	47.9
Others	400.0	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>(446.0)</b>	<b>(1,137.0)</b>	<b>(1,136.3)</b>	<b>(1,325.4)</b>
Repayment of lease liabilities	(341.0)	(341.0)	(341.0)	(341.0)
Dividends paid (common & pref)	—	—	—	—
Inc/(dec) in debt	960.0	860.4	(181.2)	(114.8)
Other financing cash flows	(2.0)	146.2	199.6	212.3
<b>Cash flow from financing</b>	<b>617.0</b>	<b>665.6</b>	<b>(322.5)</b>	<b>(243.5)</b>
<b>Total cash flow</b>	<b>(646.0)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Reinvestment rate (%)	63.5	76.1	59.2	58.9

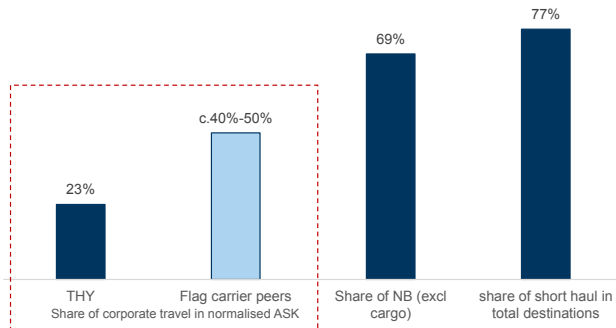
Source: Company data, Goldman Sachs Research estimates.

## Key structural advantages: Favourable cost base; cargo and domestic operations enhance resilience

THY benefits from the following structural advantages, as evident in its relatively strong operational dynamics throughout the pandemic vs. other European flag carriers: THY's revenue was down 49% yoy in 2020 (compared to c.69% for IAG and c.63% for Lufthansa), with its EBITDA margin at 19.4%, down 70 bp yoy (vs. limited EBITDA generation for European peers).

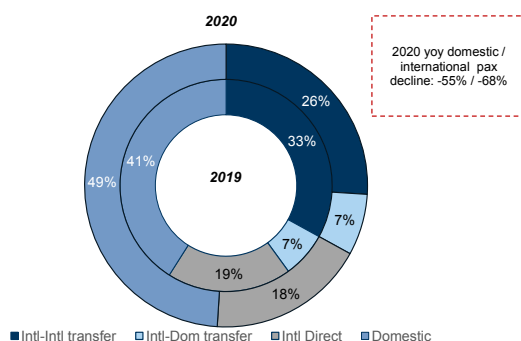
- 1. Exposure to short-haul leisure travel:** A large share of THY's passenger fleet is composed of narrow-bodies, reflecting the company's large exposure to cost-efficient short-haul flights that make up close to 80% of its total destinations. THY has a low share of corporate travel (business class made up c.20% of total revenues pre-pandemic), combined with a large share of domestic operations (domestic pax historically made up c.45% of total pax), which has allowed resilience during the pandemic. THY 'total pax were down c.62% yoy in 2020, vs. a 76% decline for Lufthansa and a 74% decline for IAG over the same period.
- 2. Favourable cost base:** THY has historically benefited from local currency weakness, noting that c.30% of its total costs are in TRY (mostly staff costs), while only c.10% of revenues are TRY-based. The TRY depreciated by c.25% yoy on average vs. its EUR-USD basket in 2020, and on average by c.20% over the last five years, providing THY with an even more favourable cost base. We note that THY CASK (ex-fuel) has averaged c.US\$c 4.4 over the last five years (2015-19) vs. c. US\$c 6.5 for Lufthansa and c. US\$c 5.1 for IAG.
- 3. Strong cargo operations:** THY managed to grow its cargo operations during the pandemic, benefiting from Turkey's position as a large exporter of medical supplies. Driven by a shortage of global cargo capacity, THY cargo yields increased by c.67% yoy in 2020, with the company's total cargo revenues growing by c.60% yoy (despite lower volumes). We note that THY now has 4.7% share in the global cargo market vs. 1.8% in 2015.

**Exhibit 1: THY is more exposed to leisure than corporate travel, and short-haul vs. long-haul destinations (mostly in Europe)**  
THY operational metrics, 2020



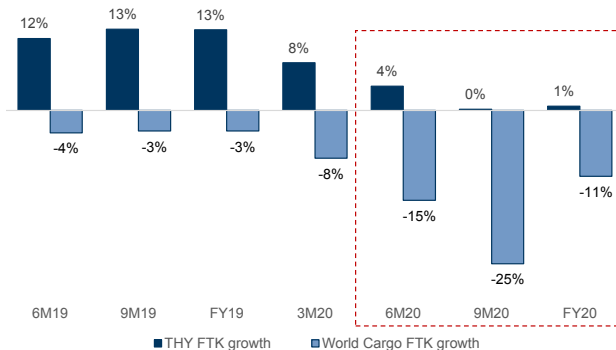
Source: Company data.

**Exhibit 3: THY's domestic business has proved to be resilient, allowing for lower pax declines in 2020 vs. European flag carriers**  
Passenger breakdown by type of travel



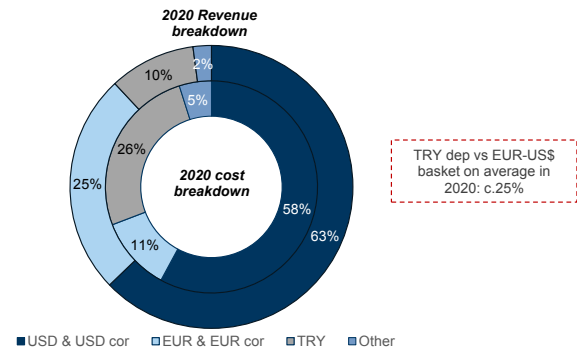
Source: Company data.

**Exhibit 5: THY's cargo volumes have remained more resilient against a backdrop of lower cargo volumes globally...**  
FTK growth: THY vs. World cargo market



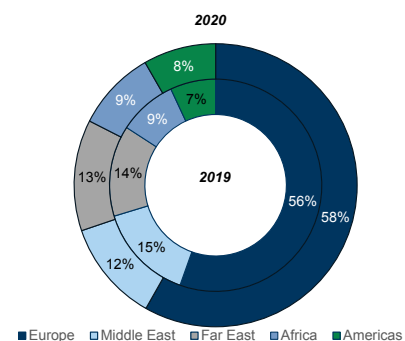
Source: Company data, IATA Economic Performance of the Airline Industry Reports.

**Exhibit 2: Given c.30% of costs in TRY, vs. only c.10% of revenue, THY benefits from TRY weakness operationally**  
Revenue and cost breakdown by currency



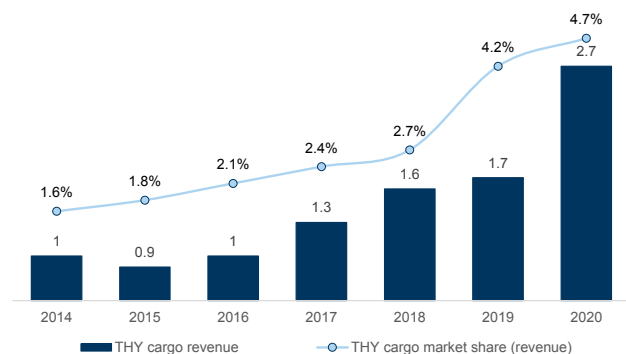
Source: Company data, Datastream.

**Exhibit 4: THY has large exposure to Europe as reflected by its pax mix**  
THY international passengers breakdown by geography



Source: Company data.

**Exhibit 6: ...paving the way for a higher market share for THY, coupled with higher yields on global shortage in the cargo market**  
THY Cargo revenue (US\$ bn) and THY's share in world cargo market by revenue

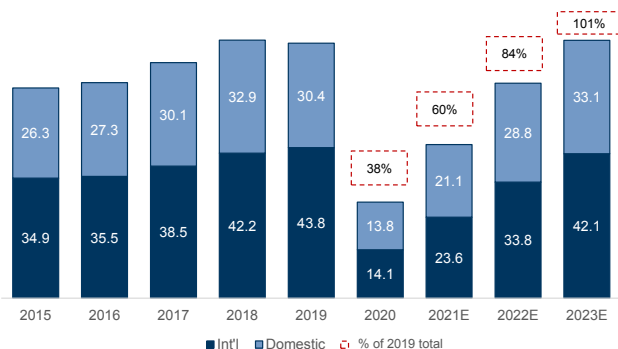


Source: Company data, IATA Economic Performance of the Airline Industry Reports.

# We expect more visible recovery from 2022; sustained cost control supportive of core profitability

## Exhibit 7: We forecast pax at 60% of 2019's level in 2021, up from 38% in 2020

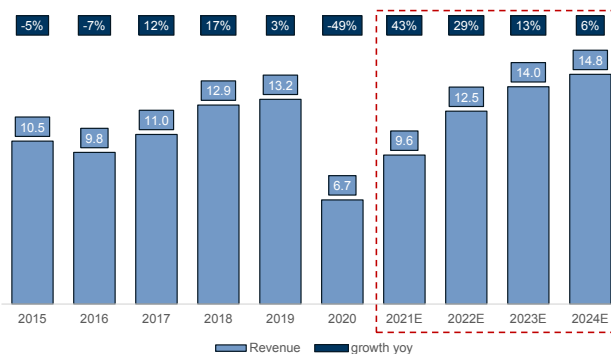
Passenger breakdown, international vs. domestic; total passengers as % of 2019



Source: Company data, Goldman Sachs Global Investment Research.

## Exhibit 9: We expect revenue growth of 43%/29% in 2021/22; recovery in yields would imply upside risks to our numbers

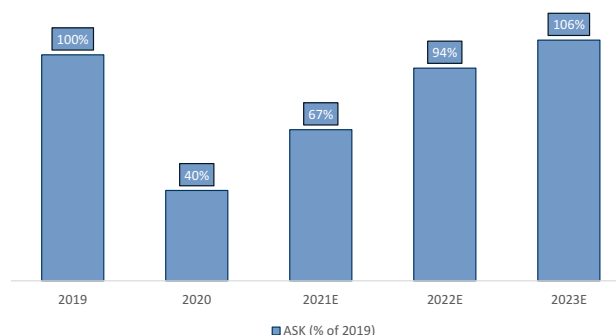
Total revenue (US\$ bn) and yoy revenue growth



Source: Company data, Goldman Sachs Global Investment Research.

## Exhibit 8: THY's management expects to reach 60%-70% of 2019 ASK in 2021; we expect a steeper recovery in 2022

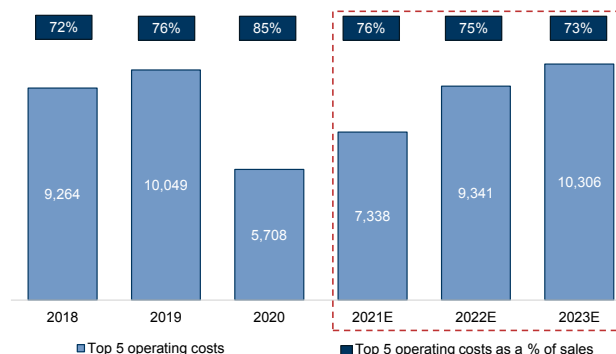
ASK as % of 2019



Source: Company data, Goldman Sachs Global Investment Research.

## Exhibit 10: We expect sustained cost savings, mainly across personnel costs...

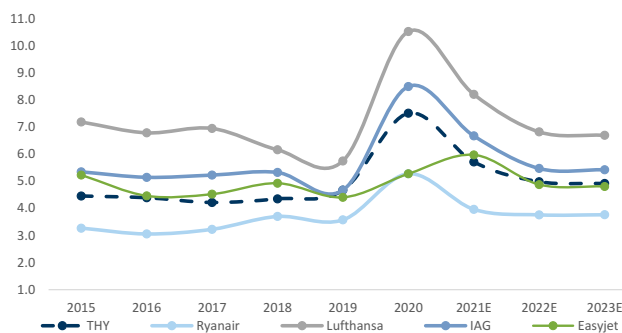
Top-5 operating costs\*



\*Top 5 operating costs include fuel, staff, aircraft ownership (inc. depreciation), airports & air navigation, and sales & marketing.

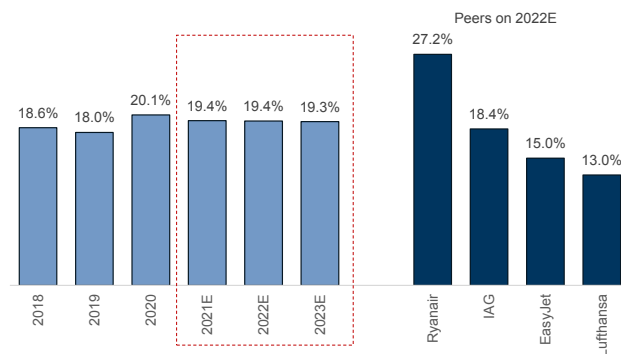
Source: Company data, Goldman Sachs Global Investment Research.

**Exhibit 11: ...with THY leading on cost; we forecast ex-fuel CASK to continue to trend below European flag carriers**  
Ex-Fuel CASK (US\$c)



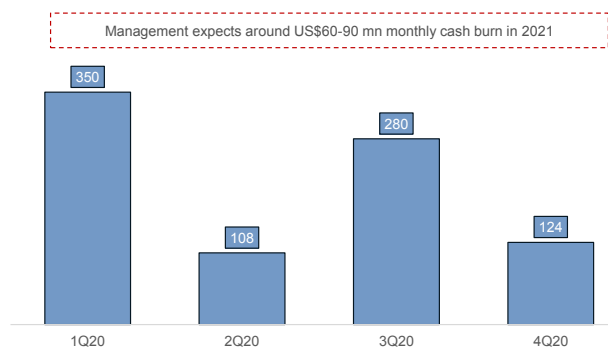
Source: Company data, Goldman Sachs Global Investment Research.

**Exhibit 12: We expect THY's core profitability to remain resilient vs. its history and other European airlines**  
EBITDA margin



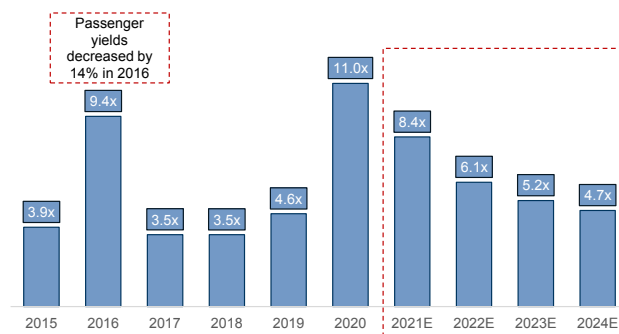
Source: Company data, Goldman Sachs Global Investment Research.

**Exhibit 13: Management anticipates lower monthly cash burn of US\$60-90 mn on recovering traffic vs. 2020**  
Monthly cash burn (US\$ mn) on company definition based on change in net debt ((Cash+ST financial investments) - (ST+LT bank borrowings))



Source: Company data.

**Exhibit 14: While leverage is high, we expect ratios to come down on higher absolute profitability (as has been the case in 2016)**  
Net debt / EBITDA



Source: Company data, Goldman Sachs Global Investment Research.

## Reflecting more upbeat guidance: Our revenue/ EBITDA estimates are up c.11%/15% over 2021-23

### What is changing:

Reflecting more upbeat expectations by management and better than expected FY20 financial results, we revise our forecasts for THY.

- **Revenues:** Our revenue estimates across FY21-23E increase by c.11% on average, as we increase our ASK assumptions on: (1) global travel restrictions continuing to ease; (2) travel sentiment improving (with forward bookings for March and April higher yoy); and (3) increasing vaccine penetration globally, potentially leading to an unlocking of pent-up demand for leisure travel, with Turkey still being one of the leading travel destinations among tourists (noting that Turkey currently does not have a quarantine requirement for travellers). Our new ASK assumptions across FY21-23E are 67%/94%/106% of 2019 ASK (vs. 59%/78%/99% previously), in line with management's expectation of 2021 ASK in the region of 60%-70% of 2019 ASK.
- **EBITDA:** We expect clean EBITDA margin (excluding FX gains and losses from other operating income) to decline by 70 bp yoy to 19.4% in 2021, from the high of c.20.1% in 2020, as certain cost savings (such as partial work schemes and government support) are either relaxed or have already ended. Nevertheless, we see some of the savings as sustainable, such as the c.40% weighted average personnel cost reduction, based on an agreement the company struck with the labour union. The company expects this agreement to continue into the foreseeable future. As result, we raise our EBITDA margin expectations by 40 bp on average over FY22-23E, to 19.4% on average.
- **Net income:** On improving operating profitability, our EPS estimates increase by 45% on average across FY22-23E to TRY0.28/TRY0.43 (vs TRY0.15/TRY0.42 previously).

**On higher FY23E EBITDAR (including heavy maintenance capex on operating leases and wet leases), our 12-month target price increases by c.11% to TRY18.2, implying potential upside of 23%.**

### Exhibit 15: Our revenue / EBITDA estimates are up c.11%/15% on average over 2021-23

Estimate changes

TRY mn		TP (TRY)	Rating	Revenue			EBITDA			EBITDA Margin			EPS		
				2021E	2022E	2023E	2021E	2022E	2023E	2021E	2022E	2023E	2021E	2022E	2023E
Turkish Airlines	New	18.2	Buy	9,622	12,456	14,039	1,866	2,412	2,707	19.4%	19.4%	19.3%	0.01	0.28	0.43
	Old	16.4	Buy	8,565	10,893	13,232	1,567	2,003	2,568	18.3%	18.4%	19.4%	0.00	0.15	0.42
	Change	10.9%		12%	14%	6%	19%	20%	5%	110bps	98bps	-13bps	n.a.	89%	2%

Source: Goldman Sachs Global Investment Research.

**Exhibit 16: We are broadly in-line with management's 2021 expectations**

	Metrics	2021 company expectations	GSe
ASK	ASK (as % of 2019)	+65%-70%	c.67%
Capex	Capex	US\$1.4 bn	c.US\$1.4 bn
Cash burn	Monthly cash burn	US\$60 mn - US\$90 mn	c.US\$72 mn

Source: Company data, Goldman Sachs Global Investment Research.



## Our 12-month price target implies >25% upside; we reiterate our Buy rating

THY's shares are down c.26% since the start of 2020 (in euro terms) vs. the average of GS-covered European airlines of c.-22% over the same period. The stock is trading at 4.5x 2023E P/E, a c.27% discount to history. Our new 12-month price target of TRY18.2 implies >25% upside from current levels. We reiterate our Buy rating.

We value Turkish Airlines on an EV/EBITDAR multiple of 5.2x, applied to 2023E EBITDAR (EBITDA including heavy maintenance capex on operating leases and wet leases, as defined by the company), discounted back two years at a CoE of 11.7%.

### Exhibit 17: Turkish Airlines trades at 6.2x EV/EBITDA on our 2023 estimates

Valuation comps

Company name	EV/EBITDA				P/E				EV/Sales				ND/EBITDA			
	2015-2019 median	2021E	2022E	2023E	2015-2019 median	2021E	2022E	2023E	2015-2019 median	2021E	2022E	2023E	2015-2019 median	2021E	2022E	2023E
Turkish Airlines	6.0x	9.9x	7.3x	6.2x	6.2x	6.8x	4.5x		1.1x	1.7x	1.3x	1.1x	4.1x	8.4x	6.1x	5.2x
Lufthansa AG	3.3x	54.1x	4.6x	4.3x	3.9x	7.9x	6.9x		0.4x	0.9x	0.5x	0.5x	1.4x	35.2x	2.9x	2.6x
IAG	4.1x		6.9x	5.2x	5.7x	14.1x	6.9x		0.7x	2.0x	1.0x	0.9x	1.2x		3.7x	2.7x
Ryanair	9.1x	28.5x	9.1x	7.1x	13.9x	13.8x	10.8x		2.5x	3.8x	2.5x	2.0x	0.2x	3.5x	1.0x	0.6x
easyJet	7.5x		7.3x	6.1x	12.4x	19.2x	13.9x		1.0x	2.3x	0.9x	0.8x	0.2x		1.9x	1.4x

Source: Company data, Goldman Sachs Global Investment Research.

*All prices as of the close of March 17, unless otherwise stated.*

## Key downside risks to our view

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1. **A more gradual than expected recovery:** A less pronounced than expected recovery in passenger volumes driven by unforeseen changes in vaccination rollouts and/or increased health concerns around travel would imply downside risks to our estimates, leading to lower than expected recovery in revenue.
2. **Cost overruns leading to lower profitability and cash flows:** Cost overruns, especially relating to fuel hedging given the recent increase in oil prices, and/or any unforeseen reversal in tight cost control could lead to higher-than-expected than expected cash burn that could drive leverage higher.
3. **Failure in negotiations with OEMs.** We note that THY is currently in negotiations with Boeing regarding future aircraft deliveries. A potential failure in negotiations to delay pre-delivery payments could impact cash flows adversely.
4. **Adverse currency moves impacting profitability.** THY benefits operationally from a weaker TRY and a stronger EUR due to its revenue/cost structure. Adverse currency moves could impact profitability, implying downside risks to our estimates.

# Disclosure Appendix

## Reg AC

We, Asli Tuncer, Cem Unal and Ashwath P T, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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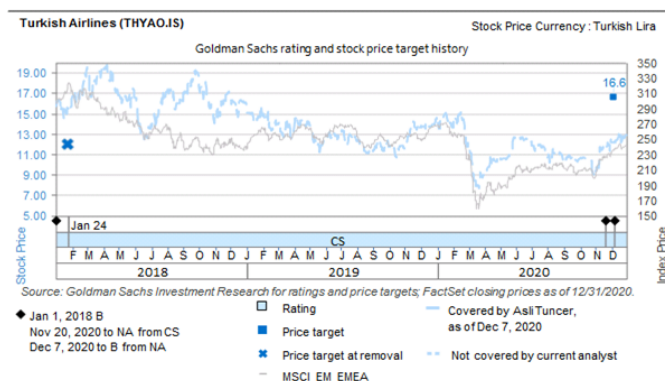
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