EkspresInvest A SUBSIDIARY OF DENİZBANK

Turkey / sector / automotive

Otokar

Armored for growth

May 13, 2008

MARKET OUTPERFORMER (initiated)

OTKAR.IS **OTKAR TI**

Report priced as of May 12, 2008

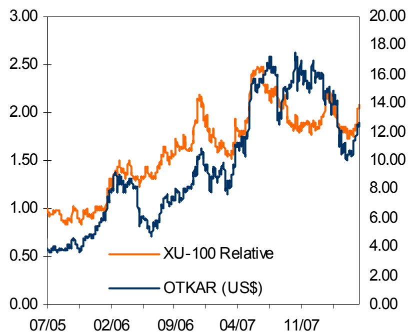
Current	
Price (YTL)	15.80
Price (US$)	12.60
Mcap (US$mn)	303
Free Float (FF)	28%
FF. MCap	85
Foreign Share in FF	58%
12M Target	
Price (YTL)	20.40
Price (US$)	15.80
Mcap (US$mn)	380
US$ upside	25%

Relative Performance to ISE-100

1m	3m	6m	12m
15%	1%	8%	9%

Avg. Daily Trading Volume (US$mn)

1m	3m	6m	12m
1.1	1.3	0.9	1.0



Kurthan Atmaca
kurthana@ekspresinvest.com
+90 212 336 5164

Market leader in the midibus and the minibus segments… Considering its solid market share in the commercial vehicle segment, Otokar will benefit from the mild recovery in the auto demand (4% YoY growth) expected this year, in our view.

Generous revenue stream from the Tank project for five years… Otokar was officially selected to lead the project for producing a locally-designed national main battle tank for the Turkish Armed Forces. The budget of the project is US$500mn and it will be finalized in five years. We expect that the company will receive an extra cash-inflow of US$80mn in 2008 from this project, while the remaining amount will be paid equally between 2009 and 2012. These figures will make up 20-22% of the total revenues.

A strong year for Otokar… Taking into account the already secured revenues amounting to approximately US$130mn from the agreements signed last year, cash inflow from the Tank project starting this year, rising capacity utilization and the positive contribution to the top-line from the contract signed with Otoyol, we believe that 2008 will be an excellent year for Otokar in terms of its operational performance. Note that the upcoming 1Q08 results are likely to be very good and might also boost the stock performance in the short term, in our view.

New tenders will secure further growth in top-line and profitability. The Under Secretariat of Defense Industry (UDI) has opened two bids for a total of 4,131 vehicles for the armed forces. The total value of the tenders is estimated to be US$2.5bn. These potential new armored vehicle orders from the tenders might have a boosting effect to top-line and profitability in 2009 and 2010. Note that, according to our estimates, a possible 1,000 units delivery from this tender would increase our 2009 and 2010 revenue forecast by US$250mn-US$350mn.

Initiating coverage with MARKET OUTPERFORMER… Our target Mcap of US$380mn offers 25% upside potential from the current levels. We believe that Otokar has a different angle compared to the other listed automotive companies. It offers exposure to defense-related products, which makes the company resilient to demand fluctuations in the domestic auto market. Additionally, a moderate weakness in the YTL will have a positive effect to Otokar's financial performance given its long FX position. Risks to our valuation include deterioration in the macroeconomic figures, which would have a negative impact on the domestic auto demand. The sustainability of the defense vehicle orders in the coming years is dependent on the number of tenders won, which is difficult to foresee.

Summary Financials	2006A	2007A	2008E	2009E
Revenues (US$mn)	235	328	422	486
EBITDA (US$mn)	33	37	50	58
Net Income (US$mn)	29	29	42	44
EBITDA Margin	14.2%	11.4%	11.9%	11.8%
Net Margin	12.3%	8.8%	9.8%	9.1%
Revenue growth	11%	39%	29%	15%
EBITDA growth	83%	12%	34%	15%
Net Income growth	314%	0%	44%	7%
P/E	10.5	10.5	7.3	6.8
EV/EBITDA	10.6	9.5	7.0	6.1
EV/Sales	1.5	1.1	0.8	0.7

Investment Case

We initiate our coverage for Otokar with a "MARKET OUTPERFORMER" rating. Our target Mcap of US$380mn offers 25% upside potential from the current levels. We believe that 2008 will be a good year for Otokar in terms of operational performance, given (1) the cash inflow from the Tank project starting this year, (2) the revenues already secured with the agreements signed last year, (3) the rising capacity utilization and the positive contribution to the top-line thanks to the production agreement with Otoyol. Besides, the imminent 1Q08 results are expected to be strong, which might boost the stock performance in the short term. Given its large market share in commercial vehicle segment, Otokar will also benefit from the expected mild recovery in the auto demand (4% YoY growth in 2008). Last but not least, possible new orders for armored vehicles from the tenders held by the Under Secretariat of Defense Industry (UDI) can boost both the top-line and the profitability in 2009 and 2010.

Market leader by far in the midibus and the minibus niche markets. Otokar is one of the leading commercial-vehicle manufacturers in Turkey with its 26% and 98% market shares in the midibus and the minibus segments, respectively. It produces and sells trailers to logistics companies. Otokar differentiates itself from the other automotive producers thanks to its ability to produce armored vehicles. It also manufactures Land Rover Defenders under the Land Rover license and armored tactical vehicles for both the Turkish Armed Forces and the militaries of other countries.

Enjoys lucrative profit margins from defense vehicle sales. Although the company is known as a commercial vehicle producer, its operating margins are significantly higher than its peers' due to more profitable armored-vehicle sales. Note that the gross margin of the defense vehicle sales can reach up to 45% levels. We expect Otokar to increase the share of this segment in its revenues in the coming years, leading to higher operational margins and lower exposure to demand volatility in the domestic market. As a negative, the demand for the defense products is rather unpredictable given that a significant portion of the orders are obtained through tenders.

The Tank project will warrant US$500mn revenues for the next five years. Otokar was officially selected to lead the project for producing a locally-designed main battle tank for the Turkish Armed Forces. The company will handle the design and development process of the prototype. The budget of the project is US$500mn and will be finalized in five years. We expect that the company will receive an extra cash-inflow of US$80mn in 2008 from this project, while the remaining amount will be paid equally between 2009 and 2012. These figures will make up 20-22% of the total revenues. In the second phase, Turkish Armed Forces is going to pick a company for the mass production of the final tank prototype. We believe that Otokar has a substantially high chance of being selected, considering that it will coordinate both the design and the research & development for the prototypes, as well as manufacturing them. If Otokar is indeed picked for the mass production, we believe that the outlook of the company will change drastically, given that the estimated unit sale price of a single unit is around EUR20mn.

Any potential wins in the new tenders will boost profitability. UDI has opened bids for two different tenders for a total of 4,131 vehicles for the armed forces. The total value of these tenders is estimated to be US$2.5bn. Otokar is interested in manufacturing 3,109 vehicles out of the 4,131, since the remaining portion includes heavy load transporters for which the company does not produce. Considering that most of the other bidders are focused on load transporters, we believe that the probability for the company to win the tender is quite high. A possible 1,000 units delivery for this tender would increase our revenue estimates by

US$250mn-US$350mn in 2009 and 2010, according to our estimates. For the sake of conservatism, we do not include such prospects in our valuation.

Some 30% of the 2008 revenues are already secured. Otokar received US$330mn worth of orders from both domestic and international clients in the last two years. Particularly, the company received large orders for defense vehicles in 2007, which secured more than US$130mn revenues for 2008. In other words, the company has already guaranteed 30% of its estimated revenues in 2008. We expect Otokar to enhance its profitability significantly in 2008, thanks to the income from the Tank project and to a weaker YTL outlook given the company's long FX position.

The company agreed with Otoyol for the production of the latter's Eurobus midibus models in Otokar's plant. Koc Holding has decided to close down the production facilities of Otoyol, which held 33% market share in the midibus segment. Otokar will undertake the production of these units in its own plant, in other words Otokar will be contract manufacturer of Otoyol. This agreement will have a positive impact to Otokar in terms of raising its capacity utilization rate in midibus production from the 40-50% levels up to 85%, and in terms of additional top-line and profitability growth. Since we do not have the details of the agreement, we have not incorporated the potential contribution into our valuation.

The announcement of robust 1Q08 financials might create momentum for the share price performance, while the dividend outlook continues to be promising. As a consistent high dividend yielding stock, Otokar paid US$23mn (YTL30mn) dividend starting from May 12th, yielding 7.4%. Furthermore, we expect a set of robust 1Q08 results thanks to the deliveries of orders obtained in 2006-end and 2007.

Risks to our valuation: The main risks are the deterioration in macroeconomic figures, which might trigger a rise in interest rates and in return have a negative impact on the auto demand. The sustainability of defense-related vehicle orders in the coming years is dependent on the number of tenders won, which is difficult to foresee. Moreover, tax hikes for autos and high gasoline prices could pose a risk.

Model Assumptions and Valuation

DCF Model

We have used a DCF model to value Otokar. Our analysis yields a fair value of US$380mn, corresponding to a 25% upside potential from the current Mcap. Basic assumptions of our DCF model are as follows:

- Our forecast horizon is ten years (2008-2017).
- Despite the prevailing high interest rates, we still expect the automotive sector to post a moderate 4.1% growth in 2008, followed by a 4.5% increase in 2009, thanks to the pent-up demand since 2005. Our 2008 growth rate projections for the passenger car (PC) and the light commercial vehicle (LCV) segments are 5% and 3%, respectively. For 2009, we forecast 5% growth for the PC segment and 4% growth for the LCV segment. For the longer term, we assume a CAGR of 4.1% for the auto market until 2017, which is lower than our long term GDP estimate of 5.0%.
- We keep the minibus unit sales at 350/year throughout our forecast period since they are being replaced with other mass transportation vehicles and the metro in the main arteries. Having said that, we do not expect any further contraction in the minibus sales in the coming years, considering the need for this type of vehicle in narrow streets.
- We forecast the company’s trailer sales to grow by 4% annually, taking into account the rising trade activity driven by economic growth, and consequently the logistic companies’ increasing demand.
- We project the company’s domestic midibus sales volume to increase by 10% to 1,100 in 2008. For 2009 and 2010, we project sales volumes of 1,144 and 1,195, respectively, and we increase this figure by 4% (in line with our LCV market growth rate) for the remainder of our forecast period. For the exports, we foresee 300 and 315 unit sales in 2008 and 2009, respectively, and increase this figure by 15 units per year until 2017-end.
- We forecast the company to sell 300 armored vehicles and 650 Land Rover’s in 2008, and we expect these figures to reach 420 and 800 in 2009, respectively. Note that, armored vehicle figures are subject to change since the sales are mostly carried out through tenders. We gradually reach to 465 units of armored vehicles and 1,200 units of Land Rover in 2017.
- We keep both the domestic and the export unit prices constant throughout our forecast period. Note that trailer and midibus sales are in EUR terms, while Land Rover sales are in GBP, and armored vehicle sales are in US$ terms. Minibus sales are in YTL terms.
- Otokar has a flexible plant capacity of 9,750 unit/year with a single shift. The company is capable of switching to two shifts when necessary. We assumed single shift throughout our forecast period.
- In our model, revenues grow 29% in 2008, followed by another 15% in 2009, reaching US$422mn and US$486mn, respectively. With the termination of the Tank project, revenues decline to US$421mn in 2013 from US$507mn in 2012. Then the top-line climbs up to US$466mn in 2017, implying a 3.6% CAGR between 2007-2017.
- We expect the EBITDA margin to increase to 11.9% in 2008 and remain at 11.8% in 2009. We foresee EBITDA margin to reach to 12.0% in 2017, after a volatile pattern.
- We assume the marketing, sales & distribution expenses/sales ratio at 12%, the general management expenses/sales ratio at 5% and the research & development expense/sales ratio at 2.5% throughout our forecast period.
- We expect the company’s capex to reach US$15mn in 2008 and to US$10mn in 2009, followed by an average figure of US$4mn in the following years.

- We have subtracted dividend payments of US$23mn (YTL30mn) for 2007 from the net cash item.
- We use 8.0% risk-free rate, 5.5% equity risk premium and 0.7 beta to reach a cost of equity of 11.6%. With an 8.0% cost of debt, our WACC is 11.1% for 2008, and remains constant at that level going forward.
- We use a terminal growth rate of 2% and assume the 20% tax rate to remain constant throughout our forecast period.

FIGURE 1 – DCF Analysis for Otokar

(US$mn)	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Sales	**422**	**486**	**490**	**500**	**507**	**421**	**431**	**442**	**454**	**466**
Sales Growth	*29%*	*15%*	*1%*	*2%*	*1%*	*-17%*	*2%*	*3%*	*3%*	*3%*
Gross Profit	128	150	151	154	156	133	135	138	140	143
Gross margin	*30.4%*	*30.9%*	*30.8%*	*30.8%*	*30.7%*	*31.7%*	*31.4%*	*31.2%*	*30.9%*	*30.7%*
EBIT	46	54	55	57	57	51	51	51	52	52
EBIT margin	*10.9%*	*11.0%*	*11.3%*	*11.3%*	*11.3%*	*12.1%*	*11.8%*	*11.6%*	*11.4%*	*11.2%*
Depreciation	4	4	4	4	3	3	3	4	4	4
Severance Payment	0	0	0	0	0	0	0	0	0	0
EBITDA	**50**	**58**	**59**	**61**	**60**	**55**	**55**	**55**	**56**	**56**
EBITDA margin	*11.9%*	*11.8%*	*12.1%*	*12.1%*	*11.9%*	*13.0%*	*12.7%*	*12.5%*	*12.3%*	*12.0%*
Tax	-9	-11	-11	-11	-11	-10	-10	-10	-10	-10
Capex	-15	-10	-5	-4	-4	-4	-4	-4	-4	-4
Change in Working Capital	-5	-2	-2	-2	-2	-2	-2	-2	-2	-2
Free Cash Flow	**21**	**35**	**41**	**44**	**43**	**39**	**39**	**40**	**40**	**40**
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%
Discount Factor	1.0	1.1	1.2	1.4	1.5	1.7	1.9	2.1	2.3	2.6
PV of Free Cash Flow	**21**	**31**	**33**	**32**	**29**	**23**	**21**	**19**	**17**	**16**
NPV	**243**									
Terminal Growth	2%									
Terminal Value	187									
Net Cash (a/o 4Q07) *	-50									
Participations	0									
Fair Value (US$mn)	**380**									
Current Mcap	303									
Upside Potential	**25%**									

Source: Ekspres Invest estimates

**Adjusted for the US$23mn of dividends paid*

Sensitivity analysis

Our sensitivity analysis reflects the variations in Otokar's DCF driven fair value estimate against deviations in some key parameters from our base case scenario. The parameters we have modified are the WACC and the terminal growth rate. The table below depicts the sensitivity of the company's valuation to deviations in these two parameters.

FIGURE 2 – Sensitivity Analysis to WACC and Terminal Growth Rate

Change in WACC / Terminal Growth Rate	WACC+2%	WACC+1%	Implied WACC	WACC-1%	WACC-2%
0%	284	311	342	381	429
1%	294	323	359	404	461
2%	306	339	**380**	433	503
3%	320	358	407	472	563

Source: Ekspres Invest estimates

Company in brief

- Otokar, a member of the Koc Group, manufactures minibuses, medium size buses (midibuses), semi-trailers, tactical wheeled armored vehicles and off-road vehicles. The company operates a 190k sqm factory in Sakarya with 1,224 employees.
- The company was established by Turkey's first intercity bus manufacturer Unver family in 1963. In the early 70s, Koc Group acquired the majority stake and obtained the control of the company. In the mid 80s, Otokar began to manufacture its first armored vehicles for cash-carriage. In 1987, the company kicked off the production of 4x4 tactical vehicles under the license of Land Rover. Gaining experience and improving its research and development department, Otokar was the first to manufacture 4x4 light-armored tactical vehicles in Turkey. Following the merger with Istanbul Freuhauf Tasit Araclari in 2002, Otokar strengthened its already robust market position in the sector by including trailers and semi-trailers in its product range. Being highly experienced in public transportation, Otokar developed a small bus, dubbed Sultan. It also launched a newly-designed bus model, called Doruk.
- Otokar has the intellectual rights of all the vehicles manufactured in its plant. This leads to low licensing costs. A strong research and development department helps the company to improve efficiency of the product development stage by lowering the engineering costs and enables Otokar to produce high margin products.
- The company has 31 midibus and minibus dealers, seven of which is located abroad. It has eight trailer dealers in Turkey.
- The major shareholders of Otokar are Koc Holding and Unver Holding with respective stakes of 44.68% and 24.81%. Koc Holding has the control of the company. The remaining 27.63% is free float.

FIGURE 3 – Otokar Shareholder Structure

Shareholders	Stake (%)
Koc Holding	44.68%
Unver Holding	24.81%
Others	2.88%
Free Float	27.63%
Total	**100.0%**

Source: Company

Capacity & Production

Flexible production capacity. Otokar's annual production capacity is 9,750 units. However, the manufacturing facilities are flexible, therefore production figures can easily be increased by running multiple shifts when required – particularly for urgent defense related orders. Land Rover production capacity is the highest with 3,600 units per year. Minibus and midibus annual production capacities follow with 2,325 and 2,100 units, respectively. Otokar is also capable of manufacturing 425 units of armored vehicles per year at one shift, however the production can be raised to 700 units by running two shifts. This figure can even reach to 1,000 units with three shifts. Last but not least, Otokar has a production capacity of 1,300 trailer & tankers per year.

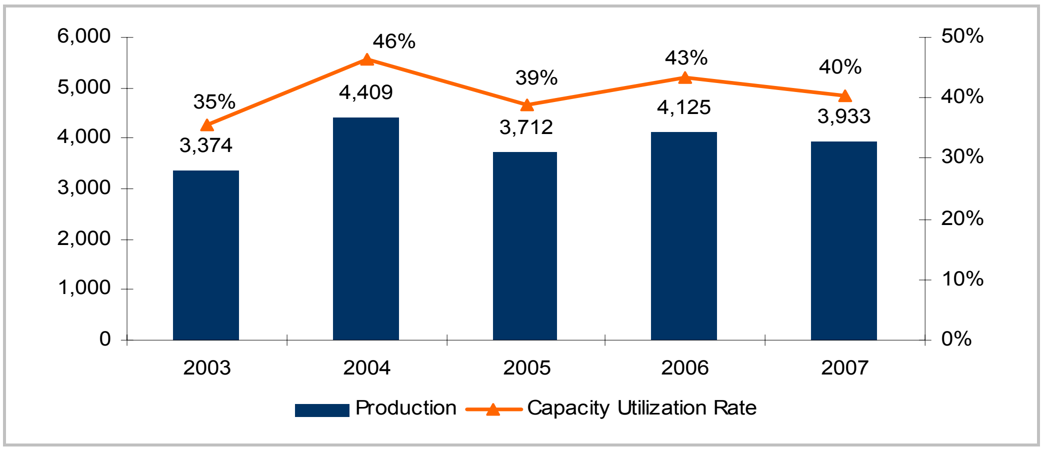
FIGURE 4 – Capacity Breakdown

Vehicle Type	Units/year
Midibus & Otobus	2,100
Trailer & Tankers	1,300
Land Rover	3,600
Armored Vehicle	425
Minibus	2,325
Total	**9,750**

Source: Company

Operating with low capacity utilization rates. Otokar operates with lower capacity utilization rates (CUR) compared to other listed automotive manufacturers. The company's CUR was at 40% in 2007. It prefers to operate with idle capacity in order to be ready for urgent and bulky defense orders from domestic and international markets.

FIGURE 5 – Production and Capacity Utilization Rates



Source: Company

Capacity utilization rate is expected to rise thanks to a production agreement with Otoyol. Otokar signed an agreement in February 2008 with Koc Holding's 73% subsidiary Otoyol for the production of Otoyol's Eurobus midibuses in its production plant. Recall that Otoyol had decided to shutdown its own production facilities (annual manufacturing capacity of 20k) in 2007 due to its inefficiency. The company had sold 1,308 units of midibus in 2006 and had held 33% market share in this segment. However, according to automotive manufacturers' association data, its midibus sales declined sharply in 2007 to 357 units. According to the new agreement, Otokar will produce Eurobus model midibuses for Otoyol starting in May or June. The output will be determined according to market demand. Note that all the raw material procurement and after sales service costs will belong to Otoyol. Otokar will act as a contract manufacturer with a fixed profit margin for each unit produced. Moreover, Otokar will be able to increase its capacity utilization by using the idle capacity in its midibus and minibus production line. Given the current midibus production utilization rate of 40-55%, the new Eurobus production is foreseen to carry the CUR to 80-90% levels. Although we expect this project to increase Otokar's profitability, we have not included its potential positive contribution in our valuation as the details are not available yet.

Products

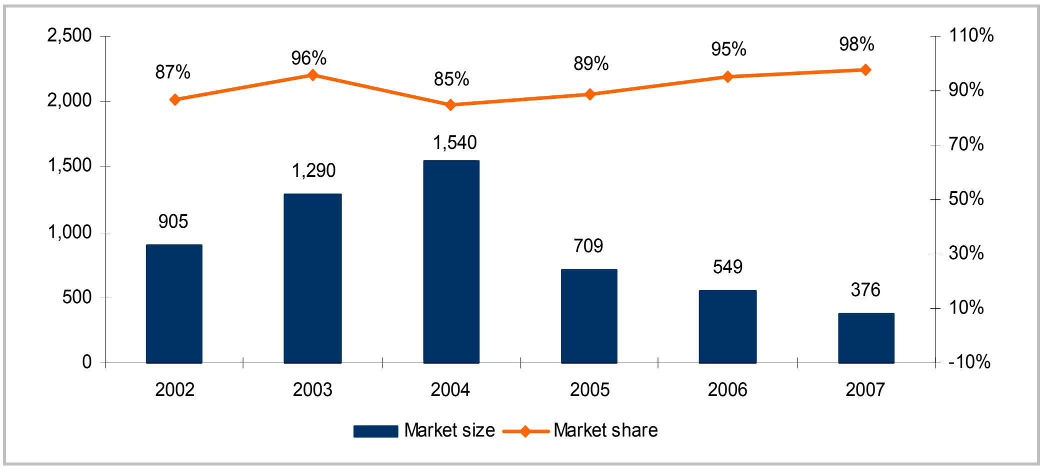
Otokar manufactures commercial and military vehicles. Its product range consists of commercial vehicles such as midibuses, minibuses, buses, trailers, and armored vehicles used for military purposes. Although the profitability of armored vehicles is significantly higher than the commercial vehicles, tender-based nature of the business creates significant volatility in the sales volumes and revenues generated from this segment.

1. Commercial Vehicles

a. Minibuses

The legendary model of Otokar. Otokar's most popular minibus model, M-2000, is targeted for mass transportation. Although its sales figures have been declining since 2004 due to improved mass transportation facilities such as metro, the product is still very popular in larger cities. Otokar recently introduced the upgraded model, M-3000. The company has a virtually monopolistic position in this segment with a market share of 98% as of 2007-end. Otokar produces minibuses only for the domestic market.

FIGURE 6 – Minibus Market Size and Market Share of Otokar

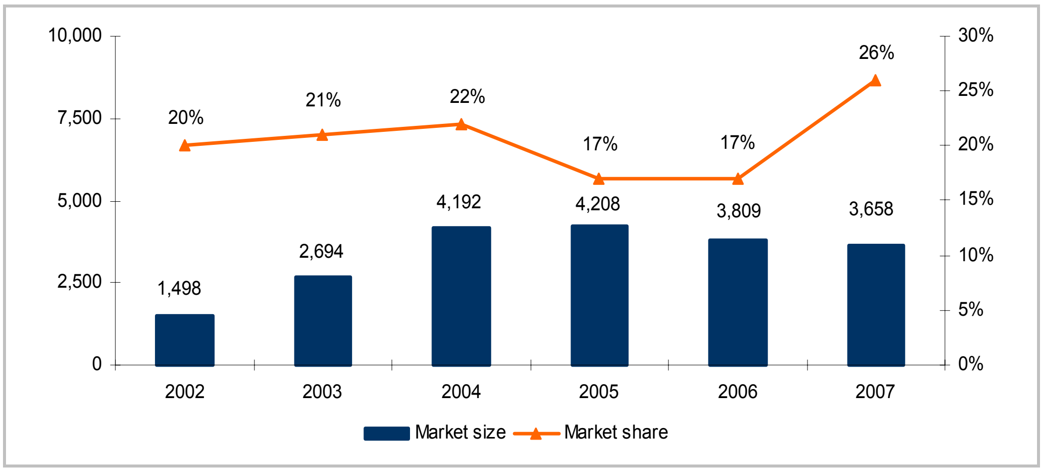


Source: Company

b. Midibuses

Strong presence in the midibus market thanks to the success of Sultan model. Midibuses are widely used in personnel transportation, as well as intercity and tourism carriage. Otokar grabbed a market share of 26% in 2007-end, up from 17% in 2006. It benefited from its rival Otoyol's retreat, which sold 1,308 and 357 units in 2006 and 2007, respectively. Anadolu Isuzu and Temsa are the other main competitors. Otokar sells its midibuses under the name of Sultan in the domestic market, which has become a well-known and popular model since its launch. The same model is exported under the brand name of "Navigo" to Eastern and Central European countries. In 1H07, Otokar launched the first version of its medium size bus series to the market under the brand name of "Doruk," which will be sold to both the domestic and the export markets.

FIGURE 7 – Midibus Market Size and Market Share of Otokar



Source: Company

c. Trailers & Semi-trailers

High growth potential in trailer sales. Otokar produces trailers, semi-trailers and oil/water tankers under the Fruehauf license since 2002. The company ranked second with a market share of 24% in 2007, coming after Tırsan, which dominates the market with a share of 36% as of 2007-end. Otokar sold 1,375 trailers in 2007, while the total sales volume of the market was 5,692. Considering the rising trade activity in Turkey, the company sees high growth potential in this segment. An added opportunity is the shift from trucks to trailers in the domestic market following the introduction of new transportation regulations and tonality limit controls in 2006. Otokar sells trailers through its eight dealers spread across Turkey.

FIGURE 8 – Trailer Market Shares (as of 2007-end)

Company	Market share
Tırsan	36%
Otokar-Fruehauf	**24%**
Enka	14%
Dogus Krone	13%
Koluman Kögel	13%

Source: Company

2. Military Vehicles

a. Armored vehicles

Most profitable product segment. Otokar has the means to produce fully customized armored tactical vehicles in order to meet client requirements. These products are its own design and the company enjoys a very strong research & development (R&D) department, which has a significant competitive edge in the global arena. Otokar participates in tenders and receives orders for its military vehicles. Armored vehicle sales have an important contribution to the company's profitability given their lucrative margins.

b. Land Rover vehicles

Prevailing unrest in the Middle East increases the sales volumes. The company produces Land Rover licensed Land Rover Defender vehicles, and exports them to Middle East, North Africa and Gulf Region countries. The company renews its license automatically with Land Rover every five years without any negotiations.

Sales

Volatility due to unpredictable sales volumes of the defense vehicles. Otokar's sales volume declined by 2% CAGR during 2004-2007, down to 4,121 units. The sales performance is linked to the demand in the domestic commercial vehicle market and to the armored vehicle exports. 2004 was a strong year due to the pent up demand in the auto market which boosted the commercial vehicle sales, while 2006 saw high armored vehicle sales volumes.

FIGURE 9 – Unit Sales by Vehicle Type

	2004	2005	2006	2007	2008E	2009E	2010E
Trailer	1,157	1,155	1,340	1,375	1,425	1,482	1,541
Midibus	1,108	747	769	1,238	1,200	1,251	1,308
Land Rover	563	1,101	678	782	650	800	850
Armored Vehicles	127	178	529	358	300	420	420
Minibus	1,416	569	464	368	350	350	350
Total	**4,371**	**3,750**	**3,780**	**4,121**	**3,925**	**4,303**	**4,469**

Source: Company, Ekspres Invest estimates

Products are priced in foreign currencies. The export prices of the commercial vehicles are set in euros, while domestic sales are naturally in YTL terms. Armored vehicle and Land Rover sales are contracted in US$ and GBP terms. Trailers are sold in EUR terms as the client base is composed of logistics companies, which usually generate cash in EUR terms.

FIGURE 10 – Currencies used in sales prices

Vehicle Type	Domestic	Export
Midibus	YTL	Euro
Armored	US$	US$
Land Rover	GBP	GBP
Trailer	Euro	Euro
Otobus	Euro	Euro
Minibus	YTL	n.a.

Source: Company

Income generated from the Tank project will change the revenue breakdown. The revenue breakdown of the company has been volatile, because the defense vehicle orders are dependent on the number of tenders won. 2006 year is a good example for this situation as the armored vehicles' share in the revenues jumped to 32% from 4% attained in 2004, boosted by the orders from international markets. Starting in 2008, Otokar will be receiving the initial proceeds from the Tank project, which will have positive contribution to the top-line, changing the revenue breakdown noticeably.

FIGURE 11 – Revenue Breakdown

	2004A	2005A	2006A	2007A	2008E	2009E	2010E
Trailer	22%	18%	20%	17%	16%	14%	14%
Midibus	30%	19%	18%	21%	21%	18%	18%
Land Rover	11%	25%	11%	11%	8%	8%	9%
Armored Vehicles	4%	18%	32%	39%	26%	30%	30%
Minibus	29%	13%	7%	6%	4%	3%	3%
Tank Project	0%	0%	0%	0%	20%	22%	22%
Others (inc. spare parts)	5%	8%	12%	6%	5%	4%	4%

Source: Company, Ekspres Invest estimates

More than US$130mn of revenues secured for 2008. Otokar obtained important orders for defense vehicles in 2007, which secured approximately US$130mn revenues according to the management.

FIGURE 12 – Tenders won in 2007 and 2008

Date	Vehicle Type	Units	Total Contract Value (US$ mn)
21.03.2007	Cobra	288	129.0
26.03.2007	Cobra	n.a.	52.8
01.05.2007	Tactical armored vehic.	546	45.3
18.05.2007	Cobra, Sultan minibus	99	14.5
06.07.2007	Cobra	55	23.0
12.11.2007	Cobra	n.a.	4.8
10.12.2007	Tactical armored vehic.	100	39.0
19.03.2008	Cobra	n.a.	9.0
Total			**317.4**

Source: Company

Cost Structure and Other Issues

Raw materials compose the major portion of the costs. Some 60% of the costs are composed of raw materials and components, 7% is labor, 6% represents depreciation, and 27% is attributable to overhead. Engines of armored and of some commercial vehicles are imported, which make up a significant portion of the raw material costs. These are mostly FX denominated. Otokar is able to limit its license and royalty costs, as most of its products are its own brands.

FIGURE 13 – Cost Structure

Breakdown	Share
Raw material	60%
Overhead	27%
Labor	7%
Depreciation	6%

Source: Company

New projects on the horizon

National Tank Project

In March 2007, Otokar was awarded the contract for producing a locally-designed tank for the Turkish Armed Forces. The project will be composed of two phases. In the first phase, Otokar will complete the design, R&D and the production of four prototypes. In the second phase, the UDI will pick one of the prototypes to become the main national battle tank. It will also decide which company will carry out the mass production.

Guaranteed revenue stream for five years from the first phase. For the design and development studies - the first phase of the project - the budget is determined as US$500mn. The Military of Defense will pay this amount to Otokar for fulfilling its obligations. The company aims to start its R&D and design operations within 2008 and should complete the development studies till 2012. We presumed that Otokar will receive US$500mn until 2012, with an initial US$80mn to be obtained in 2008, and the remaining portion to be received in equal installments between 2009 and 2012.

Otokar does not need new investments for this project. According to the agreement, Otokar will act as the key contractor and will be responsible for organizing and coordinating all of the R&D and design activities. It will use subcontractors for technical assistance and know-how. Apart from supporting its staff with the employment of new engineers and technical personnel, the management foresees no extra spending or any capacity expansion for this project.

The mass production might dramatically change the big picture for the company. As we mentioned above, UDI will choose which company will carry out the mass production of the tanks. Without doubt, Otokar will be the foremost candidate for this project given all the design and R&D studies for the prototype production are being undertaken by the company. Although there is no precise figure for the number of tanks planned to be produced, a considerable investment will be needed for mass production. Note that, based on our research, even the basic models of a battle tank are sold at a price of EUR20mn. Hence, if Otokar is picked for the second phase of the project as well, the implications will be huge, in our view. However, we do not incorporate this prospect to our valuation since there is no solid information regarding the production figures and the investments needed for serial production. As a final note, the Tank project will enhance the company’s reputation and recognition in the global arena, as well as in Turkey.

New tenders are on the way

New orders might boost the profitability in 2009 and 2010. UDI has decided to procure various armored vehicles and announced two tenders for a total of 4,131 units. The total value of these tenders is expected to be around US$2-2.5bn and the deliveries are to be due in 2009 and 2010. Since a wide range of vehicles with diverse specifications will be ordered, the bidders are expected to differentiate accordingly. Also note that, only the domestic companies will be permitted to submit proposals.

Tender for the procurement of 2,720 units. In April 2008, offers were submitted for 2,720 units of tactical wheeled vehicle procurement and the tender is expected to be finalized in 4Q08. Considering that Otokar has a good reputation thanks to its vast experience in producing particularly command control vehicles such as Cobra and Land Rover, we believe that its chances of winning the tender for the 860 units portion are high. The competitors of the company will be FNSS, BMC, MAN and Hema. Otokar will also participate in the personnel and load carrier (706 units) and the mine resistant personnel carrier vehicle (468 units) tenders. We believe that the company is also among the favorites to win the mine resistant personnel carrier tender.

FIGURE 14 – Type of Vehicles needed by UDI

Vehicle Type	# of Units
Command Control Vehicle	860
Personnel and Load Carrier	706
Mine Resistant Personnel Carrier	468
Load Carrier	686
Total	**2,720**

Source: Company

Tender for the purchase of 1,411 vehicles. In March 2008, UDI decided to hold a tender for 1,411 units of vehicle procurement. Apart from Otokar, BMC, FNSS, Hema - Disli, Nurol Makina and Uzel-Sinlak participated. Otokar will be interested in the production of 1,075 of these vehicles, which are weapon carriers. Once again, we believe that Otokar has a high chance to be one of the winning parties.

New tenders are potential catalyst to the financial performance of the company. Although we do not include in our valuation any potential income to be generated from these tenders, we underline that even a moderate 1,000 unit order would bring extra US$350mn of proceeds, given a single armored vehicle's average sale price of US$350k. The company expects the tender results to be announced in 4Q08.

Forecasts

Unit sales

1. Commercial vehicle segment – Domestic sales

The expected rebound in the auto demand will help Otokar increase its domestic sales. As one of the leading players in the midibus segment, we expect Otokar to sell 1,100 units, up 10% YoY, with the help of new launches, and 1,144 in 2009, up 4% YoY. We assume minibus unit sales to be stable at 350 throughout our forecast period considering the trend towards mass transportation in big cities. The management does not foresee an annual sales figure below 350 in the minibus segment. Parallel to economic growth in Turkey, we expect trailer sales to increase by 3.6% YoY to 1,425 in 2008 and by 4% YoY to 1,482 units in 2009.

2. Commercial vehicle segment – Exports

New launches are expected to generate sustainable growth in export volumes. With the positive effect from new launches such as Vectio in the midibus segment, we believe that Otokar will increase its exports to 300 units in 2008, up by 26% YoY. On top of this, we expect 5% increase in export volumes to 315 in 2009.

3. Military vehicle segment – Domestic Sales and Exports

Our assumptions are conservative due to the uncertainty in tender based orders. Since the sustainability of defense vehicle orders in the coming years is dependent on the number of tenders won, which is difficult to foresee, we base our assumptions for 2008 to the management's guidance. We expect total sales volumes of armored vehicles and Land Rover's to reach 300 and 700 units, respectively. For 2009, we increase these figures to 420 for the armored vehicles and 800 for Land Rover's. Please note that new orders from upcoming tenders carry a significant upside risk to our valuation.

FIGURE 15 – Otokar Unit Sales

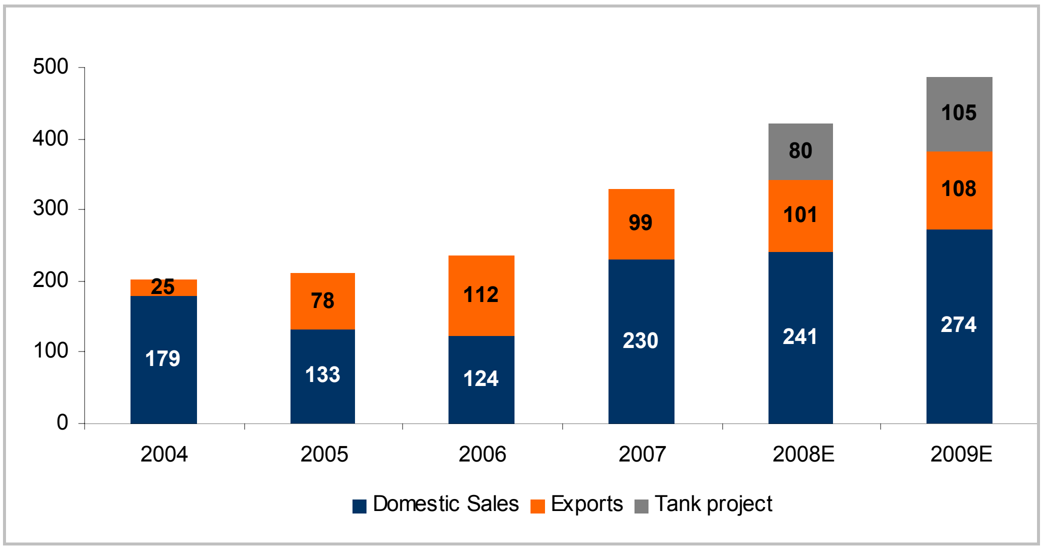
Unit sales	2005A	2006A	2007A	2008E	2009E	2010E	2011E	2012E
Domestic Sales	**2,600**	**2,513**	**2,943**	**3,175**	**3,476**	**3,612**	**3,756**	**3,895**
Minibus	569	464	313	350	350	350	350	350
Midibus + Bus	706	611	1,000	1,100	1,144	1,195	1,243	1,293
Land Rover	122	23	70	150	250	275	300	325
Armored Vehicle	50	75	190	150	250	250	260	260
Trailer	1,153	1,340	1,370	1,425	1,482	1,541	1,603	1,667
Exports	**1,150**	**1,267**	**1,130**	**1,000**	**1,035**	**1,075**	**1,120**	**1,165**
Minibus	0	0	0	0	0	0	0	0
Midibus + Bus	41	158	235	300	315	330	345	360
Land Rover	979	655	720	550	550	575	600	625
Armored Vehicle	128	454	175	150	170	170	175	180
Trailer	2	0	0	0	0	0	0	0
Total Sales Vol.	**3,750**	**3,780**	**4,073**	**4,175**	**4,511**	**4,687**	**4,876**	**5,060**
Growth	*n.a.*	*1%*	*8%*	*3%*	*8%*	*4%*	*4%*	*4%*

Source: Company, Ekspres Invest estimates

Revenues

Revenues will jump in 2008 thanks to the contribution of the Tank project. Otokar increased its revenues with a CAGR of 17% between 2004-2007. We expect the company to generate US$422mn in 2008, up by 29% YoY, thanks to US$80mn expected income from the Tank project. We project revenues to increase by 15% in 2009, to reach US$486mn, driven by the second installment, this time US$100mn. We estimate the company's revenues to decline to US$421mn in 2013 due to the end of phase one of the project and to increase gradually to US$466mn in 2017, with 3.6% CAGR between 2007-2017.

FIGURE 16 – Otokar Revenue Estimates (US$mn)

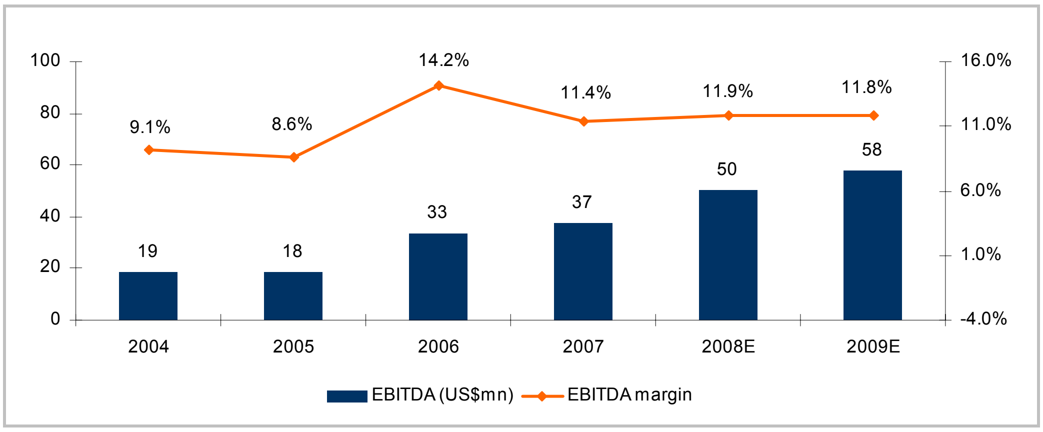


Source: Company, Ekspres Invest estimates

Margins

New orders from tenders might boost profitability. The profitability of the company is highly dependent on the military vehicle orders given the high profit margin on these products. 2006 year is a good example for this situation as Otokar's EBITDA margin jumped to 14.2% from 8.6% in 2005, parallel to the surge in the military vehicle orders. We project Otokar to slightly increase its EBITDA margin to 11.9% in 2008 and to keep it almost at the same level of 11.8% in 2009. We forecast its EBITDA to reach US$50mn in 2008 and to US$58mn in 2009, compared to US$37mn in 2007.

FIGURE 17 – Otokar EBITDA Estimates

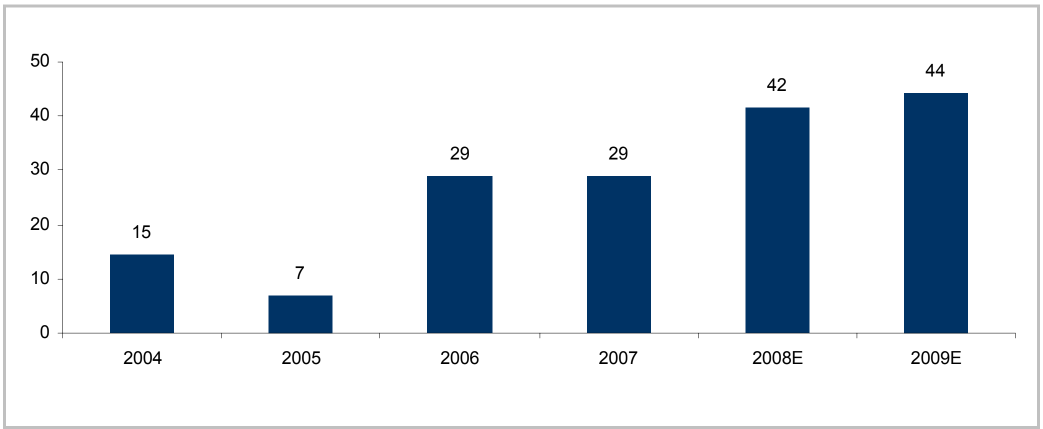


Source: Company, Ekspres Invest estimates

Net Income

Thanks to the surge in revenues with the new Tank project, the bottom-line will see a boost. Otokar's net income performance will be affected positively by the income generated from the Tank project starting from 2008 till 2012. We forecast the company to post a net income figure of US$42mn in 2008, up by 44% YoY. For 2009, we forecast a net earnings figure of US$44mn, which will correspond to 7% YoY growth.

FIGURE 18 – Otokar Net Income Estimates (US$mn)



Source: Company, Ekspres Invest estimates

A consistent high dividend yielding stock. The company's track record for its dividend yield has been satisfactory so far. Otokar distributed US$23mn (YTL30mn) this month, yielding 7.4%. We expect the yield to reach 9.9% in 2008E, assuming a dividend payout ratio of 70%, conservatively below the average 81% over the last three years. Considering that the company has no significant investment plans for the near future, we expect Otokar to continue to distribute sizeable dividends in the coming years.

FIGURE 19 – Dividend payments and yield estimates

	2005A	2006A	2007A	2008E	2009E
Cash divid. (US$mn)	7.1	20.9	23.0	29.1	31.0
Dividend Yield (%)	4.0%	6.9%	7.4%	9.9%	11.8%

Source: Company, Ekspres Invest estimates

FIGURE 20 – IFRS Summary Income Statement and Forecasts

US$mn	2006A	2007A	2008E	2009E
Revenues	**235**	**328**	**422**	**486**
COGS	-161	-240	-294	-336
Gross Profit	**74**	**88**	**128**	**150**
Operating Expenses	-45	-54	-82	-97
Operating Profit/(Loss)	**29**	**34**	**46**	**54**
Other income	28	15	17	6
Other Expenses	-17	-13	-4	-1
Financial expenses	-4	0	-7	-3
Profit Before Tax and Minorities	**36**	**35**	**52**	**55**
Minority Interest	0	0	0	0
Income/Loss Before Taxes	36	35	52	55
Tax	-7	-7	-10	-11
Net Income/Loss	**29**	**29**	**42**	**44**
EBITDA	**33**	**37**	**50**	**58**

Source: Company and Ekspres Invest estimates

FIGURE 21 – IFRS Summary Balance Sheets and Forecasts

US$mn	2006A	2007A	2008E	2009E
Current Assets	**128**	**182**	**198**	**213**
Cash and Banks	0	3	10	18
Trade Receivables	53	79	89	105
Due from related parties (net)	0	0	0	0
Inventories (net)	65	86	86	79
Other Current Assets	8	13	12	11
Fixed Assets	**55**	**70**	**74**	**84**
Long term Receivables	25	28	31	37
Equity Participations	1	1	1	1
Net Tangible Assets	28	36	37	42
Intangible fixed assets	0	5	4	4
Deferred tax receivable	0	0	0	0
Other	0	0	0	0
TOTAL ASSETS	**182**	**251**	**271**	**298**
Short Term Liabilities	**82**	**123**	**148**	**163**
Short term borrowings	33	29	29	29
Trade Payables	39	37	69	84
Due to Related Parties	1	5	4	5
Advances	3	34	30	31
Corporate tax payable	1	13	11	10
Other Payables	4	6	5	5
Long Term Liabilities	**5**	**5**	**5**	**5**
Long term borrowings	0	0	0	0
Retirement pay provision	4	5	4	4
Deferred Tax Liabilities	1	1	1	1
Minority Interests	**0**	**0**	**0**	**0**
Shareholders Equity	**96**	**123**	**118**	**130**
TOTAL LIAB. AND SH. EQUITY	**182**	**251**	**271**	**298**

Source: Company and Ekspres Invest estimates

A SUBSIDIARY OF DENİZBANK
Buyukdere Cad. No: 106 Kat: 15 34394 Esentepe, Istanbul TURKEY

Haldun Alperat	**General Manager**	halduna@ekspresinvest.com +90 212 336 5151

Equity Research

Sinan Goksen	**Head of Research**	sinang@ekspresinvest.com +90 212 336 5190

Macroeconomic Research

Guldem Atabay	**Chief Economist**	guldema@ekspresinvest.com +90 212 336 5193

Institutional Sales

Can Oksun	**Head of Institutional Sales**	cano@ekspresinvest.com +90 212 267 3402

Trading

Oguzhan Gurkan	**Head of Trading**	oguzhang@ekspresinvest.com +90 212 356 2231