

DESA - BUY

DESA TI

The Cuoio Renaissance in Italy

■ A Dash of La Dolce Vita to the Business

With the completion of the 2k sqm factory investment on a 5k sqm land in Toscana in May 2023, the company became able to produce leather goods for the most Italian luxury brands with an important insignia of "Made in Italy" that is much sought-after. The prime materials utilized for the leather primarily hail from Turkey to undergo finishing in Italy, acquiring the esteemed Italian passport. Although the initial impact on turnover for this year is anticipated to be no more than a couple of million euros, we project EUR15mn contribution to the topline for 2024. This 20% expected addition to the topline is set to grow exponentially, owing to the factory's strategic proximity to the realm of luxury brands.

■ Suitcase segment is a cash cow

On top of its 53 own branded stores to sell its own products, Desa sells Samsonite branded products through a network of 36 Desa-Samsonite and 16 Samsonite JV stores. Under a strategic agreement with Samsonite, the suitcases are costed in TRY but sold based on the prevailing FX rate. This pricing arrangement allows the company to garner additional markup when favorable exchange rates come into play. Desa also stands to benefit from a potentially robust tourism season, which is poised to bolster the company's topline.

■ Normalization is ahead after a weak first quarter

As a result of the unwavering FX rate driven mounting TRY costs on raw materials, along with the weak demand resulted in quarterly contraction in operational earnings in 1Q23. The weak demand was offset by climbing exports with lower mark-up compared to domestic sales. Therefore, the EBITDA margin marked historical low level of 8.5%. We envisage a normalization in operational profitability up to 20% levels from 2Q23 onwards, which will be celebrated by the market in our view.

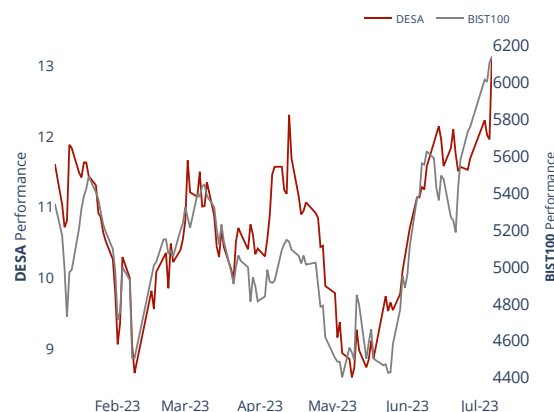
■ Appealing Valuation

We issue a BUY recommendation for DESA with a target price of TRY 21.4/share derived solely through our DCF model, representing an 63% upside potential. The company also trades at a compelling 4.7x 2024F EV/EBITDA.



DESA 7/7/2023

Desa Deri	
Rating	BUY
Free float	22%
Mcap (USD mn)	123.5
Mcap (TRY mn)	3,216.9
Target Mcap (TRYmn)	5,251.8
Share Price (TRY)	13.13
Target Price (TRY mn)	21.44
Upside down	63%
Avg. DT Vol. (TRY mn)	14
EV (TRY mn)	2906
Latest Financials	2023/03
Weekly Return	12.32
Monthly Return	17.86
YY Return	447.81
Weekly Relative R.	5.33
Monthly Relative R.	3.42
YY Relative R.	114.82



Ratio	2022	2023E	2024E
P/E	10.22	8.82	8.74
EV/ Sales	1.95	1.14	0.90
EV/EBITDA	7.51	5.98	4.74
EBITDA Mrg.	26%	19%	19%
Net Profit Mrg.	21%	14%	11%
EV/EBIT	10.5	7.1	5.6
Growth	2022	2023E	2024E
Sales	214%	88%	26%
EBITDA	240%	38%	26%
W.Cap	2022	2023E	2024E
Days Sales Outstanding	50	50	50
Days Sales of Inventory	74	122	140
Days Payable Outstanding	121	121	121

Investment Thesis

Foremost, we like the company for its vertically integrated business model. The company processes leather in its own tanneries and factories, to produce clothing, bags and accessories. Locally Desa sells its production through its own network as well as Samsonite branded stores. Semi-finished products and final goods are also sold to premium international buyers. The company keeps all stages under control from production to distribution. By monitoring various stages of production and distribution of leather, a company can streamline operations, reduce transaction costs, and achieve economies of scale. Secondly, we believe that the investors have underestimated Desa's position as the leather provider of big luxury giants such as Prada, MiuMiu, Furla. We expect the company to add new apparel chains to its clientele in the near future thanks to its know-how to serve to global brands. The recent start of sales in Europe through Zalando will further help the business reach wider international brand recognition. Sales via the Zalando platform first started in Germany in January 2023 and later in France, the Netherlands, Belgium and Austria. Further, we think that the company's Leather Working Group gold rating, which only 31 companies managed to receive globally, will help the company reach many countries and customers in the coming periods.

In the second half of 2022, DESA started its factory investment in Italy, Poppi to produce "Made in Italy" products in order to improve its relationship with luxurious brands. Although the initial impact on turnover for this year is anticipated to be modest, we project EUR15mn impact in 2024, which is set to climb thanks to its location. Share of Italy in top-line is set to grow exponentially, owing to the factory's strategic proximity to the realm of luxury brands.

The company sells premium Samsonite suitcases via 36 Samsonite stores which is a cash cow making up 41% of revenues in 2022. In accordance with the agreement with Samsonite, the costs are in TRY and selling prices are denominated in US\$, which caters the company extra markup when the exchange rate goes up. The possibility of a strong tourism season ahead will also support the company's topline. We think that as a consequence of the successful and longstanding relationship with Samsonite as well as its own production expertise, the company might start producing the Samsonite brand locally in Turkey in the next few years.

Catalysts

Any additional deal with another large-scale apparel company could have a positive impact on the company's P/L, as well as its global recognition. We give strong likelihood of an addition of such a reputable buyer to the already top-tier client base within a year.

Retail segment has the highest markup followed by wholesale and luxury channels at 2.5, 2.0 and 1.4, respectively. Better than expected tourism season and increased local demand are the catalysts that should contribute to the operational earnings and our valuation.

Local competitors such as Matras, Inci and Hotic are either totally eliminated or lost ground to a large extent providing the company with pricing advantage and market dominance.

Desa is cash-rich with a net cash position reaching an all-time high level of TRY311mn, most of which is allocated to FX denominated high yielding Eurobonds and T1 subordinated papers of top tier banks, which will further enhance earnings from 2Q onwards.

The company makes 70% of Turkey's leather goods exports to Italy all by itself. The company will be eligible for further subsidies as the economy administration lays more emphasis on exports. Also the value add is much higher for Desa's products at up to US\$110/kg, while the average for the leather industry Turkey's exports stand at around US\$14/kg and the average for Turkey's exports is stagnant around US\$1.2

Risks

The company's response to the fluctuating exchange rate is a tale of mixed outcomes. On the one hand, the surge in the exchange rate proves advantageous for exports, propelling them to unprecedented heights. However, on the flip side, the decline in domestic purchasing power stemming from the exchange rate's downturn dampens higher margin domestic business. Furthermore, the conundrum deepens as the export products, although flourishing, suffer from low markup. This leads to lower operational margins. Depending on demand conditions, 30%-50% of top-line stems from exports.

The company had a stock turnover day of 232 in 2021, which decreased to 54 days and company has negative NWC as of 1Q23. Any mean reversion might affect our valuation.

Company Background

Founded as a family company in 1972, Desa has been continuing its operations as a producer of leather and leather products, Desa's operations include a tannery, three plants for production of women, men wear, handbags and accessories as well as distribution of those products via whole and retail channels. Desa's retail operations are mainly domestic with 53 Desa, 36 Desa Samsonite, 1 Desa Franchise and 16 Samsonite JV, 2 Tumi and 2 virtual store totalling 109 stores in Turkey.

Shareholder Structure

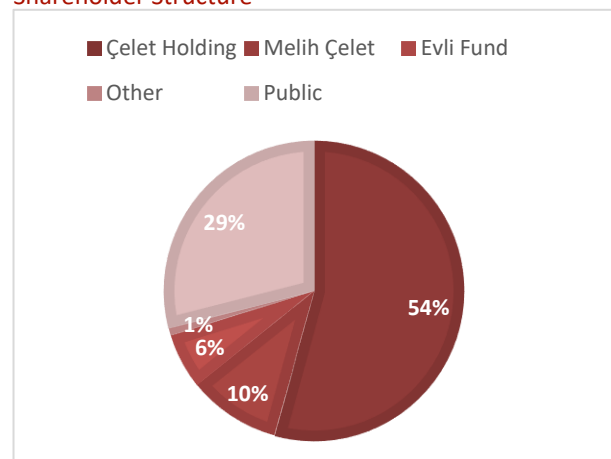


Exhibit 1: # of stores



Exhibit 2: Historical breakdown of Store Numbers

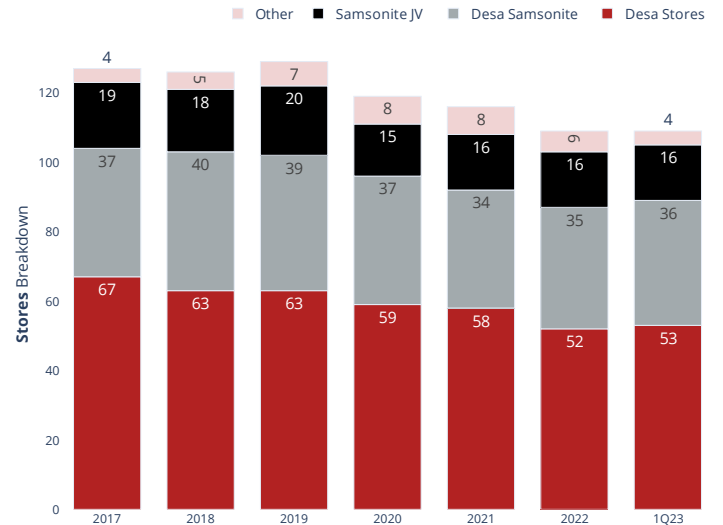


Exhibit 3: Gross Space Breakdown

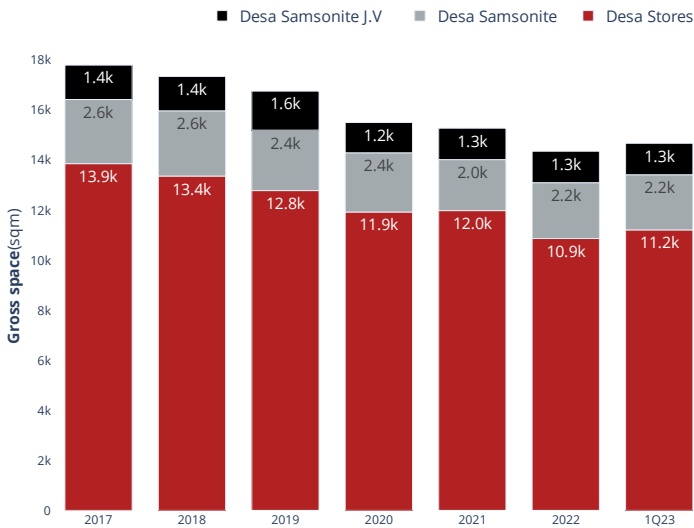


Exhibit 4: Sales Breakdown

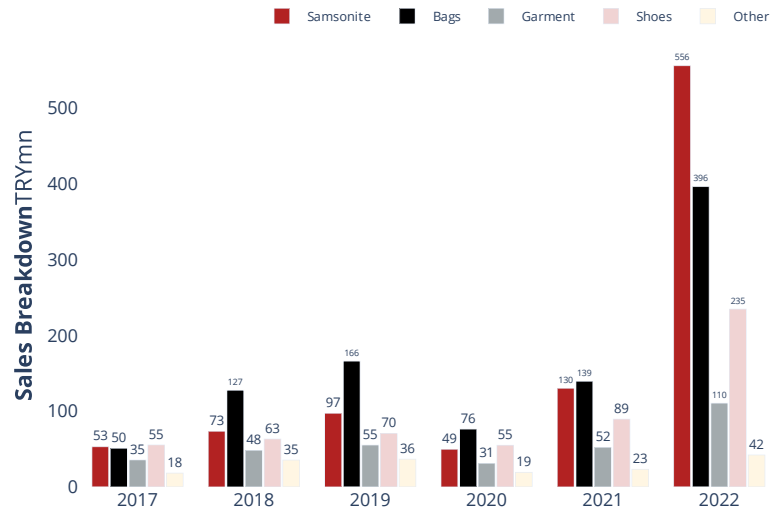
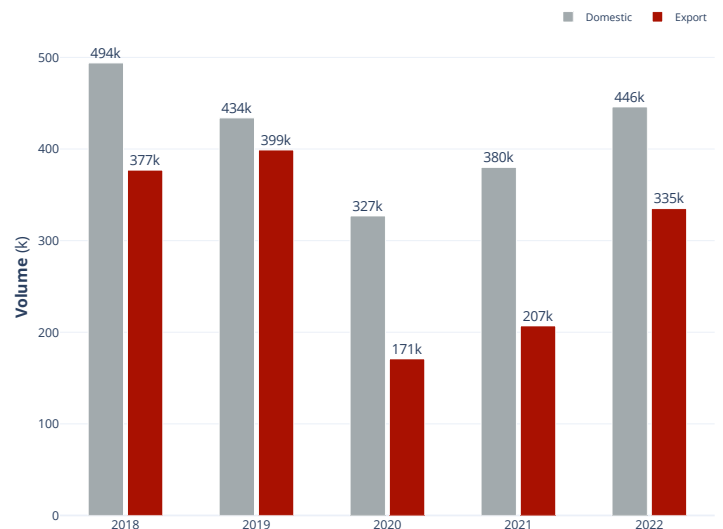


Exhibit 5: Historical 5-Y EV/EBITDA



Source: Desa

Exhibit 6: Volume of Domestic and Int Sales (Pieces sold)



Sector Outlook

In May 2023, exports of the leather sector increased by 28.4% to US\$149.5mn. As of May, Turkey's overall exports increased by 14.4% to US\$21.7bn. The share of leather and leather products exports in total exports was 0.7% in May. While Italy, Germany and Ukraine are among the top three leading countries in Turkey's leather exports, Italy, USA and UK are among the top three countries in Desa's exports. We think that the company's Leather Working Group gold rating, which only 31 companies in the world have, will help the company reach many countries and customers in the coming periods.

Exhibit: The export progression of leather industry.

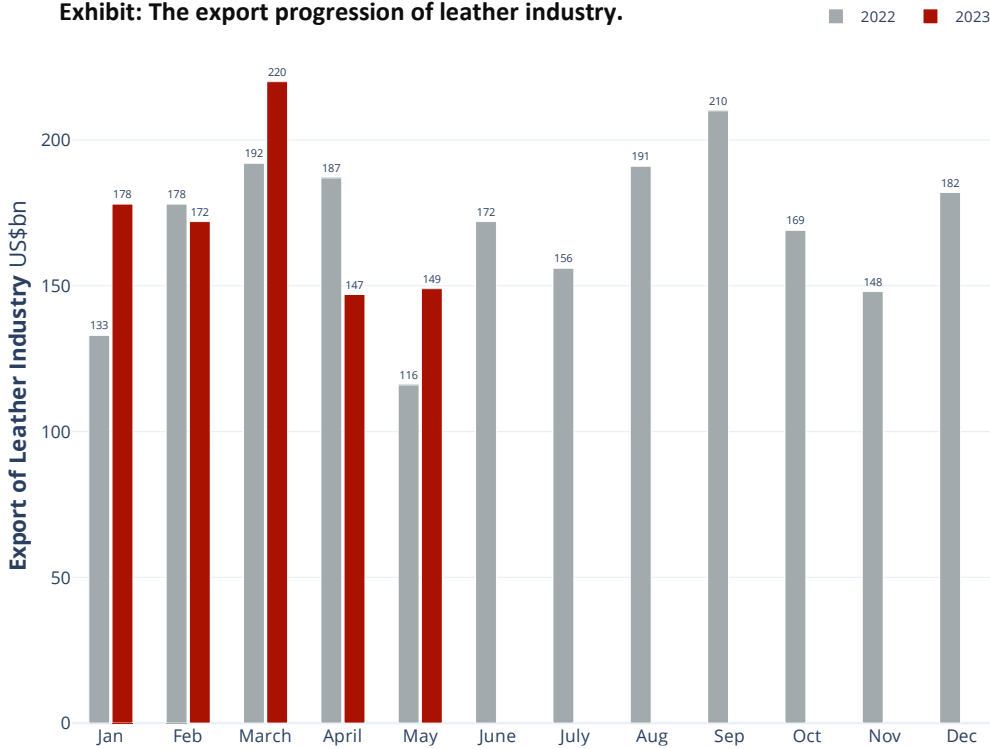
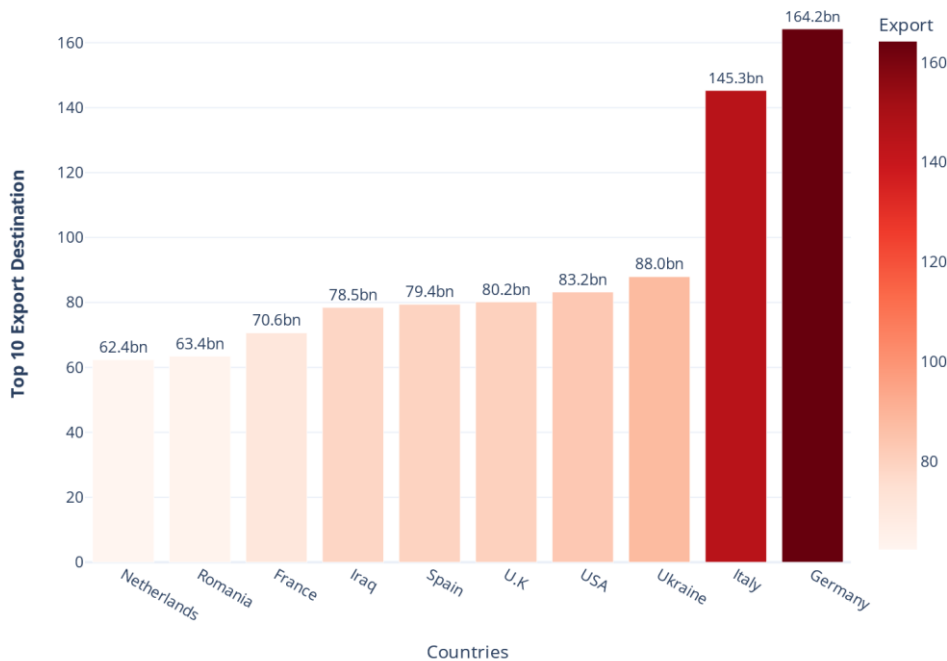


Exhibit: The top 10 Export Destination in 2022 in US\$bn



Revenue Model

	2022	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
#of Desa stores*	58	61	64	66	68	70	72	74	76
<i>average sqm per store</i>	187	187	187	187	187	187	187	187	187
Revenue per sqm (k)	20	32	40	48	56	64	73	82	84
Revenue per store (mn)	4	6	8	9	11	12	14	15	16
#of Desa Samsonite stores	35	37	39	41	43	45	47	49	51
<i>average sqm per store</i>	63	63	63	63	63	63	63	63	63
Revenue per sqm (k)	252	358	450	540	632	720	816	918	1,027
Revenue per store (mn)	16	23	28	34	40	45	51	58	65
Sales Channels									
Retail	769	1,199	1,587	1,990	2,429	2,884	3,397	3,970	4,495
B2B	142	221	293	367	448	532	627	733	830
Export	448	1,139	1,349	1,691	2,064	2,451	2,887	3,374	3,821
Total	1,359	2,559	3,228	4,049	4,942	5,867	6,911	8,077	9,146
<i>Growth</i>		88%	26%	25%	22%	19%	18%	17%	13%

*1 Desa Franchise and 2 Tumi and 2 virtual and 1 North Cyprus Branch is included to Desa stores. The Desa stores in fact is 52 in the end of 2022.

Inclusion of Samsonite J.V

Desa holds a 40% ownership stake in the Samsonite Joint Venture (J.V.), which oversees the operation of 16 retail stores directly operated by the J.V. and a number of franchisee stores and corners in Turkey, Georgia, Armenia, Syria and Northern Cyprus. As part of our valuation process, we include the Samsonite J.V. by utilizing a price-to-earnings (P/E) ratio of 12.1, which represents the analyst's estimated forecast for the controlling entity, Samsonite International SA, in the year 2023. To account for the specific characteristics and risks associated with emerging markets, we also apply a 20% discount. Samsonite J.V. generated a net profit of TRY91.4mn in 2022 under UFRS and contributes to our valuation by TRY354mn.

Exhibit 5: Samsonite International SA – Analyst Expectations

	2022(A)	2023(E)	2024(E)	2025(E)
EBITDA (Mn)	4,664.08	5,629.12	6,248.19	6,755.96
Margin	20.68%	19.32%	19.09%	19.16%
EPS	1.7	1.86	2.23	2.45
EPS Growth	2103.03%	9.81%	19.43%	10.12%
P/E	13.32	12.13	10.16	9.22
EV/EBITDA	10.01	8.29	7.47	6.91
EV/Sales	2.07	1.6	1.43	1.32

Implied Multiples of DESA

	TRY	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F
EV/FCF		7.1	8.4	6.7	4.8	4.1	3.5	3.0	2.7
EV/EBIT		4.6	3.4	2.7	2.3	2	1.8	1.6	1.5
EV/EBITDA		6.0	4.7	3.6	2.8	2.4	2.0	1.7	1.5
P/E		8.8	8.7	7.9	6.2	5.2	4.4	3.8	3.3

Valuation

We issue a BUY recommendation for DESA with a one-year target price of TRY21.4, representing a 63% upside potential. We incorporated the terminal growth as 6% in our TRY based DCF model, an equity risk premium of 8% and a beta of 1x. For the weighted average cost of capital calculations, we are using the market value of shareholders' equity rather than the stated book value of equity. For the risk-free rate, we plugged in 10-y Turkey's Bond yield which was 17% at the time of this report.

TLmn	2023	2024	2025	2026	2027	2028	2029	2030
Revenue	2,559	3,228	4,049	4,942	5,867	6,911	8,077	9,146
<i>Revenue Growth</i>	<i>88%</i>	<i>26%</i>	<i>25%</i>	<i>22%</i>	<i>19%</i>	<i>18%</i>	<i>17%</i>	<i>13%</i>
EBITDA	486	613	810	1,038	1,232	1,451	1,696	1,921
<i>EBITDA Margin</i>	<i>19%</i>	<i>19%</i>	<i>20%</i>	<i>21%</i>	<i>21%</i>	<i>21%</i>	<i>21%</i>	<i>21%</i>
EBIT	409	516	688	890	1,056	1,244	1,454	1,646
Tax (-)	86	108	145	187	222	261	305	346
Effective Tax Rate	21%	21%	21%	21%	21%	21%	21%	21%
NOPAT	323	408	544	703	834	983	1,149	1,301
<i>NOPAT Margin</i>	<i>12.6%</i>	<i>12.6%</i>	<i>13.4%</i>	<i>14.2%</i>	<i>14.2%</i>	<i>14.2%</i>	<i>14.2%</i>	<i>14.2%</i>
Depreciation and Amortization (+)	77	97	121	148	176	207	242	274
Net Working Capital (NWC)	-69	-7	104	195	313	465	656	870
NWC/Revenue	-3%	0%	3%	4%	5%	7%	8%	10%
Change in Working Capital (-)	-87	63	111	92	118	152	191	214
Net Income	365	368	405	519	616	726	848	960
CAPEX / Revenue	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
CAPEX (-)	77	97	121	148	176	207	242	274
Free Cash Flows	411	345	433	611	716	831	958	1,087
Risk Free Rate	17%	17%	17%	17%	17%	17%	17%	17%
Beta	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Risk Premium	8%	8%	5%	5%	5%	5%	5%	5%
Cost of Equity	25%	25%	22%	22%	22%	22%	22%	22%
Cost of Debt After Tax	19%	19%	17%	17%	17%	17%	17%	17%
Equity Percentage	88%	88%	88%	88%	88%	88%	88%	88%
Debt Percentage	12%	12%	12%	12%	12%	12%	12%	12%
WACC	23.9%	23.9%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%
Discount Factor	1.00	0.81	0.67	0.55	0.46	0.38	0.31	0.26
Discounted Cash Flows (1 year forward)	411	279	289	337	327	313	298	280
DCF value 2022-2030	2,533							
Terminal Growth Rate	6%							
Terminal Value	7,690							
PV of Terminal Value	1,980							
Net Debt	-384							
Samsonite J.V	355							
Fair Value	5,252							
number of shares	245							
12 month price target (TL)	21.4							
Current Stock Price (TL)	13.1							
Upside Potential	63%							

NWC FORECAST

Estimate	2022	2023	2024	2025	2026	2027	2028	2029	2030
Accounts Receivable		357	450	565	690	819	964	1127	1276
Accounts Payable		860	1085	1361	1661	1972	2323	2715	3074
Inventory		434	628	900	1167	1467	1824	2244	2667
NWC		-69	-7	104	195	313	465	656	870
Change in NWC			63	111	92	118	152	191	214
Days Sales Outstanding:	50	50	50	50	50	50	50	50	50
Days Sales of Inventory:	74	122	140	160	170	180	190	200	210
Days Payable Outstanding:	121	121	121	121	121	121	121	121	121

Historical	2014	2015	2016	2017	2018	2019	2020	2021
Days Sales Outstanding:	14	19	13	21	25	30	40	74
Days Sales of Inventory:	309	354	577	512	319	218	446	232
Days Payable Outstanding:	123	121	211	258	196	170	211	230

PEER COMPARISON

In the context of relative valuation, an analysis was conducted on comparable companies listed in foreign stock exchanges operating within the textile and apparel industry. Considering Desa's distinctive vertical business model, wherein the company exercises control over various stages from tannery to production and production to distribution, identifying truly similar companies with a comparable model becomes challenging. Nevertheless, a few companies were included as a reference to validate our valuation approach. 2023E EV/EBITDA for Desa is just 6x that is 26% lower than global market peer group median (8x), despite Desa significantly higher growth.

Security	Security Name	Country of Origin	Market Capitalization (mn.)	P/E	P/E Est. This Year	P/E Est. Next Year	EV/EBITDA	EV/EBITDA Est. This Year	EV/EBITDA Est. Next Year
507880:INM	VIP INDUSTRIES LTD	India	1,056.66	55.65	34.53	28.43	10.58	21.97	17.90
MAVI:IS	MAVI GIYIM	Turkey	635.52	6.96	7.97	6.73	3.70	3.58	2.59
1910:HK	SAMSONITE INTERNATIONAL SA	United States	4,163.18	13.31	12.02	10.00	10.01	8.05	7.41
1913:HK	PRADA SPA	Italy	17,245.21	35.18	24.08	21.33	12.51	9.94	9.15
TPR:USY	TAPESTRY INC	United States	10,090.16	11.20	11.16	10.24	9.61	9.25	8.78
CPRI:USY	CAPRI HOLDINGS LTD	United States	4,319.47	7.01	5.98	5.55	7.55	7.32	6.82
RMS:FR	HERMES INTERNATIONAL SA	France	225,172.62	63.65	51.69	45.95	37.58	31.95	28.18
VRA:USN	VERA BRADLEY INC	United States	201.47		10.87	8.99	29.14	8.01	6.62
OXM:USY	OXFORD INDUSTRIES INC	United States	1,633.37	9.79	9.45	9.07	7.96	7.02	6.72
BOSS:DEX	HUGO BOSS AG	Germany	5,439.62	23.57	19.43	16.12	8.73	7.55	6.83
CFR:CH	COMPAGNIE FINANCIERE RICHEMONT SA (A)	Switzerland	87,541.51	24.11	20.28	18.79		12.08	11.09
DERIM:IS	DERIMOD	Turkey	28.33	8.15			4.41		
	Median		4,241.33	13.31	12.02	10.24	9.61	8.05	7.41
	Average		29,793.93	23.51	18.86	16.47	12.89	11.52	10.19
	DESA		123.50	10.60	7.9	7.8	8.2	6	4.7
	Discount			-20%	-34%	-24%	-15%	-26%	-37%

Source: Equity RT

BALANCE SHEET AND INCOME STATEMENT

Balance Sheet			Growth		
DESA	1Q22	4Q22	1Q23	q-q	y-y
Current Assets	457	886	930	5%	104%
Cash and Cash Equivalents	61	205	138	-33%	125%
Securities (net)	130	266	369	39%	183%
Short Term Trade Receivables	97	190	214	13%	121%
Other Short Term Receivables	8	9	10	10%	27%
Inventory	146	163	176	8%	20%
Other Current Assets	14	54	23	-56%	65%
Non-Current/Fixed Assets	230	397	451	14%	96%
Long Term Trade Receivables	-	-	-	-	-
Other Long Term Receivables	0	15	27	79%	7725%
Long Term Financial Assets	8	8	8	0%	2%
Long Term Tangible Assets	125	237	238	0%	90%
Long Term Intangible Assets	1	1	0	-4%	-10%
Other Fixed Assets	96	136	177	30%	84%
Total Assets	687	1,283	1,381	8%	101%
Short Term Liabilities	287	561	619	10%	115%
Short Term Financial Debts	83	87	93	7%	12%
Short Term Payables	167	335	399	19%	139%
Other Short-Term Liabilities	29	63	72	14%	145%
Short Term Provisions	6	11	12	14%	104%
Long-Term Liabilities	172	148	154	4%	-11%
Long Term Debt	146	94	104	10%	-29%
Long Term Provisions	7	8	15	92%	107%
SHAREHOLDER'S EQUITY	227	574	608	6%	168%
Paid in Capital	49	49	49	0%	0%
Reserves and Other Equity Items	96	179	176	-2%	83%
Net Income/Loss for the Period	21	287	38	-87%	76%
Retained Earnings	61	59	346	490%	471%
Total Equity and Liabilities	687	1,283	1,381	8%	101%

Income Statement			Growth		
DESA	1Q22	4Q22	1Q23	q-q	y-y
Sales Revenues (net)	191.9	470.8	429.8	-9%	124%
Cost of sales (-)	-122.2	-261.5	-296.1	13%	142%
GROSS OPERATING PROFIT/LOSS	69.6	209.3	133.8	-36%	92%
Operating expenses (-)	-47.5	-92.2	-119.4	30%	151%
NET OPERATING INCOME/LOSS	22.1	117.1	14.3	-88%	-35%
Other Income and Expenses (Net)	3.9	14.6	16.7	15%	329%
Financial Expenses (-)	-4.9	3.2	1.6	-50%	-132%
PROFIT/LOSS BEFORE TAX	25.4	152.2	44.9	-70%	77%
Taxes	4.1	33.7	7.4	-78%	82%
NET INCOME/LOSS FOR THE PERIOD	21.3	118.6	37.5	-68%	76%

Footnote Table			Growth		
DESA	1Q22	4Q22	1Q23	q-q	y-y
Depreciation Expenses	12.5	76.2	22.3	-71%	78%
Severance pay	6.5	7.9	27.5	247%	321%
Financing Expenses	26.8	81.4	23.6	-71%	-12%

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