

ISE TURKEY, EQUITY STRATEGY - JULY 09

Introduction - Portfolio Investments in Emerging Market Investments and Turkish Case

Recommendation list		
	Rec.	Upside
AKBNK	SELL	-10%
BIMAS	BUY	22%
GARAN	BUY	16%
HALKB	BUY	20%
ISCTR	HOLD	13%
TCELL	BUY	31%
THYAO	BUY	29%
TTKOM	BUY	40%
TUPRS	BUY	42%
YKBNK	HOLD	8%

Since the beginning of 2000s, prudent macroeconomic management and policy continuity encouraged world investors to venture into emerging markets such as Russia, China, India, Turkey, and Brazil. At the same time, in a low-risk, low-return environment, the global search for yield is accelerating the development of domestic markets. Emerging markets have been experiencing solid growth with improving external accounts and debt ratios, benign levels of inflation, and credible, independent monetary policy. Technological developments, greater transparency, more readily available information and instantaneous global communication are driving market inefficiencies to record low levels, limiting arbitrage opportunities but heightening pricing accuracy.

This coincidence of positive ingredients for the global economy has been further enhanced by a non-existence of shocks or political crises. Emerging economies have shaken them off to a greater extent than might have been expected just a few years ago. Emerging economies had to take several steps to improve after the financial and economic crises that most of them faced in the late 1990s and at the beginning of the 2000s. Most of the emerging countries such as Russia, Mexico, Brazil, Turkey, Argentina, and South Korea improved their chances of weathering any such crises by reducing their likelihood of occurrence in the first place. International reserve accumulation and debt management strategies significantly improved the creditworthiness of several emerging countries.

Kadir Tezeller

Head of Research

hkaracigan@sekeryatirim.com

Aktug Sami Baloglu

Analyst

abaloglu@sekeryatirim.com

The ISE Index during 2008-2009

Between January and July 2008, the MSCI EM significantly outperformed the MSCI Turkey. This was caused by two unfavorable developments for Turkey: the rise in commodity prices and the filing of the closure case against the ruling party in March 2008. Between July 2008 and September 2008, the MSCI Turkey significantly outperformed, as oil prices retreated to US\$100 level, while the closure case culminated in favor of the AKP.

The ISE Index has boosted since its lowest level in March benefiting mostly from the restoring risk appetite around the globe. The positive trend is due to the banking sector stocks, which are in much better shape compared to its regional peers and achieved to post remarkable profits during 1Q09, and expect to post even better results during 2Q09. Thus, the ISE Index has outperformed its peers and has started to increase from 23,000 levels to its current levels around 38,000 since March 6. The Increase of ISE Index by 65% is due to:

- Over selling of the Turkish Stocks during Q408.
- Perception that the global crisis has bottomed, and that a V shape recovery is more likely to take place.
- Interest rate cuts of the Central Banks (FED, ECB, BoE, BoJ).
- Governments all over the world have issued stimulus packets (bailing outs).

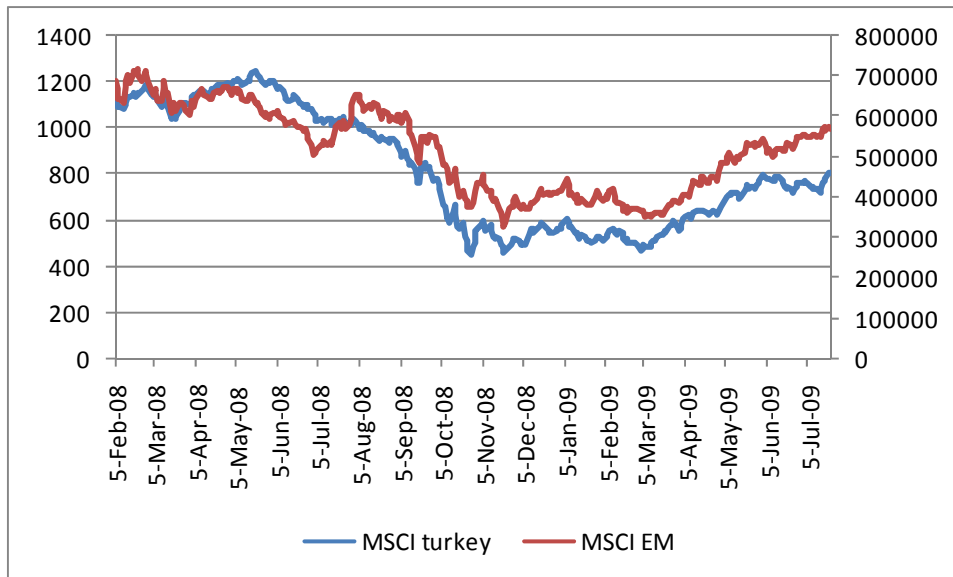
In addition to the above mentioned macro and micro measures, as well as the usual global investment cycle behavior, the ISE-listed (free float) stocks are 65% owned by international investors. During 12 month period, the MSCI Turkey had outperformed relatively compared to MSCI EM, MSCI EMEA, MSCI Eastern Europe and MSCI World Index by 20%, 36%, 27% and 60%, respectively. The reasons for that are:

- Banking Industry in Turkey was less impacted relatively to the other countries and banks are expected to disclose higher earning profits than expected.
- Expectations on a Stand-by agreement with the International Monetary Fund.
- CBRT's more than expected rate cuts from 16.75% to 8.25% during the past eight months.
- Sharp decline in oil prices.

Exhibit 2: Relative Performance of Turkish Equities

Relative to MSCI Turkey	1m	3m	12m	YtD
MSCI EM	2%	-1%	-20%	5%
MSCI EMEA	-2%	-4%	-36%	-7%
MSCI Eastern Europe	-3%	-12%	-27%	-21%
MSCI World	-15%	-13%	-60%	-11%

Exhibit 1: MSCI EM INDEX vs. MSCI TURKEY



The Importance of the IMF Deal

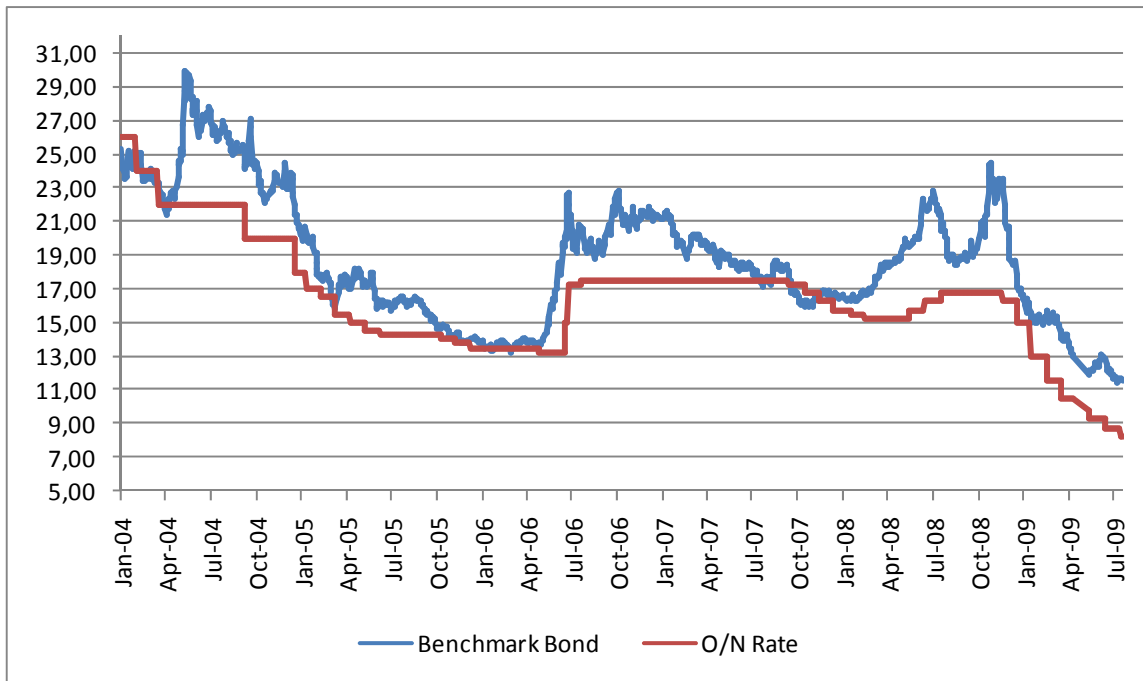
Whether Turkey will sign a deal with the IMF and the timing of it is the leading question marks for the markets. The potential deal with the International Monetary Fund was at the center stage over the last one year and an influencing factor for the Turkish markets occasionally. However, despite the conflicting views between the IMF and the Turkish Government, we still expect the IMF agreement to be signed before IMF’s officials visit to Turkey on late September. Should the global environment turn harsh again, we think things might move a lot faster on the government side to reach an agreement.

Failure to reach an agreement with the IMF will likely have adverse consequences for the economy and the markets, in our opinion. As already mentioned, the fiscal situation is tense, and in the absence of IMF funds, the government would have to issue a lot more treasuries. This could put upward pressure on interest rates and crowd out the private sector, thus delaying the recovery. Turkey’s external financing framework would remain fragile, with negative implications for the TRY and the risk premium of Turkish assets.

The measures, the government is working on, extend to 2010 as well and to justify a relatively painless package, the AKP seems to be counting on its own scenario for the outlook of global liquidity conditions and hence, the scope of Turkey’s external funding gap problem. Currently, the recent developments indicate that unless the global picture deteriorates out of the blue, IMF deal will continue to remain as a reserve solution for the government.

Although The AKP administration had lost momentum on key remits: EU convergence process, structural reforms, and fiscal discipline, we can still talk about a political stability in Turkey. Moreover, Turkey has not also entered into an election atmosphere yet which makes us bullish about the market.

Exhibit 3: CBT Policy Rate vs. Benchmark Bond Yields



Central Bank’s Rate Cut

The Turkish Central Bank had cut a total 850 basis points during the past eight months. Despite the global turmoil, the CBRT cut interest rates aggressively, without a significant increase in risk perception. We believe that Turkey is finally benefiting from the post-2001 reforms, especially due to the strength of its banking sector and relatively low public indebtedness.

Although fiscal support to growth through lower tax rates seems to be a long term dream, significant monetary easing by the CBRT has already been under way.

Expectations for 2009 and 2010

We base our main scenario on two different assumptions depending on the IMF agreement’s likelihood. We expect the positive mood to continue on the third quarter of the year. However, we expect the market to turn into a negative mood if the IMF agreement is not signed before the IMF meeting in Istanbul on 28th of September.

We have assumed two different scenarios (an optimistic base scenario and a worst scenario case) for the next twelve months.

Base Case Scenario - Optimistic Perspective

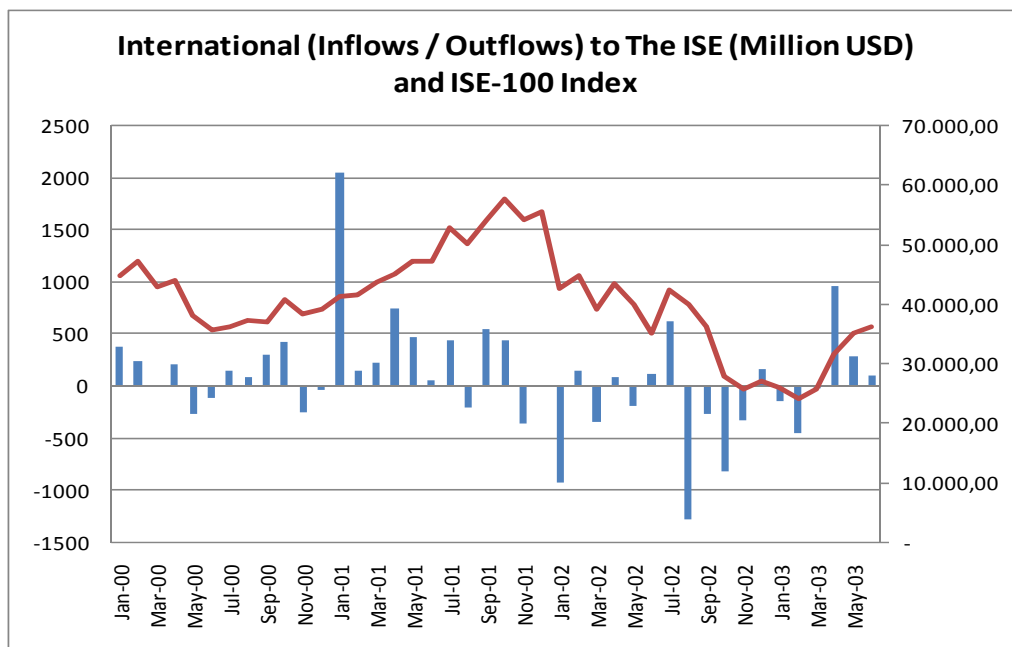
Basically, we believe that the Turkish government is more likely to sign an agreement with the International Monetary Fund after they announced the new measures packet. If this scenario

takes place, the pressure on interest rates will likely to disappear. The benchmark Treasury bond's rate will most probably decrease to the funding rates from 11.50% even if the CBRT pauses on interest rate cuts.

Highly positive expectations for the banking earning results announcements will continue to stimulate the ISE Index. While the domestic demand has begun to revive with the government's tax cut in the second quarter, we believe that the positive impact of CBRT's interest rate cut will physically be felt on the market and industrial companies' balance sheets in Q4.

Within our base case scenario, we believe Turkey will continue diversifying itself from the rest of other emerging markets with increasing portfolio investment and capital inflow.

Exhibit 4: Int'l Inflows to / Outflows from the ISE & the ISE-100 (USD mn)



With the likelihood of the optimistic scenario, we also expect that;

- Turkey will recover faster than its peers, and generate a positive growth rate in Q4
- Better expected P/E ratios and higher valuations, representing a discount to their peers
- Further interest rate cut expectations by the CBRT
- Easing current account deficit
- Stability in exchange rate

Multiple Comparisons

The ISE Index has increased around 65% during the past five months, meanwhile the banking stocks have outperformed over the ISE index with an increase of 90%. If our optimistic scenario

comes to reality, we believe that the banking stocks still have room to go up higher, thanks to further decline in interest rates. We would also recommend having exposure to large cap industrials that would positively be affected by a revival in domestic demand.

MSCI Turkey are trading at a 10.43x P/E based on 2009 forecasts, still representing a discount to their peers in other EMs. We believe that this discount will close fast as Turkey will be among the first ones to emerge from the crisis.

Exhibit 5: Macro Indicators (Base Case Scenario)

Base Case Scenario	2005	2006	2007	2008	2009F	2010F	2011F	2012F	2013F
Macro Indicators									
Real GDP	649,0	758,0	843,0	950,0	949,8	1.031,8	1.148,0	1.287,7	1.456,1
Real GDP (USD bn)	484,0	529,4	648,2	734,1	590,0	625,3	667,4	767,6	890,6
Real GDP (%)	8,4%	6,9%	4,7%	1,1%	-5,5%	2,0%	3,5%	4,1%	4,8%
GDP per Capita (USD)	6.659	7.212	9.333	10.368	8.250	8.658	9.150	10.419	11.968
Population	72,3	73,0	70,6	70,8	71,5	72,2	72,9	73,7	74,4
Unemployment	10,0%	11,0%	11,0%	14,0%	14,5%	13,8%	12,7%	12,4%	12,2%
Monetary Indicators									
CPI (average %)	8,0%	9,6%	8,7%	10,4%	5,8%	6,5%	7,5%	7,7%	8,0%
CPI (year-end %)	7,7%	9,7%	8,4%	10,1%	5,2%	6,8%	8,4%	8,6%	8,8%
CB O/N Policy Rate (year-end)	13,5%	17,5%	15,8%	15,0%	8,0%	9,5%	11,0%	11,6%	12,3%
FX Reserve (USD bn)	50,3	60,8	73,3	71,0	66,0	68,0	75,0	77,5	80,0
USD/TRY (average)	1,34	1,43	1,30	1,29	1,61	1,65	1,72	1,68	1,64
EUR/TRY	1,67	1,80	1,78	1,90	2,33	2,46	2,65	2,52	2,40
Balance of Payments									
Current Account Balance (% GDP)	-4,6%	-6,0%	-5,8%	-5,6%	-2,5%	-3,5%	-3,4%	-3,8%	-4,2%
Foreign Trade Balance (% GDP)	-6,8%	-7,7%	-7,1%	-7,2%	-3,0%	-3,5%	-4,5%	-5,1%	-5,8%
Total Foreign Debt (% GDP)	35,2%	39,4%	37,8%	38,0%	45,2%	43,3%	40,4%	37,7%	35,1%
Foreign Direct Investment	9,0	19,3	19,9	15,6	7,0	8,0	12,0	14,0	16,0

Risks involved within the optimistic scenario

- A further depression in the global markets.
- Non-realization of the improvement on the local demand side.
- Increasing budget deficit which does not ease interest rates.
- The Government can decelerate to do further structural reforms because of the elections in 2011.
- Conflicts with the European Union during the ongoing negotiation process.

Worst Case Scenario (without the IMF deal)

If the IMF deal will not happen, then we expect a negative mood in the capital markets since the non-existence of the IMF has not been priced in. Therefore;

- Benchmark Treasury bonds rates will increase.
- Debt rollover ratio will increase to 115%.
- The CBRT will have to restart hiking interest rates.
- Volatility on the FX market- Turkish Lira will depreciate.

- Out flow of foreign portfolio investments.
- The economic contraction will further increase during 2009, expectations for the growth perspective will likely to decrease.

In case of the worst case scenario, we recommend to diminish the weight of stocks in their portfolios. However, we are still bullish in the medium and long run since the retraction of the ISE Index will offer more arbitrage opportunities when the risk appetite rises. We believe that the Government will not take those risks listed above, and they will have to sign an agreement with the IMF considering the negative climate change in the capital markets.

Exhibit 6: Macro Indicators (Worst Case Scenario)

Worst Case Scenario	2005	2006	2007	2008	2009F	2010F	2011F	2012F	2013F
Macro Indicators									
Real GDP	649,0	758,0	843,0	950,0	932,7	991,9	1.072,6	1.171,1	1.291,0
Real GDP (USD bn)	484,0	529,4	648,2	734,1	555,2	566,8	586,1	650,6	729,4
Real GDP (%)	8,4%	6,9%	4,7%	1,1%	-6,5%	1,0%	2,5%	3,1%	3,8%
GDP per Capita (USD)	6.659	7.212	9.333	10.368	7.764	7.848	8.035	8.831	9.802
Population	72,3	73,0	70,6	70,8	71,5	72,2	72,9	73,7	74,4
Unemployment	10,0%	11,0%	11,0%	14,0%	15,5%	16,4%	16,0%	15,8%	15,5%
Monetary Indicators									
CPI (average %)	8,0%	9,6%	8,7%	10,4%	5,0%	5,3%	5,5%	5,9%	6,3%
CPI (year-end %)	7,7%	9,7%	8,4%	10,1%	4,5%	5,4%	6,1%	6,4%	6,8%
CB O/N Policy Rate (year-end)	13,5%	17,5%	15,8%	15,0%	7,5%	8,5%	9,5%	9,9%	10,3%
FX Reserve (USD bn)	50,3	60,8	73,3	71,0	58,0	65,0	70,0	72,5	75,0
USD/TRY (average)	1,34	1,43	1,30	1,29	1,68	1,75	1,83	1,80	1,77
EUR/TRY	1,67	1,80	1,78	1,90	2,44	2,61	2,82	2,71	2,60
Balance of Payments									
Current Account Balance (% GDP)	-4,6%	-6,0%	-5,8%	-5,6%	-2,0%	-2,6%	-3,0%	-3,3%	-3,5%
Foreign Trade Balance (% GDP)	-6,8%	-7,7%	-7,1%	-7,2%	-2,5%	-3,0%	-3,5%	-4,0%	-4,5%
Total Foreign Debt (% GDP)	35,2%	39,4%	37,8%	38,0%	49,7%	48,6%	43,7%	41,2%	38,7%
Foreign Direct Investment	9,0	19,3	19,9	15,6	6,0	7,0	10,0	11,3	12,5

Top Picks
BANKING INDUSTRY

- **Garanti Bank (GARAN.TI, Current Mcap: TRY 18,984 mn, Upside Potential: 15%)**
On the back of healthy NIM, continuing trading gains, increased liquidity and free funds, and large spreads on loans providing large room to absorb the rise in deposit costs, we see a 15% upside potential at a target price of TRY 5.40. The stock currently trades at P/BV of 1.9x and P/E of 9.7x. We expect the Bank to deliver an even better P/L performance in 2Q09 with respect to 1Q09, on the back of margin enhancement, and relatively lower provision expenses. Through these means, the Bank promises greater potential for profit growth yoy in '09. The endurance of the Bank against macro

downturns is increasing as it switches from fixed rate bonds to CPI linkers. We have a “BUY” recommendation for Garanti.

- **Halkbank (HALKB.TI, Current Mcap: TRY 8,375 mn, Upside Potential: 20%)** Strong '09E profits to be generated mainly from sustainable sources combined with the likelihood of distributing some of its'09 net earnings as dividends are the factors that reinforce our enthusiasm for Halkbank. The Bank does not have any syndicated loans while government bond redemptions provide constant funding inflows. Bonds are mainly of floating rate type, which provide protection against interest rate increases. Moreover, Halkbank is the leading bank in terms of loan growth, while being one of those banks with the least NPL generation. Thus, the Bank boasts impressive efficiency numbers. The Cost/Income is one of the lowest in the sector, since the average salaries of managerial personnel are lower than peers; the majority of the branch premises are owned by the Bank; and it does not compete to grab market share in credit cards. Loans/Deposits ratio is 65%, the lowest in the sector. We have a “BUY” recommendation for Halkbank.

TELECOM INDUSTRY

- **Turkcell (TCELL.TI, Current Mcap: TRY 18,480 mn, Upside Potential: 31%)** With 61.4 million subscribers, Turkcell is a global cellular operator with a strong position in its domestic and international markets and has the potential to build revenue on 3G services. Turkcell is gradually increasing its shares of revenues from international operations in particular from key growth Eurasian Emerging Markets. Turkcell's new Strategy is based on increasing postpaid base, 1.3 million net subscribers surged from 18% in 1Q08 to 22% in 1Q09 while ARPU increased by 9% to TRY 17.1 in 1Q09 yoy. Based on our analysis, our target market capitalization for TCELL stands at USD 16,355 million. Considering TCELL's current market capitalization which is around USD 12,504 million, our target value represents a 31% upside potential. Finally, we had assigned a BUY rating for Turkcell's share price performance.
- **Turk Telekom (TTKOM.TI, Current Mcap: TRY 15,470 mn, Upside Potential: 40%)** Turk Telekom (TT), the integrated telecom operator, has a notable presence in all major segments of the Turkish telecom market, namely fixed line, broadband internet and mobile communication. TT's mobile business Avea registered a robust subscriber acquisition performance, following the MNP process gaining foothold in the post-paid subscriber market, reaching 12.6 million subscribers in 2Q09 (400k qoq increase). We expect Avea to overtake Vodafone and move to 2nd position in terms of revenues, prioritising growth in on-net traffic over profitability in the medium term. TT's broadband business, currently mostly ADSL-oriented, has been on a rapid sustainable growth track, adding 200k subscribers in 2Q09 and thus reaching 6 million subscribers. Based on our analysis of Turk Telekom (TT), we have derived a USD 14,616 million target Mcap for Turk Telekom. Our current rating is a “BUY” rating, corresponding to TRY 6.20 /share target price, offering a 40% upside potential on a blended DCF and peer universe comparison.

AIRLINES

- **Turkish Airlines (THYAO.TI, Current Mcap: TRY 1,951 mn, Upside Potential: 29%)** Turkish Airlines has currently a total of 133 aircrafts. The company has announced that its fleet expansion program will take place between 2009 and 2023 with a number of 105 aircrafts. The currently established international destinations combined with new aircrafts will likely to increase the seat capacity and contribute positively to the company's revenues. In that sense, we expect Turkish Airlines to generate TRY 7.39 billion net sales during 2009. According to our DCF analysis, our target market capitalization for THY stands around TRY 2,510 million. Considering THY's current market capitalization which is around TRY 1,951 million, our target value represents a %29 upside potential. We still maintain our positive view for THY shares.

RETAILING

- **BİM A.S. (BIMAS.TI, Current Mcap: TRY 4,364 mn, Upside Potential: 22%)** BİM is organically growing through new store openings. Increases on the client number per-store combined with growth in basket-size of stores had a positive impact on the company's net sales figures. Based on our DCF analysis, our target market cap for BİM stands at TRY 5,303 million. Considering the BİM's current market capitalization around TRY 4,364 million, our target value represents an upside potential of %22. Thus, our current rating for BİM is "BUY".

OIL & GAS

- **Tupras (TUPRS.TI, Current Mcap: TRY 4,608 mn, Upside Potential: 42%)** We predict that product demand and price adjustments might be achieved for the remainder of the year owing to positive expectations coming up forefront since April regarding the global downturn and entering into the high season on the 2nd and 3rd quarters. In line with our projections, we expect the contractions to be limited to 4% in domestic sales volume, 20% in export volume and dropping down by 7.5% on the aggregate. As a result of our DCF analysis we have come up with a target Mcap for Tupras as TRY 6.5 billion. According to our target price estimates, Tupras has an earnest 42% upside potential and we maintain our "BUY" recommendation.

Şeker Securities

Şeker Yatırım Menkul Değerler A.Ş. İnönü Cad. Tımşah Han No: 36 Beyoğlu - İSTANBUL

Phone: +90 (212) 334 33 33 Fax: +90 (212) 334 33 34

E-mail: research@sekeryatirim.com

Web: www.sekeryatirim.com

For additional information, please contact:

Hakan Karacıgan Group Head of ICM and Research 90 (212) 334 91 01 hkaracigan@sekeryatirim.com

Sales

Batuhan Alpman Senior Sales & Trading 90 (212) 334 91 03 balpman@sekeryatirim.com

Atakan Andic Sales & Trading 90 (212) 334 91 02 aandic@sekeryatirim.com

Macro Economy

Seher Fazlioglu Economist 90 (212) 334 91 04 sfazlioglu@sekeryatirim.com

Research

Kadir Tezeller Head of Equity Research 90 (212) 334 33 33 ktezeller@sekeryatirim.com

Volkan Muhurcuoglu Analyst 90 (212) 334 33 33 vmuhurcuoglu@sekeryatirim.com

Aktug Sami Baloglu Analyst 90 (212) 334 33 33 abaloglu@sekeryatirim.com

BASIS FOR 12m RECOMMENDATIONS

BUY: Requires 15% or more estimated upside.

SELL: Requires 10% or more downside.

HOLD: When estimated relative return is limited between -10% and 15% in either direction.

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