

Equity Research
Europe

EMERGING MARKETS

Turkey

Banks

Akbank

Reuters: AKBNK.IS Bloomberg: AKBNK TI

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Initiating Coverage

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Going Strong: Initiate with Overweight-V

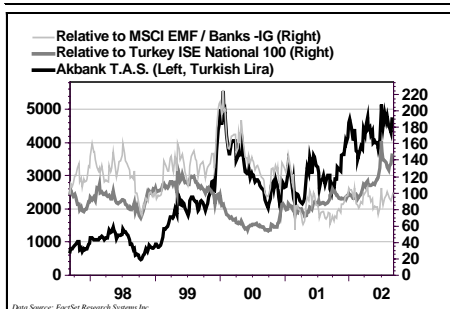
STOCK RATING OVERWEIGHT-V

Price (September 4, 2002) TL4,700/Usc .0029
Price Target TL5,311/Usc .0033
52-Week Range TL5,400-3,400/
Usc .00332-.0021

Stock ratings are relative to the analyst's industry (or industry team's) coverage universe.

- **Large free capital base is Akbank's major advantage**
Akbank's biggest advantage is its US\$1bn free capital base, which provides it with the capacity to grow its assets at a time when most of its competitors are struggling due to capital shortage. We estimate a CAGR of 19% in the loan book during 2001–2004.
- **Balance sheet risk is low**
Akbank's balance sheet risk is the lowest among the big-four banks. This is due to the lowest NPL ratio of 1.6%, the highest NPL coverage at 100%, a small participation portfolio, no FX mismatch and high free equity level.
- **We see 13% upside potential in the stock**
At 1.2x 2003 estimated book value, the stock is trading at a 40% premium to the industry, which we think is justified given its ROE of double the industry average. On our target market cap of US\$2.6 billion, we see 13% potential upside in the stock and assign an Overweight rating.
- **Industry view: Cautious**
We believe weak industry fundamentals and high systemic risks will result in the banking stocks under-performing the ISE-100 index.

Stock Price Performance



Company Description

Established in 1947, Akbank is one of the big four listed commercial banks in Turkey. It is the flagship company of Sabanci group - a leading conglomerate in Turkey. Akbank has a 17% market share in loans and 11% in deposits. The bank has a very strong local franchise, operating through a network of 615 domestic branches and employs more than 8,000 people.

Fiscal Year Ends (Dec 31)	2001	2002e	2003e	2004e
EPS (Usc)	-.0002	.00037	.00044	.00049
Net Interest Income(US\$ mn)	1,924	852	866	871
Provisions(US\$ mn)	53.2	31.0	36.3	30.0
Fees and Commissions(US\$ mn)	250	422	472	497
Net Income (US\$ mn)	-163.1	296.1	353.3	392.7
P/E	N/M	7.8	6.6	5.9
Price/Book	1.8	1.4	1.2	1.0
Market Cap (US\$mn)	2,316	LT Est EPS Growth (02-04) (%)		15.15
Book Value (US\$)	1,293	ROAE (02E) (%)		20
Shares Outstanding (mn)	800,000	Free Float (%)		33.0

e = Morgan Stanley Research estimates

Going Strong: Initiate with Overweight-V: Initiate with Overweight-V

Summary and Investment Conclusion

Akbank is the only bank in our universe that will be able to generate ROE above its cost of capital during 2002–2004, according to our estimates. Akbank's biggest advantage is its large free capital base, which has allowed it to take advantage of the crisis in the industry to build up market share and grow its balance sheet. The bank's conservative lending policies during 1999–2001 have delivered a healthy loan book with no outstanding provisioning. With loan book expected to grow at 19% pa during 2001–2004 and the highest margins in the industry, we expect Akbank's profits to grow at 15% CAGR during this period. At 1.4x our estimated 2002 book, the stock is trading at a 40% premium to the industry, which we think is justified given its ROE is double the industry average. With a target market cap of US\$2.6 billion, we see 13% upside in the stock and give it an Overweight-V rating.

For more details, please see our full report, *Turkish Banks: Growth and Profitability Remain Elusive*, published today.

Valuation methodology

We calculate fair values for the Turkish banks using the **Warranted Equity Valuation (WEV) method**, which determines a target price/book ratio, using growth, ROE and cost of equity. Cost of equity is derived via a capital asset pricing model using the 30-year Eurobond as the risk-free rate. All our calculations are based on IAS 29 accounts. The formula to arrive at the target book value of a stock is: Target price/book ratio = (ROE — growth) / (Cost of equity — growth).

However, since Turkish banks often carry substantial industrial portfolios on their books, we have chosen to adjust the book value and profitability before applying the WEV formula as below.

- We use average free equity during 2002–2003, instead of total equity in target price/book calculations, to eliminate the impact of investments and fixed assets. Hence, the target price/book ratio is calculated for free equity only. The assumption is that we should only pay a premium/apply a discount to that part of the capital that is used for core banking activities. Capital tied up in other activities is

taken at book value and then adjusted for any identifiable unrealised gains/losses.

- We deduct any non-recurring trading gains or one-off profits from ROE calculations. Turkish banks often trade investments within group companies to boost profitability. We also use average earnings forecasts for 2002–2003 to smooth out the impact of the latest economic crisis.
- Finally, we deduct un-provisioned NPLs, assuming a collateral cover of 50% and a tax rate of 30%. This adjustment is very important considering there are US\$2.6 billion worth of un-provisioned NPLs within the big four banks. YKB and Isbank are most affected by this adjustment.

The last part of the equation, growth, is largely subjective. We have tried to estimate it using capital base, franchise strength and market share in loans/deposits as the major factors influencing growth.

Exhibit 1

Cost-of-Equity Calculations

	Risk-Free Rate (%)	Equity Risk Premium (%)	Beta	Cost of Equity (%)
Akbank	13.0	5.0	1.05	18.25
Garanti	13.0	5.0	1.13	18.65
Isbank	13.0	5.0	1.04	18.20
Yapi Kredi Bank	13.0	5.0	1.27	19.35

Source: Morgan Stanley Research, Bloomberg

Exhibit 2

Target Price Calculation for Akbank, 2002–2003e

US\$m	
Average free equity (2002–2003)	1,380.1
Average recurring earnings (2002–2003)	314.7
Average ROE (%)	22.8
Cost of equity	18.25
Estimated long-term growth rate (%)	10.0
Target price/Book (x)	1.6
Target market cap for book	2,142.0
Other assets at book	475.6
Deduction for NPLs and others	0.0
Target market cap	2,617.6
Potential upside from current level (%)	13.0

E = estimates

Source: Morgan Stanley Research

Key risks to Akbank's price target

- Rising interest rates could inflict losses on the bond portfolio, and 25% of Akbank's securities portfolio is fixed-rate TL bonds.
- With around US\$1 billion in free equity, rising inflation levels could hurt profitability by causing monetary adjustment losses.
- Banking capital is low and asset growth will lag, we think, if the bank fails to lift its free capital base.
- Recovery in the macro environment is fragile. We expect asset growth and margins will be hurt if growth fails to take off.

Global Stock Ratings Distribution

(as of August 31, 2002)

Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight	695	34%	288	43%	41%
Equal-weight	935	46%	284	42%	30%
Underweight	411	20%	104	15%	25%
Total	2,041		676		

Data include common stock and ADRs currently assigned ratings. For disclosure purposes (in accordance with NASD and NYSE requirements), we note that Overweight, our most positive stock rating, most closely corresponds to a buy recommendation; Equal-weight and Underweight most closely correspond to neutral and sell recommendations, respectively. However, Overweight, Equal-weight, and Underweight are not the equivalent of buy, neutral, and sell but represent recommended relative weightings (see definitions below). An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations.

ANALYST STOCK RATINGS

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V). We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Ratings prior to March 18, 2002: SB=Strong Buy; OP=Outperform; N=Neutral; UP=Underperform. For definitions, please go to www.morganstanley.com/companycharts.

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Attractive (A). The analyst expects the performance of his or her industry coverage universe to be attractive vs. the relevant broad market benchmark over the next 12-18 months.

In-Line (I). The analyst expects the performance of his or her industry coverage universe to be in line with the relevant broad market benchmark over the next 12-18 months.

Cautious (C). The analyst views the performance of his or her industry coverage universe with caution vs. the relevant broad market benchmark over the next 12-18 months.

Stock price charts and rating histories for companies discussed in this report are also available at www.morganstanley.com/companycharts. You may also request this information by writing to Morgan Stanley at 1585 Broadway, 14th Floor (Attention: Research Disclosures), New York, NY, 10036 USA.

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INDUSTRY COVERAGE: EMERGING EURO — BANKS

Company	Ticker	Rating as of	Price at 09/04/02	Company	Ticker	Rating as of	Price at 09/04/02
Bank PEKAO	BAPE.WA	O 03/18/02	PLZ84.70	OTP	OTPB.BU	O-V 09/06/02	Ft2,036.00
BRE Bank	BREP.WA	U 03/18/02	PLZ78.00				

Stock ratings are subject to change. Please see latest research for each company.