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Diversified Banks
CEEMEA

Turkish Banks

Value Proposition

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- **Value Proposition** — The selloff of Turkish banks in the run up to the CBT's recent extraordinary rate hikes presents an attractive opportunity to buy Turkish banks at lower valuations. The key listed banks are trading at or below one standard deviation below five year historical average two year forward P/E ratios and one year forward P/B ratios. Many are trading at 2009 crisis lows on a one year forward P/BV basis.
- **Going Orthodox** — Now that monetary policy is on a more orthodox track we think the risk of further rate and currency volatility, while certainly not ruled out, is less than it was prior to the extraordinary rate hikes. This gives us more confidence that in 2-3 quarters banks will re-price the asset side of their balance sheets and that margins will recover. It also leads us to be less worried about deteriorating asset quality from the corporate sector, which borrows heavily in FX from the banks.
- **All About the Cycle** — The key risk to our revised forecasts is that the economic slowdown is much more pronounced than the 2.3% GDP growth currently forecast by Citi economists, leading to slower loan growth and a worse asset quality cycle than expected. While we expect a moderate increase in gross cost of risk this and next year and a decline in recoveries (shown in other income), we concede we may be too optimistic on this front if the economy stutters. We also take a closer look at the rapid increase in loan growth in recent years and the risk this poses.
- **Gauging for Resilience** — As we have done in previous research we look at a number of metrics to gauge which banks stand out in a period of tighter liquidity, e.g. loan-to-deposit ratios, capital ratios, TL deposit mix, demand deposit mix, dependence on TL repo funding, share of FRN securities in the asset mix and asset-liabilities duration mismatch/gap. With the exception of its high reliance on TL deposits Halkbank stacks up best vs. peers on our calculations.
- **Earnings Revisions** — We cut in aggregate our earnings forecasts for our large cap banks universe this year by 29% (includes the earlier revision to our Garanti numbers in early February) and by 10% next year and in 2016 to reflect the impact of lower loan growth and lower margins following extraordinary rate hikes. We also lower our target prices on the estimate cuts and higher cost of equity.
- **Remain buyers** — We continue to rate all of the large cap banks under coverage Buys, largely on valuation grounds.

		Rating		Target Price		Current Year Earnings Estimates	
Company	Ticker	Old	New	Old	New	Old	New
Garanti	GARAN.IS	1	1	TL7.43	TL7.43	TL0.68	TL0.68
Halkbank	HALKB.IS	1	1	TL18.25	TL14.26	TL1.73	TL1.67
Isbank	ISCTR.IS	1	1	TL6.10	TL4.92	TL0.75	TL0.61
Vakifbank	VAKBN.IS	1	1	TL4.95	TL3.94	TL0.65	TL0.46
Yapi Kredi	YKBNK.IS	1	1	TL4.85	TL4.05	TL0.54	TL0.38

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Contents

Value Proposition

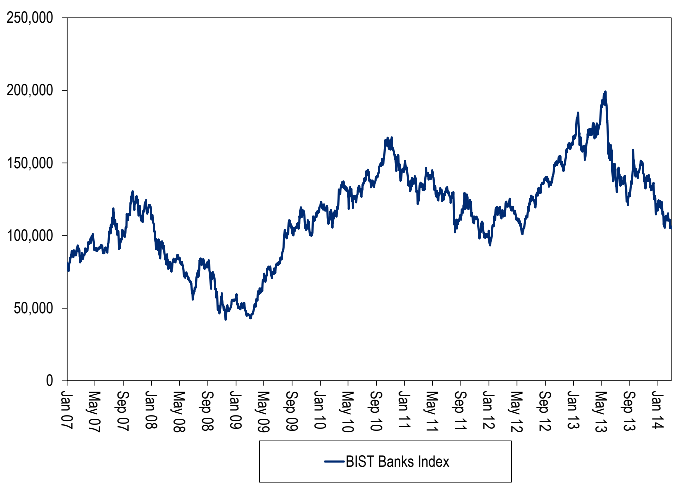
In July of last year we started becoming more constructive on Turkish bank equity; we were much too early. Since then the stock prices of the major banks in our coverage universe declined by 22% and over the same time period the Lira weakened by 14% against the US dollar. Still, we think the selloff in Turkish bank equity in the run up to Central Bank of Turkey's (CBT) recent emergency rate hike provides an attractive entry point to buy Turkish bank stocks. While higher rates lead to mid-term margin pressure, this should reverse once banks re-price most of their assets in 2-3 quarters. And now that monetary policy has returned to more a more orthodox path, we see less risk of further interest rate and currency volatility. Indeed, investors that bought banks following the last two major rate hike cycles made good returns. But the growth outlook is very uncertain with higher rates, increased geopolitical tension and local political uncertainty all weighing on the outlook. We thus see risks to the downside in terms of our loan growth and loan loss provisioning forecasts if growth comes well below Citi economists' base case scenario of 2.3% real GDP growth this year.

Rate cycles and margins

Turkish banks and the Turkish currency have sold off materially

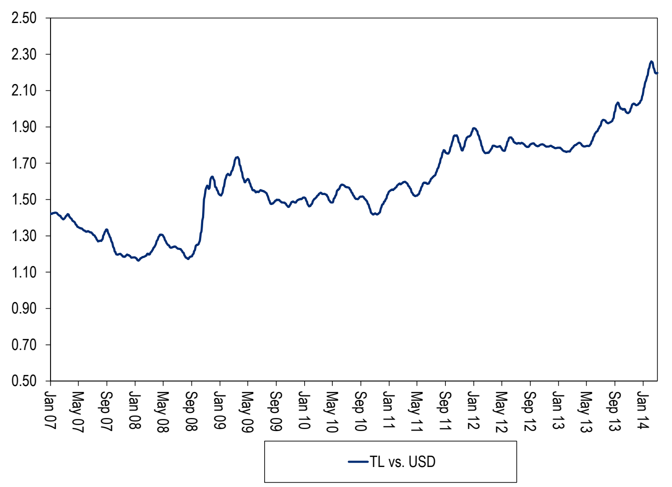
The selloff in Turkish bank equity in the run up to Central Bank of Turkey's (CBT) recent emergency rate hike provides, in our view, an attractive entry point to buy Turkish bank stocks. Since its peak in May last year the banks index has declined by 44% and the currency has weakened by 17% against the US dollar.

Figure 1. Turkey – BIST Banks Index



Source: ThompsonReuters

Figure 2. Turkey – Turkish Lira Exchange Rate vs. USD



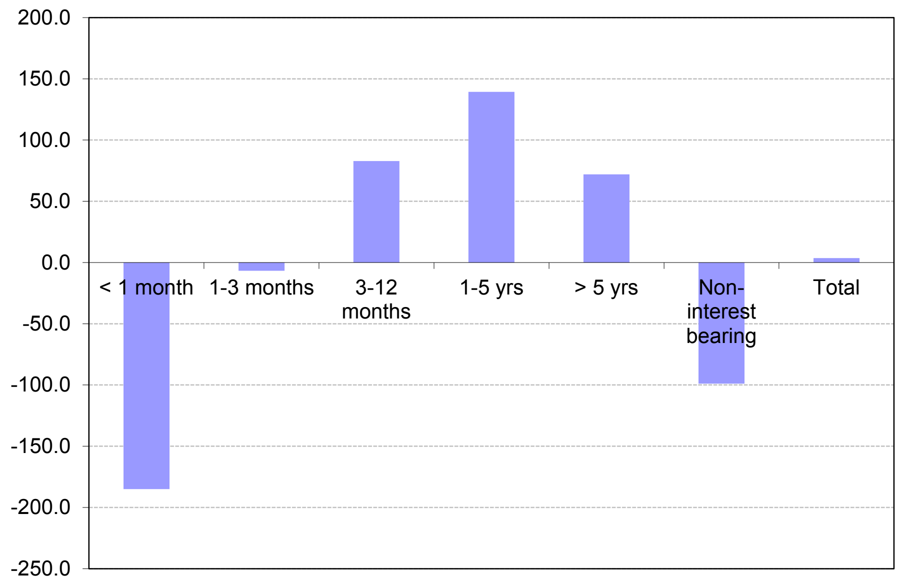
Source: ThompsonReuters

The return to a more orthodox monetary policy has brought some stability to the currency and, we hope, to the rate environment

The return to a more orthodox monetary policy has stabilized the currency and while it can still be debated whether rates are high enough (Citi's economist's analysis suggest the benchmark 2yr bond yield should rise to 12%, see: Turkey Macro View - Time to get real about interest rates?), further large rate moves are less likely than before the CBT action.

This is important given the duration mismatch of Turkish bank balance sheets which make near term margin developments very sensitive to interest rate moves. On average large listed Turkish banks have an asset-liabilities durations mismatch about 8.5 months. In the figure below we illustrate the aggregate asset-liabilities gap by next re-pricing date of the large cap listed Turkish banks as of end 2013. (A detailed file with this data for individual banks is available on request).

Figure 3. Turkish Large Cap Banks – Aggregate Asset-Liabilities Gap, 31 December 2013



Source: Company Reports

The rate hikes have led us to cut NIM forecasts by 67bp this year

This has led us to cut our net interest margin forecast for our universe of Turkish banks on average by 67bp this year, 23bp next year, and 25bp in 2016.

Figure 4. Turkish Banks – Changes to NIM on AIEA

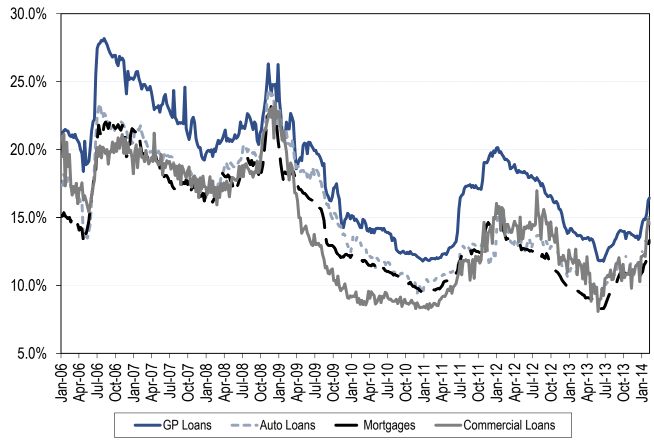
	2014E			2015E			2016E		
	OLD	NEW	chg	OLD	NEW	chg	OLD	NEW	chg
HALKB	4.10%	3.55%	-0.54%	4.40%	3.91%	-0.49%	4.43%	3.94%	-0.49%
GARAN*	3.89%	2.89%	-1.01%	3.97%	3.61%	-0.35%	4.03%	3.64%	-0.38%
ISCTR	3.77%	3.13%	-0.65%	3.85%	3.55%	-0.31%	3.94%	3.52%	-0.41%
YKBNK	3.79%	3.17%	-0.62%	3.89%	3.86%	-0.03%	3.92%	3.86%	-0.06%
VAKBN	4.28%	3.56%	-0.72%	4.42%	3.98%	-0.44%	4.40%	3.96%	-0.45%

Note: * - New forecasts as of 10 Feb 2014, see: Garanti Bank (GARAN.IS) - Remaining Buyers Post Rate Hikes
Source: Citi Research estimates

But asset re-pricing is under-way

But banks are busy re-pricing their assets to the new rate environment and after two quarters of painful margin contraction, we expect margins to recover. As seen in the figures below loan rates on new business have been moving steadily up, following the sharp increase in deposit rates.

Figure 5. Turkish Banks – Interest Rates on New Loans (%)

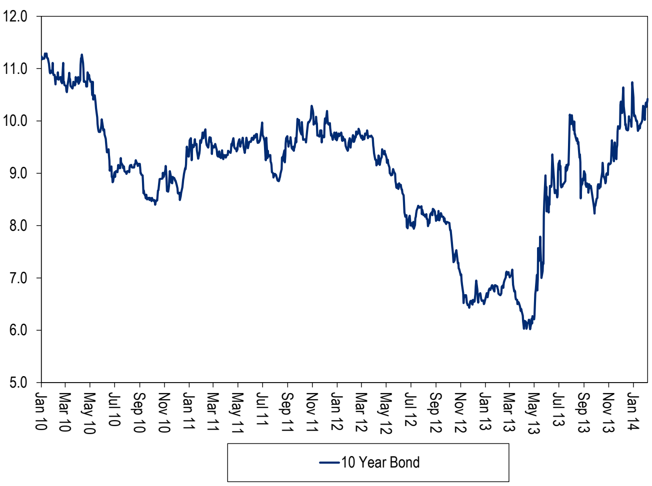


Source: CBT

Figure 6. Turkish Banks – Average Deposit Rates (Up to 3 Month Maturity) (%)

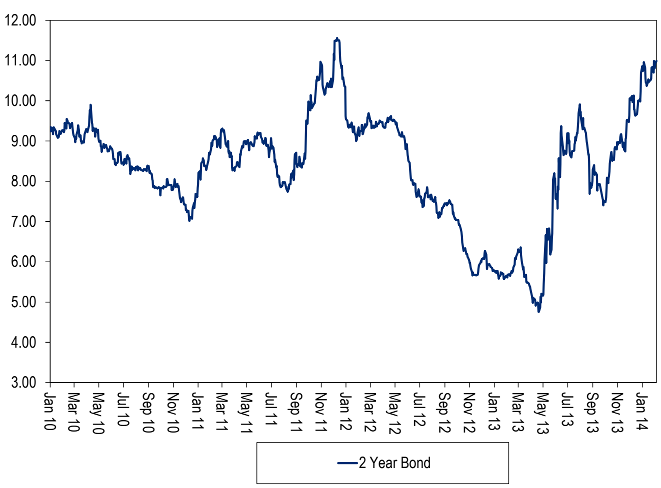
Source: CBT

Figure 7. Turkey – 10 Year Benchmark Sovereign Bond Yield (%)



Source: ThompsonReuters

Figure 8. Turkey – 2 Year Benchmark Sovereign Bond Yield (%)



Source: ThompsonReuters

Rate cycles

The last two large rate hike cycles were good times to buy Turkish banks

We note that the last two times the CBT undertook large rate hikes – e.g. in 2006 and 2011 - it was a good time to buy Turkish bank equities. In 2006 rates moved up by 625bp over a 2 month period starting on 8/6/2006 and didn't go back down to the starting level of rates until Jan 2009. From the date of the first rate hike the bank index (BIST Financials - local currency index) delivered the following returns: 3M: -1%, 6M: +1%, 12M +16%.

In the 2011 cycle the overnight rate was hiked by 350bp in late October and returned to the starting level of rates around a year later (21/11/12 to be exact). The bank index performed as follows: 3M: -15%, 6M: +2%, 12M: +18%.

On top of this in 2006 the currency strengthened considerably: by 14% yoy from the date of the rate hike vs. USD. In 2011 the currency remained largely stable.

We screen for resilience to this period of tighter liquidity using six metrics

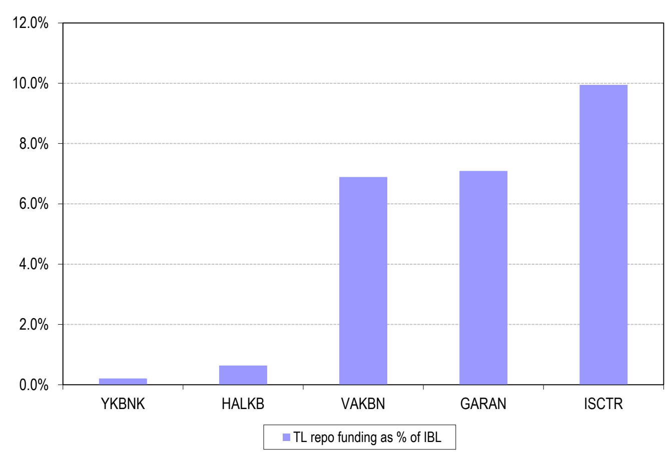
Tight Liquidity – Gauging for Resilience

While no bank in our coverage universe is immune from the negative impact of higher rates, we outline how the banks under coverage stack up on a number of key metrics that we use to gauge their ability to weather a period of tighter liquidity, namely:

- Low dependence on increasingly expensive TL repo funding;
- Low dependence on TL deposits;
- A higher share of TL floating rate notes securities in the asset mix;
- And a higher level of free funds (free equity & demand deposits) as a percent of interest earnings assets;
- A low duration mismatch between interest earnings assets and interest bearing liabilities (including off balance sheet exposures).
- And a low loan-to-deposit ratio

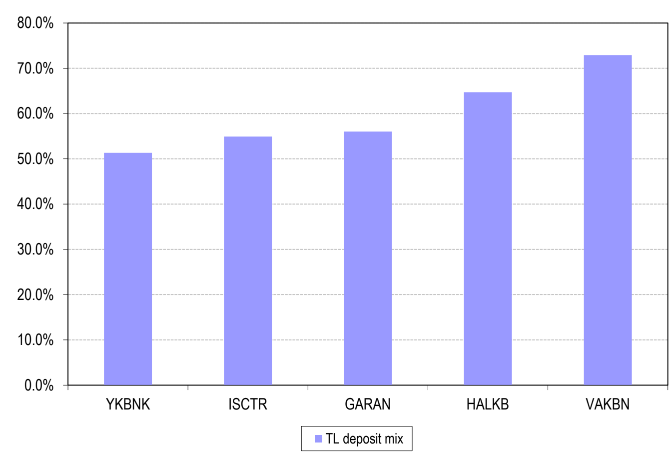
We illustrate these key metrics of Turkish key listed banks as of end 2013 in the figures below.

Figure 9. Turkish Banks – TL Repo Funding as % of IBL, 2013



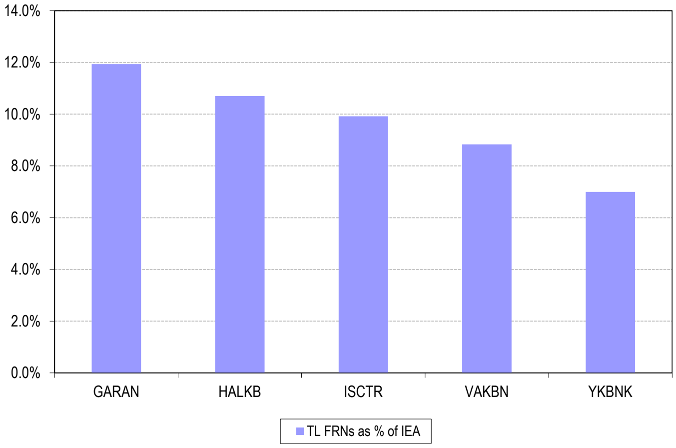
Source: Company reports

Figure 10. Turkish Banks – TL Deposits as % of Total Deposits, 2013



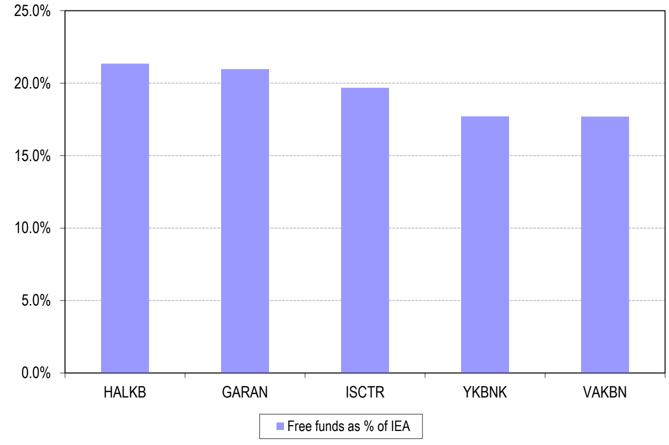
Source: Company reports

Figure 11. Turkish Banks – TL FRNs as % of IEA, 2013



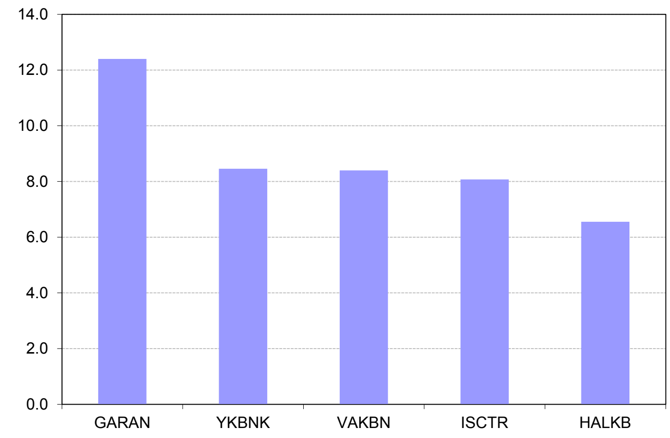
Source: Company reports

Figure 12. Turkish Banks – Free Funds as % of IEA, 2013



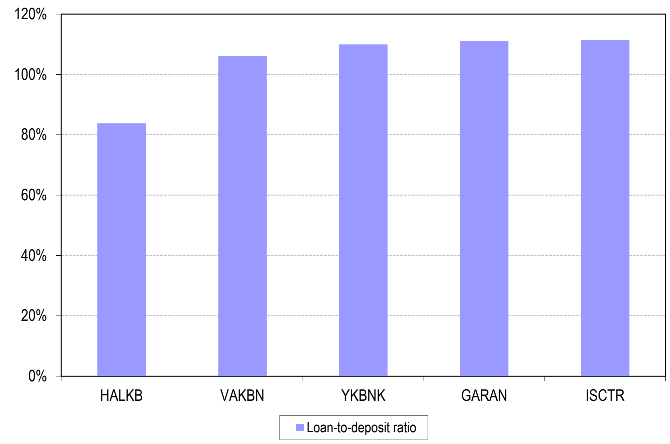
Source: Company reports

Figure 13. Turkish Banks – IEA-IBL Duration Mismatch, Months, 2013



Source: Company reports and Citi Research

Figure 14. Turkish Banks – Loan-to-Deposit Ratio, 2013



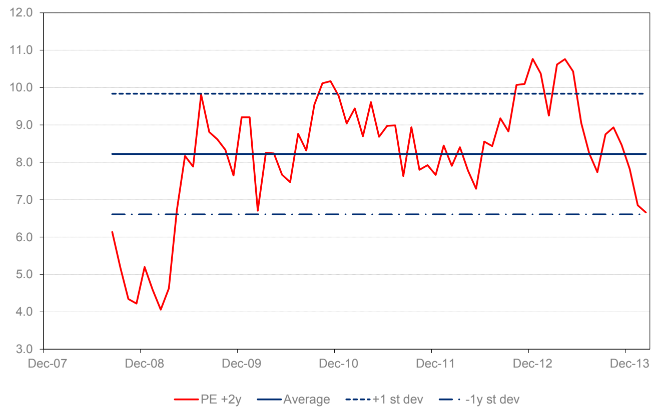
Source: Company reports

Valuations reaching historical troughs

Following the selloff valuations are reaching attractive levels

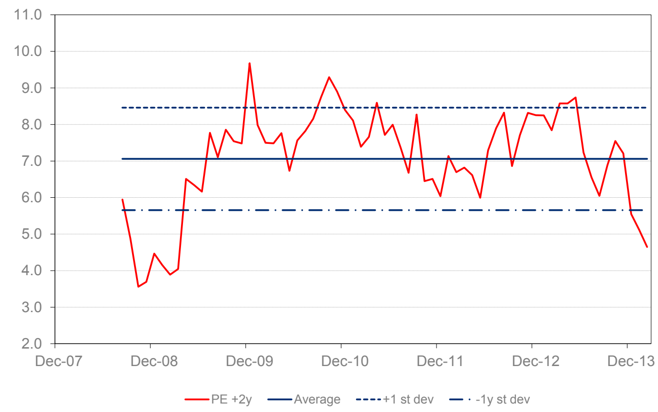
Following the recent sell off Turkish bank stocks trade either at (e.g. Garanti) or well below (e.g. the rest of the large listed Turkish banks) one standard deviation below five year historical 2 year forward price-earnings multiples. Some banks are now trading close to trough valuations seen in the Global Financial Crisis in 2008/09, namely Isbank and Yapi Kredi. Others could still de-rate further if those lows are tested.

Figure 15. Garanti – 2 Years Forward P/E (x)



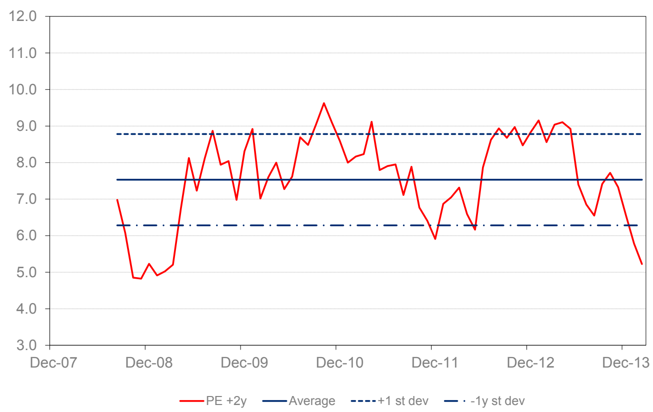
Source: DataStream

Figure 16. Halkbank -- 2 Years Forward P/E (x)



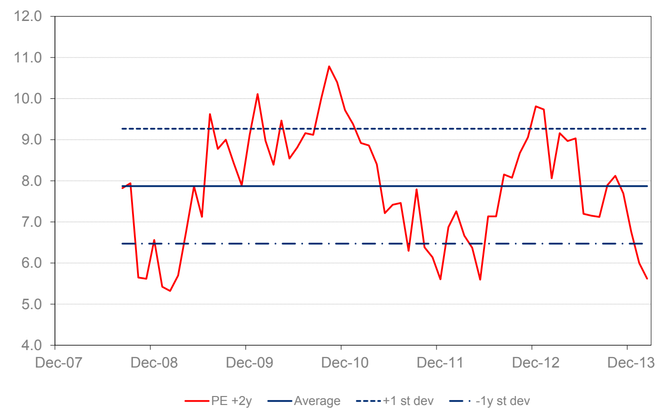
Source: DataStream

Figure 17. Isbank -- 2 Years Forward P/E (x)



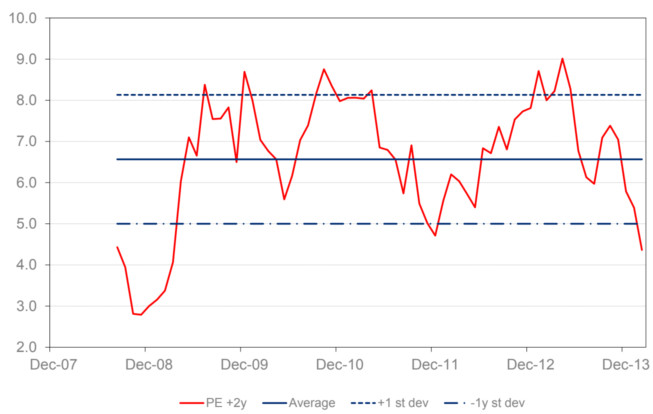
Source: DataStream

Figure 18. Yapi Kredi – 2 Years Forward P/E (x)



Source: DataStream

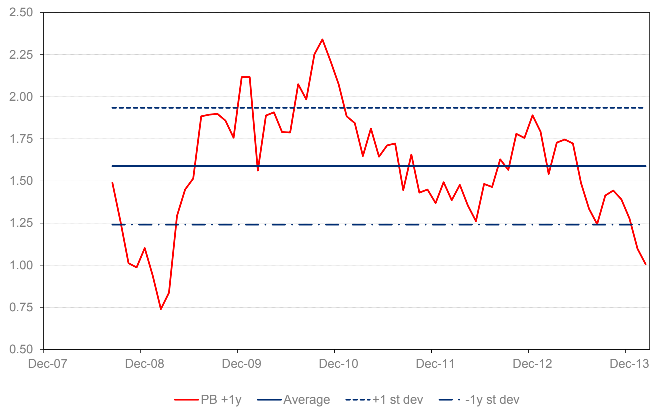
Figure 19. Vakifbank – 2 Years Forward P/E (x)



Source: DataStream

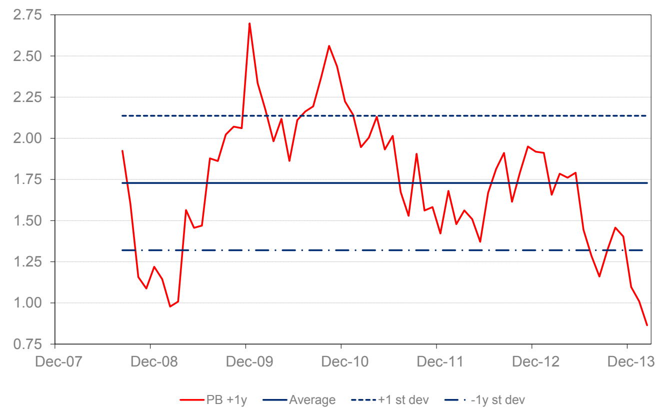
On a price/book value basis all banks trade well under one standard deviation below five year historical averages and below the P/BV lows seen in the global financial crisis in 2008/09, with the notable exceptions of Garanti and Vakifbank.

Figure 20. Garanti – 1 Year Forward P/BV (x)



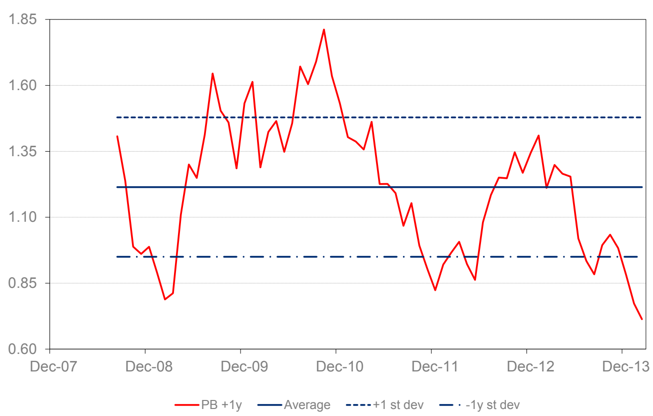
Source: DataStream

Figure 21. Halkbank – 1 Year Forward P/BV (x)



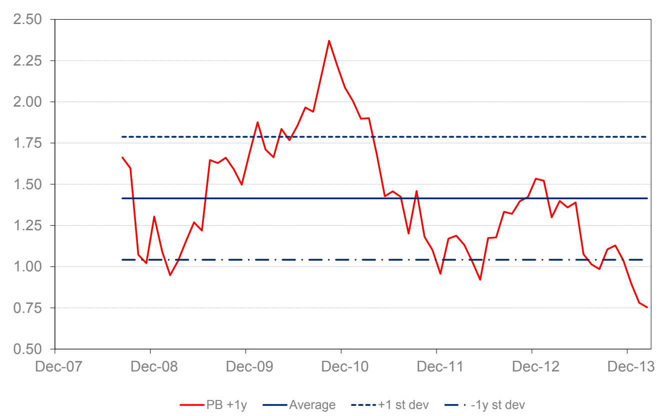
Source: DataStream

Figure 22. Isbank – 1 Year Forward P/BV (x)



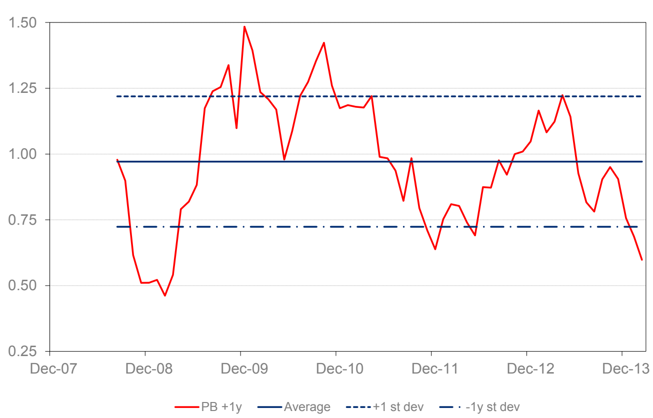
Source: DataStream

Figure 23. Yapi Kredi – 1 Year Forward P/BV (x)



Source: DataStream

Figure 24. Vakifbank – 1 Year Forward P/BV (x)



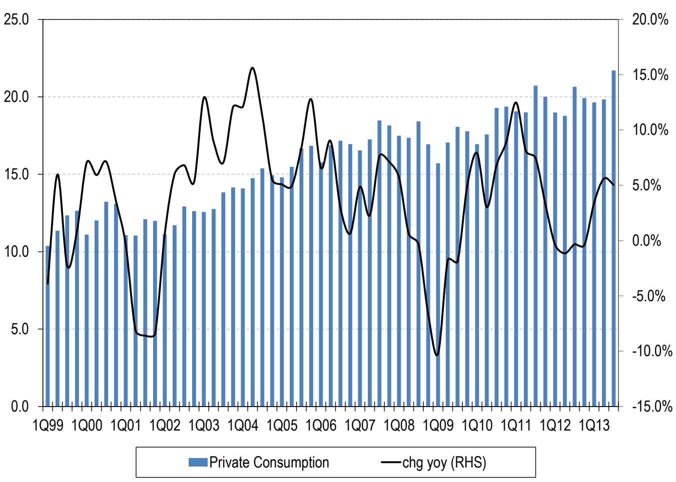
Source: DataStream

Asset quality – how bad will the cycle be?

The key downside risk is that economic and asset quality cycle is worse than expected

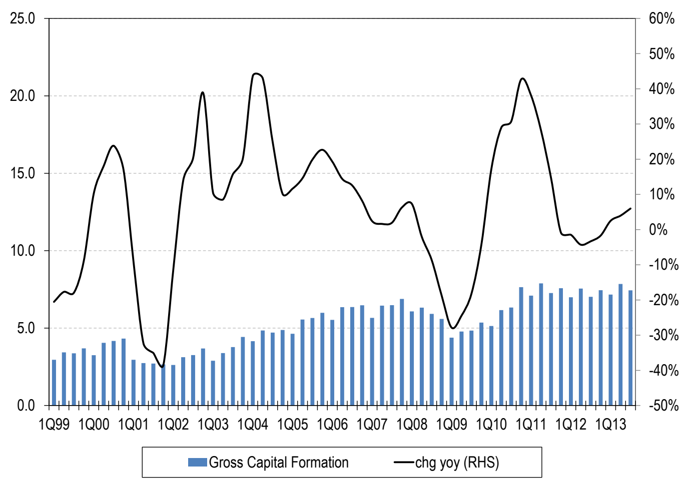
With less risk of further large rate hikes on the horizon, we think the trajectory of margins is less uncertain than in the past. The key risk now for Turkish bank financial performance is the asset quality cycle. Higher rates and the weaker currency are likely to lead the economy to slow or at least lead to a rebalancing away from consumption, the main driver of GDP growth in recent years, towards public investment and external driven demand.

Figure 25. Turkey – Private Consumption (TL trn)



Source: CBT

Figure 26. Turkey – Gross Fixed Capital Formation (TL trn)



Source: CBT

Citi economists' base case is for GDP to slow to 2.3% this year…

Citi economists are forecasting GDP to slow to 2.3% this year, down from 4% in 2013. Most Turkish banks on their post 2013 earnings conference calls also seemed to expect that GDP this year will remain in the 2-3% level.

Figure 27. Turkey – Key Economic Data

	2006	2007	2008	2009	2010	2011	2012	2013E	2014E	2015E	2016E
Nominal GDP, US$ bn	529	646	731	615	731	775	788	831	778	868	888
Real GDP, % yoy	6.9	4.7	0.7	-4.8	9.2	8.8	2.2	4.0	2.3	3.5	3.9
CPI, % yoy	9.7	8.4	10.1	6.5	6.4	10.4	6.2	7.4	8.2	7.0	6.7
Current account	-31.8	-37.8	-40.4	-12.1	-45.4	-75.1	-48.5	-65.0	-38.1	-41.5	-48.9
% of GDP	-6.0	-5.8	-5.5	-2.0	-6.2	-9.7	-5.9	-7.8	-5.2	-5.3	-5.5
Fiscal deficit % of GDP	-0.6	-1.6	-1.8	-5.5	-3.6	-1.3	-2.0	-1.2	-2.8	-3.2	-3.3

Source: Citi Research, CBT, Haver

…under which case we don't expect any major asset quality issues

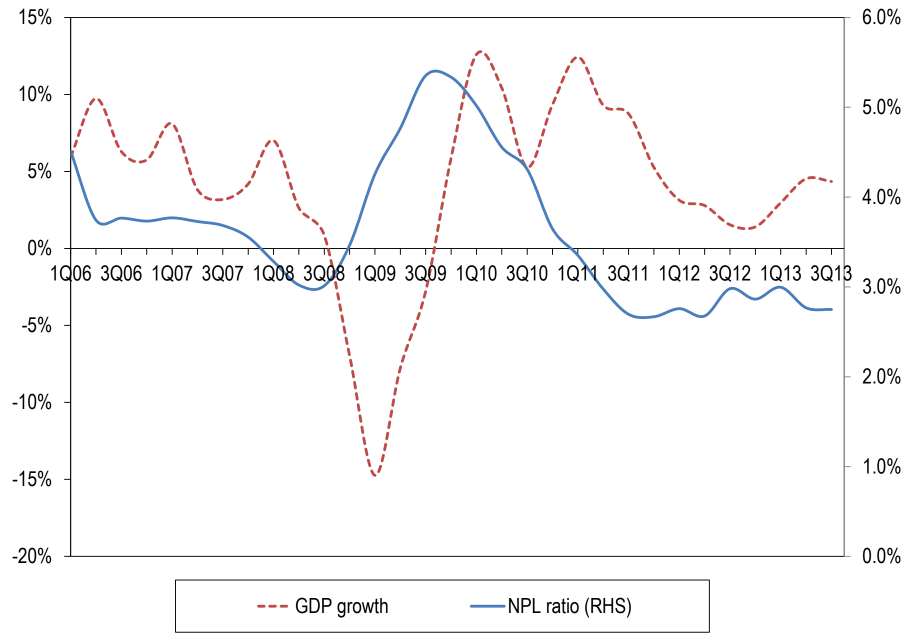
Under this base case macro scenario we are not particularly worried about the outlook for asset quality. While NPLs are expected to rise and provision to follow, we don't expect a major asset quality problem. Yet given the sharp increase in rates and political uncertainty many fear that growth may be much weaker than forecast.

Looking back to the last cycle

In the 2009 cycle NPLs peaked at 5.3%...

Looking back to learn from previous asset quality cycles we focus on the downturn in 2008 and 2009. At the time the sharp slowdown in the economy led the sector NPL ratio to increase from c 3% to a peak of 5.3%. As the economy recovered, the NPL ratio also rapidly declined back to its pre-slowdown level of c 3% where the ratio has been since.

Figure 28. Turkey – GDP growth vs. Sector NPL ratio

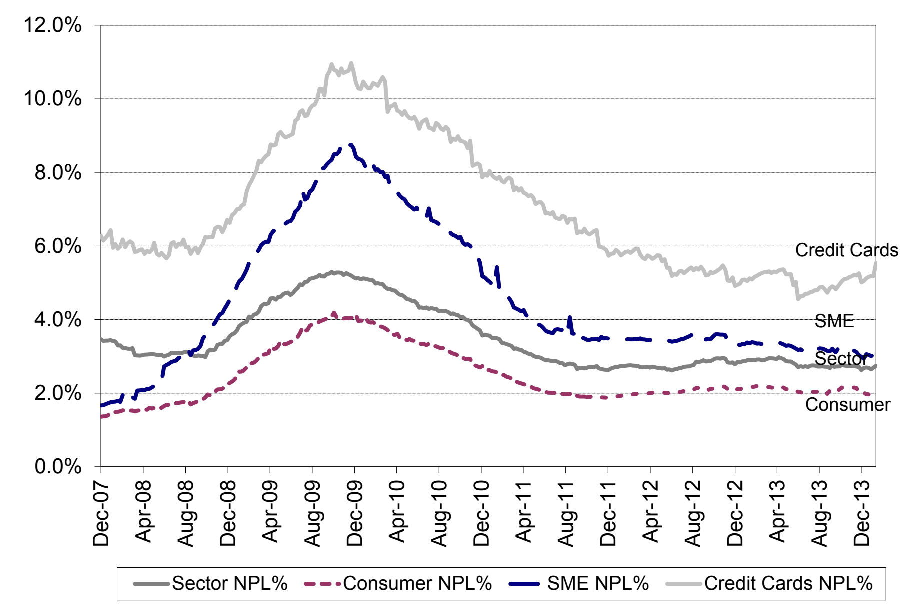


Source: BRSA and CBT

…tracking the economic slowdown and deterioration in asset quality was broad based…

As illustrated in the figure below, the deterioration in asset quality in the 2008-09 slowdown was broad-based with all segments seeing an increase in NPLs, although the increase in NPL ratios was somewhat more pronounced in credit cards and SME loans.

Figure 29. Turkey – Sector Non-Performing Loans by Segment



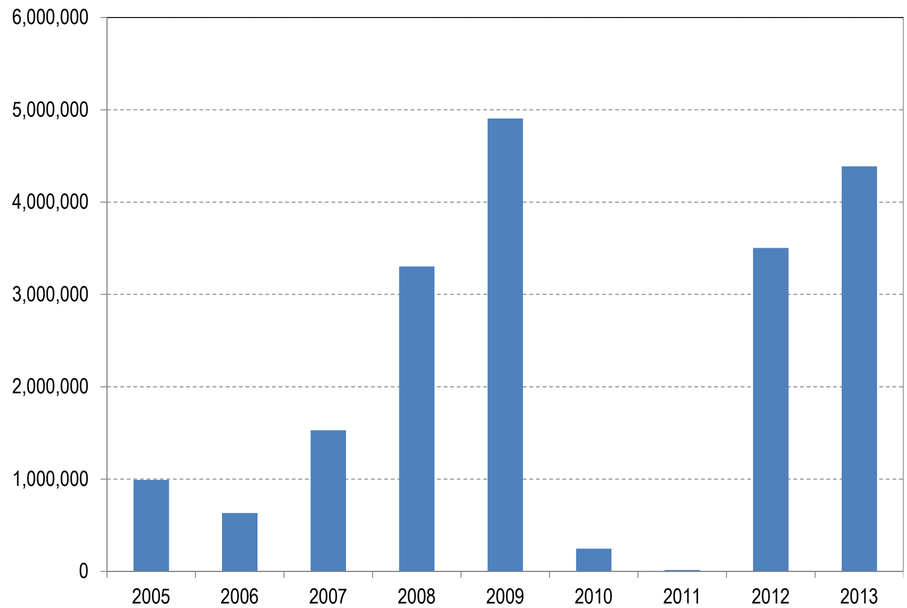
Source: BRSA

…and net NPL inflows peaked at 5x the 2005-07 level

We also tracked net NPL inflows (new NPLs less collections) over time of the large listed banks. Annual net NPL inflows peaked at almost 5x the 2005-07 average level and then the sector saw limited net NPL inflows for two years. While aggregate net

NPL inflows have almost returned to the 2009 level in 2013, this is on the back of strong loan growth over the past several years.

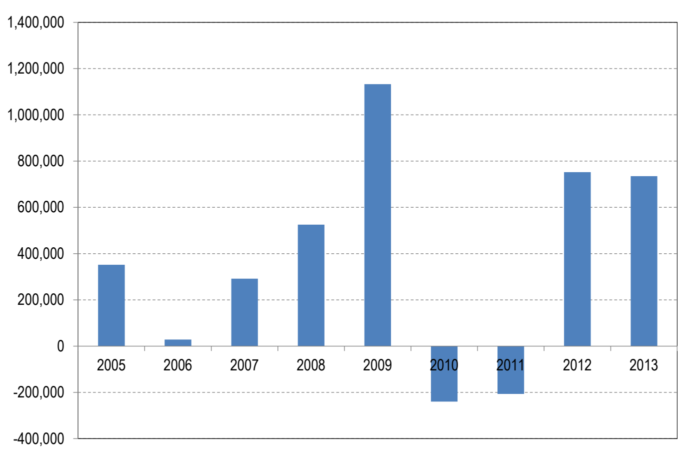
Figure 30. Large Turkish Listed Banks – Net NPL Inflows (TL '000)



Source: Company reports and Citi Research

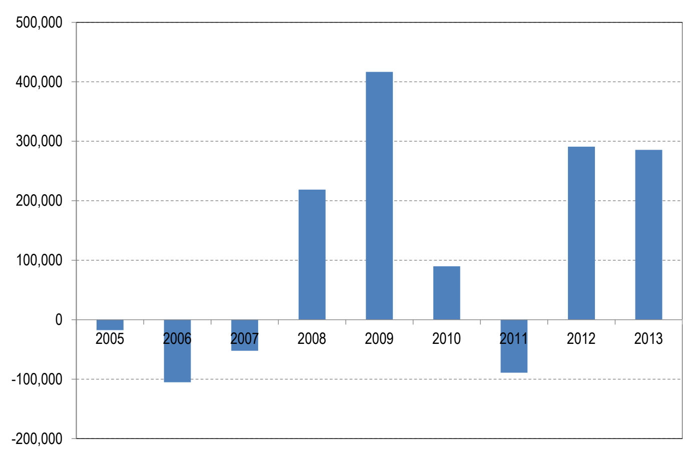
In the figures below we illustrate the net NPL inflows recorded by large listed Turkish banks over the past nine years.

Figure 31. Garanti – Net NPL Inflows (TL '000)



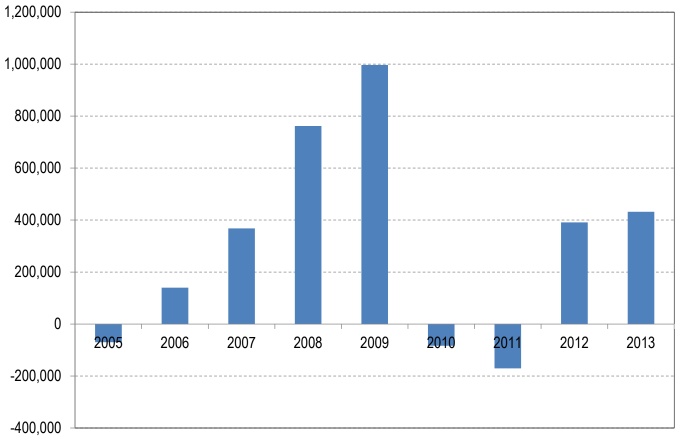
Source: Company reports

Figure 32. Halkbank – Net NPL Inflows (TL '000)



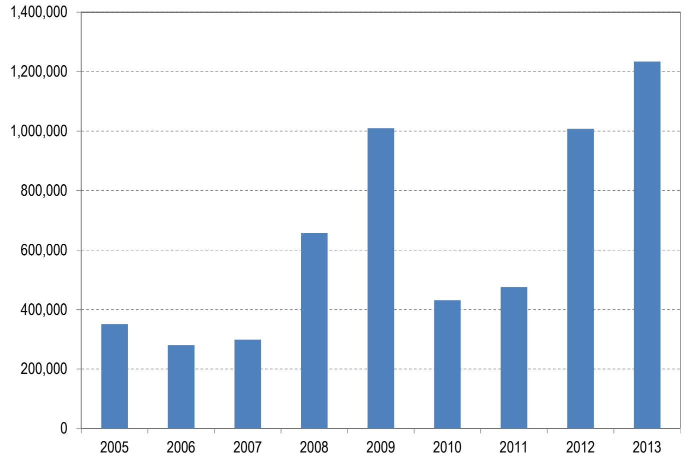
Source: Company reports

Figure 33. Isbank – Net NPL Inflows (TL '000)



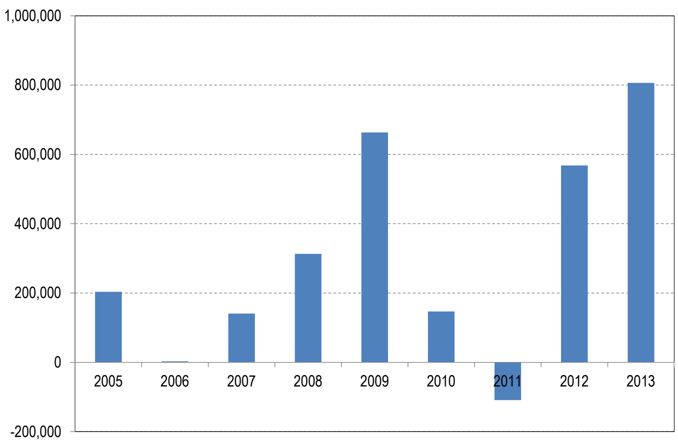
Source: Company Reports

Figure 34. Yapi Kredi Bank – Net NPL Inflows (TL '000)



Source: Company Reports

Figure 35. Vakifbank – Net NPL Inflows (TL '000)

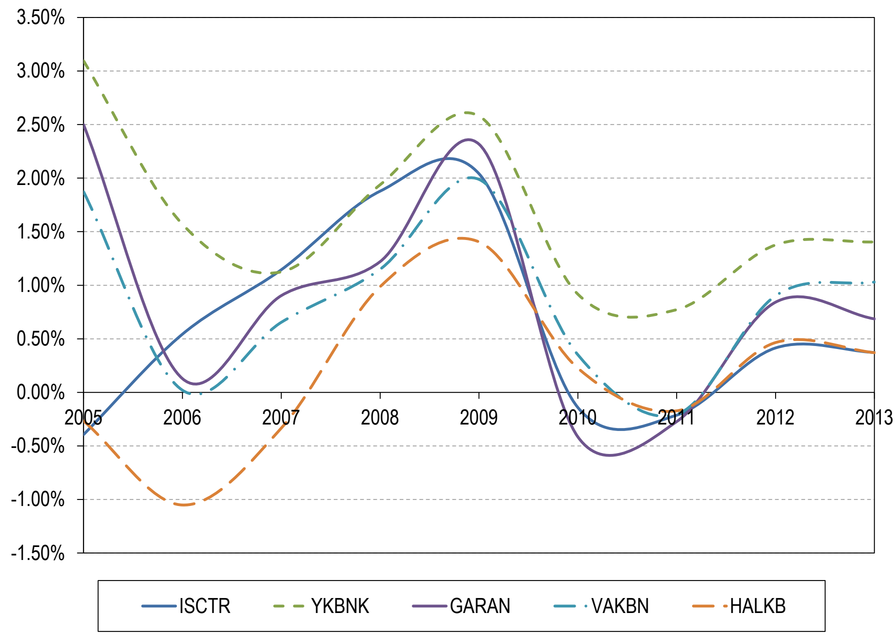


Source: Company Reports

Net NPL inflows have risen substantially in recent years…

Indeed, despite the strong increase in net NPL inflows in absolute terms in recent years, strong loan growth over the same time period has meant that NPL inflows as a percentage of average gross loans remains less than half of the 2009 level, as shown in the figure below.

Figure 36. Turkish Large Listed Banks – Net NPL Inflow as % of Average Gross Loans



Source: Company reports and Citi Research

…but only modestly in relative terms given strong credit growth; moreover provision coverage remains robust

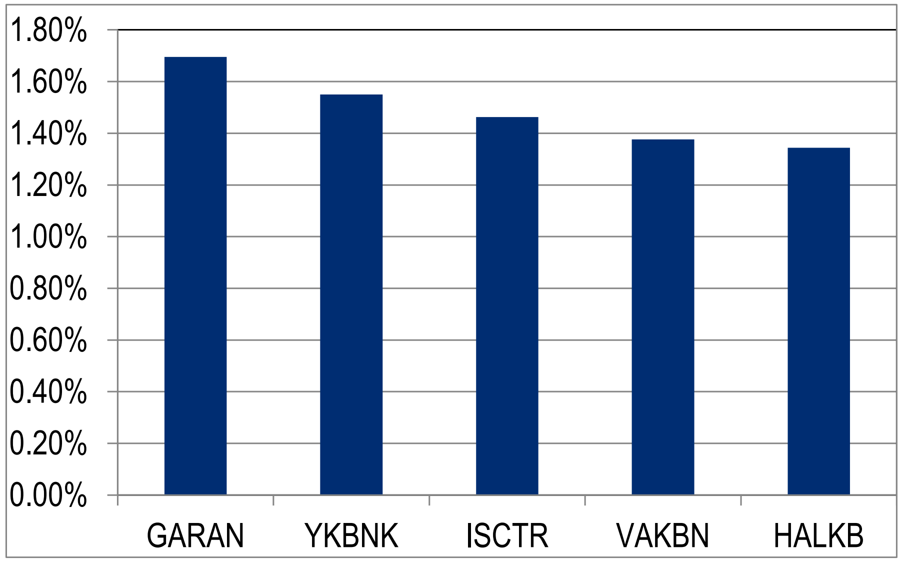
NPLs of Turkish banks remain at reasonably low levels (2-4%) and provision coverage appears adequate at around 80%. We also remind that the regulator requires the banks to build substantial general provision coverage of performing and watch classified loans. As of end 2013 the main listed banks had general reserves of 1.5% of performing loans or 60% of existing NPLs.

Figure 37. Turkish Banks – NPL Ratio and Provision Coverage of NPLs

I. NPL ratio	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014E**	**2015E**	**2016E**
ISCTR	3.9%	4.3%	4.5%	5.5%	3.7%	2.1%	1.9%	1.6%	2.0%	2.4%	2.5%
YKBNK	7.3%	5.9%	4.4%	6.6%	3.5%	3.1%	3.3%	3.6%	4.3%	4.8%	4.8%
GARAN	2.3%	2.3%	2.5%	4.4%	3.0%	1.8%	2.3%	2.1%	2.7%	3.2%	3.2%
VAKBN	5.3%	4.7%	4.6%	5.9%	4.8%	3.7%	3.9%	3.9%	4.5%	4.9%	4.9%
HALKB	8.7%	5.5%	4.8%	5.0%	3.9%	2.9%	2.9%	2.6%	3.0%	3.4%	3.4%
II. Coverage of NPLs	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014E**	**2015E**	**2016E**
ISCTR	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	78.9%	80.4%	80.4%	80.4%	80.4%
YKBNK	81.8%	80.0%	62.4%	84.4%	77.1%	64.7%	61.4%	67.7%	67.7%	67.7%	67.7%
GARAN	70.9%	63.7%	63.7%	81.0%	81.9%	81.7%	80.9%	81.0%	81.0%	81.0%	81.0%
VAKBN	100.0%	100.0%	94.2%	93.7%	98.9%	95.0%	90.3%	92.8%	92.8%	92.8%	92.8%
HALKB	98.6%	98.7%	82.9%	81.4%	83.3%	84.0%	82.5%	80.6%	80.6%	80.6%	80.6%

Source: Company Reports and Citi Research Estimates

Figure 38. Turkish Banks – General Reserve Coverage of Performing Loans (%), 31 Dec 2013



Source: Company Reports

We forecast only a modest increase in cost of risk for our universe

We illustrate below historical and forecast gross cost of risk (loan loss, general and other provisions as a percent of average performing loans) for the major listed Turkish banks. With the exception of Garanti and Vakifbank, we forecast higher gross cost of risk in 2014 than in 2013. As we think the deterioration in loan quality will occur with a small lag to the economic slowdown we expect gross cost of risk to increase for most banks – Yapi Kredi and Halkbank being the exceptions – in 2015 before moderating in 2016.

Figure 39. Turkish Banks -- Gross Cost of Risk (Loan loss, general and other provisions as a percent of average loans)

	2006	2007	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E
ISCTR	3.68%	5.25%	4.07%	4.88%	2.04%	1.80%	1.23%	1.21%	1.31%	1.43%	1.28%
YKBNK	2.06%	1.71%	1.70%	4.17%	2.42%	1.29%	1.84%	1.74%	1.90%	1.79%	1.64%
GARAN	1.50%	1.07%	1.34%	3.33%	1.04%	1.13%	1.36%	1.47%	1.28%	1.40%	1.24%
VAKBN	2.18%	1.80%	2.35%	3.07%	2.48%	1.79%	2.26%	2.42%	2.27%	2.16%	1.88%
HALKB	2.28%	1.53%	2.04%	2.28%	1.22%	1.40%	1.47%	1.13%	1.28%	1.47%	1.21%

Source: Company Reports and Citi Research Estimates

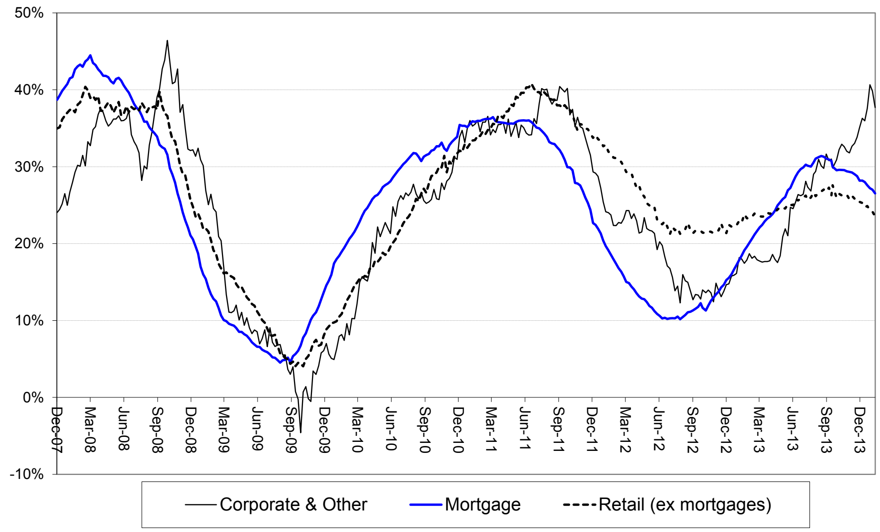
Still, we note that if the economic slowdown triggers deterioration in asset quality closer to that seen in the 2008-09 crisis then there is substantial downside risk to our provisioning forecasts as in 2009 gross cost of risk averaged c 230bp vs the 116bp and 125bp we forecast on average this year and in 2015.

Rapid Pace of Credit Growth A Concern

Credit growth has exceeded GDP growth by 2.3x since 2009

Of concern is the rapid pace of loan growth in recent years. Since the 2008-09 economic downturn, which saw a sharp deceleration in loan growth, total sector lending has grown at a CAGR of 28%. Over the same time period nominal GDP has grown by a CAGR of c 12%, e.g. credit growth exceeded the rate of GDP growth by 2.3x. As can be seen in the figure below credit growth has been broad-based spanning corporate, mortgage, and consumer lending.

Figure 40. Turkey – Sector Loan Growth (Y-o-Y)

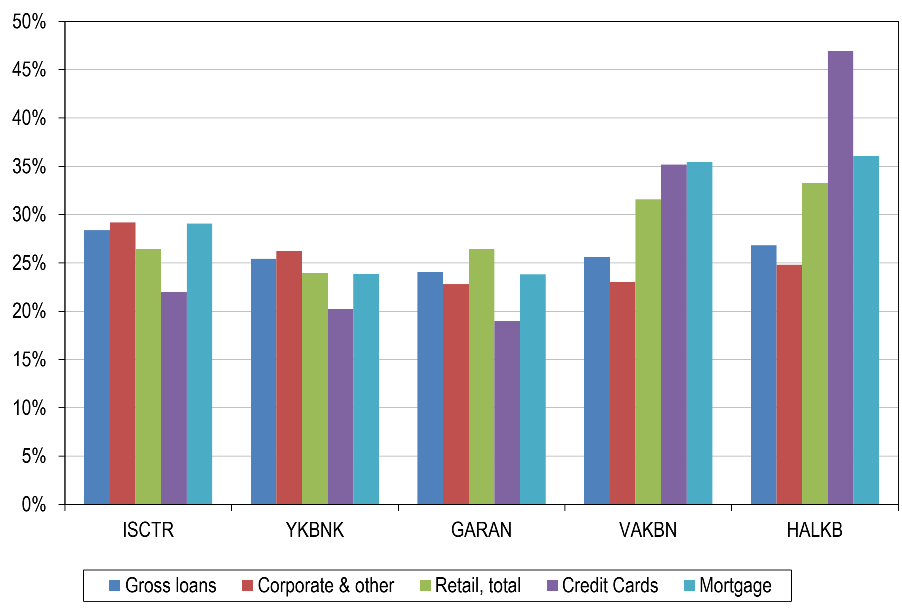


Source: BRSA

The large listed banks grew credit in line with the sector

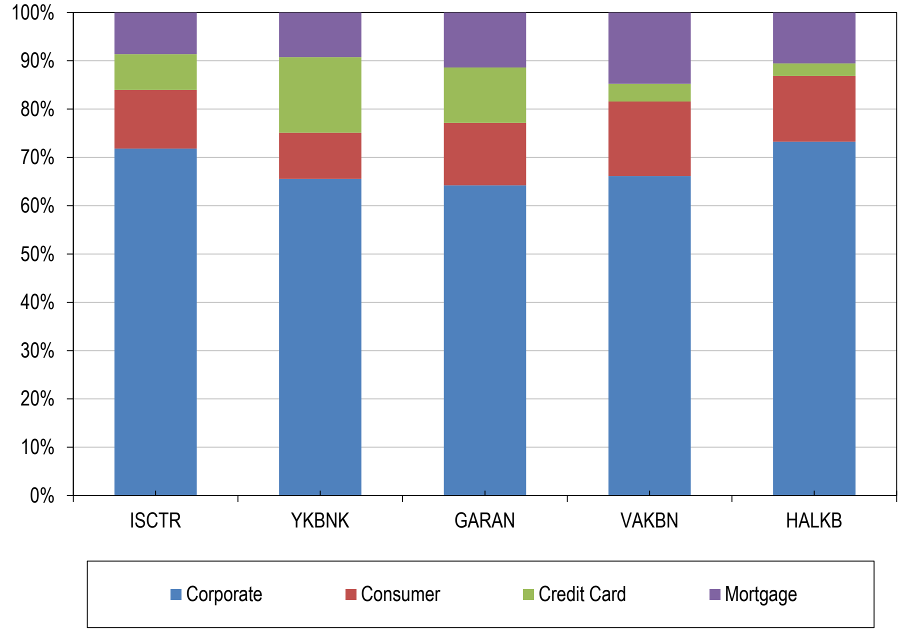
The large listed banks grew largely in line with the sector with the 2009-13 CAGR in gross lending ranging between 24% at Garanti to 28% for Isbank. Again, in line with the sector growth was broad based with strong lending dynamics seen in all lending segments.

Figure 41. Large Listed Turkish Banks – 2009-13 CAGR in Lending (%)



Note: According to BRSA classifications, may vary with bank presentation
Source: Company reports

Figure 42. Large Listed Turkish Banks – Structure of Loan Books, 31 Dec 2013



Note: According to BRSA classifications, may vary with bank presentation
Source: Company reports

In the figures below we outline the growth rates in lending of all the major listed Turkish banks over the past several years.

Figure 43. Turkish Large Listed Banks – Growth in Total Net Loans (Y-o-Y)

	2007	2008	2009	2010	2011	2012	2013
ISCTR	16%	40%	3%	34%	42%	18%	26%
YKBNK	27%	34%	-1%	40%	28%	14%	27%
GARAN	36%	33%	0%	31%	29%	11%	29%
VAKBN	30%	29%	14%	31%	27%	20%	27%
HALKB	56%	41%	26%	38%	27%	19%	29%

Source: Company reports

Figure 44. Turkish Large Listed Banks – Growth in Corporate & SME Loans (Y-o-Y)

	2007	2008	2009	2010	2011	2012	2013
ISCTR	8%	48%	4%	31%	45%	16%	26%
YKBNK	24%	34%	-1%	42%	26%	10%	29%
GARAN	39%	40%	2%	30%	27%	7%	29%
VAKBN	28%	28%	14%	23%	18%	23%	29%
HALKB	42%	42%	25%	31%	24%	18%	27%

Source: Company reports

Figure 45. Turkish Large Listed Banks – Growth in Retail Loans (including credit cards) (Y-o-Y)

	2007	2008	2009	2010	2011	2012	2013
ISCTR	34.6%	23.9%	3.3%	30.6%	29.3%	19.8%	26.2%
YKBNK	26.3%	27.9%	5.2%	25.8%	29.8%	20.7%	19.8%
GARAN	31.7%	20.4%	3.0%	27.8%	28.9%	19.6%	29.8%
VAKBN	32.9%	31.8%	17.9%	46.4%	41.7%	15.0%	25.7%
HALKB	92.4%	33.1%	33.5%	55.0%	31.3%	17.8%	31.6%

Source: Company reports

Figure 46. Turkish Large Listed Banks – Growth in Retail Credit Card Loans (Y-o-Y)

	2007	2008	2009	2010	2011	2012	2013
ISCTR	25.7%	36.8%	3.9%	15.6%	25.4%	22.5%	24.8%
YKBNK	16.1%	12.5%	0.2%	13.1%	18.3%	30.9%	19.2%
GARAN	18.3%	23.3%	0.6%	11.9%	22.9%	18.9%	22.7%
VAKBN	-12.7%	37.3%	33.2%	41.2%	33.4%	42.7%	24.2%
HALKB	27.4%	44.9%	23.3%	44.3%	26.9%	36.8%	86.1%

Source: Company reports

Penetration remains reasonable

Despite strong credit growth Turkey credit penetration is not high

Despite strong growth in credit in recent years penetration of credit is still at reasonably low levels. Loans-to-GDP have grown to 65% from 55% over the past four years and is up from less than 40% before 2005.

Figure 47. Turkey – Banking Sector Penetration as % of GDP

	Deposits	Loans	Mortgages	Retail Loans (excl. Credit Cards)	Credit Cards	SME	Commercial & Corporate
Dec-02	39.9%	13.5%	0.1%	0.6%	1.2%	0.0%	11.6%
Dec-03	34.5%	14.7%	0.2%	1.3%	1.5%	0.0%	11.9%
Dec-04	35.4%	18.2%	0.5%	2.3%	2.5%	1.5%	11.9%
Dec-05	40.1%	24.6%	2.0%	4.6%	2.7%	2.6%	14.8%
Dec-06	42.1%	29.6%	3.1%	6.3%	2.9%	3.2%	17.2%
Dec-07	43.3%	34.0%	3.8%	8.0%	3.2%	3.9%	18.9%
Dec-08	48.8%	39.0%	4.1%	8.8%	3.6%	4.1%	22.6%
Dec-09	55.4%	41.8%	4.7%	9.7%	3.8%	3.9%	24.4%
Dec-10	58.7%	48.7%	5.5%	11.7%	4.1%	4.9%	28.0%
Dec-11	56.3%	53.4%	5.7%	13.0%	4.5%	5.8%	30.2%
Dec-12	57.7%	56.9%	6.1%	13.7%	5.4%	6.2%	31.6%
Dec-13	**64.7%**	**67.9%**	**7.0%**	**15.8%**	**5.9%**	**8.1%**	**38.0%**

Source: BRSA and Citi Research

Of particular concern when speaking to investors is the strong pace of growth in consumer loans over the past several years and the prevalence of FX loans to the corporate sector.

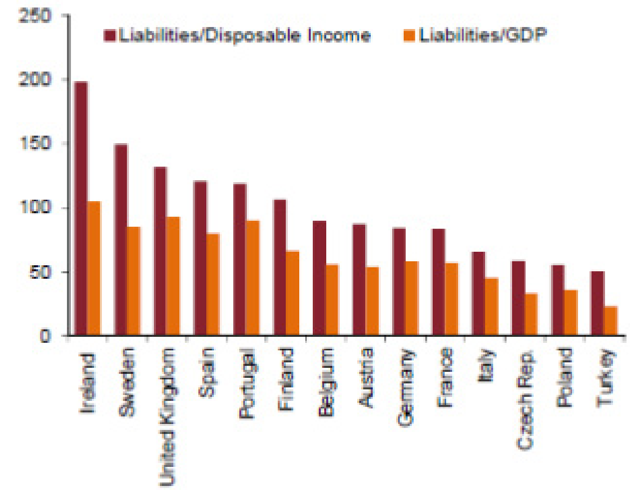
Since the end of 2009 sector non-mortgage retail credit has expanded at a CAGR of 28% and since the end of 2002 it has expanded by a CAGR of 39%. Nominal GDP has grown at CAGR of 12% and 14% over those two periods accordingly, e.g. retail credit (ex mortgages) has expanded at roughly 2.3x and 2.7x faster than GDP growth over these two periods.

Despite strong growth in retail credit households don't appear particularly levered

Nevertheless, according to the CBT debt of households still appears manageable as household liabilities as a percentage of disposable income and GDP remain at low levels versus peers globally. Additionally, the CBT estimates that the household interest payments account for 5.4% of disposable income. As all retail lending in Turkey is in local currency and fixed rate, we don't anticipate any major credit

problems from retail lending in the near future unless the economy worsens significantly and we see a sharp increase in unemployment.

Figure 48. Household Liabilities to Disposable Income and GDP



Source: CBT Nov 2013 Financial Stability Report

Figure 49. Turkey – Leverage of Households

	12.11	12.12	12.13
Household Disposable Income	531,2	613,9	673,6[2]
Household Liabilities	252,0	299,9	372,1
Household Interest Payments	23,1	30,0	36,5
Interest Payments/ Hh. Disposable Income (%)	4,4	4,9	5,4
Liabilities/ Hh. Disposable Income (%)	47,4	48,8	55,2

Source: CBT Nov 2013 Financial Stability Report

However national statistics are often misleading as what matters is where the credit is concentrated, e.g. if it is being extended to lower income individuals in greater quantities than to the rest of the population. Using banking association data we are able to see to what income brackets banks have been extending retail credit in recent years.

However, since 2008 on average 46% of new retail credit extended has been granted to lower income individuals

What we find from the data is that on average since 2008 46% of new retail credit extended has been granted to lower income individuals with a monthly salary of less than TL 2,000 (US$913). However growth in new credit issued in recent quarters has been concentrated in higher income brackets. In the first nine months of 2013 new retail credit issued to individuals with a monthly salary of less than TL 2,000 has grown 72%, but it has increased by a higher 97% to individuals in higher income brackets.

Figure 50. Turkish Banks -- Distribution of New Retail Credit Issued by Income Level, Volume of Credit

Monthly Salary=>	TL 0 - 1,000	TL 1,001-2,000	TL 2,001-3,000	TL 3,001-5,000	TL 5,001+	Unclassified
2008	**22%**	**21%**	11%	10%	19%	17%
2009	**23%**	**25%**	14%	12%	19%	7%
2010	**23%**	**25%**	16%	12%	17%	7%
2011	**27%**	**23%**	16%	11%	15%	8%
2012	**25%**	**21%**	17%	12%	15%	10%
1Q13	**21%**	**22%**	20%	13%	15%	9%
2Q13	**21%**	**21%**	20%	13%	18%	8%
3Q13	**22%**	**23%**	19%	13%	15%	8%

Source: Association of Turkish Banks and Citi Research

Figure 51. Turkish Banks -- New Retail Credit Issued by Income Level (Chg YoY)

Monthly Salary=>	TL 0 - 1,000	TL 1,001-2,000	TL 2,001-3,000	TL 3,001-5,000	TL 5,001+	Unclassified	Total
2008	**19%**	**20%**	28%	18%	14%	-17%	11%
2009	**24%**	**47%**	49%	41%	23%	-53%	20%
2010	**57%**	**55%**	80%	57%	38%	52%	56%
2011	**27%**	**0%**	10%	-1%	-5%	39%	10%
2012	**-9%**	**-11%**	9%	5%	2%	20%	-1%
1Q13	**53%**	**94%**	151%	145%	99%	81%	97%
2Q13	**62%**	**95%**	130%	131%	142%	40%	97%
3Q13	**45%**	**92%**	73%	79%	65%	11%	62%

Source: Association of Turkish Banks and Citi Research

Additionally it appears that the size of loans as a percent of annual salary has been increasing this past year, especially for clients with the lowest income, as is illustrated in the figure below.

Figure 52. Turkish Banks -- Credit Issued Per Customer / Estimated Annual Average Salary (x)

Monthly Salary=>	TL 0 - 1,000	TL 1,001-2,000	TL 2,001-3,000	TL 3,001-5,000	TL 5,001+*
2008	0.93	0.45	0.43	0.42	0.44
2009	0.91	0.51	0.46	0.48	0.47
2010	1.19	0.65	0.59	0.63	0.56
2011	1.31	0.63	0.57	0.60	0.56
2012	1.33	0.57	0.55	0.55	0.47
1Q13	**1.64**	0.70	0.70	0.66	0.54
2Q13	**1.85**	0.78	0.78	0.77	0.48
3Q13	**1.74**	0.71	0.69	0.65	0.55

Note: * - Assumes the average annual wage in the income bracket is 12x the average of the range, with the exception of the last column where we estimate the average annual wage at 12x TL 5,001.
Source: Association of Turkish Banks and Citi Research

On the other hand, much of the retail lending extended is of relatively long maturity. On average since 2008 about 78% of credit extended has had a maturity of over 2 years. Given that retail loans in Turkey are fixed rate and in local currency this means that individuals have effectively “locked in” low rates

Figure 53. Turkish Banks -- Distribution of New Retail Credit Issued by Maturity

	3-12 Months	13-18 Months	19-24 Months	25-36 Months	37-48 Months	49-72 Months	73 + Months	Unclassified
2008	11%	5%	15%	**20%**	**7%**	**14%**	**17%**	**10%**
2009	11%	5%	17%	**23%**	**11%**	**16%**	**17%**	**0%**
2010	7%	3%	12%	**22%**	**15%**	**19%**	**22%**	**0%**
2011	6%	3%	11%	**20%**	**12%**	**27%**	**20%**	**0%**
2012	7%	3%	13%	**20%**	**14%**	**25%**	**18%**	**0%**
1Q13	5%	2%	11%	**17%**	**12%**	**29%**	**24%**	**0%**
2Q13	4%	2%	10%	**16%**	**12%**	**31%**	**25%**	**0%**
3Q13	5%	2%	9%	**17%**	**12%**	**32%**	**23%**	**0%**

Source: Association of Turkish Banks and Citi Research

Clients that don’t lose their jobs are thus expected to be able to continue servicing their retail debt obligations. Issues will occur if we see a material increase in the unemployment rate or when loans mature and the cost of rolling over retail debt, potentially, becomes more expensive.

Relative to average current prevailing rates for general purposes (GPL) consumer loans, average sector GPL loan rates were lower than now for:

- 2 weeks in the second half of September 2009

- 87 weeks from the beginning of November 2009 – the beginning of July 2011.
- And 69 weeks from the end of October 2010 – the beginning of February 2013.

Clients that took on credit during these periods will find it more expensive to roll their debts.

Figure 54. Turkey – General Purpose Loan (GPL) Rates, Now vs. Periods When they Were Higher

	GPL Rates During Time Period		Difference vs. today	
Period:	**AVERAGE**	**MIN**	**AVERAGE**	**MIN**
Sep-09	16.2%	16.2%	-0.20%	-0.23%
Nov 09-Jul 11	13.3%	11.8%	-3.10%	-4.65%
Oct 12 - Feb 14	13.8%	11.8%	-2.66%	-4.66%
GPL Rate Now	16.4%			

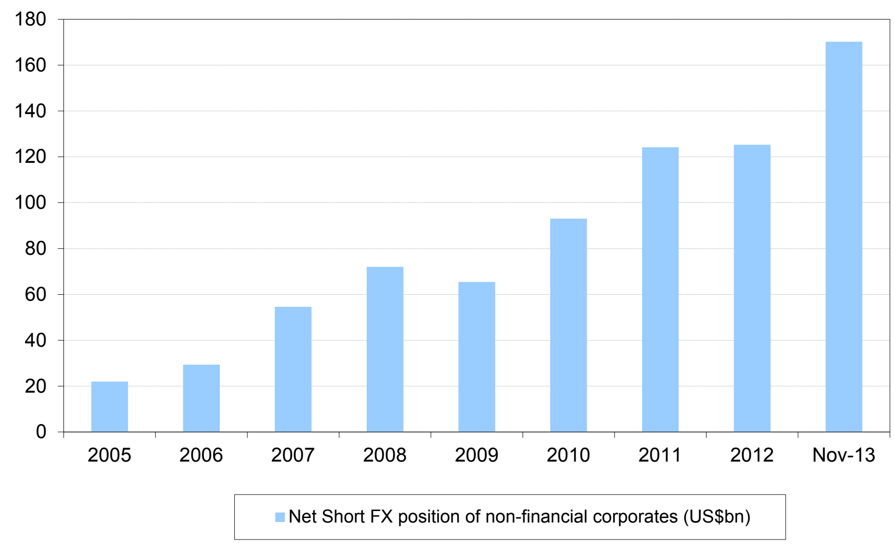
Source: Company Reports

Open FX Position of the non-corporate sector

The open FX position of the non-corporate sector remains large at US$170bn

While Turkish banks have limited open FX positions, this is not the case for their clients. According to the CBT the open FX position of the non-financial corporate sector amounted to US$170bn as of end November 2013, up from US$148bn as end 2012 and US$123bn at end 2011. Thus potential asset quality issues from the banks' lending in FX is a concern following the substantial weakening of the TL.

Figure 55. Turkey – Net Short FX Position of the Non-financial Corporates (US$bn)

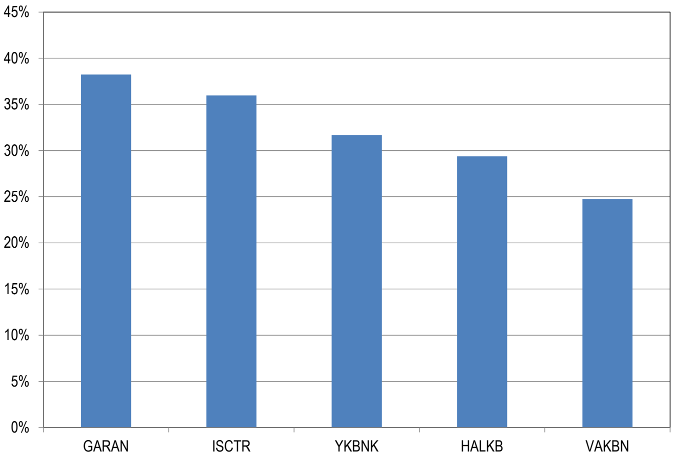


Source: CBT

Garanti and Isbank have the most exposure to FX loans, but Isbank and Halkbank have grown FX loan books fastest in recent years

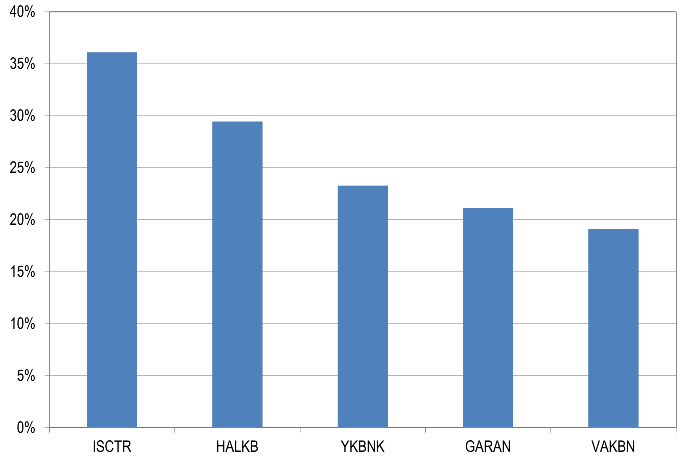
FX loans made up 32% of loans at the large listed Turkish banks with Garanti and Isbank the most exposed and Vakifbank and Halkbank the least exposed. However, over the past four years the bank's that have expanded their FX loan books most are Isbank and Halkbank.

Figure 56. Turkish Large Listed Banks – FX Loans % of Total, 31 Dec 2013



Source: Company reports

Figure 57. Turkish Large Listed Banks – FX Loan Growth CAGR*, 2009-13



Note: * - In TL terms.
Source: Company reports

The banks are less concerned with asset quality risk emanating from a weaker TL following the CBT's extraordinary rate hikes

The banks maintain that they only lend to corporates that have FX revenue, e.g. exporters and the tourism sector, and that they are not particularly concerned with that the recent weakening of the currency will lead to a major bad debts problem. And now that the currency seems to have stabilized somewhat, the banks seem more comfortable with that they will not see major issues with FX loans extended. Turkish bank and their customers have seen substantial currency volatility over time and so we are reasonably comfortable that the recent exchange rate moves will not lead to a major asset quality problem.

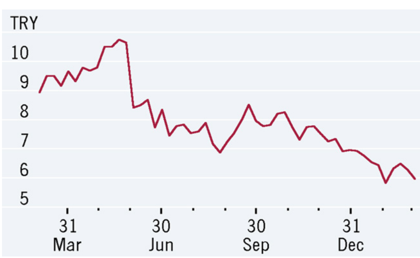
Company Focus

Garanti Bank (GARAN.IS)

Facing stiffer margin headwinds than competition

Buy	**1**
Price (04 Mar 14)	TL6.12
Target price	TL7.43
Expected share price return	21.4%
Expected dividend yield	2.8%
Expected total return	**24.2%**
Market Cap	TL25,704M
	US$11,516M

Price Performance
(RIC: GARAN.IS, BB: GARAN TI)



- **Earnings Cut In February** — On February 10th we cut our earnings forecasts for Garanti by 28% this year, 2% next year and by 3% in 2016 to reflect the recent extraordinary rate hikes and the more uncertain growth outlook for Turkey.
- **Target Price Cut in February** — On February 10th as a result of the downgrade we also cut our target price to its current level of TL 7.43 from TL 9.15 previously.
- **Duration Mismatch Weighs on Margin** — Garanti stands out for having one of the longest duration mismatches of the large listed Turkish banks of c 12 months, well above the average of c 8 months. This means that the bank will see more margin pressure medium term. This is reflected in downbeat management guidance for c 95-100bp of NIM compression this year, the highest of the large listed banks. While we forecast lower NIM compression of 82bp this year, we note that we use a different methodology for calculating NIM than management and our margin forecast, we believe, is largely in line with management's target range.
- **Loan Growth** — We forecast loan growth of 15% this year (down from 29% in 2013) which is in line with management guidance. We note management is of the view that a pick up in external demand driven by the weaker TL is likely to stave off a pronounced slowdown in the economy.
- **Solid Risk Management Track Record** — Garanti has a strong track record of managing credit risk through the cycle. We thus don't expect any deterioration in gross cost of risk for the bank, in fact as they decided to report the positive impact of general provision releases on SME and export loans in 2014 instead of in 4Q13 we actually expect a small decline in gross cost of risk this year to 128bp and then an increase next year to 140bp (vs. 147bp in 2013).
- **Remains a Buy** — Our valuation work suggests sufficient upside to warrant a Buy but we stress that the valuation is highly sensitive to the cost of equity, which is closely linked to the risk free rate. We currently value Garanti using a cost of equity of 16% based off the assumption that the risk free rate remains at 10%. We note the risk free rate peaked at 10.7% in January but was as low as 6% in May last year. A 50bp lower/higher COE would result in target prices 7% higher/6% lower than our current target price.

Garanti Bank (TRY)

Year to 31 Dec	2012A	2013A	2014E	2015E	2016E
Net Income (TLM)	3,334.1	3,381.1	2,870.0	4,416.3	5,340.6
Diluted EPS (TL)	0.79	0.81	0.68	1.05	1.27
Diluted EPS (Old) (TL)	0.79	0.81	0.68	1.05	1.27
PE (x)	7.7	7.6	9.0	5.8	4.8
P/BV (x)	1.2	1.1	1.0	0.9	0.8
DPS (TL)	0.14	0.14	0.17	0.21	0.26
Net Div Yield (%)	2.3	2.3	2.7	3.5	4.3
ROE (%)	15.8	13.7	10.6	15.3	16.4

Figure 58. Garanti – BRSA Unconsolidated Income Statement (TLm)

	2011	2012	2013	2014E	2015E	2016E
I. Interest Income	**10,484**	**12,670**	**12,741**	**15,636**	**19,802**	**22,921**
on TL Loans	4,893	6,496	6,826	8,553	11,254	13,280
on FX Loans	1,700	1,945	2,245	2,769	3,306	3,697
on Securities	3,542	3,880	3,408	3,897	4,728	5,343
on Liquid Assets & Others	348	349	262	416	515	601
II. Interest Expense	**(5,795)**	**(6,952)**	**(6,386)**	**(9,819)**	**(11,447)**	**(13,201)**
on TL Deposits	(3,110)	(4,097)	(3,699)	(5,772)	(6,637)	(7,633)
on FX Deposits	(846)	(850)	(770)	(956)	(1,273)	(1,531)
on Borrowed Funds	(931)	(892)	(862)	(1,591)	(1,870)	(2,242)
on Others	(907)	(1,113)	(1,055)	(1,500)	(1,667)	(1,795)
III. Net Interest Income	**4,689**	**5,719**	**6,356**	**5,817**	**8,355**	**9,719**
Fee & commission income, net	2,008	2,008	2,615	2,955	3,340	3,774
Trading income, net	332	614	297	230	236	243
Other banking income, net	903	299	457	411	432	453
IV. Total Banking Income	**7,931**	**8,640**	**9,725**	**9,414**	**12,363**	**14,189**
Personnel expenses	(1,248)	(1,501)	(1,666)	(1,883)	(2,128)	(2,405)
Other operating costs	(1,958)	(2,040)	(2,540)	(2,692)	(3,015)	(3,377)
V. Total Operating Costs	**(3,206)**	**(3,541)**	**(4,206)**	**(4,575)**	**(5,143)**	**(5,781)**
VI. Operating Income	**4,725**	**5,099**	**5,519**	**4,839**	**7,220**	**8,408**
Loan loss provisions	(309)	(764)	(853)	(1,016)	(1,246)	(1,357)
Other provisions	(514)	(414)	(771)	(605)	(809)	(747)
VII. Operating Income After Provisions	**3,903**	**3,921**	**3,895**	**3,217**	**5,165**	**6,304**
Income from associates	6	2	56	11	12	12
VIII. Pre-tax income	**3,908**	**3,923**	**3,951**	**3,228**	**5,176**	**6,317**
Tax	(838)	(853)	(946)	(726)	(1,165)	(1,421)
IX. Net Income, unconsolidated	**3,071**	**3,070**	**3,006**	**2,502**	**4,012**	**4,895**
X. Net Income, consolidated	***3,326***	***3,334***	***3,381***	***2,870***	***4,416***	***5,341***

Source: Company Reports and Citi Research Estimates

Figure 59. Garanti – BRSA Unconsolidated Balance Sheet (TLm)

TL in Millions	2011	2012	2013	2014E	2015E	2016E
Cash and Banks	15,372	8,994	11,373	11,817	14,463	17,575
Money Market	0	0	191	0	0	0
Securities Portoflio	32,664	38,423	37,416	42,280	47,777	53,988
Trading Securities	1,657	1,183	1,802	2,036	2,300	2,600
Available for Sale	26,221	35,875	21,630	24,442	27,619	31,210
Held Until Maturity	4,787	1,364	13,984	15,802	17,857	20,178
Loans, net	82,318	91,422	118,189	135,918	157,265	181,912
TL Loans	48,440	57,227	72,993	83,942	99,052	116,881
FX Loans	33,878	34,195	45,196	51,976	58,213	65,031
NPLS, net	280	403	482	723	976	1,132
Gross NPLs	1,532	2,114	2,538	3,808	5,140	5,963
Provisions for NPLs	(1,252)	(1,711)	(2,056)	(3,085)	(4,164)	(4,831)
Reserve deposits	7,185	14,865	20,906	23,877	27,316	30,975
Accrued Interest	3,843	0	0	0	0	0
Financial subsidiaries	2,083	2,502	3,108	3,419	3,658	3,841
Non-financial subsidiaries	106	108	108	113	119	125
Fixed assets	1,244	1,129	1,361	1,389	1,416	1,445
Other assets	1,549	2,348	3,763	3,838	3,915	3,993
Total Assets	**146,642**	**160,192**	**196,896**	**223,373**	**256,904**	**294,985**
Total Deposits	84,152	87,482	106,474	122,445	140,811	161,933
TL Deposits	47,470	49,999	59,656	68,604	78,895	90,729
FX Deposits	36,682	37,484	46,818	53,841	61,917	71,204
Interbank money market	10,955	13,500	14,584	16,043	17,647	19,412
Funds borrowed	20,524	21,678	29,478	33,860	40,631	48,758
Bonds issued	3,704	5,862	10,380	10,725	11,150	11,629
Other funds	0	0	0	0	0	0
Payables	6,162	7,442	9,936	11,923	14,278	16,324
Accrued Interest Payables	391	0	0	0	0	0
Provisions	2,097	2,803	3,312	3,751	4,372	4,901
Subordinated Loans	1,081	117	147	147	149	151
Total Liabilities	**129,066**	**138,883**	**174,311**	**198,893**	**229,039**	**263,108**
Book Value, unconsolidated	**17,577**	**21,309**	**22,585**	**24,480**	**27,865**	**31,877**
Book Value, consolidated	***17,787***	***21,516***	***23,016***	***24,775***	***28,188***	***32,233***
Total Liabilities and Equity	**146,642**	**160,192**	**196,896**	**223,373**	**256,904**	**294,985**

Source: Company Reports and Citi Research Estimates

Figure 60. Garanti – Key Ratios

	2011	2012	2013	2014E	2015E	2016E
Revenue Related						
Net Interest Margin (on AIEA)	3.7%	3.9%	3.7%	2.9%	3.6%	3.6%
Banking Income Breakdown						
a. Net Interest Income	59.1%	66.2%	65.4%	61.8%	67.6%	68.5%
b. Fee income	25.3%	23.2%	26.9%	31.4%	27.0%	26.6%
c. Trading income	4.2%	7.1%	3.1%	2.4%	1.9%	1.7%
d. Other income	11.4%	3.5%	4.7%	4.4%	3.5%	3.2%
Cost Ratios						
Cost-income	-40.4%	-41.0%	-43.3%	-48.6%	-41.6%	-40.7%
Cost-to-average assets	-2.4%	-2.3%	-2.4%	-2.2%	-2.1%	-2.1%
Return Ratios						
ROE, bank only	18.0%	15.8%	13.7%	10.6%	15.3%	16.4%
ROA, bank only	2.3%	2.0%	1.7%	1.2%	1.7%	1.8%
ROE, consolidated	19.3%	17.0%	15.2%	12.0%	16.7%	17.7%
ROA, consolidated	2.2%	1.9%	1.7%	1.2%	1.6%	1.7%
Balance Sheet Ratios						
Loans-to-assets	56.1%	57.1%	60.0%	60.8%	61.2%	61.7%
Securities-to-assets	22.3%	24.0%	19.0%	18.9%	18.6%	18.3%
IEA-IBL	115.5%	119.9%	117.2%	117.2%	117.9%	118.1%
Loans-to-deposits	97.8%	104.5%	111.0%	111.0%	111.7%	112.3%
TL Loans-to-TL deposits	102.0%	114.5%	122.4%	122.4%	125.5%	128.8%
FX Loans-to-FX deposits	92.4%	91.2%	96.5%	96.5%	94.0%	91.3%
TL mix in Loans	58.8%	62.6%	61.8%	61.8%	63.0%	64.3%
TL mix in Deposits	56.4%	57.2%	56.0%	56.0%	56.0%	56.0%
Equity-to-assets	12.0%	13.3%	11.5%	11.0%	10.8%	10.8%
Asset Quality						
NPL%	1.8%	2.3%	2.1%	2.7%	3.2%	3.2%
Coverage of NPLs	81.7%	80.9%	81.0%	81.0%	81.0%	81.0%
LLP as % of Loans	0.42%	0.88%	0.81%	0.80%	0.85%	0.80%
Gross cost of risk	1.13%	1.36%	1.47%	1.28%	1.40%	1.24%
Other						
Payout ratio	20%	19%	23%	36%	27%	27%
Effective tax rate	21.4%	21.7%	23.9%	22.5%	22.5%	22.5%
Capital Adequacy Ratio	16.9%	18.2%	14.4%	13.4%	12.8%	12.3%
Tier-1 Ratio	15.0%	16.4%	13.2%	12.3%	11.9%	11.6%
Valuation / Per Share Data						
P/E (Consolidated)	7.5	7.5	7.4	8.7	5.7	4.7
P/BV (Consolidated)	1.41	1.17	1.09	1.01	0.89	0.78
EPS (TL) (Consolidated)	0.79	0.79	0.81	0.68	1.05	1.27
BVPS (TL) (Consolidated)	4.24	5.12	5.48	5.90	6.71	7.67
ROE (Consolidated)	19.3%	17.0%	15.2%	12.0%	16.7%	17.7%
DPS (TL)	0.14	0.14	0.14	0.17	0.21	0.26

Source: Company Reports and Citi Research Estimates

Figure 61. Garanti – Warranted Equity Valuation (TL)

Sustainable LT ROE, Consolidated	17.7%
Cost of Equity	16.0%
LT Growth Rate	8.0%
Implied Target P/TBV	1.21
Consolidated Equity, 2016E (TLm)	32,233
Total Value, 2016E	38,993
Total Value, 12M fwd	29,339
(+) Discounted Value of Future Dividends 2014E	900
(+) Discounted Value of Future Dividends 2015E	948
Target Valuation (TLm)	31,187
Target Valuation / Share (TL)	**7.43**
DPS	0.17
Current Price	5.97
Share Price Return (SPR)	**24.4%**
Dividend Yield	2.8%
Estimated Total Return (ETR)	**27.2%**

Source: Citi Research

Company Focus

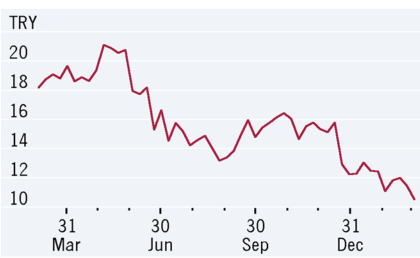
Halkbank (HALKB.IS)

Well positioned for tighter liquidity, remains a Buy

- Target Price Change
- Estimate Change

Buy	**1**
Price (04 Mar 14)	TL11.00
Target price	TL14.26
from TL18.25	
Expected share price return	29.6%
Expected dividend yield	3.6%
Expected total return	**33.3%**
Market Cap	TL13,750M
	US$6,160M

Price Performance
(RIC: HALKB.IS, BB: HALKB TI)



- **Lowering earnings and target price** — We lower our net income forecasts by 3% this year and 6% next year and by 8% in 2016 as we incorporate higher cost of funding in our model after the recent sharp rate hike by the CBT. We revise our target price to TL14.26 per share from TL18.25 per share previously due to lower earnings and higher cost of equity (to 16% from 15% previously).

- **NIM under pressure but less so than peers** — We lower our NIM estimate for 2014 by 54bps to 3.55% on the back of higher funding costs in a higher local interest rate environment with liabilities re-pricing faster than assets. We expect NIM to recover by 36bpst to 3.91% in 2015 as assets re-pricing catches up. Note that we believe Halkbank is better placed than peers with its low dependence on expensive repo funding, the lowest loan-to-deposit ratio, higher share of TL floating rate notes, the highest level of free funds, and lower level of asset-liability duration mismatch.

- **Growth and asset quality outlook cloudy but not doomed** — We expect 2014 loan growth of 12% (compared to 16-17% of management guidance) driven by a 13% TL loan growth and 10% FX loan growth (in TL terms). Although we have kept our TL loan growth assumption the same, we have increased our FX lending volume estimate by 18% on the back of weaker TL and more focus on commercial lending rather than retail lending. On the asset quality front, we incorporate total gross risk cost of 128bps compared to management guidance of 100-110bps. Therefore, we are more cautious than management on both loan growth and asset quality front although we do not expect Turkey to go into a recession (per Citi economists).

- **Upbeat guidance** — Management has given a relatively upbeat guidance with single-digit earnings growth, 30-40bps NIM contraction, 16-17% loan growth, c12% deposit growth , 10-12% fee growth , a flat NPL ratio, gross cost of risk at 100-110bps, and opex growth of 10%.

- **Best positioned for tighter liquidity, remains a Buy** — We maintain our Buy rating on the shares as our revised TP offers an upside of 33% (cum-dividend 36%). We also believe that Halkbank is best positioned in this tighter liquidity environment with its peer leading level of liquidity, one of lowest level of asset-liability duration mismatch and relatively higher share of floating rate securities (second after Garanti).

Halkbank (TRY)

Year to 31 Dec	2012A	2013A	2014E	2015E	2016E
Net Income (TLM)	2,642.3	2,805.0	2,091.8	2,653.2	3,169.5
Diluted EPS (TL)	2.11	2.24	1.67	2.12	2.54
Diluted EPS (Old) (TL)	2.11	2.18	1.73	2.26	2.75
PE (x)	5.2	4.9	6.6	5.2	4.3
P/BV (x)	1.1	1.0	0.9	0.8	0.7
DPS (TL)	0.25	0.37	0.40	0.44	0.56
Net Div Yield (%)	2.2	3.4	3.6	4.0	5.1
ROE (%)	24.8	20.8	13.6	15.3	16.1

Figure 62. Halkbank – BRSA Unconsolidated Income Statement (TLm)

TL in Millions	2011	2012	2013	2014E	2015E	2016E
I. Interest Income	**7,279**	**8,991**	**9,205**	**12,961**	**15,242**	**17,223**
on TL Loans	4,426	5,719	5,964	8,128	9,850	11,328
on FX Loans	820	1,011	1,170	1,510	1,734	2,007
on Securities	2,019	2,239	2,053	3,089	3,398	3,603
on Liquid Assets & Others	14	22	17	235	260	285
II. Interest Expense	**(3,805)**	**(4,515)**	**(4,376)**	**(7,878)**	**(8,995)**	**(10,186)**
on TL Deposits	(2,769)	(3,589)	(3,302)	(6,082)	(6,908)	(7,944)
on FX Deposits	(403)	(495)	(537)	(740)	(891)	(1,079)
on Borrowed Funds	(127)	(149)	(222)	(383)	(511)	(511)
on Others	(507)	(281)	(315)	(673)	(685)	(651)
III. Net Interest Income	**3,473**	**4,476**	**4,829**	**5,084**	**6,247**	**7,037**
Fee & commission income, net	728	858	930	1,042	1,167	1,307
Trading income, net	208	555	244	(58)	56	70
Other banking income, net	594	360	768	537	564	592
IV. Total Banking Income	**5,003**	**6,249**	**6,771**	**6,605**	**8,034**	**9,006**
Personnel expenses	(732)	(843)	(1,084)	(1,246)	(1,408)	(1,577)
Other operating costs	(993)	(1,255)	(1,571)	(1,775)	(2,006)	(2,267)
V. Total Operating Costs	**(1,725)**	**(2,098)**	**(2,655)**	**(3,022)**	**(3,415)**	**(3,844)**
VI. Operating Income	**3,278**	**4,152**	**4,116**	**3,583**	**4,619**	**5,162**
Loan loss provisions	(211)	(383)	(436)	(716)	(1,013)	(867)
Other provisions	(479)	(504)	(413)	(429)	(479)	(536)
VII. Operating Income After Provisions	**2,588**	**3,265**	**3,267**	**2,438**	**3,127**	**3,759**
Income from associates	49	64	97	102	107	113
VIII. Pre-tax income	**2,637**	**3,329**	**3,365**	**2,540**	**3,234**	**3,872**
Tax	(592)	(734)	(614)	(508)	(647)	(774)
IX. Net Income	**2,045**	**2,595**	**2,751**	**2,032**	**2,588**	**3,097**
X. Net Income, consolidated	***2,027***	***2,642***	***2,805***	***2,092***	***2,653***	***3,169***

Source: Company Reports and Citi Research Estimates

Figure 63. Halkbank – BRSA Unconsolidated Balance Sheet (TLm)

TL in Millions	2011	2012	2013	2014E	2015E	2016E
Cash and Banks	1,957	3,305	2,644	3,094	3,208	3,528
Money Market	0	12	0	0	0	0
Securities Portoflio	22,489	22,954	28,559	31,415	33,306	35,317
Trading Securities	128	105	164	180	194	210
Available for Sale	8,363	9,394	9,541	10,495	11,334	12,241
Held Until Maturity	13,998	13,456	18,855	20,740	21,777	22,866
Loans, net	55,236	65,551	84,413	94,644	108,022	123,309
TL Loans	37,761	47,729	59,625	67,376	77,483	89,105
FX Loans	17,475	17,822	24,788	27,267	30,539	34,204
NPLS, net	267	343	435	565	735	845
Gross NPLs	1,669	1,960	2,245	2,919	3,794	4,363
Provisions for NPLs	(1,402)	(1,617)	(1,810)	(2,353)	(3,059)	(3,518)
Reserve deposits	6,791	11,802	19,180	21,098	23,208	25,529
Accrued Interest	1,570	0	0	0	0	0
Financial subsidiaries	926	1,880	2,390	2,509	2,635	2,767
Non-financial subsidiaries	1	7	37	39	41	43
Fixed assets	1,011	1,123	1,068	1,089	1,111	1,133
Other assets	875	1,304	1,217	1,242	1,266	1,292
Total Assets	**91,124**	**108,282**	**139,944**	**155,694**	**173,531**	**193,762**
Total Deposits	65,983	79,974	100,756	111,425	126,603	143,888
TL Deposits	44,019	54,151	65,202	73,026	83,980	96,577
FX Deposits	21,964	25,823	35,554	38,399	42,623	47,311
Interbank money market	4,905	381	771	507	580	658
Funds borrowed	6,291	7,303	13,615	17,019	17,019	17,019
Bonds issued	496	2,038	4,165	4,165	4,373	4,592
Other funds	1,345	1,408	1,489	1,141	653	0
Payables	1,764	2,525	2,912	3,203	3,524	3,876
Accrued Interest Payables	264	0	0	0	0	0
Provisions	1,436	2,329	2,090	2,414	2,772	3,169
Subordinated Loans	0	0	0	0	0	0
Total Liabilities	**82,484**	**95,959**	**125,798**	**139,873**	**155,524**	**173,202**
Book Value	**8,640**	**12,323**	**14,146**	**15,821**	**18,007**	**20,561**
Book Value, consolidated	***8,554***	***11,495***	***13,596***	***15,330***	***17,583***	***20,208***
Total Liabilities and Equity	**91,124**	**108,282**	**139,944**	**155,694**	**173,531**	**193,762**

Source: Company Reports and Citi Research Estimates

Figure 64. Halkbank – Key Ratios

	2011	2012	2013	2014E	2015E	2016E
Revenue Related						
Net Interest Margin (on AIEA)	4.5%	4.7%	4.0%	3.6%	3.9%	3.9%
Banking Income Breakdown						
a. Net Interest Income	69.4%	71.6%	71.3%	77.0%	77.8%	78.1%
b. Fee income	14.6%	13.7%	13.7%	15.8%	14.5%	14.5%
c. Trading income	4.1%	8.9%	3.6%	-0.9%	0.7%	0.8%
d. Other income	11.9%	5.8%	11.3%	8.1%	7.0%	6.6%
Cost Ratios						
Cost-income	-34.5%	-33.6%	-39.2%	-45.8%	-42.5%	-42.7%
Cost-to-average assets	-2.1%	-2.1%	-2.1%	-2.0%	-2.1%	-2.1%
Return Ratios						
ROE, bank only	25.4%	24.8%	20.8%	13.6%	15.3%	16.1%
ROA, bank only	2.5%	2.6%	2.2%	1.4%	1.6%	1.7%
ROE, consolidated	25.5%	26.4%	22.4%	14.5%	16.1%	16.8%
ROA, consolidated	2.5%	2.6%	2.3%	1.4%	1.6%	1.7%
Balance Sheet Ratios						
Loans-to-assets	60.6%	60.5%	60.3%	60.8%	62.2%	63.6%
Securities-to-assets	24.7%	21.2%	20.4%	20.2%	19.2%	18.2%
IEA-IBL	109.8%	114.1%	112.0%	112.3%	112.9%	113.5%
Loans-to-deposits	83.7%	82.0%	83.8%	84.9%	85.3%	85.7%
TL Loans-to-TL deposits	85.8%	88.1%	91.4%	92.3%	92.3%	92.3%
FX Loans-to-FX deposits	79.6%	69.0%	69.7%	71.0%	71.7%	72.3%
TL mix in Loans	68.4%	72.8%	70.6%	71.2%	71.7%	72.3%
TL mix in Deposits	66.7%	67.7%	64.7%	65.5%	66.3%	67.1%
Equity-to-assets	9.5%	11.4%	10.1%	10.2%	10.4%	10.6%
Asset Quality						
NPL%	2.9%	2.9%	2.6%	3.0%	3.4%	3.4%
Coverage of NPLs	84.0%	82.5%	80.6%	80.6%	80.6%	80.6%
LLP as % of Loans	0.43%	0.63%	0.58%	0.80%	1.00%	0.75%
Gross cost of risk	1.40%	1.47%	1.13%	1.28%	1.47%	1.21%
Other						
Payout ratio	15%	18%	18%	27%	27%	26%
Effective tax rate	22.4%	22.0%	18.2%	20.0%	20.0%	20.0%
Capital Adequacy Ratio	14.3%	16.2%	13.9%	13.5%	13.1%	12.8%
Tier-1 Ratio	13.8%	14.3%	12.7%	12.2%	11.9%	11.6%
Valuation / Per Share Data						
P/E (Consolidated)	6.5	5.0	4.7	6.3	5.0	4.2
P/BV (Consolidated)	1.5	1.1	1.0	0.9	0.8	0.7
EPS (TL) (Consolidated)	1.62	2.11	2.24	1.67	2.12	2.54
BVPS (TL) (Consolidated)	6.84	9.20	10.88	12.26	14.07	16.17
ROE (Consolidated)	25.5%	26.4%	22.4%	14.5%	16.1%	16.8%
DPS (TL)	0.32	0.25	0.37	0.40	0.44	0.56

Source: Company Reports and Citi Research Estimates

Figure 65. Halkbank – Warranted Equity Valuation

Sustainable LT ROE, Group	16.8%
Cost of Equity	16.0%
LT Growth Rate	8.0%
Implied Target P/TBV	1.1
Consolidated Equity, 2016E (TLm)	20,208
Total Value, 2016E	22,163
Total Value, 12M fwd	16,676
(+) Discounted Value of Future Dividends 2014E	550
(+) Discounted Value of Future Dividends 2015E	603
Target Valuation (TLm)	17,829
Target Valuation / Share (TL)	**14.26**
DPS	0.40
Current Price	10.55
Share Price Return (SPR)	**35.2%**
Dividend Yield	3.8%
Estimated Total Return (ETR)	**39.0%**

Source: Citi Research

Company Focus

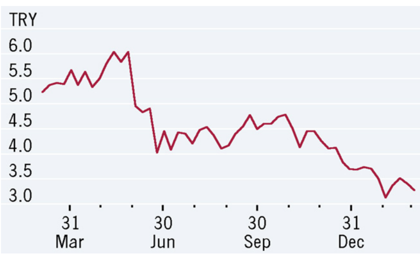
Yapi Kredi Bank (YKBNK.IS)

A buy on valuation grounds, but historical track record in credit risk management a concern in the current environment

- Target Price Change
- Estimate Change

Buy	**1**
Price (04 Mar 14)	TL3.36
Target price	TL4.05
from TL4.85	
Expected share price return	20.5%
Expected dividend yield	2.1%
Expected total return	**22.6%**
Market Cap	TL14,606M
	US$6,544M

Price Performance
(RIC: YKBNK.IS, BB: YKBNK TI)



- **Earnings Downgrade** — We cut our BRSA unconsolidated earnings forecasts for Yapi Kredi by 35% this year and 4% next to reflect the impact of the extraordinary CBT rate hikes and the more uncertain growth outlook for Turkey.
- **Target Price Cut** — The earnings downgrade and the use of a higher cost of equity (16% from 15% previously) leads us to downgrade our target price TL 4.05 from TL 4.85 previously.
- **Duration Mismatch** — Yapi Kredi's duration mismatch is in the middle to top of the pack of its large listed peers at c 8.5 months. We bring our NIM on AIEA down by 62bp this year, 3bp next year and 6bp in 2016 to reflect the new rate and growth environment. In terms of the metrics we look at to gauge resilience to periods of tighter liquidity we note that Yapi Kredi screens poorly on the ratio of free funds to interest bearing liabilities and in exposure to TL floating rate securities but well positioned in terms of its low reliance on TL repo funding and its low dependence on expensive TL deposits.
- **Guidance** — Management's guidance for the outlook in 2014 comprises: Base case GDP growth of 2.5%, CPI of 7.8%, loan growth of 14% (from 27% yoy in FY13), c.50bp lower NIM yoy, a 60bp increase in the NPL ratio and a 25bp increase in risk cost yoy, low double digit fee growth, and slightly above sector level costs (eg more than 9-10%).
- **Cost of Risk** — Yapi Kredi's somewhat poor track record of managing credit risk, as seen by the bank's higher gross cost of risk than peers over time, is a concern in the current environment. We factor in a 16bp increase in gross cost of risk this year to reflect this risk.
- **Buyers** — We rate Yapi Kredi a Buy largely on valuation grounds as at we consider the bank inexpensive at a 20% discount to this year's book value and a 2015E P/E of 5x.

Figure 66. Yapi Kredi – BRSA Unconsolidated Income Statement (TLm)

Yapi Kredi Bank (TRY)

Year to 31 Dec	2012A	2013A	2014E	2015E	2016E
Net Income (TLM)	2,087.7	3,659.0	1,671.1	2,873.5	3,474.5
Diluted EPS (TL)	0.48	0.84	0.38	0.66	0.80
Diluted EPS (Old) (TL)	0.48	0.53	0.54	0.66	0.76
PE (x)	7.0	4.0	8.7	5.1	4.2
P/BV (x)	0.9	0.8	0.8	0.7	0.6
DPS (TL)	0.00	0.07	0.07	0.09	0.12
Net Div Yield (%)	0.0	2.1	2.1	2.7	3.4
ROE (%)	13.4	18.7	8.2	13.4	14.4

TL in Millions	2011	2012	2013	2014E	2015E	2016E
I. Interest Income	**7,138**	**9,373**	**9,236**	**11,651**	**14,637**	**16,798**
on TL Loans	4,567	6,428	6,259	7,630	9,976	11,573
on FX Loans	1,038	1,161	1,299	1,665	1,990	2,290
on Securities	1,470	1,605	1,519	2,077	2,316	2,499
on Liquid Assets & Others	62	179	159	279	354	436
II. Interest Expense	**(3,845)**	**(4,881)**	**(4,571)**	**(6,855)**	**(8,019)**	**(9,277)**
on TL Deposits	(2,340)	(3,210)	(2,811)	(4,346)	(5,128)	(6,052)
on FX Deposits	(726)	(768)	(691)	(982)	(1,202)	(1,396)
on Borrowed Funds	(447)	(554)	(701)	(956)	(1,085)	(1,170)
on Others	(332)	(349)	(368)	(571)	(603)	(660)
III. Net Interest Income	**3,292**	**4,492**	**4,664**	**4,797**	**6,618**	**7,520**
Fee & commission income, net	1,827	1,761	2,006	2,287	2,607	2,972
Trading income, net	(255)	(39)	115	(50)	(60)	(71)
Other banking income, net	811	338	452	385	365	402
IV. Total Banking Income	**5,676**	**6,552**	**7,238**	**7,418**	**9,531**	**10,824**
Personnel expenses	(1,138)	(1,236)	(1,330)	(1,530)	(1,729)	(1,936)
Other operating costs	(1,552)	(1,756)	(2,009)	(2,250)	(2,520)	(2,772)
V. Total Operating Costs	**(2,690)**	**(2,993)**	**(3,339)**	**(3,780)**	**(4,248)**	**(4,708)**
VI. Operating Income	**2,985**	**3,559**	**3,899**	**3,639**	**5,283**	**6,116**
Loan loss provisions	(456)	(788)	(1,097)	(1,318)	(1,392)	(1,602)
Other provisions	(303)	(506)	(378)	(605)	(685)	(584)
VII. Operating Income After Provisions	**2,227**	**2,266**	**2,424**	**1,716**	**3,205**	**3,930**
Income from associates	128	183	133	139	146	154
Extraordinary items	0	0	1,172*	0	0	0
VIII. Pre-tax income	**2,355**	**2,449**	**3,729**	**1,856**	**3,352**	**4,084**
Tax	(498)	(536)	(526)	(390)	(704)	(858)
IX. Net Income	**1,857**	**1,913**	**3,203**	**1,466**	**2,648**	**3,226**
X. Net Income, consolidated	***2,285***	***2,088***	***3,659***	***1,671***	***2,873***	***3,475***

Note: * - Gain from sale of insurance business.
Source: Company Reports and Citi Research Estimates

Figure 67. Yapi Kredi – BRSA Unconsolidated Balance Sheet (TLm)

TL in Millions	2011	2012	2013	2014E	2015E	2016E
Cash and Banks	2,827	4,236	4,751	5,946	6,798	7,093
Money Market	2,138	2,730	2,900	2,958	3,017	3,077
Securities Portoflio	19,572	21,388	21,231	22,497	23,824	26,157
Trading Securities	448	840	1,665	1,749	1,836	1,928
Available for Sale	7,056	14,861	13,112	13,905	14,735	16,237
Held Until Maturity	12,068	5,686	6,454	6,844	7,253	7,992
Loans, net	65,837	74,795	94,891	107,875	124,116	142,823
TL Loans	43,190	54,024	64,825	73,900	85,724	99,440
FX Loans	22,647	20,770	30,067	33,975	38,392	43,383
NPLS, net	735	975	1,147	1,549	2,014	2,316
Gross NPLs	2,080	2,526	3,558	4,803	6,244	7,180
Provisions for NPLs	(1,345)	(1,551)	(2,410)	(3,254)	(4,230)	(4,864)
Reserve deposits	8,721	9,561	17,028	19,582	22,520	25,898
Accrued Interest	1,677	0	0	0	0	0
Financial subsidiaries	1,847	3,861	2,407	2,527	2,654	2,786
Non-financial subsidiaries	2	7	7	7	8	8
Fixed assets	1,009	985	934	953	972	992
Other assets	3,737	3,642	3,585	3,657	3,730	3,804
Total Assets	**108,103**	**122,180**	**148,881**	**167,552**	**189,651**	**214,954**
Total Deposits	63,248	68,044	86,308	99,525	114,604	131,582
TL Deposits	34,831	41,441	44,303	52,278	61,688	72,792
FX Deposits	28,417	26,603	42,004	47,247	52,916	58,791
Interbank money market	5,918	4,730	3,393	3,054	2,901	3,191
Funds borrowed	13,723	12,420	16,428	18,399	20,239	22,263
Bonds issued	1,096	2,326	5,847	6,431	7,075	7,782
Other funds	0	0	0	0	0	0
Payables	6,961	9,294	9,956	11,449	13,166	15,111
Accrued Interest Payables	269	0	0	0	0	0
Provisions	2,664	3,307	3,161	3,607	4,112	4,491
Subordinated Loans	2,524	5,196	6,481	6,473	6,546	6,646
Total Liabilities	**96,403**	**105,318**	**131,572**	**148,938**	**168,644**	**191,067**
Book Value	**11,700**	**16,862**	**17,309**	**18,614**	**21,008**	**23,886**
Book Value, consolidated	***12,568***	***15,975***	***18,283***	***19,793***	***22,413***	***25,540***
Total Liabilities and Equity	**108,103**	**122,180**	**148,881**	**167,552**	**189,651**	**214,954**

Source: Company Reports and Citi Research Estimates

Figure 68. Yapi Kredi – Key Ratios

	2011	2012	2013	2014E	2015E	2016E
Revenue Related						
Net Interest Margin (on AIEA)	3.7%	4.2%	3.6%	3.2%	3.9%	3.9%
Banking Income Breakdown						
a. Net Interest Income	58.0%	68.6%	64.4%	64.7%	69.4%	69.5%
b. Fee income	32.2%	26.9%	27.7%	30.8%	27.4%	27.5%
c. Trading income	-4.5%	-0.6%	1.6%	-0.7%	-0.6%	-0.7%
d. Other income	14.3%	5.2%	6.2%	5.2%	3.8%	3.7%
Cost Ratios						
Cost-income	-47.4%	-45.7%	-46.1%	-50.9%	-44.6%	-43.5%
Cost-to-average assets	-2.8%	-2.6%	-2.5%	-2.4%	-2.4%	-2.3%
Return Ratios						
ROE, bank only	16.9%	13.4%	18.7%	8.2%	13.4%	14.4%
ROA, bank only	1.9%	1.7%	2.4%	0.9%	1.5%	1.6%
ROE, consolidated	19.7%	14.6%	21.4%	8.8%	13.6%	14.5%
ROA, consolidated	2.2%	1.7%	2.5%	1.0%	1.5%	1.6%
Balance Sheet Ratios						
Loans-to-assets	60.9%	61.2%	63.7%	64.4%	65.4%	66.4%
Securities-to-assets	18.1%	17.5%	14.3%	13.4%	12.6%	12.2%
IEA-IBL	115.4%	122.6%	119.8%	119.8%	120.4%	120.9%
Loans-to-deposits	104.1%	109.9%	109.9%	108.4%	108.3%	108.5%
TL Loans-to-TL deposits	124.0%	130.4%	146.3%	141.4%	139.0%	136.6%
FX Loans-to-FX deposits	79.7%	78.1%	71.6%	71.9%	72.6%	73.8%
TL mix in Loans	65.6%	72.2%	68.3%	68.5%	69.1%	69.6%
TL mix in Deposits	55.1%	60.9%	51.3%	52.5%	53.8%	55.3%
Equity-to-assets	10.8%	13.8%	11.6%	11.1%	11.1%	11.1%
Asset Quality						
NPL%	3.1%	3.3%	3.6%	4.3%	4.8%	4.8%
Coverage of NPLs	64.7%	61.4%	67.7%	67.7%	67.7%	67.7%
LLP as % of Loans	0.78%	1.12%	1.29%	1.30%	1.20%	1.20%
Gross cost of risk	1.29%	1.84%	1.74%	1.90%	1.79%	1.64%
Other						
Payout ratio	0%	16%	9%	27%	19%	22%
Effective tax rate	21.1%	21.9%	14.1%	21.0%	21.0%	21.0%
Capital Adequacy Ratio	14.7%	16.3%	16.0%	14.6%	13.9%	13.2%
Tier-1 Ratio	11.2%	10.8%	11.3%	10.6%	10.4%	10.2%
Valuation / Per Share Data						
P/E (Cons)	6.2	6.8	3.9	8.5	5.0	4.1
P/BV (Cons)	1.1	0.9	0.8	0.7	0.6	0.6
EPS (TL) (Cons)	0.53	0.48	0.84	0.38	0.66	0.80
BVPS (TL) (Cons)	2.89	3.67	4.21	4.55	5.16	5.88
ROE (Cons)	19.7%	14.6%	21.4%	8.8%	13.6%	14.5%
DPS (TL)	0.00	0.00	0.07	0.07	0.09	0.12

Source: Company Reports and Citi Research Estimates

Figure 69. Yapi Kredi – Warranted Equity Valuation

Sustainable LT ROTE, Group	15.4%
Cost of Equity	16.0%
LT Growth Rate	8.0%
Implied Target P/TBV	0.92
Consolidated Equity, 2016E (TLm)	24,146
Adjustments	0
Adjusted Consolidated Equity	24,146
Total Value, 2016E	22,292
Total Value, 12M fwd	16,773
(+) Discounted Value of Future Dividends 2014E	400
(+) Discounted Value of Future Dividends 2015E	431
Target Valuation (TLm)	17,604
Target Valuation / Share (TL)	**4.05**
DPS	0.07
Current Price	3.28
Share Price Return (SPR)	**23.5%**
Dividend Yield	2.1%
Estimated Total Return (ETR)	**25.6%**

Source: Citi Research

Company Focus

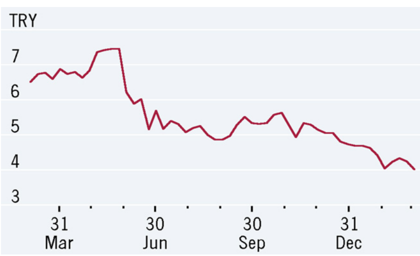
Isbank (ISCTR.IS)

NIM pressure at the top of management's guidance range

- Target Price Change
- Estimate Change

Buy	**1**
Price (04 Mar 14)	TL4.14
Target price	TL4.92
from TL6.10	
Expected share price return	18.8%
Expected dividend yield	3.8%
Expected total return	**22.6%**
Market Cap	TL18,630M
	US$8,346M

Price Performance
(RIC: ISCTR.IS, BB: ISCTR TI)



- **Earnings Downgrade** — We cut our BRSA unconsolidated earnings forecasts for Isbank by 35% this year and 4% next to reflect the impact of the extraordinary CBT rate hikes and the more uncertain growth outlook for Turkey.

- **Target Price Cut** — The earnings downgrade and the use of a higher cost of equity (16% from 15% previously) leads us to downgrade our target price TL 4.92 from TL 6.10 previously.

- **Duration Mismatch** — Isbank's duration mismatch is in the middle of the pack of the large listed bank at c 8 months. We bring our NIM on AIEA down by 65bp this year, 31bp next year and 41bp in 2016 to reflect the new rate and growth environment. In terms of the metrics we look at to gauge resilience to periods of tighter liquidity we note that Isbank screens poorly in terms of its reliance on TL repo funding (c 10% of interest bearing liabilities as of end 2013) and on loan-to-deposit ratio (111.5% as of end 2013).

- **Guidance** — Management's guidance for the outlook in 2014 comprises: Base case GDP growth of 2.5%-3%, CPI of 8-8.5%, loan growth of 14-16%, deposit growth of 12-14%, a +20-30bp increase in the NPL ratio, a 19-69bp decline in NIM, c15% growth in fees, gross cost of risk of 110-110bp, and OPEX growth (ex 4Q one off costs) of CPI +4%. We are largely in line with management guidance but have incorporated NIM pressure this year at the top end of their guidance range.

- **Valuation** — We value Isbank in two ways: (1) First we value the bank using a SOP approach where we value the core banks (excluding participations) and we add the estimated value of participations using a NAV based approach. (2) We also value the bank using a more basic warranted equity valuation based on the Group's consolidated sustainable ROE. The first method suggests substantial upside while the second, which arguably doesn't fully capture the value of Isbank's substantial non-financial investments, does not. We set our target price at the simple average of these two methods.

- **Buyers** — We rate Isbank a Buy largely on valuation grounds as at we consider the bank inexpensive at a 25% discount to this year's book value and a 2015E P/E of 5x.

Isbank (TRY)

Year to 31 Dec	2012A	2013A	2014E	2015E	2016E
Net Income (TLM)	3,412.0	3,235.9	2,730.5	3,557.9	4,125.3
Diluted EPS (TL)	0.76	0.72	0.61	0.79	0.92
Diluted EPS (Old) (TL)	0.76	0.78	0.75	0.82	0.95
PE (x)	5.5	5.8	6.8	5.2	4.5
P/BV (x)	0.8	0.8	0.7	0.6	0.6
DPS (TL)	0.12	0.15	0.16	0.18	0.20
Net Div Yield (%)	2.9	3.6	3.8	4.3	4.8
ROE (%)	16.3	13.7	10.7	12.6	13.0

Figure 70. Isbank – BRSA Unconsolidated Income Statement (Tlm)

TL in Millions	2011	2012	2013	2014E	2015E	2016E
I. Interest Income	**10,898**	**13,390**	**13,461**	**17,418**	**20,744**	**23,543**
on TL Loans	5,928	7,979	8,284	10,675	13,344	15,345
on FX Loans	1,206	1,706	2,095	2,589	2,986	3,406
on Securities	3,722	3,650	3,031	3,875	4,087	4,420
on Liquid Assets & Others	43	55	50	279	327	372
II. Interest Expense	**(6,337)**	**(7,462)**	**(6,805)**	**(10,876)**	**(12,459)**	**(14,241)**
on TL Deposits	(4,155)	(4,480)	(3,990)	(6,285)	(7,265)	(8,396)
on FX Deposits	(822)	(989)	(864)	(1,088)	(1,449)	(1,665)
on Borrowed Funds	(229)	(260)	(339)	(483)	(575)	(647)
on Others	(1,130)	(1,733)	(1,612)	(3,020)	(3,171)	(3,533)
III. Net Interest Income	**4,562**	**5,928**	**6,655**	**6,543**	**8,285**	**9,303**
Fee & commission income, net	1,429	1,706	1,919	2,169	2,450	2,794
Trading income, net	306	590	223	186	275	276
Other banking income, net	1,311	1,172	1,038	934	888	976
IV. Total Banking Income	**7,608**	**9,397**	**9,836**	**9,832**	**11,898**	**13,349**
Personnel expenses	(1,819)	(1,821)	(2,276)	(2,503)	(2,854)	(3,253)
Other operating costs	(1,662)	(2,663)	(2,687)	(2,606)	(2,919)	(3,269)
V. Total Operating Costs	**(3,481)**	**(4,484)**	**(4,963)**	**(5,109)**	**(5,773)**	**(6,522)**
VI. Operating Income	**4,126**	**4,912**	**4,873**	**4,722**	**6,125**	**6,826**
Loan loss provisions	(597)	(601)	(834)	(1,145)	(1,377)	(1,570)
Other provisions	(786)	(608)	(633)	(732)	(935)	(792)
VII. Operating Income After Provisions	**2,743**	**3,703**	**3,406**	**2,845**	**3,813**	**4,464**
Income from associates	556	418	450	473	520	572
VIII. Pre-tax income	**3,298**	**4,121**	**3,857**	**3,318**	**4,333**	**5,037**
Tax	(631)	(811)	(693)	(664)	(867)	(1,007)
IX. Net Income	**2,667**	**3,310**	**3,163**	**2,654**	**3,467**	**4,029**
X. Net Income, consolidated	***2,272***	***3,412***	***3,236***	***2,730***	***3,558***	***4,125***

Source: Company Reports and Citi Research Estimates

Figure 71. Isbank – BRSA Unconsolidated Balance Sheet (TLm)

TL in Millions	2011	2012	2013	2014E	2015E	2016E
Cash and Banks	3,471	3,191	3,747	6,346	6,391	7,979
Money Market	43	0	0	0	0	0
Securities Portoflio	41,228	38,673	38,179	37,797	40,054	44,137
Trading Securities	1,576	1,373	2,204	2,204	2,335	2,573
Available for Sale	26,186	26,347	28,348	28,348	30,041	33,102
Held Until Maturity	13,466	10,953	7,627	7,246	7,679	8,461
Loans, net	90,424	106,716	134,843	151,462	172,617	196,756
TL Loans	57,817	70,750	86,350	99,303	114,198	131,328
FX Loans	32,607	35,063	47,418	52,159	58,418	65,429
NPLS, net	0	426	438	613	846	972
Gross NPLs	1,984	2,025	2,238	3,133	4,323	4,972
Provisions for NPLs	(1,984)	(1,599)	(1,800)	(2,520)	(3,478)	(4,000)
Reserve deposits	12,505	14,199	20,808	23,929	27,317	30,898
Accrued Interest	3,678	0	0	0	0	0
Financial subsidiaries	2,455	3,505	3,780	3,969	4,287	4,629
Non-financial subsidiaries	3,820	4,195	3,981	4,180	4,514	4,875
Fixed assets	1,860	1,821	1,832	1,868	1,906	1,944
Other assets	2,184	2,717	2,893	2,951	3,010	3,070
Total Assets	**161,669**	**175,444**	**210,500**	**233,114**	**260,940**	**295,261**
Total Deposits	97,881	105,383	120,975	136,394	154,686	174,868
TL Deposits	59,972	64,990	66,440	76,406	88,699	102,118
FX Deposits	37,909	40,394	54,535	59,988	65,987	72,750
Interbank money market	19,461	13,519	20,916	21,962	23,060	28,338
Funds borrowed	11,148	10,748	15,922	16,718	18,390	20,229
Bonds issued	3,781	6,364	10,095	10,600	11,130	11,858
Other funds	0	0	0	0	0	0
Payables	6,462	8,984	9,867	12,020	14,383	16,492
Accrued Interest Payables	432	0	0	0	0	0
Provisions	4,582	5,922	6,161	6,585	7,191	7,623
Subordinated Loans	0	1,804	2,984	2,984	2,984	2,984
Total Liabilities	**143,747**	**152,725**	**186,921**	**207,264**	**231,825**	**262,392**
Book Value	**17,921**	**22,719**	**23,579**	**25,850**	**29,115**	**32,869**
Book Value, consolidated	***17,840***	***21,967***	***22,761***	***25,049***	***28,330***	***32,099***
Total Liabilities and Equity	**161,669**	**175,444**	**210,500**	**233,114**	**260,940**	**295,261**

Source: Company Reports and Citi Research Estimates

Figure 72. Isbank – Key Ratios

	2011	2012	2013	2014E	2015E	2016E
Revenue Related						
Net Interest Margin (on AIEA)	3.4%	3.8%	3.7%	3.1%	3.5%	3.5%
Banking Income Breakdown						
a. Net Interest Income	60.0%	63.1%	67.7%	66.5%	69.6%	69.7%
b. Fee income	18.8%	18.2%	19.5%	22.1%	20.6%	20.9%
c. Trading income	4.0%	6.3%	2.3%	1.9%	2.3%	2.1%
d. Other income	17.2%	12.5%	10.6%	9.5%	7.5%	7.3%
Cost Ratios						
Cost-income	-45.8%	-47.7%	-50.5%	-52.0%	-48.5%	-48.9%
Cost-to-average assets	-2.4%	-2.7%	-2.6%	-2.3%	-2.3%	-2.3%
Return Ratios						
ROE, bank only	15.3%	16.3%	13.7%	10.7%	12.6%	13.0%
ROA, bank only	1.8%	2.0%	1.6%	1.2%	1.4%	1.4%
ROE, consolidated	13.3%	17.1%	14.5%	11.4%	13.3%	13.7%
ROA, consolidated	1.4%	1.8%	1.5%	1.1%	1.3%	1.3%
Balance Sheet Ratios						
Loans-to-assets	55.9%	60.8%	64.1%	65.0%	66.2%	66.6%
Securities-to-assets	25.5%	22.0%	18.1%	16.2%	15.4%	14.9%
IEA-IBL	111.6%	120.0%	117.9%	118.6%	119.3%	119.3%
Loans-to-deposits	92.4%	101.3%	111.5%	111.0%	111.6%	112.5%
TL Loans-to-TL deposits	96.4%	108.9%	130.0%	130.0%	128.7%	128.6%
FX Loans-to-FX deposits	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
TL mix in Loans	63.9%	66.3%	64.0%	65.6%	66.2%	66.7%
TL mix in Deposits	61.3%	61.7%	54.9%	56.0%	57.3%	58.4%
Equity-to-assets	11.1%	12.9%	11.2%	11.1%	11.2%	11.1%
Asset Quality						
NPL%	2.1%	1.9%	1.6%	2.0%	2.4%	2.5%
Coverage of NPLs	100.0%	78.9%	80.4%	80.4%	80.4%	80.4%
LLP as % of Loans	0.78%	0.61%	0.69%	0.80%	0.85%	0.85%
Gross cost of risk	1.80%	1.23%	1.21%	1.31%	1.43%	1.28%
Other						
Payout ratio	20%	20%	22%	30%	26%	25%
Effective tax rate	19.1%	19.1%	19.1%	20.0%	20.0%	20.0%
Capital Adequacy Ratio	14.1%	16.3%	14.4%	13.6%	12.9%	12.2%
Tier-1 Ratio	13.0%	13.0%	11.6%	11.1%	10.8%	10.4%
Valuation / Per Share Data						
P/E (Cons)	8.0	5.3	5.6	6.6	5.1	4.4
P/E (Core)	9.8	3.9	4.2	5.2	3.8	3.3
P/BV (Cons)	1.0	0.8	0.8	0.7	0.6	0.6
P/BV (Core)	1.8	0.7	0.7	0.6	0.6	0.5
EPS (TL) (Cons)	0.50	0.76	0.72	0.61	0.79	0.92
EPS (TL) (Core)	0.47	0.64	0.60	0.48	0.65	0.77
BVPS (TL) (Cons)	3.96	4.88	5.06	5.57	6.30	7.13
BVPS (TL) (Core)	2.59	3.34	3.52	3.93	4.51	5.19
ROE (Cons)	13.3%	17.1%	14.5%	11.4%	13.3%	13.7%
ROE (Core)	18.9%	21.7%	17.6%	13.0%	15.5%	15.8%
DPS (TL)	0.15	0.12	0.15	0.16	0.18	0.20

Source: Company Reports and Citi Research Estimates

Figure 73. Isbank – Valuation method (1) SOP – Core Banks + Participations

Sustainable LT ROE, Core Bank ex participations	15.8%
Cost of Equity	16.0%
Long Term Nominal TL Growth Rate	8.0%
Implied Target P/BV	1.0
2016E Core Equity (TLm)	23,364
Adjustments	0
Adjusted Core Equity	23,364
Total Core Value, Core Bank, 2016E (TLm)	22,867
Total Core Value, Core Bank,12M fwd (TLm)	17,206
(+) Value of Participations (TLm)	6,829
(+) Discounted Value of Future Dividends 2014E (TLm)	800
(+) Discounted Value of Future Dividends 2015E (TLm)	776
Target Valuation (TLm)	25,610
Target Valuation / Share (TL)	**5.69**
DPS (TL)	0.16
Current Price (TL)	4.02
Share Price Return (SPR)	**41.6%**
Dividend Yield	3.9%
Estimated Total Return (ETR)	**45.4%**

Source: Citi Research

Figure 74. Isbank – Valuation method (2) Group Warranted Equity Valuation

Sustainable LT ROE, Group	13.7%
Cost of Equity	16.0%
LT Growth Rate	8.0%
Implied Target P/TBV	0.71
Consolidated Equity, 2016E (TLm)	32,099
Adjustments	0
Adjusted Consolidated Equity	32,099
Total Value, 2016E	22,683
Total Value, 12M fwd	17,067
(+) Discounted Value of Future Dividends 2014E	800
(+) Discounted Value of Future Dividends 2015E	776
Target Valuation (TLm)	18,643
Target Valuation / Share (TL)	**4.14**
DPS	0.16
Current Price	4.02
Share Price Return (SPR)	**3.1%**
Dividend Yield	3.9%
Estimated Total Return (ETR)	**6.9%**

Source: Company Reports and Citi Research Estimates

Figure 75. Isbank – Valuation

(1) SOP (Core Bank + Participations) Valuation per share (TL)	5.69
(2) Group Warranted Equity Valuation per share (TL)	4.14
Average / Target Price (TL)	**4.92**
Current price (TL)	4.02
Share Price Return (SPR)	22%
Dividend Yield	3.9%
Estimated Total Return (ETR)	**26.2%**

Source: Citi Research

Company Focus

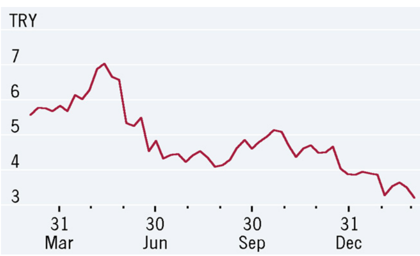
Vakifbank (VAKBN.IS)

Awaiting revised guidance – buy on valuation grounds

- Target Price Change
- Estimate Change

Buy	**1**
Price (04 Mar 14)	TL3.35
Target price	TL3.94
from TL4.95	
Expected share price return	17.6%
Expected dividend yield	1.8%
Expected total return	**19.4%**
Market Cap	TL8,375M
	US$3,752M

Price Performance
(RIC: VAKBN.IS, BB: VAKBN TI)



- **Cutting estimates and target price** — We lower our net income forecasts by 29% this year, and 9% each in 2015 and 2016 as we incorporate higher cost of funding environment in our model after the recent hike by the CBT. Our target price is now TL3.94 vs. TL4.95 previously on the back of lower earnings and higher cost of equity (16% vs. 15% previously).

- **NIM estimates lowered** — Our NIM forecast is now lower by 72bps at 3.56% for 2014 as the sharp rise in TL interest rates hurt the Bank's profitability due to its peer leading TL deposit mix level of above 70%. Loan-to-deposit ratio being above 100% and relatively high level of asset-liability duration mismatch also contribute to the relatively sharper NIM decline expectation for the Bank in 2014. Although we lower 2015 NIM estimate lower by 44bps as well, we note that NIM should recover by 42bps from 2014 to 2015 as assets re-pricing catches up. Management stated that it had originally budgeted for a 30bps NIM contraction in 2014 but this is more likely to be around 65bps now (as of mid-February).

- **Fee income growth lowered** — Vakifbank posted impressive fee growth in 2013 of 53% as the Bank benefited from increased focus on fee generation. We now forecast fee growth of 18% vs. 30% previously given regulatory uncertainties and the higher level of interest rates making refinancing related fee generation unlikely. Management has budgeted for 20-25% fee income growth but this is under the original loan growth assumption of 20%, which we believe will be revised lower in March.

- **Growth and asset quality** — We expect loan growth of 14% this year compared to management's original budget of 20%, which we believe is likely to come down when it is updated in March. Our loan growth expectations for 2015 and 2016 are also 14% although the mix should sway slightly more towards TL lending. On the asset quality front, we incorporate total gross cost of risk of 227bps compared to 160bps of management guidance (subject to revision).

- **Guidance delayed** — Management stated that given the uncertain outlook after the CBT's sharp rate hike, it will provide its 2014 guidance in March.

- **Maintain Buy** — At 0.6x 2014E book value, we believe the negatives are largely priced in for the Bank. Management's upbeat NIM guidance for 2015, which is that NIM should rise to 2013 levels, is reassuring. We maintain our Buy rating with our target price offering upside of 20% (cum-dividend 22%).

Vakifbank (TRY)

Year to 31 Dec	2012A	2013A	2014E	2015E	2016E
Net Income (TLM)	1,423.5	1,645.5	1,155.9	1,837.7	2,239.8
Diluted EPS (TL)	0.57	0.66	0.46	0.74	0.90
Diluted EPS (Old) (TL)	0.62	0.70	0.65	0.82	0.99
PE (x)	5.9	5.1	7.2	4.6	3.7
P/BV (x)	0.7	0.7	0.6	0.5	0.5
DPS (TL)	0.01	0.04	0.06	0.07	0.09
Net Div Yield (%)	0.4	1.2	1.8	2.1	2.7
ROE (%)	13.8	12.9	8.3	12.2	13.2

Figure 76. Vakifbank – BRSA Unconsolidated Income Statement (TLm)

TL in Millions	2011	2012	2013	2014E	2015E	2016E
I. Interest Income	**6,501**	**8,757**	**9,221**	**12,556**	**14,838**	**16,732**
on TL Loans	4,207	6,079	6,645	8,914	10,847	12,474
on FX Loans	726	888	919	1,171	1,338	1,527
on Securities	1,509	1,766	1,591	2,239	2,388	2,427
on Liquid Assets & Others	59	25	66	233	266	303
II. Interest Expense	**(3,607)**	**(4,672)**	**(4,431)**	**(7,641)**	**(8,673)**	**(9,846)**
on TL Deposits	(2,529)	(3,384)	(3,102)	(5,571)	(6,325)	(7,210)
on FX Deposits	(410)	(540)	(421)	(557)	(638)	(730)
on Borrowed Funds	(135)	(136)	(135)	(275)	(288)	(300)
on Others	(533)	(611)	(774)	(1,239)	(1,423)	(1,607)
III. Net Interest Income	**2,894**	**4,085**	**4,790**	**4,915**	**6,165**	**6,885**
Fee & commission income, net	559	448	687	810	932	1,071
Trading income, net	39	337	232	150	153	160
Other banking income, net	885	625	708	567	623	686
IV. Total Banking Income	**4,377**	**5,494**	**6,416**	**6,441**	**7,873**	**8,802**
Personnel expenses	(834)	(917)	(1,112)	(1,268)	(1,432)	(1,619)
Other operating costs	(1,107)	(1,344)	(1,518)	(1,730)	(1,955)	(2,210)
V. Total Operating Costs	**(1,941)**	**(2,261)**	**(2,630)**	**(2,998)**	**(3,388)**	**(3,828)**
VI. Operating Income	**2,436**	**3,232**	**3,786**	**3,443**	**4,485**	**4,973**
Loan loss provisions	(411)	(735)	(1,260)	(1,480)	(1,582)	(1,567)
Other provisions	(495)	(669)	(597)	(622)	(697)	(696)
VII. Operating Income After Provisions	**1,530**	**1,828**	**1,929**	**1,342**	**2,206**	**2,711**
Income from associates	45	57	54	59	65	72
VIII. Pre-tax income	**1,575**	**1,885**	**1,983**	**1,401**	**2,271**	**2,782**
Tax	(348)	(425)	(397)	(308)	(500)	(612)
IX. Net Income	**1,227**	**1,460**	**1,586**	**1,093**	**1,772**	**2,170**
X. Net Income, consolidated	***1,304***	***1,423***	***1,646***	***1,156***	***1,838***	***2,240***

Source: Company Reports and Citi Research Estimates

Figure 77. Vakifbank – BRSA Unconsolidated Balance Sheet (TLm)

TL in Millions	2011	2012	2013	2014E	2015E	2016E
Cash and Banks	2,842	2,959	3,814	3,845	4,556	4,534
Money Market	190	0	0	0	0	0
Securities Portoflio	18,795	18,467	22,128	22,643	22,838	23,396
Trading Securities	174	86	436	462	490	540
Available for Sale	12,649	14,128	16,288	16,777	16,945	17,453
Held Until Maturity	5,972	4,254	5,404	5,404	5,404	5,404
Loans, net	56,585	67,868	86,496	98,464	112,506	128,566
TL Loans	38,508	51,368	65,083	74,194	85,323	98,122
FX Loans	18,186	16,765	21,670	24,270	27,182	30,444
NPLS, net	109	265	256	333	416	478
Gross NPLs	2,157	2,725	3,531	4,591	5,739	6,599
Provisions for NPLs	(2,048)	(2,460)	(3,275)	(4,258)	(5,323)	(6,121)
Reserve deposits	6,425	11,323	17,793	20,462	23,532	27,061
Accrued Interest	1,106	0	0	0	0	0
Financial subsidiaries	717	1,143	1,398	1,468	1,541	1,618
Non-financial subsidiaries	148	167	213	224	235	246
Fixed assets	1,094	1,135	1,224	1,285	1,349	1,416
Other assets	1,176	1,253	2,174	2,283	2,397	2,517
Total Assets	**89,184**	**104,580**	**135,496**	**151,006**	**169,370**	**189,835**
Total Deposits	60,667	67,242	81,533	91,469	103,303	116,696
TL Deposits	42,982	49,566	59,441	67,169	76,572	87,292
FX Deposits	17,685	17,676	22,092	24,301	26,731	29,404
Interbank money market	5,940	8,490	14,477	14,697	14,583	14,583
Funds borrowed	8,237	7,475	11,405	11,975	12,574	13,202
Bonds issued	495	2,430	6,885	8,950	11,635	14,544
Other funds	41	31	23	26	28	30
Payables	2,824	3,390	4,350	5,321	6,377	7,307
Accrued Interest Payables	272	0	0	0	0	0
Provisions	1,410	1,963	2,232	2,742	3,302	3,832
Subordinated Loans	0	1,640	1,974	2,125	2,121	2,092
Total Liabilities	**79,886**	**92,662**	**122,880**	**137,305**	**153,924**	**172,287**
Book Value	**9,298**	**11,918**	**12,616**	**13,701**	**15,446**	**17,548**
Book Value, consolidated	***9,239***	***11,431***	***12,166***	***13,301***	***15,096***	***17,248***
Total Liabilities and Equity	**89,184**	**104,580**	**135,496**	**151,006**	**169,370**	**189,835**

Source: Company Reports and Citi Research Estimates

Figure 78. Vakifbank – Key Ratios / Per Share Data

	2011	2012	2013	2014E	2015E	2016E
Revenue Related						
Net Interest Margin (on IEA)	3.7%	4.4%	4.1%	3.6%	4.0%	4.0%
Banking Income Breakdown						
a. Net Interest Income	66.1%	74.4%	74.6%	76.3%	78.3%	78.2%
b. Fee income	12.8%	8.1%	10.7%	12.6%	11.8%	12.2%
c. Trading income	0.9%	6.1%	3.6%	2.3%	1.9%	1.8%
d. Other income	20.2%	11.4%	11.0%	8.8%	7.9%	7.8%
Cost Ratios						
Cost-income	-44.4%	-41.2%	-41.0%	-46.5%	-43.0%	-43.5%
Cost-to-average assets	-2.4%	-2.3%	-2.2%	-2.1%	-2.1%	-2.1%
Return Ratios						
ROE, bank only	13.7%	13.8%	12.9%	8.3%	12.2%	13.2%
ROA, bank only	1.5%	1.5%	1.3%	0.8%	1.1%	1.2%
ROE, consolidated	14.8%	13.8%	13.9%	9.1%	12.9%	13.8%
ROA, consolidated	1.5%	1.4%	1.3%	0.8%	1.1%	1.2%
Balance Sheet Ratios						
Loans-to-assets	63.4%	64.9%	63.8%	65.2%	66.4%	67.7%
Securities-to-assets	21.1%	17.7%	16.3%	15.0%	13.5%	12.3%
IEA-IBL	112.7%	117.8%	114.1%	114.7%	115.3%	115.7%
Loans-to-deposits	93.3%	100.9%	106.1%	107.6%	108.9%	110.2%
TL Loans-to-TL deposits	89.6%	103.6%	109.5%	110.5%	111.4%	112.4%
FX Loans-to-FX deposits	102.8%	94.8%	98.1%	99.9%	101.7%	103.5%
TL mix in Loans	68.1%	75.7%	75.2%	75.4%	75.8%	76.3%
TL mix in Deposits	70.8%	73.7%	72.9%	73.4%	74.1%	74.8%
Equity-to-assets	10.4%	11.4%	9.3%	9.1%	9.1%	9.2%
Asset Quality						
NPL%	3.7%	3.9%	3.9%	4.5%	4.9%	4.9%
Coverage of NPLs	95.0%	90.3%	92.8%	92.8%	92.8%	92.8%
LLP as % of Loans	0.81%	1.18%	1.63%	1.60%	1.50%	1.30%
Gross cost of risk	1.79%	2.26%	2.42%	2.27%	2.16%	1.88%
Other						
Payout ratio	3%	7%	9%	16%	13%	12%
Effective tax rate	22.1%	22.6%	20.0%	22.0%	22.0%	22.0%
Capital Adequacy Ratio	13.4%	16.1%	13.7%	12.8%	12.3%	11.9%
Tier-1 Ratio	12.4%	12.3%	10.6%	10.1%	9.9%	9.8%
Valuation / Per Share Data						
P/E (Cons)	6.2	5.6	4.9	6.9	4.4	3.6
P/BV (Cons)	0.9	0.7	0.7	0.6	0.5	0.5
EPS (TL) (Cons)	0.52	0.57	0.66	0.46	0.74	0.90
BVPS (TL) (Cons)	3.70	4.57	4.87	5.32	6.04	6.90
ROE (Cons)	14.8%	13.8%	13.9%	9.1%	12.9%	13.8%
DPS (TL)	0.01	0.01	0.04	0.06	0.07	0.09

Source: Company Reports and Citi Research Estimates

Figure 79. Vakifbank – Warranted Equity Valuation

Sustainable LT ROE, Group	13.8%
Cost of Equity	16.0%
LT Growth Rate	8.0%
Implied Target P/TBV	0.73
Consolidated Equity, 2016E (TLm)	17,248
Adjustments	0
Adjusted Consolidated Equity	17,248
Total Value, 2016E	12,612
Total Value, 12M fwd	9,489
(+) Discounted Value of Future Dividends 2014E	175
(+) Discounted Value of Future Dividends 2015E	194
Target Valuation (TLm)	9,858
Target Valuation / Share (TL)	**3.94**
DPS	0.06
Current Price	3.21
Share Price Return (SPR)	**22.8%**
Dividend Yield	1.9%
Estimated Total Return (ETR)	**24.7%**

Source: Citi Research Estimates

Garanti Bank

Company description

Garanti was established as a privately owned commercial bank in Ankara in 1946 and is the second-largest private bank in Turkey with TL221 billion in consolidated assets (2013). It provides retail, commercial, corporate and private banking services and is a business partner for large local companies as well as multinationals.

Investment strategy

We see Garanti as the industry benchmark on revenue and cost efficiency and, along with its high free funds base, it commands one of the highest ROAs in the system. The case for high sustainable ROEs for Garanti is also underpinned by its low balance sheet leverage and strong capital position. This, in our view, drives Garanti's longer-term value proposition. We rate Garanti Buy (1).

Valuation

We value Group using a warranted equity approach assuming that our forecast 2016 Group ROE of 17.7% is sustainable and using a cost of equity of 16%. Assuming a nominal growth rate of 8%, this values the stock at 1.21x 2016E consolidated book value. Discounting this back to today, along with the discounted value of expected dividends, leads us to arrive at our target price of TL 7.43.

Risks

The major industry-specific risks are: (i) interest rate risk; (ii) local currency risk; (iii) NPL risk; and (iv) regulatory risk. The company-specific risks are: (i) relatively high contribution of credit cards on fee income and regulatory risks in this business line; and (ii) overcrowded foreign investor base, which could create stronger selling pressure in a top-down market sell-off.

If the impact on the company from any of these factors proves to be more negative than we anticipate, then the stock will likely have difficulty achieving our financial and price targets. Conversely, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

Halkbank

Company description

Halkbank is Turkey's seventh-largest lender by assets with a specific focus on SME banking and is majority-owned by the state. The bank has a strong distribution network of 861 branches (as of end-2Q13) with at least one in every city. Halkbank has a strong and stable deposit and customer base, with over 4.9 million retail customers, 387,000 SME customers and 4,000 corporate customers.

Investment strategy

Halkbank commands the highest ROAs among peer banks, driven by higher NIMs through a higher yielding SME loan book and a low cost base. Running a slightly more levered balance sheet, Halkbank drives a significant ROE gap vs. peers, which should underpin a wide valuation premium. Furthermore, having the lowest LDR in its peer group, strong balance sheet liquidity and strong capital generation

capability should all help Halkbank maintain its edge over peers in its ability to grow. We rate Halkbank Buy (1).

Valuation

Our analysis points to a fair value of TL14.26 per share for Halkbank, exclusive of the TL0.40 dividend per share. We value the bank using a warranted equity valuation approach under the assumption that our 2016 consolidated ROE of 16.8% is sustainable, a 16% cost of equity and a 8% growth rate, implying that the bank is worth 1.1x 2016 consolidated book value. Discounting this implied value to one year from today along with the discounted value of dividends we arrive at our target price.

Risks

The major industry-specific risks are: (i) interest rate risk; (ii) local currency risk; and (iii) asset quality risk. We see the company-specific risks as: (i) Halkbank's higher concentration of SME loans in its loan portfolio could lead to a more pronounced impact on asset quality vs. peers over an economic downturn; (ii) the government's privatization strategy for Halkbank could result in further secondary offerings of stock, which could weigh on the bank's stock performance; (iii) removal of state banks' privileged status for collecting state deposits could result in deposit losses; (iii) higher negative exposure to a hawkish TL rates scenario due to more TL skewed balance sheet on both IEAs and IBLs; (v) Halkbank's overcrowded foreign investor base could create stronger selling pressure in any top-down market sell-off.

If the impact on the company from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our price target. Conversely, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

Yapi Kredi Bank

Company description

Yapı Kredi was established in 1944 as Turkey's first nationwide private bank. It is currently positioned as the fifth largest by asset size, with leading positions in credit cards, assets under management, non-cash loans, leasing and factoring. The bank’s financial services network, through its 907 branches (2011) across the country, constitute a premier franchise in retail, corporate and commercial banking, offering a broad range of banking products, including asset management, leasing, insurance and brokerage.

Investment strategy

We see Yapi Kredi as a good long term play in a lower inflation, lower interest rate environment due its leading fee income capability and operating leverage. As such, it is not the best positioned for volatility. Still, on valuation grounds, we rate the shares Buy (1).

Valuation

Our valuation points to a fair value of TL4.05 per share. We value the bank using a warranted equity valuation approach assuming our 2016 Group ROTE forecast of 15.4% is sustainable, a cost of equity of 16% and a growth rate of 8%. This implies a fair value of 0.92x tangible book value in 2016. We discount this value back to one

year from today along with the discounted value of dividends to arrive at our target price.

Risks

The major industry-specific risks are: (i) interest rate risk; (ii) local currency risk; and (iii) NPL risk. The company-specific risks are: (i) relatively high contribution of credit cards on fee income and regulatory risks in this business line and (iii) heightened asset quality risk due to a more retail oriented loan book.

If the impact on the company from any of these factors proves to be more negative than we anticipate, then the stock will likely have difficulty achieving our financial and price targets. Conversely, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

Isbank

Company description

Isbank, founded by Ataturk in 1924, is Turkey's largest private bank with TL201 billion of consolidated assets as of end-2012. It has the largest branch network and the largest ATM coverage. The major shareholder is Isbank's own private pension fund with 39.3% stake. The largest minority shareholder is CHP, representing Ataturk's 28.1% shares. The remaining 32.6% is the free float. Isbank, due to its wide branch network is the #1 private bank in deposits (both TL and FX), TL loans, debit cards and mutual funds. Isbank also has a large participation portfolio, with assets in glass, telecoms, insurance, REIT and brokerage, among others.

Investment strategy

Isbank's new strategy focuses on capitalising on the bank's balance sheet strength along with exploiting its premium and diversified deposit franchise to suppress cost of funding. We rate the shares a Buy on valuation grounds (1).

Valuation

Our valuation points to a fair value of TL4.92 per share for Isbank. We value Isbank two ways: (1) First we value the core banking business by using a warranted equity approach assuming that our forecast long-term core banking ROE (adjusted for employee dividends) of 15.8% is sustainable and a cost of equity of 16%. To this value we add the estimated value of participation using a NAV-based approach. This approach arrives at a fair value of TL 5.69 per share. (2) Second, we value the Group using a warranted equity approach assuming our 2016 Group ROE of 13.7% is sustainable, a cost of equity of 16% and a growth rate of 8%. This approach implies the business is worth 0.71x 2016 consolidated equity. Discounting this back to one year from today along with the discounted value of dividends implies a fair value of TL 4.14 per share. We set our target price at the average of these two methods at TL 4.92 per share.

Risks

The major industry-specific risks are: (i) interest rate risk; (ii) local currency risk; and (iii) NPL risk. The company-specific risks are: (i) a return back to over-provisioning may put bottom line performance under pressure; and (ii) a relatively higher exposure to SMEs which could negatively impact asset quality performance in a slower economy.

If the impact on the company from any of these factors proves to be more negative than we anticipate, then the stock will likely have difficulty achieving our financial and price targets.

Vakifbank

Company description

Vakifbank was established in 1954 under a special law to provide banking services to charitable foundations. Since the 1980s, the bank's activities were extended to include a diverse range of financial services including, but not limited to, retail and commercial banking, credit cards, insurance, and brokerage services. Within the Turkish banking sector, the bank is the 6th largest bank by assets and has 680 branches as of the end of 2011. Vakifbank's main shareholder is the GDF (Turkish Prime Ministry's General Directorate of Foundations) with a 58.5% stake. The largest minority shareholder is Vakifbank pension fund with a 16.1% stake. The free float is 25.2%.

Investment strategy

As one of the few banks that delivered earnings growth in 2013 we expect the bank's increasing focus on fee income to continue to pay benefits and support earnings growth. We rate the shares a Buy (1).

Valuation

Our valuation points to a fair value TL3.94/share, exclusive of TL0.06 dividend/share. We value the share using a warranted equity approach under the assumption that our 2016 Group ROE forecast of 13.8% is sustainable, a cost of equity of 16%, and a growth rate of 8%. This implies a fair target price-to-book multiple of 0.73x in 2016. We arrive at our target price by discounting this value back to one year from today along with the discounted value of dividends.

Risks

The major industry-specific risks are: (i) interest rate risk; (ii) local currency risk; and (iii) NPL risk. The company-specific risks are: (i) inability to improve fee income generation capacity; (ii) risk of deposit losses as result of a potential end of state banks' privileged status for state-owned enterprise deposits; (iii) higher negative exposure to a hawkish TL rates scenario due to more TL skewed balance sheet on both IEAs and IBLs; (iv) an SPO could create a negative sentiment on the shares temporarily.

If the impact on the company from any of these factors proves to be more negative than we anticipate, then the stock will likely have difficulty achieving our financial and price targets. Conversely, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

Notes

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Isbank (ISCTR.IS)

Ratings and Target Price History
Fundamental Research

Analyst: Simon Nellis
Covered since December 3 2012

	Date	Rating	Target Price	Closing Price
1	5-May-11	*2M	*5.70	5.44
2	22-Sep-11	2M	*4.90	4.57
3	7-Oct-11	Stock rating system changed		
4	7-Oct-11	*2	4.90	4.63
5	20-Jan-12	2	*3.80	3.58
6	24-Apr-12	2	*4.30	4.05
7	12-Jul-12	*3	*4.65	4.83
8	13-Feb-13	*2	*7.13	6.46
9	25-Feb-13	2	*7.00	6.20
10	30-Jul-13	*1	*6.10	5.26

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Isbank (ISCTR.IS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Simon Nellis
Covered since December 3 2012

	Date	Rating	Target Price	Closing Price
1	18-Oct-11	*ADD LP	-	4.73
2	10-Oct-12	*REM LP	-	5.84

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Halkbank (HALKB.IS)

Ratings and Target Price History
Fundamental Research

Analyst: Simon Nellis
Covered since December 3 2012

Date	Rating	Target Price	Closing Price
1 5-May-11	*2M	*15.00	13.25
2 22-Sep-11	*1M	*15.40	11.90
3 7-Oct-11	Stock rating system changed		
4 7-Oct-11	*1	15.40	12.10
5 20-Jan-12	1	*12.75	10.75
6 24-Apr-12	1	*14.00	12.20
7 12-Jul-12	*2	*16.25	14.20
8 23-Oct-12	*1	*18.45	15.30
9 12-Feb-13	1	*22.90	17.45
10 25-Feb-13	1	*24.20	16.55
11 30-Jul-13	1	*18.25	14.65

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Halkbank (HALKB.IS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Simon Nellis
Covered since December 3 2012

Date	Rating	Target Price	Closing Price
1 13-Jul-11	*ADD LP	-	11.80
2 18-Oct-11	*ADD MP	-	12.55
3 10-Oct-12	*REM MP	-	15.15

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Vakifbank (VAKBN.IS)

Ratings and Target Price History
Fundamental Research

Analyst: Simon Nellis
Covered since December 3 2012

Date	Rating	Target Price	Closing Price
1 5-May-11	2M	*4.10	4.04
2 22-Sep-11	2M	*4.00	3.50
3 7-Oct-11	Stock rating system changed		
4 7-Oct-11	*1	4.00	3.50
5 20-Jan-12	*2	*2.80	2.60
6 24-Apr-12	*3	*3.00	3.13
7 12-Jul-12	3	*3.45	3.62
8 14-Feb-13	*2	*6.00	5.36
9 30-Jul-13	*1	*4.95	4.35

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Vakifbank (VAKBN.IS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Simon Nellis
Covered since December 3 2012

	Date	Rating	Target Price	Closing Price
1	13-Jul-11	*ADD LP	-	3.72
2	18-Oct-11	*REM LP	-	3.43

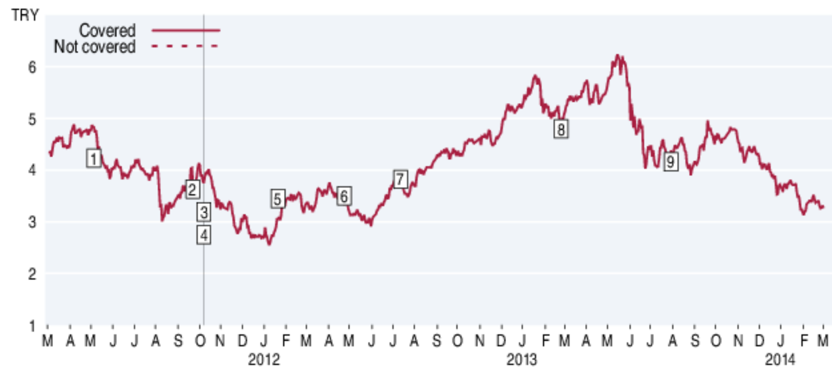
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Yapi Kredi Bank (YKBNK.IS)

Ratings and Target Price History
Fundamental Research

Analyst: Simon Nellis
Covered since December 3 2012



	Date	Rating	Target Price	Closing Price
1	5-May-11	1M	*5.90	4.83
2	22-Sep-11	1M	*5.40	3.78
3	7-Oct-11	Stock rating system changed		
4	7-Oct-11	*1	5.40	3.75
5	20-Jan-12	*2	*3.20	3.05
6	24-Apr-12	2	*3.60	3.33
7	12-Jul-12	2	*4.10	3.70
8	25-Feb-13	*1	*5.90	4.88
9	30-Jul-13	1	*4.85	4.38

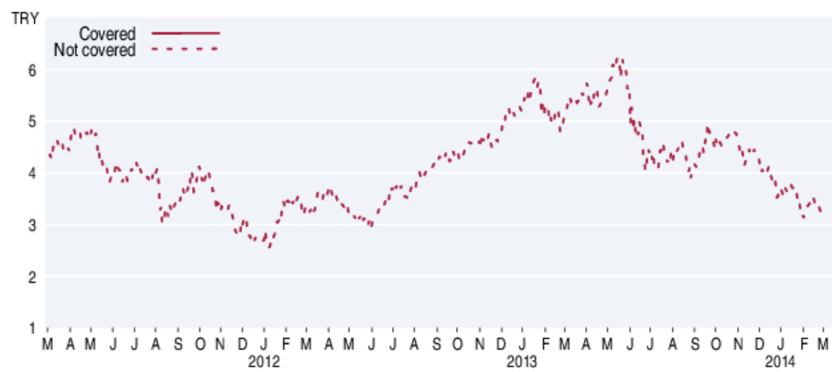
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Yapi Kredi Bank (YKBNK.IS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Simon Nellis
Covered since December 3 2012



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Garanti Bank (GARAN.IS)

Ratings and Target Price History
Fundamental Research

Analyst: Simon Nellis
Covered since December 3 2012

Date	Rating	Target Price	Closing Price
1 5-May-11	*2M	*8.60	8.08
2 30-Jun-11	*1M	8.60	7.36
3 22-Sep-11	*2M	*7.95	6.96
4 7-Oct-11	Stock rating system changed		

Date	Rating	Target Price	Closing Price
5 7-Oct-11	*1	7.95	6.52
6 19-Jan-12	1	*6.95	6.30
7 24-Apr-12	*2	*7.25	6.70
8 12-Jul-12	*1	*8.30	6.98

Date	Rating	Target Price	Closing Price
9 1-Nov-12	*2	*8.65	8.68
10 25-Feb-13	2	*9.50	8.32
11 30-Jul-13	*1	*9.15	7.84
12 10-Feb-14	1	*7.43	6.33

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Garanti Bank (GARAN.IS)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Simon Nellis
Covered since December 3 2012

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			Relative Rating		
Data current as of 31 Dec 2013	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Research Global Fundamental Coverage	49%	40%	12%	6%	88%	6%
% of companies in each rating category that are investment banking clients	55%	52%	44%	62%	52%	49%

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Citigroup Global Markets Ltd	Simon Nellis
Citibank Anonim Sirketi	Osman Memisoglu

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