EARNINGS REVIEW 4Q17

Turkey | Banks | 14 February 2018

Vakifbank

Leading NI evolution QoQ and YoY

Expected impact: Positive

Vakifbank posted TRY901mn net income (+28.6% QoQ, +15.2% YoY, +37.7% YtD) in its Q4 bank only financials. The results came above both our call of TRY842mn and consensus estimates of TRY861mn by 7.0% and 4.6%, respectively. Our estimates deviated from the actual results due to higher than expected other income (House call: TRY245mn vs. Actual: TRY491mn) and provisions expense (House call: TRY737mn vs. Actual: TRY868mn). In Q4, net earnings encountered remarkable expansion on the back of; i) impressive NII performance (+28.5% QoQ, +19.0% YoY, +23.8% YtD), ii) hiked other income (+35.6% QoQ), iii) sustained fee growth (+4.4% QoQ, +35.7% YtD), and iv) positive trading line (4Q17: TRY41mn, 3Q17: TRY4mn). Further expansion in the bottom-line was limited due to; i) soared provisions expense (+52.8% QoQ), ii) no dividend income contribution (4Q17: TRY0mn, 3Q17: TRY30mn) and sticky OPEX (+7.0% QoQ, 15.3% YtD). Reported and trade adjusted NIM expanded by impressive 65bps and 71bps QoQ to 3.81% and 3.88%, respectively, dominantly on the back of CPI-linker gains (+313.4% QoQ) and progressive asset repricing. As for asset quality, despite doubled net NPL inflows (4Q17: TRY624mn, +107.5% QoQ), the NPL ratio displayed limited weakening of 4bps QoQ to 4.01% mainly sponsored by favourable denominator effect (loan growth 4Q17: +5.1% QoQ). In tandem, slightly reduced specific provisioning (-4.7% QoQ) led to a close-to-flat decline in coverage ratio to 86.4% (-18bps QoQ) while resulting in somewhat softer, but still elevated specific CoR of 123bps (-9bps QoQ) in Q4. As for solvency metrics, CAR and CET1 showed declines of 67bps and 46bps to 15.52% and 12.33%, respectively, mainly due to non-CGF driven RWA expansion and TRY weakness. ROAE rose by an eye-catching 341bps to 16.82% in Q4, which brought FY17 data print up by 251bps YoY to 17.52%, the highest among the listed peer banks. All told, we keep our FV of TRY8.00, offering 16% upside potential at current valuations, and maintain our BUY recommendation.

Keeping its foot on core business enthusiastically - Vakifbank posted a strong 5.1% QoQ (24.8% YoY) advance in lending business, which aligned exactly to the sector's average with TRY (+3.9% QoQ vs sector: 4.1% QoQ) and FC loans (+8.3% QoQ vs sector: 7.4% QoQ) growing on sound foot. The bank said the lending growth was visible in all segments. Deposits remained major funding source for the lending business (+6.6% QoQ vs. sector +4.7% QoQ) with the increased emphasis on FC deposits (+17.7% QoQ) although it refrained from competing on expensive TRY deposits (1.7% QoQ). Hence, LDR fell 161bps to 117.8% Q4, yet one of the highest among Tier1 class we cover.

CGF loans remained subdued - The utilisation of credit guarantee fund (CGF) remained subdued at TRY 18.6bn (outstanding amount after redemptions) in Q4. Hence it proves not to be difficult to say that TRY business loans were mainly driven by the CGF in 2017. The bank is expected to utilise further in 2018 given the fresh TRY50bn facility in the CGF scheme.

Constructive guidance for core business – The bank hinted high mid-teens lending growth for FY2018 vs 24.8% YoY in FY2017, indicating not a significant deceleration in lending business. Also, the currently unapproved CGF roll-over guarantees would act as an additional driver for the TRY loans, if granted by the authorities. This indicates upside risks to the 2018 TRY loan growth performance, if the re-utilisation portion of the CGF were to be approved.

Core spreads widened as guided – With loan re-pricing supporting the books, the TRY loan yields increased by 70bps QoQ to 14.76% while FC yields improved by a relatively moderate 42bps QoQ to 6.05% which altogether translated into 61bps QoQ rise in blended loan yields to 12.23%. More positive news was that blended deposit costs showed a contraction 12bps QoQ to 7.28% in Q4 thanks to optimisation of cost of financing through non-deposit items such as securities issued, funds borrowed and money market sources. All told, blended core spreads widened by 73bps QoQ to 4.95% in Q4.

GLOBAL SECURITIES

BUY	16% upside
Fair Value	TRY8.00
Prev. (BUY)	Prev. (TRY8.00)
Bloomberg ticker	**VAKBN TI**
Share Price	TRY6.91
Market Cap	USD4.5bn/TRY17.3bn
Free Float	25%

TRYmn [4Q17]	Actual	Consensus	Deviation	Global Est
Net income	901	861	5%	842

TRY mn	4Q17	4Q16	YoY	3Q17	QoQ
NII	2,319	1,949	19.0%	1,804	28.5%
Net fees	372	278	33.7%	356	4.4%
LLP	868	709	22.3%	568	52.8%
OPEX	1,203	962	25.0%	1,124	7.0%
Net income	901	782	15.2%	701	28.6%

Performance	1M	3M	6M	12M
Absolute	22%	9%	4%	61%
Relative	9%	-2%	-10%	6%
Relative $	27%	4%	-3%	51%

Estimates	2016	2017	2018E	2019E
Securities	27,611	32,253	33,368	34,601
Loans	146,619	182,932	212,820	246,258
Deposits	123,838	155,277	178,570	206,365
Book value	19,239	23,258	25,932	28,915
Net income	2,703	3,723	4,194	4,648
P/E (x)	6.39	4.64	4.12	3.72
P/BV (x)	0.90	0.74	0.67	0.60
P/Deposits	0.14	0.11	0.10	0.08

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NIM improves on the back of core spreads and generous CPI linkers - Given the impressive core spreads widening in Q4, the reported NIM rose by 65bps QoQ to 3.81% in the quarter which actually found significant support from decent CPI linkers gain (Q4: TRY463mn; +313.4% QoQ). Hence, CPI linkers-excluded NIM improved by a more moderate 8bps to 3.04%. Trading account remained the contributing factor to NII. The bank saw some TRY41mn as trading gain, up from TRY4mn in Q3. Hence, trade adjusted NIM came in closer to the reported data, widening by 71bps QoQ to 3.88% in 4Q17. As for swap book, it's not meaningful to calculate the impact of swap book on NIM as there is negligible short-term swap utilisation. The swap adjusted NIM showed an improvement of 65bps to 3.81% in Q4 thanks to LTD spread expansion and CPI linker contribution which altogether resulted in 28.5% QoQ NII expansion.

Accelerated net inflows remain well digested with loan growth - NPLs grew at an accelerated pace of 6.2% QoQ to TRY7.6bn vs. the loan book growth of 5.1% QoQ due to doubled net NPL inflows in Q4. Despite improved collections performance (4Q17: TRY399mn, +24.9% QoQ), the rise in new additions to NPL (4Q17: TRY1,023mn, +65.0% QoQ) led to an inflated figure of TRY624mn (+107.5% QoQ) in net additions. The NPL ratio however showed a limited increase of 4bps to 4.01% in the quarter on the back of favourable denominator effect (loan growth 4Q17: +5.1% QoQ). With elevated net inflows and no NPL write-offs as usual in Q4, the bank booked TRY508mn specific provisions which in fact declined in QoQ terms (-4.7% QoQ) and resulted in very limited 18bps QoQ drop in the coverage ratio to 86.4%. The slight decline in specific provisions expense coupled with strong loon book expansion improved specific CoR performance by 9bps QoQ to 123bps in Q4. Nevertheless, specific CoR continued to remain elevated in Q4. Also, Vakifbank's Group 2 share in total loans improved by 46bps QoQ to 2.95% despite the re-classification of OTAS loans as Group 2 in Q4. Note that the management did not address the size of OTAS loans but rather hinted an insignificant amount compared to its peers' exposures in that old cash loan.

Promotion payments to pensioners remain as setback in OPEX - OPEX rose by an additional 7.0% QoQ and 15.3% YtD in Q4 which basically suffered from the government's self-imposed promotion payments to retiree salaries. The bank booked TRY94.6mn as 'promotion payments to pensioners' under OPEX in 2017. Further to that, based previous IR presentations, this expense will continue to be booked in the forthcoming period, totalling to c.TRY350mn by the end of 2019, TRY100mn of which will be booked in 2018. C/I ratio however declined 663bps to 37.3% easing concerns over operating efficiency owing to strong bottom-line growth. Against this backdrop, the 2017 OPEX growth target of CPI plus 1-2ppts (low teens) was missed to some extent.

Promising performance in fee income - Fee income maintained robust growth trajectory, increasing by an impressive 35.7% YtD (+4.4% QoQ, +33.7% YoY) in Q4 in accordance with solid lending activity, more than doubling FY17 guidance of 15%. This might be the best fee income growth in Tier1 class. While some of the outperformance came from low base effect, the management's commitment to catch up with peers' fee activity was pivotal.

Ready for IFRS9 - The management said Vakifbank is ready to implement the new accounting system. In this regard, the bank recycled TRY500mn of its excess general provisions as free provisions, which brought the bank's total free provisions account to TRY500mn as of 4Q17. Also note that the current coverage ratio of 86.4% looks high enough to meet the provision requirements by IFRS9 standards.

Some weakness in capital management in Q4 - The bank's capitalization eased to some extent with CAR and CET1 ratios declining by 67bps QoQ and 46bps QoQ to 15.52% and 12.33%, respectively, in the quarter. The decline in CAR was mainly driven by the non-CGF book driven RWA increase (-144bps QoQ) and currency depreciation (-26bps QoQ), while internal capital generation (+215bps QoQ), TRY TierII bond issuance (+19bps) and exchange transaction effect (+38bps QoQ) helped the bank's capitalization.

Stake transfer will come soon - The bank management stated that the General Directorate of Foundations' planned 58.45% stake transfer in VAKBN to Turkish Treasury could take a start after the independent appraisal report were to be finalized. According to the management, the three independent auditors are likely to deliver their appraisal values to the cabinet one month after the FY2017 consolidated results are announced as early as next week. Then, the cabinet will decide on the transaction price. To remind, the amount will be paid by the issuance of Islamic bonds (Sukuk).

Constructive guidance for FY18 - For FY18, the management targets; Blended loan growth: 16-17% YoY (TRY: High-teens, FC: Low single digits), Blended deposit growth: 15% YoY (TRY: High-teens, FC: Low single digits), Fee growth: 25% YoY, OPEX >15% YoY, NIM: 4.2% (Flattish YoY), ROAE: 17%, CAR: >15%, CET1: >12%, NPL ratio: 4.0-4.1% (Flattish YoY). Also worth to mention, as of 1Q18 the bank will use "Expectation methodology" for CPI linkers accounting, which should ultimately result in reduced volatility on quarterly net income figures. In detail, the bank will wield the average of i) bank's YE CPI house view and ii) the expected YE CPI on CBRT inflation survey report. As for margins, the bank expects the core spreads to continue to expand throughout H1 on the back of i) the progressive asset repricing and ii) some softening of deposit costs in accordance with optimisation of financing side despite potential negative implications of the draft plan for Treasury Single Account regime which could end up with deposit outflow from state-run banks. The bank sees no material risk to deposit costs as it believes the government will avoid any action to hike deposit rates.

Constructive guidance for FY18 - For FY18, the management targets; Blended loan growth: 16-17% YoY (TRY: High-teens, FC: Low single digits), Blended deposit growth: 15% YoY (TRY: High-teens, FC: Low single digits), Fee growth: 25% YoY, OPEX >15% YoY, NIM: 4.2% (Flattish YoY), ROAE: 17%, CAR: >15%, CET1: >12%, NPL ratio: 4.0-4.1% (Flattish YoY). Also worth to mention, as of 1Q18 the bank will use "Expectation methodology" for CPI linkers accounting, which should ultimately result in reduced volatility on quarterly net income figures. In detail, the bank will wield the average of i) bank's YE CPI house view and ii) the expected YE CPI on CBRT inflation survey report. As for margins, the bank expects the core spreads to continue to expand throughout 1H2018 on the back of i) the progressive asset repricing and ii) some softening of deposit costs in accordance with optimisation of financing side despite potential negative implications of the draft plan for Treasury Single Account (TSA) implementation which could end up with deposit outflow from state-run banks. The bank sees no material risk to deposit costs from the TSA as it believes the government will avoid any action to hike deposit rates.

Bottom-line: Maintaining our FV estimate of TRY8.00 and BUY recommendation! With strong NII, sustained fee-income generation, and helpful trading line, bottom-line posted 28.6% QoQ expansion in Q4 and rose to TRY901mn with a 37.7% YtD rise. The upbeat bottom-line translated into a 341bps QoQ increase in annual ROAE to 16.82% with an impressive 17.5% in YtD terms – the highest one among listed peer banks (sector average: 14.9%). Also, the planned stake transfer in VAKBN could be a catalyst as this transfer seems to be finalized at some premium price in the absence of tender call, in our opinion. All told, **we keep our FV estimate of TR8.00 and BUY rating for the stock unchanged, offering 16% upside potential, amid the bank's constructive guidance for core spread and NIM evolution for 1H18 in particular.** Note that Vakifbank trades at 2018E P/BV of 0.67x against the peer average of 0.80x going into publication.

Exhibit 1: Summary balance sheet (TLmn)

BRSA, Solo (TRYmn)	12M16	3M17	6M17	9M17	12M17	QoQ	YoY	YtD
Cash and central bank	24,365	23,300	26,245	26,243	28,645	9.2%	17.6%	17.6%
Banks	3,890	5,500	3,398	5,743	11,888	107.0%	205.6%	205.6%
Money markets	0	360	0	0	1,652	n/a	n/a	n/a
Security portfolio	**27,611**	**28,786**	**29,352**	**30,213**	**32,253**	**6.8%**	**16.8%**	**16.8%**
Trading	1,611	1,771	1,669	1,648	1,937	17.5%	20.2%	20.2%
Available for sale	17,819	18,386	18,691	19,574	13,550	-30.8%	-24.0%	-24.0%
Held to maturity	8,181	8,628	8,992	8,991	16,766	86.5%	105.0%	105.0%
Total loans	147,712	154,227	168,323	174,983	183,972	5.1%	24.5%	24.5%
Performing loans	**146,619**	**153,168**	**167,128**	**174,018**	**182,932**	**5.1%**	**24.8%**	**24.8%**
TL loans	99,028	104,628	119,391	125,319	130,197	3.9%	31.5%	31.5%
FC loans	47,591	48,540	47,737	48,699	52,735	8.3%	10.8%	10.8%
Non-performing loans	**6,414**	**6,728**	**7,030**	**7,192**	**7,638**	**6.2%**	**19.1%**	**19.1%**
Provisioning for NPL	5,320	5,669	5,836	6,227	6,599	6.0%	24.0%	24.0%
Total assets	**212,540**	**221,012**	**236,623**	**246,815**	**270,572**	**9.6%**	**27.3%**	**27.3%**
Deposits	**123,838**	**129,985**	**141,341**	**145,719**	**155,277**	**6.6%**	**25.4%**	**25.4%**
TL deposits	86,113	88,301	100,786	101,758	103,533	1.7%	20.2%	20.2%
FC deposits	37,725	41,683	40,555	43,961	51,744	17.7%	37.2%	37.2%
Funds borrowed	**24,194**	**26,662**	**26,135**	**27,502**	**28,308**	**2.9%**	**17.0%**	**17.0%**
Money market borrowing	12,895	11,001	13,673	16,173	22,271	37.7%	72.7%	72.7%
Securities issued	14,708	15,590	15,512	16,216	19,485	20.2%	32.5%	32.5%
Leasing debts	0	0	0	0	0	n/a	n/a	n/a
Subordinated debt	5,031	5,200	5,023	5,647	5,936	5.1%	18.0%	18.0%
Shareholder's equity	**19,239**	**20,676**	**21,615**	**22,232**	**23,258**	**4.6%**	**20.9%**	**20.9%**
Total liabilities	**212,540**	**221,012**	**236,623**	**246,815**	**270,572**	**9.6%**	**27.3%**	**27.3%**

Source: Bank financials, Global Securities

Exhibit 2: Balance sheet ratios

Balance sheet ratios	12M16	3M17	6M17	9M17	12M17
Securities/Assets	13.0%	13.0%	12.4%	12.2%	11.9%
Trading/Total securities	5.8%	6.2%	5.7%	5.5%	6.0%
AFS/Total securities	64.5%	63.9%	63.7%	64.8%	42.0%
HTM/Total securities	29.6%	30.0%	30.6%	29.8%	52.0%
Liquid assets/Total assets	26.3%	26.2%	24.9%	25.2%	27.5%
Loans/Assets	69.0%	69.3%	70.6%	70.5%	67.6%
LDR	118.4%	117.8%	118.2%	119.4%	117.8%
Deposit/Total assets	58.3%	58.8%	59.7%	59.0%	57.4%
Funds borrowed/Total assets	11.4%	12.1%	11.0%	11.1%	10.5%
MM/Total assets	6.1%	5.0%	5.8%	6.6%	8.2%
Securities issued/Total assets	6.9%	7.1%	6.6%	6.6%	7.2%
Equity/Total assets	9.1%	9.4%	9.1%	9.0%	8.6%
Leverage	11.0	10.7	10.9	11.1	11.6
Free equity to assets	7.3%	7.6%	7.5%	7.4%	7.0%
IEA/IBL	112.1%	112.0%	112.1%	111.8%	111.3%
IEA/Total Assets	95.3%	95.5%	95.6%	95.7%	95.1%
CAR	14.16%	15.45%	15.74%	16.19%	15.52%
CET1	11.47%	12.36%	12.80%	12.79%	12.33%
T1	11.42%	12.34%	12.78%	12.76%	12.31%

Source: Bank financials, Global Securities

Exhibit 3: Summary P&L (TLmn)

BRSA, Solo (TRYmn)	4Q16	1Q17	2Q17	3Q17	4Q17	QoQ	YoY	12M16	12M17	YoY
Interest income	**4,446**	**4,841**	**5,157**	**5,285**	**6,161**	**16.6%**	**38.6%**	**16,558**	**21,444**	**29.5%**
Loans	3,889	3,927	4,357	4,755	5,224	9.9%	34.3%	14,212	18,263	28.5%
Banks	7	8	9	16	21	30.3%	179.6%	25	53	110.3%
Securities	519	846	732	448	842	87.9%	62.3%	2,204	2,869	30.1%
Interest expense	**2,498**	**2,464**	**3,035**	**3,481**	**3,842**	**10.4%**	**53.8%**	**9,591**	**12,823**	**33.7%**
Deposits	1,822	1,735	2,218	2,585	2,667	3.2%	46.3%	7,214	9,205	27.6%
Funds borrowed	136	142	162	170	198	16.9%	45.3%	386	672	74.2%
Money market	248	270	349	390	514	31.8%	107.2%	993	1,523	53.4%
Debt instruments	202	215	221	249	334	34.0%	65.9%	680	1,020	50.0%
Net interest income	**1,949**	**2,377**	**2,121**	**1,804**	**2,319**	**28.5%**	**19.0%**	**6,967**	**8,621**	**23.8%**
Net fee and commission income	**278**	**291**	**312**	**356**	**372**	**4.4%**	**33.7%**	**981**	**1,331**	**35.7%**
Dividend income	0	43	21	30	0	-99.8%	93.5%	92	94	2.0%
Commercial profit gain/loss	265	117	1	4	41	855.2%	-84.4%	484	164	-66.1%
Other operating income	152	440	381	362	491	35.6%	223.5%	954	1,674	75.4%
Total operating income	**2,644**	**3,267**	**2,836**	**2,557**	**3,223**	**26.1%**	**21.9%**	**9,477**	**11,883**	**25.4%**
LLPs and other provisions	**709**	**733**	**619**	**568**	**868**	**52.8%**	**22.3%**	**2,247**	**2,788**	**24.1%**
Other operating expense	962	1,016	1,078	1,124	1,203	7.0%	25.0%	3,835	4,421	15.3%
Net operating income	**972**	**1,518**	**1,140**	**865**	**1,153**	**33.2%**	**18.6%**	**3,396**	**4,675**	**37.7%**
Tax provision	190	293	243	165	251	52.7%	32.1%	692	952	37.4%
Net profit	**782**	**1,225**	**897**	**701**	**901**	**28.6%**	**15.2%**	**2,703**	**3,723**	**37.7%**

Source: Bank financials, Global Securities

Exhibit 4: Profitability ratios

Profitablity ratios	12M16	3M17	6M17	9M17	12M17
ROAA	1.53%	2.28%	1.58%	1.16%	1.40%
ROAE	17.50%	26.90%	18.07%	13.41%	16.82%
NIM	4.04%	4.68%	3.94%	3.16%	3.81%
Adjusted NIM	4.6%	4.9%	3.9%	3.2%	3.9%
IEA yield (quarterly)	9.39%	9.70%	9.77%	9.46%	10.37%
IBL cost (quarterly)	5.85%	5.45%	6.37%	6.92%	7.13%
IEA-IBL Spread (quarterly)	3.54%	4.25%	3.40%	2.55%	3.24%
Securities yield (Blended)	7.94%	12.55%	10.47%	6.16%	11.23%
Loans yield (Blended)	11.43%	10.90%	11.33%	11.63%	12.23%
Deposits cost (Blended)	6.11%	5.58%	6.70%	7.40%	7.28%
Loans-deposits spread (Blended)	5.32%	5.32%	4.63%	4.22%	4.95%
Securities issued cost (Blended)	6.17%	5.81%	5.81%	6.44%	7.70%
Interest on loans / Total interest income	87.5%	81.1%	84.5%	90.0%	84.8%
Interest on securities / Total interest income	11.7%	17.5%	14.2%	8.5%	13.7%
Net interest income / Total operating income	73.7%	72.7%	74.8%	70.6%	71.9%
Net fee income / Total operating income	10.5%	8.9%	11.0%	13.9%	11.5%
Net fee income / Opex	28.9%	28.6%	28.9%	31.7%	30.9%
Net fee income / Assets	0.52%	0.53%	0.53%	0.58%	0.55%
Non-banking income / Total operating income	15.8%	18.4%	14.2%	15.5%	16.5%
LLPs / Total operating income	26.8%	22.4%	21.8%	22.2%	26.9%
Cost/Income ratio	36.4%	31.1%	38.0%	43.9%	37.3%

Source: Bank financials, Global Securities

Exhibit 5: Publication schedule

Date	Publication
10.05.2018	1Q18 Earnings release
09.08.2018	2Q18 Earnings release

Source: Public disclosure platform

Exhibit 6: Recommendation history

26.02.2007 (Initiation date)	Rating	Target Price	Prev. Day's close	Upside
04.01.2018	Buy	8.00	6.79	17.8%
14.06.2017	Hold	6.95	6.54	6.3%
11.05.2017	Hold	6.50	6.12	6.3%
21.02.2017	Hold	5.45	5.13	6.2%
09.05.2016	Hold	5.25	4.38	19.9%

Source: Global Securities

Exhibit 7: Coverage universe recommendation overview

	Buy	Hold	Reduce	Sell	U/R
Universe	20	18	1	1	0
Universe %	50%	45%	3%	3%	0%

Source: Global Securities

Date of completion of this report: 14.02.2018 08:35 UTC+3

Date of email-distribution of this report: 14.02.2018 08:40 UTC+3

Explanation of Rating System

12-MONTH RATING DEFINITION

BUY: Buy stocks are expected to have a total return of at least 15% and are the most attractive stocks in our coverage universe on a 12-month horizon.

HOLD: Hold stocks are expected to deliver a positive total return of up to 15% within a 12-month period.

REDUCE: Reduce stocks are expected to achieve a negative total return up to -10% within a 12-month period.

SELL: Sell stocks are expected to post a negative total return of more than -10% within a 12-month period.

ANALYST CERTIFICATION

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