EARNINGS REVIEW 1Q18

Turkey | Banks | 26 April 2018

Akbank

Stage II share swelled w/ re-classifications

Expected impact: Slightly positive

Akbank posted TRY1,709mn net income (+12.2% QoQ, +18.0% YoY) in its Q1 bank only financials. The results came above both our call of TRY1,631mn and the consensus estimate of TRY1,587mn by 4.8% and 7.7%, respectively. Bottom-line was able to expand on the back of i) reduced provisions burden (-39.1% QoQ), ii) softened trading loss (-29.9% QoQ), iii) geared up income under equity (+58.3% QoQ), and iv) increased fee income (+2.7% QoQ). With the glass half empty, further progression of NI was limited due to i) substantial impact of CPI linker normalization (-41.4% QoQ) on NII (+0.1% QoQ) and ii) normalized other income (-56.1% QoQ). Reported NIM and Swap adj. NIM worsened by 21bps and 31bps QoQ to 4.09% and 3.49%, respectively. On the asset quality front, combination of softened net NPL inflows of TRY259mn, TRY775mn write-offs and positive denominator effect (Loans: +4.7% QoQ) led to improved NPL ratio (-34bps QoQ to 1.99%). Following IFRS-9 related adjustments and specific provisions of Q1, the post IFRS-9 specific coverage ratio finalized at 77.4%. The bank booked TRY398mn (-20.5% QoQ) specific provisions which resulted in inched down specific CoR readings (-2bps QoQ) of 82bps. The bank currently holds 25% provision for the OTAS loan and also announced that Yildiz Holding exposure has been transferred to Stage II as of 1Q18. Following re-classifications and loan expansion of the quarter, the bank booked TRY300mn general provisions, putting some burden on the bottom-line. CAR and CET1 slightly eased by 21bps and 67bps QoQ to 16.82% and 14.66%, respectively, due to TRY depreciation and dividend impact of Q1. ROAE improved by 159bps QoQ to 17.85%, one of the best profitability readings among Tier1 peers. Nevertheless, given uncertain macro environment we reduce our FV estimate to TRY11.00/share from TRY11.75/share with BUY rating unchanged, offering 23% upside potential at current valuation.

Core business keeps growing with steady LDR - In Q1, Akbank did not take its foot off the core business, posting a 4.7% QoQ advance in the overall lending, closer to the sector average of +4.9% QoQ. Looking at currency decomposition, TRY loan growth (+3.5% QoQ) was only a tad below the sector average (+3.9% QoQ) while FC loans achieved 7.4% QoQ growth (sector : 6.9% QoQ), most of which came from TRY depreciation. Regarding the segmental distribution in the lending business, the bank demonstrated a great focus on commercial loans (+5% QoQ) and GPLs (+6%), while cutting back on mortgage (-3% QoQ) and credit cards (-2% QoQ) and remaining subdued on auto loans. Note that Treasury-backed (CGF) loans no longer drive the lending business. The bank utilised an additional c.TRY1bn loans under the newly granted but comparably much smaller CGF limit. Although the annual pace of loan book slowed from 17.7% in 4Q17 to 16.5% in 1Q18 as a result of the softening of CGF utilisation, the FY2018 guidance range of 13-15% remains comfortably within reach according to the bank. On the liability side, Akbank refrained from competing on TRY deposits (+0.5% QoQ vs sector average : 3.7% QoQ); but rather put great emphasis on FC deposits (TRY terms: +8.9% QoQ; sector average : 5.0% QoQ) which altogether translated into 4.7% QoQ or 16.9% YoY rise in blended terms in Q1 vs FY2018 guidance range of 13-15%. Against this backdrop, the LDR remained steady at 102.9% in Q1 (vs FY2018 projection of <105%), still one of the lowest among Tier1 banks.

Core spreads still widening - With loan re-pricing supporting the books, TRY yields increased by 54bps QoQ, whereas FC yields fell by 33bps QoQ which altogether translated into 20bps QoQ increase in blended yields. More positive news was that blended deposit costs declined by 33bps QoQ owing to the bank's increased efforts of controlling deposit costs in Q1. All told, blended core spreads improved by an additional 53bps QoQ to 5.52% in Q1.

NIM evolution under pressure – While CPI linkers continued to generate steady interest income as much as TRY423mn up by 24.4% YoY in Q1, its sequential contribution to NII eased by 41.4% QoQ. Relatively softer CPI linker income prevented Akbank from reflecting a decent expansion to the NIM.

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GLOBAL SECURITIES

BUY	23% upside
Fair Value	TRY11.00
Prev. (BUY)	Prev. (TRY11.75)
Bloomberg ticker	**AKBNK TI**
Share Price	TRY8.96
Market Cap	USD8.8bn/TRY35.8bn
Free Float	52%

TRYmn [1Q18]	Actual	Consensus	Deviation	Global Est
Net income	1,709	1,587	8%	1,631

TRY mn	1Q18	1Q17	YoY	4Q17	QoQ
NII	3,099	2,386	29.9%	3,097	0.1%
Net fees	743	632	17.5%	723	2.7%
LLP	698	460	51.7%	1,147	-39.1%
OPEX	1,300	1,097	18.5%	1,295	0.4%
Net income	1,709	1,448	18.0%	1,523	12.2%

Performance	1M	3M	6M	12M
Absolute	13%	5%	1%	34%
Relative	1%	-6%	-12%	-11%
Relative $	18%	0%	-6%	26%

Estimates	2016	2017	2018E	2019E
Securities	58,226	67,967	70,163	74,131
Loans	161,673	190,356	217,306	247,464
Deposits	158,878	184,904	211,090	238,730
Book value	32,376	40,425	45,308	49,839
Net income	4,820	6,039	6,667	7,411
P/E (x)	7.43	5.93	5.38	4.84
P/BV (x)	1.11	0.89	0.79	0.72
P/Deposits	0.23	0.19	0.17	0.15

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In fact, the normalisation of CPI linker gains resulted in 21bps QoQ contraction in the reported NIM to 4.09% in Q1, while CPI linkers-excluded NIM widened by 24bps to 3.52%. Given the hefty short term swap utilisation, cost of swap book rose by an additional 26.9% QoQ to TRY448mn in Q1. Hence, the swap adjusted NIM ratio contracted by 31bps to 3.49% in the quarter. Trading account remained the leaking factor due to the elevated utilisation of currency swaps to fund the TRY loans expansion. This ended up with trading loss of TRY144mn in the quarter albeit with a 29.9% QoQ decline. In tandem, trade adjusted NIM contracted by 11bps QoQ to 3.90% in Q1.

…constructive guidance for Q2 - Despite the latest 75bps rate hike by the CBRT, the management has highlighted its confidence for NIM evolution in Q2 on the back of a couple mitigating factors such as i) narrowing maturity mismatch on TL side to 4 months from 5 months, ii) on-going yield enhancement and iii) strict control on deposit costs and well-disciplined funding strategy. Hence, despite the continuation of hefty swap costs, the bank sees an upside potential for NIM in Q2 and shows comfortable stance for achieving the FY2018 NIM guidance at c.3.5% by the end of the year.

The NPL ratio improves with reduced net inflows and write-offs in Q1 - NPLs grew at a tolerable pace of 6.35% QoQ (Adj. for TRY775mn write-offs) to TRY4.8bn vs. the loan book growth of 4.7% QoQ. Paced down net inflows were mainly attributable to new additions falling 20.7% QoQ to TRY522mn and collections remaining steady at TRY263mn (+1.7% QoQ) in Q1. All these numbers translated into TRY259mn (-35.2% QoQ) net additions to NPL. With reduced net inflows and adequate provisioning, the bank booked TRY398mn specific provisions (-20.5% QoQ) which resulted in inched down specific CoR at 82bps (-2bps QoQ). The NPL ratio improved by 34bps to 1.99% mainly sponsored by TRY775mn write-offs and decent denominator effect (Loans: +4.7%) of the quarter. This is indeed the lowest NPL ratio among Tier1 banks. With the introduction of IFRS-9 reporting as of 1Q18, certain abnormalities might be observed on banking sector financials; on Akbank case we observe reduced specific provisions (-TRY591mn) and increased general provisions (+TRY670mn). With that being said, post IFRS-9 specific coverage and gross coverage has finalized at 77.4% and 161.9%, respectively as of 1Q18.

Yildiz Holding loans transferred to Stage II – The bank decided to re-classify its Yildiz Holding exposure as Stage II and booked additional general provisions accordingly. Following this reclassification and various others, Stage 2 share under total loans increased by 501bps to 10.9%. To remind, the OTAS loan has been previously transferred to Stage II and the bank currently holds 25% provisioning for this account, which is hedged for FX volatility. Taking into account the collateral base of OTAS loan which is c.65%, the effective coverage remains c.90% for this exposure. Also worth noting that, the bank continues to operate with TRY700mn of free provisions as a buffer.

Operating efficiency still promising albeit with some weakening in Q1 - On the operating side, the 1Q18 C/I ratio came in at 37.6% (+736bps QoQ and +385bps YoY). From a broader perspective, C/I ratio has been almost pegged in the 30%s levels as the bank management has concentrated its efforts on core banking business in order to deliver high earnings quality, particularly through optimisation of the branch network and digital banking. While OPEX-adjusted for personnel expenses remained nearly subdued (+0.4% QoQ) in Q1, the annual pace of increase came in at 18.5% way above CPI of 10.2% YoY and FY2018 guidance of 13% YoY. But, the bank believes FY2018 guidance should remain intact thanks to sustained efficiency gains. Last but not least, we saw fee income growth came in at a strong 17.5% YoY with 2.7% QoQ rise in Q1, surpassing the FY2018 guidance of 15% YoY. We expect operating efficiency to continue in the forthcoming period owing to disciplined cost control.

Solvency… Still, one of the best among Tier1 class - Solvency metrics faced slight decline through dividend payment (-57bps QoQ), currency impact (-36bps QoQ), operational risk (-18bps QoQ) and RWA expansion (-17bps QoQ). Even though the bank found some support from organic capital generation (+60bps QoQ) and Tier2 issuance (+55bps QoQ), CAR and CET1 eased by 21bps and 67bps QoQ to 16.82% and 14.66%, respectively, in the quarter.

Rating recommendation: BUY Maintained, FV revised down to TRY11.00 from TRY11.75 - Despite ROAE improving by 159bps QoQ to 17.85%, one of the best among Tier1 peers we cover, we have reduced our FV estimate for AKBNK to TRY11.00/share from TRY11.75/share due to weak TRY and challenging macro environment, while keeping our BUY rating unchanged, offering 23% upside potential at current valuation. Note that AKBNK trades at 2018E P/BV of 0.79x against the peer average of 0.69x going into publication.

Exhibit 2: Balance sheet ratios

Balance sheet ratios	3M17	6M17	9M17	12M17	3M18
Securities/Assets	22.0%	21.2%	21.5%	21.5%	20.7%
Trading/Total securities	12.3%	11.4%	12.1%	12.2%	0.2%
AFS/Total securities	58.1%	58.9%	59.6%	60.0%	66.2%
HTM/Total securities	29.6%	29.7%	28.3%	27.8%	16.7%
Liquid assets/Total assets	36.2%	37.4%	35.6%	35.8%	35.0%
Loans/Assets	60.5%	59.3%	60.7%	60.2%	61.8%
LDR	103.3%	99.4%	103.2%	102.9%	102.9%
Deposit/Total assets	58.5%	59.6%	58.8%	58.5%	60.0%
Funds borrowed/Total assets	10.9%	10.0%	9.6%	9.4%	9.7%
MM/Total assets	8.0%	7.8%	8.0%	8.6%	7.6%
Securities issued/Total assets	3.8%	3.9%	4.3%	4.4%	3.6%
Equity/Total assets	12.0%	12.3%	13.3%	12.8%	12.8%
Leverage	8.3	8.1	7.5	7.8	7.8
Free equity to assets	10.2%	10.5%	10.7%	10.3%	10.2%
IEA/IBL	117.9%	118.1%	118.5%	117.8%	118.0%
IEA/Total Assets	96.6%	96.7%	96.3%	96.0%	96.8%
CAR	15.70%	16.56%	17.59%	17.03%	16.82%
CET1	13.86%	14.72%	15.76%	15.33%	14.66%
T1	13.83%	14.70%	15.74%	15.29%	14.66%

Source: Bank financials, Global Securities

Exhibit 4: Profitability ratios

Profitablity ratios	3M17	6M17	9M17	12M17	3M18
ROAA	2.10%	2.21%	2.07%	2.02%	2.16%
ROAE	18.62%	19.27%	17.05%	16.25%	17.85%
NIM	3.59%	3.76%	3.58%	4.30%	4.09%
Adjusted NIM	3.59%	3.57%	3.45%	4.01%	3.90%
IEA yield (quarterly)	7.77%	8.27%	8.51%	9.39%	9.08%
IBL cost (quarterly)	4.81%	5.19%	5.70%	5.84%	5.73%
IEA-IBL Spread (quarterly)	2.96%	3.08%	2.82%	3.54%	3.35%
Securities yield (Blended)	5.70%	6.51%	6.31%	8.61%	6.41%
Loans yield (Blended)	10.36%	10.80%	11.21%	11.56%	11.76%
Deposits cost (Blended)	5.40%	5.83%	6.43%	6.57%	6.24%
Loans-deposits spread (Blended)	4.96%	4.98%	4.78%	4.99%	5.52%
Securities issued cost (Blended)	6.03%	7.39%	8.08%	8.96%	9.94%
Interest on loans / Total interest income	81.6%	80.2%	81.1%	76.8%	81.2%
Interest on securities / Total interest income	16.5%	17.7%	16.5%	20.6%	15.6%
Net interest income / Total operating income	73.3%	76.7%	77.0%	72.3%	89.6%
Net fee income / Total operating income	19.4%	20.9%	21.3%	16.9%	21.5%
Net fee income / Opex	57.6%	61.9%	60.5%	55.9%	57.2%
Net fee income / Assets	0.89%	0.96%	0.94%	0.92%	0.92%
Non-banking income / Total operating income	7.2%	2.5%	1.6%	10.9%	4.4%
LLPs / Total operating income	14.1%	10.5%	11.0%	26.8%	20.2%
Cost/Income ratio	33.7%	33.7%	35.2%	30.2%	37.6%

Source: Bank financials, Global Securities

Exhibit 5: Publication schedule

Date	Publication
09.08.2018	2Q18 Earnings release
09.11.2018	3Q18 Earnings release

Source: Public disclosure platform

Exhibit 6: Recommendation history

20.08.1992 (Initiation date)	Rating	Target Price	Prev. Day's close	Upside
01.02.2018	Buy	11.75	10.47	12.2%
04.01.2018	Buy	10.90	9.53	14.4%
26.04.2017	Buy	10.75	9.30	15.6%
24.10.2016	Buy	10.05	7.82	28.5%
26.04.2016	Hold	9.20	7.80	17.9%

Source: Global Securities

Exhibit 7: Coverage universe recommendation overview

	Buy	Hold	Reduce	Sell	U/R
Universe	21	17	2	0	1
Universe %	51%	41%	5%	0%	2%

Source: Global Securities

Date of completion of this report: 26.04.2018 08:55 UTC+3

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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.

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