

# Halkbank (HALKB.IS)

## Results: Mixed 1Q14 Results

- Citi's Take** — Halkbank posted bank-only 1Q14 net income of TL530m (-28% qoq, -26% yoy), beating our estimate of TL323m handily but falling broadly in-line (+2.7%) with CNBC-e consensus estimate of TL516m. The beat vs. our estimate was driven by a lower-than-expected NIM contraction and operating expenses. The company also posted a dividend income of TL99mn, which we had not incorporated in our estimates. ROE of 15.6% was higher than our estimate of 9.4% for the quarter. The only concern in 1Q14 results was a slight (8bps) uptick in the NPL ratio, driven by corporate and credit card segments.
- NIM beat** — Net interest income of TL1,162m (-5.4% qoq, -6.7% yoy) was 8.1% ahead of our estimate of TL1,074m. The beat was driven by lower-than-expected qoq NIM contraction of 42bps (vs. 66bps est.) to 3.30%. We believe the NIM beat was driven by a smaller-than-expected TL deposit cost increase (c90bps vs. our estimate of 200bps).
- Asset quality mixed** — We believe the overall asset quality was broadly in-line with our expectations with the NPL ratio increasing by 8bps qoq to 2.67% vs. our expectation of a 4bps increase. However, there was a c30bps qoq increase in corporate/commercial segment NPL ratio to 2.0% while the sector ratio stayed flat at 2.4%. Furthermore, NPL ratio in the credit card segment increased by c30bps to 5.1%, which was lower than the spike observed at the sector level by c90bps to 6.2%, but sector volumes were down 4.5% qoq, while Halkbank's credit card volumes increased by 1.8% qoq. NPL coverage ratio declined further to 77.4% as management adjusted coverage for a specific hotel loan due to strong collateral.
- Upbeat guidance for 2Q14** — Management guided for a gradual recovery in retail loans, which should start supporting loan yields. NIM should expand by c30bps qoq in 2Q14, driven by increasing contribution from CPI-linkers.
- Implications** — We believe consensus earnings estimates could move higher on the back of management's upbeat guidance on NIM and retail loan growth for 2Q14.

|                              |             |
|------------------------------|-------------|
| <b>Buy</b>                   | <b>1</b>    |
| Price (28 Apr 14)            | TL13.50     |
| Target price                 | TL14.26     |
| Expected share price return  | 5.6%        |
| Expected dividend yield      | 3.0%        |
| <b>Expected total return</b> | <b>8.6%</b> |
| Market Cap                   | TL16,875M   |
|                              | US\$7,908M  |

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



### 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    | 2.24    | 1.67    | 2.12    | 2.54    |
| PE (x)                 | 6.4     | 6.0     | 8.1     | 6.4     | 5.3     |
| P/BV (x)               | 1.4     | 1.2     | 1.1     | 0.9     | 0.8     |
| DPS (TL)               | 0.25    | 0.37    | 0.40    | 0.44    | 0.56    |
| Net Div Yield (%)      | 1.8     | 2.7     | 3.0     | 3.3     | 4.1     |
| ROE (%)                | 24.8    | 20.8    | 13.6    | 15.3    | 16.1    |

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Figure 1. Halkbank – Quarterly Financial Summary, BRSA Unconsolidated (TL m)

| INCOME STATEMENT                         | 1Q13         | 2Q13         | 3Q13         | 4Q13         | 1Q14         | Δ q/q         | Δ y/y         | 1Q14E        | vs. Citi     |
|--|--------------|--------------|--------------|--------------|--------------|---------------|---------------|--------------|--------------|
| <b>Net Interest Income</b>               | <b>1,245</b> | <b>1,203</b> | <b>1,153</b> | <b>1,229</b> | <b>1,162</b> | <b>-5.4%</b>  | <b>-6.7%</b>  | <b>1,074</b> | <b>8.1%</b>  |
| Fee & commission income, net             | 218          | 229          | 238          | 245          | 222          | -9.4%         | 2.0%          | 224          | -1.1%        |
| Trading income, net                      | 181          | 133          | 10           | (80)         | (80)         |               |               | (50)         |              |
| Other banking income, net                | 110          | 98           | 205          | 355          | 124          |               |               | 100          |              |
| <b>Total Banking Income</b>              | <b>1,753</b> | <b>1,664</b> | <b>1,606</b> | <b>1,749</b> | <b>1,427</b> | <b>-18.4%</b> | <b>-18.6%</b> | <b>1,349</b> | <b>5.8%</b>  |
| Total Operating Costs                    | (647)        | (673)        | (638)        | (697)        | (689)        | -1.1%         | 6.5%          | (730)        | -5.6%        |
| <b>Operating Income</b>                  | <b>1,106</b> | <b>991</b>   | <b>968</b>   | <b>1,052</b> | <b>738</b>   | <b>-29.8%</b> | <b>-33.3%</b> | <b>618</b>   | <b>19.4%</b> |
| Loan loss provisions                     | (94)         | (115)        | (95)         | (132)        | (151)        | 14.0%         | 60.6%         | (130)        |              |
| Other provisions                         | (96)         | (109)        | (157)        | (51)         | (43)         | -15%          | -55%          | (80)         |              |
| <b>Operating Income After Provisions</b> | <b>916</b>   | <b>767</b>   | <b>716</b>   | <b>869</b>   | <b>544</b>   | <b>-37.3%</b> | <b>-40.6%</b> | <b>408</b>   | <b>33.2%</b> |
| Income from associates                   | 0            | 82           | 7            | 9            | 99           |               |               | 0            |              |
| <b>Pre-tax income</b>                    | <b>916</b>   | <b>848</b>   | <b>722</b>   | <b>878</b>   | <b>644</b>   | <b>-26.7%</b> | <b>-29.8%</b> | <b>408</b>   | <b>57.5%</b> |
| Tax                                      | (203)        | (133)        | (140)        | (137)        | (113)        |               |               | (86)         |              |
| <b>Net Income</b>                        | <b>713</b>   | <b>715</b>   | <b>582</b>   | <b>741</b>   | <b>530</b>   | <b>-28.4%</b> | <b>-25.7%</b> | <b>323</b>   | <b>64.3%</b> |

| BALANCE SHEET                       | 1Q13           | 2Q13           | 3Q13           | 4Q13           | 1Q14           | Δ q/q       | Δ y/y        | 1Q14E          | vs. Citi    |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|-------------|--------------|----------------|-------------|
| Loans, net                          | 68,631         | 73,388         | 79,721         | 84,413         | 88,374         | 4.7%        | 28.8%        | 87,395         | 1.1%        |
| Gross NPLs                          | 2,004          | 2,068          | 2,134          | 2,245          | 2,425          | 8.0%        | 21.0%        | 2,357          | 2.9%        |
| Provisions for NPLs                 | (1,652)        | (1,694)        | (1,739)        | (1,810)        | (1,878)        | 3.7%        | 13.7%        | (1,901)        | -1.2%       |
| <b>Total Assets</b>                 | <b>111,347</b> | <b>116,372</b> | <b>128,480</b> | <b>139,944</b> | <b>145,524</b> | <b>4.0%</b> | <b>30.7%</b> | <b>143,765</b> | <b>1.2%</b> |
| Total Deposits                      | 80,415         | 82,193         | 90,486         | 100,756        | 100,159        | -0.6%       | 24.6%        | 97,496         | 2.7%        |
| Book Value                          | 12,968         | 12,650         | 13,162         | 14,146         | 14,527         | 2.7%        | 12.0%        | 14,338         | 1.3%        |
| <b>Total Liabilities and Equity</b> | <b>111,347</b> | <b>116,372</b> | <b>128,480</b> | <b>139,944</b> | <b>145,524</b> |             |              | <b>143,765</b> | <b>1.2%</b> |

| KEY RATIOS        | 1Q13   | 2Q13   | 3Q13   | 4Q13   | 1Q14   | 1Q14E  |
|-------------------|--------|--------|--------|--------|--------|--------|
| NIM on avg assets | 4.6%   | 4.3%   | 3.8%   | 3.7%   | 3.30%  | 3.06%  |
| ROE               | 24.5%  | 24.3%  | 19.3%  | 23.5%  | 15.6%  | 9.4%   |
| NPL%              | 2.8%   | 2.7%   | 2.6%   | 2.6%   | 2.7%   | 2.6%   |
| Coverage of NPLs  | 82.4%  | 81.9%  | 81.5%  | 80.6%  | 77.4%  | 80.6%  |
| LLP as % of Loans | -0.56% | -0.65% | -0.50% | -0.65% | -0.70% | -0.61% |
| Cost / Income     | -36.9% | -40.5% | -39.7% | -39.8% | -48.3% | -54.1% |
| Loans / Assets    | 61.6%  | 63.1%  | 62.0%  | 60.3%  | 60.7%  | 60.8%  |
| Loans / Deposits  | 85.3%  | 89.3%  | 88.1%  | 83.8%  | 88.2%  | 89.6%  |
| Equity / Assets   | 11.6%  | 10.9%  | 10.2%  | 10.1%  | 10.0%  | 10.0%  |
| Tax rate          | 22.2%  | 15.7%  | 19.5%  | 15.6%  | 17.6%  | 21.0%  |

Source: Company Reports and Citi Research Estimates

## Halkbank

### 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.

## Appendix A-1

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#### 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         |

\* Indicates change

|   | Date      | Rating | Target Price | Closing Price |
|---|-----------|--------|--------------|---------------|
| 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         |

|    | Date      | Rating | Target Price | Closing Price |
|----|-----------|--------|--------------|---------------|
| 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         |
| 12 | 5-Mar-14  | 1      | *14.26       | 11.20         |

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         |

\* Indicates change

|   | Date      | Rating  | Target Price | Closing Price |
|---|-----------|---------|--------------|---------------|
| 2 | 18-Oct-11 | *ADD MP | -            | 12.55         |

|   | Date      | Rating  | Target Price | Closing Price |
|---|-----------|---------|--------------|---------------|
| 3 | 10-Oct-12 | *REM MP | -            | 15.15         |

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12 Month Rating

Relative Rating

**Data current as of 31 Mar 2014**

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|--|-----|------|------|-----|------|------|
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