CONFERENCE CALL NOTES

Turkey | Banks | 03 May 2018

Yapı Kredi Bank

Good results and the 2020 agenda

Yapi Kredi Bank posted TRY1,244mn net income (+41.4% QoQ, +24.2% YoY) in its Q1 bank only financials. The results came above both our TRY1,100mn call and the consensus estimates of TRY1,091mn by 13.1% and 14.0%, respectively. In Q1, YKB managed to remarkably expand its net earnings on the back of; i) progressed NII (+3.1% QoQ, +29.2% YoY) despite substantial impact of CPI linker normalization, ii) remarkable fee generation performance (+25.1% QoQ), iii) inflated other income related to IFRS-9 reporting (1Q18: TRY369mn +38.6% QoQ), iv) reduced OPEX (-13.2% QoQ) and v) accelerated income under equity (1Q18: TRY211mn; +45.6% QoQ). However, additional growth for the bottom-line was limited with i) inflated provisions expense as a result of IFRS-9 reporting (1Q18: TRY958mn; +25.4% QoQ) and ii) slightly increased trading loss (+8.3% QoQ). Reported and Trade adj. NIM weakened by relatively softer 8bps and 10bps QoQ to 3.98% and 3.34%, respectively. On the asset quality front, with greatly reduced net NPL inflows (1Q18: TRY227mn vs. 4Q17: TRY634mn) and TRY634mn NPL write-off, the NPL ratio decreased by 30bps QoQ to 4.17% (still highest among Tier1 banks in our coverage universe) despite limited denominator support (loan growth 1Q18: +2.6% QoQ). Following IFRS-9 related adjustments and specific provisions of Q1, the post IFRS-9 specific coverage ratio finalized at 85.7%. The bank booked TRY590mn (+3.1% QoQ) specific provisions, resulting in close-to-flat specific CoR readings (-1bps QoQ) of 121bps. Following IFRS-9 related methodology changes, re-classifications and loan expansion of the quarter, the bank booked TRY224mn general provisions, putting limited burden on the bottom-line. As for solvency metrics, CAR and CET1 eased by 47bps and 9bps to 14.02% and 10.82%, respectively. ROAE revived to 17.13% (+468bps QoQ, +140bps YoY) in Q1. We maintain our FV of TRY4.75 and HOLD rating for YKBNK.

The bank held a conference call today at 4:00PM local time, and presented Q1 financial results and the 2020 agenda.

Lending business grows as usual… In Q1, Yapi Kredi showed a moderate 2.6% QoQ (+11.5% YoY) advance in the lending business, undershooting the sector average (4.9% QoQ) in the quarter. The loan growth was mainly led by FC business, which grew by 8.2% QoQ above the sector average of +5.0% QoQ, although most of the increase came from the TRY appreciation. The TRY loan growth showed a close-to-flat decline of 0.6% QoQ (+10.8% YoY), while the sector pressed on with the process of expanding the TRY book (+3.9% QoQ, +20.6% YoY) in Q1. Regarding the segmental distribution in the lending business, the bank showed a great focus on consumer loans (+3% QoQ) and business loans (+3% QoQ), while remaining subtle on credit cards (+0% QoQ). From a broader perspective, the Q1 loan growth looks a tad below the 2018E guidance of 12-14%, mainly projected to be driven by TRY commercial and retail loans. Also, the bank has targeted a mild increase in FC loans.

Moderate deposit growth… Deposits showed a similar performance with the lending business, increasing by 2.8% QoQ in Q1 (vs. sector +4.3% QoQ) and unveiled a significant composition change towards TRY (+12.7% QoQ) from FC (-5.3% QoQ) with an optimised cost strategy. With a 9.0% YoY increase in Q1, the overall deposit growth remained short of the 2018E guidance at the 12-14% range. The LDR fell by 24bps to 113.7% in the quarter, one of the highest in the Tier1 class yet, which however looks in line with the budgeted range of 110-115%. As for non-deposit items, YKB put emphasis on securities issued (+25.3% QoQ) whereas reducing funds borrowed (-10.7% QoQ) and money market funds (-17.6% QoQ).

Core spreads: A satisfactory widening - With loan re-pricing supporting the books, the TRY loan yields increased by an impressive 118bps QoQ, whereas FC yields fell by 32bps QoQ which altogether translated into 54bps QoQ increase in blended yields. This should be indeed one of the best loan yield performances among our Tier 1 banks coverage. Another positive news was that blended deposit costs rose by a moderate 11bps QoQ in Q1 thanks to the bank's increased efforts of optimising cost of financing and the continued emphasis on demand deposits (+2% QoQ).

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HOLD 18% upside

Fair Value	TRY4.75
Prev. (HOLD)	Prev. (TRY4.75)
Bloomberg ticker	**YKBNK TI**
Share Price	TRY4.01
Market Cap	USD4.2bn/TR17.4bn
Free Float	18%

TRYmn [1Q18]	Actual	Consensus	Deviation	Global Est
Net income	1,244	1,091	14%	1,100

TRY mn	1Q18	1Q17	YoY	4Q17	QoQ
NII	2,768	2,141	29.2%	2,684	3.1%
Net fees	986	807	22.1%	788	25.1%
LLP	958	876	9.4%	764	25.4%
OPEX	1,375	1,295	6.2%	1,585	-13.2%
Net income	1,244	1,001	24.2%	880	41.4%

Performance	1M	3M	6M	12M
Absolute	-9%	-12%	-14%	-6%
Relative	1%	1%	-7%	-14%
Relative $	-12%	-20%	-20%	-19%

Estimates	2016	2017	2018E	2019E
Securities	31,963	41,457	43,287	44,946
Loans	170,506	192,883	217,043	243,465
Deposits	154,275	169,347	189,810	213,096
Book value	26,119	30,098	33,498	37,183
Net income	2,933	3,614	4,068	4,470
P/E (x)	6.03	4.90	4.29	3.90
P/BV (x)	0.68	0.59	0.52	0.47
P/Deposits	0.11	0.10	0.09	0.08

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All told, blended core spreads widened by a 43bps QoQ to 4.80% in Q1. This might be one of the best loan-to-deposit spread evolutions in the quarter among all the banks we cover.

Weak CPI linkers weighed on NIM - Despite generous widening in core spreads, the reported NIM contracted as much as 8bps QoQ to 3.98% in Q1 due to sharp pull back in CPI linker income to TRY436mn (-34.2% QoQ). Hence, the CPI linker excluded NIM widened by 30bps QoQ to 3.35%. With the continuation of cross-currency swap utilisation, the cost of swap book rose to TRY302mn; +4.9% QoQ and +164.9% YoY. In tandem, the swap adjusted NIM ratio contracted by 8bps to 3.54%. As short term swap utilisation has been continuing, trading loss remained elevated at TRY440mn with an 8.3% QoQ increase, reaching all-time high. Hence, trade adjusted NIM contracted by 10bps to 3.34%. Note that the Bank guided a flattish NIM for FY 2018 (revised from flattish excluding the CPI linker income).

The NPL ratio improves with reduced net inflows and write-offs - NPLs grew at a tolerable pace of 2.5% QoQ (Adjusted for TRY634mn write-off) to c.TRY9.2bn vs. the loan book growth of 2.6% QoQ. Despite the decreased collections (TRY352mn, -11.2% QoQ), the dramatic improvement in new additions to NPL (TRY579mn, -43.8% QoQ) ultimately resulted in significantly reduced net inflows at TRY227mn (-64.2% QoQ). With reduced net inflows and adequate provisioning, the bank booked TRY590mn specific provisions (+3.1% QoQ) resulting in flattish quarterly specific CoR at 121bps (-1bps QoQ). Against this backdrop, the NPL ratio improved to 4.17% (-30bps QoQ) mainly sponsored by i) slower net inflows, ii) the NPL write-offs and iii) limited denominator effect (Loans: +2.6%) in the quarter. Also, note that the Bank sees no change in the FY2018 NPL guidance of c.10bps YoY decline. With the introduction of IFRS-9 reporting as of 1Q18, certain abnormalities might be observed on banking sector financials; on YKB case, we observe i) increased specific provisions (c.+TRY909mn) and decreased general provisions (c.-TRY513mn) at the time of transition according to our calculations and ii) inflated provisions expense account (TRY958mn, +25.4% QoQ) which should be evaluated in this way considering also elevated other income account (TRY369mn, +38.6% QoQ) as these accounts used to offset one other in the pre IFRS-9 era. With that being said, post IFRS-9 specific coverage and gross coverage has finalized at 85.7% and 116.2%, respectively as of 1Q18.

Some transfers to Stage II, Yıldız Holding remains Stage I – Contrary to its private peers, YKB did not transfer Yildiz Holding exposure to Stage II. Had it been transferred to Stage II, it could have some burden on the bottom-line. Following other relatively minor reclassifications (some related to IFRS-9 reporting), Stage II share under total loans increased by 155bps to 4.4% which significantly compares with AKBNK (9.1%) and GARAN (17.2%). To remind, the OTAS loan has been previously transferred to Stage II and the bank currently holds 30% provisioning for this account. Taking into account the collateral base of OTAS loan which is theoretically c.65%, the effective coverage remains c.95% for this exposure. Also worth noting that, the bank set aside additional TRY100mn free provisions increasing the total free provisions to TRY250mn which would continue to act as a buffer going forward.

Operating efficiency: Improving but still way to go - On the operating side, OPEX was down by 13.2% QoQ (+6.2% YoY) in Q1, well below the CPI (10.85% YoY). Given the current outperformance, it seems the OPEX target (2018E guidance of <CPI) should be comfortably achieved this year. Simply put, this hints that the bank has remained committed to disciplined cost management and increased efficiency. Operating efficiency may continue as the bank management has concentrated its efforts on disciplined cost control i.e. product digitalization and effective network optimization. In tandem, C/I ratio came down below the revised 2018E guidance of <40% (revised from c.40%) to 37.3% with a 1,026bps QoQ drop thanks to efficiency gains from the completion of the digitalisation process as of last year. We think that YKB's increasing efficiency on the back of digitalisation efforts should continue to shrink cost base in the forthcoming quarters, as the bulk of IT spending has been left behind.

Fee income generation remains on track – Despite moderate lending growth, fee income grew by an impressive 25.1% QoQ (+22.1% YoY) in Q1 on the backdrop of i) the bank's diversification efforts, ii) customer acquisition and iii) strong focus on digital sales. We think that these three drivers should add some further potential to fee income generation in the reminder of the year. This should be indeed one of the best fee growth performances among our Tier 1 banks coverage.

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We think the FY2018 guidance of low teens YoY growth to remain too conservative and potential upward revision in fee income targets should come on table in the coming quarters. Also, this picture gives a sense that the bank has a solid growth tempo in fee income without facing major cost pressures.

Solvency matrices continue to benefit from organic improvement, but… - Solvency metrics faced slight decline through macro environment impact (-35bps QoQ), sub-debt amortisation (-23bps QoQ) and IFRS9 transition impact (-21bps QoQ). Even though the bank found some support from organic capital generation (+32bps QoQ), CAR and CET1 eased by 47bps and 9bps in quarterly terms to 14.02% and 10.82%, respectively, in Q1. The bank revised its guidance to >15% CAR (revised from >13%) on the back of on-going internal capital generation and capital increase plan. Recall, YKBNK decided to increase its paid-in-capital by TL4.1bn to TL8.447bn through a 94.3168% rights issue that will be exercisable at TL1.00 nominal price. According to management's expectations, this issuance should increase CET1, T1 and CAR by c.150bps each. Rights issue calendar shall be determined after the necessary regulatory approvals. The management is committed to have min 300bps buffer vs the regulatory requirement of CET1 by 2020.

Separately, YKBNK mandated a group of international banks for issuance of up to USD1bn of bonds that will be eligible to be classified as the Bank's Additional Tier 1 capital. According to management's expectations, an AT1 offering of approximately USD500mn should increase T1 and CAR by c.75bps depending on regulatory approval and market conditions. So all together, the right issuance and AT1 offering can provide additional c.225bps to bank's CAR.

Other remarks from YKB Capital Markets Day - The bank management announced its strategic pillars to achieve the communicated profitability target of the 2020 agenda; i) Strengthen and optimise capital position, ii) Sustainable revenue generation by rebalancing business mix, iii) Well managed cost structure with efficiency gains and iv) Asset quality optimisation. Some guidance regarding 2020 figures are as follows; i) CET1 ratio (maintain min. 200 bps buffer against regulatory requirements) (more than or equal to CET1: 11.5%, T1: 12.0%, CAR: 14.0%), ii) C/I (less than or equal to 36%), iii) total CoR (c.100bps), iv) ROATE (more than or equal to 17%), v) ROAA (more than or equal to 1.7%), vi) loan growth (CAGR 17-20: c.13-15%), vii) fee growth (CAGR 17-20: c.15-17%), viii) Gross NPL ratio (3.7%), ix) NPL collections (CAGR 17-20: c.5-10%).

TRY4.75 FV estimate and HOLD recommendation maintained - In Q1, net earnings encountered 41.4% QoQ increase to TRY 1,244mn, up by 24.2% YoY. This translated into a 468bps QoQ increase (+140bps YoY) in ROAE to 17.13%. Despite the QoQ improvement in ROAE and continuation of operational efficiency, we keep our FV estimate unchanged at TRY4.75, offering 18% upside potential at current valuations and maintained our HOLD recommendation mainly given a couple of reasons such as on-going overhang issue due to the capitalisation process, relatively weaker asset quality than Tier1 peers despite the cleansing period last year, risk of further increase in Stage II loans and unfavourable macro conditions. Note that YKBNK trades at 2018E P/BV of 0.52x against the peer average of 0.62x going into publication.

Exhibit 1: Balance sheet ratios

Balance sheet ratios	3M17	6M17	9M17	12M17	3M18
Securities/Assets	13.0%	12.6%	13.6%	13.9%	13.3%
Trading/Total securities	7.7%	6.4%	8.3%	9.9%	0.7%
AFS/Total securities	60.5%	61.6%	62.0%	58.6%	59.2%
HTM/Total securities	31.8%	32.0%	29.7%	31.4%	40.1%
Liquid assets/Total assets	26.0%	26.0%	26.5%	29.2%	28.5%
Loans/Assets	67.7%	67.6%	67.6%	64.8%	65.0%
LDR	111.0%	112.5%	114.8%	113.9%	113.7%
Deposit/Total assets	60.9%	60.1%	58.9%	56.9%	57.1%
Funds borrowed/Total assets	11.6%	11.1%	11.2%	13.1%	11.5%
MM/Total assets	1.5%	2.0%	3.9%	4.3%	3.5%
Securities issued/Total assets	3.6%	4.4%	4.3%	4.2%	5.1%
Equity/Total assets	10.6%	10.7%	10.6%	10.1%	10.4%
Leverage	9.5	9.3	9.4	9.9	9.6
Free equity to assets	7.1%	7.3%	7.2%	6.9%	7.2%
IEA/IBL	115.3%	115.5%	115.2%	114.9%	116.0%
IEA/Total Assets	93.7%	93.6%	94.1%	94.0%	93.4%
CAR	14.40%	14.84%	14.91%	14.49%	14.02%
CET1	10.74%	11.20%	11.28%	10.91%	10.82%
T1	10.61%	11.07%	11.15%	10.78%	10.82%

Source: Bank financials, Global Securities

Exhibit 2: Profitability ratios

Profitablity ratios	3M17	6M17	9M17	12M17	3M18
ROAA	1.56%	1.36%	1.26%	1.24%	1.66%
ROAE	15.74%	13.32%	12.24%	12.45%	17.13%
NIM	3.60%	3.57%	3.55%	4.07%	3.98%
Adjusted NIM	3.6%	3.3%	3.2%	3.4%	3.3%
IEA yield (quarterly)	8.34%	8.57%	8.82%	9.25%	9.24%
IBL cost (quarterly)	5.31%	5.64%	5.94%	5.81%	5.91%
IEA-IBL Spread (quarterly)	3.03%	2.93%	2.88%	3.44%	3.33%
Securities yield (Blended)	8.88%	8.87%	9.80%	12.21%	9.34%
Loans yield (Blended)	9.74%	9.88%	10.15%	10.44%	10.98%
Deposits cost (Blended)	5.69%	6.31%	6.48%	6.07%	6.18%
Loans-deposits spread (Blended)	4.05%	3.57%	3.68%	4.37%	4.80%
Securities issued cost (Blended)	6.30%	5.79%	6.92%	7.79%	7.02%
Interest on loans / Total interest income	83.9%	82.9%	82.5%	79.0%	81.8%
Interest on securities / Total interest income	14.5%	14.1%	15.4%	19.1%	14.7%
Net interest income / Total operating income	65.8%	70.3%	73.9%	80.6%	75.1%
Net fee income / Total operating income	24.8%	25.4%	25.3%	23.7%	26.8%
Net fee income / Opex	62.3%	58.2%	58.5%	49.7%	71.7%
Net fee income / Assets	1.23%	1.18%	1.11%	1.06%	1.29%
Non-banking income / Total operating income	9.4%	4.3%	0.9%	-4.2%	-1.9%
LLPs / Total operating income	26.9%	25.6%	27.4%	22.9%	26.0%
Cost/Income ratio	39.8%	43.6%	43.2%	47.6%	37.3%

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

09.03.1999 (Initiation date)	Rating	Target Price	Prev. Day's close	Upside
30.10.2017	Hold	4.75	4.40	8.0%
03.11.2016	Hold	4.25	3.61	17.7%
03.05.2016	Buy	5.10	4.23	20.6%

Source: Global Securities

Exhibit 7: Coverage universe recommendation overview

	Buy	Hold	Reduce	Sell	U/R
Universe	22	16	2	0	1
Universe %	54%	39%	5%	0%	2%

Source: Global Securities

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

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