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# Isbank

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## *Isbank's 2007/9M Solo Results: Let unprofitable clients go to your competitors*

Isbank announced TRY 1,360 mn net earnings in the first nine months of 2007, recording 90% YoY growth. The bank reported TRY 594mn net income in Q3 2007, 17% higher than the consensus estimates.

Growth in the bottom line stemmed largely from the increase in non-interest income, spearheaded by large trading gains, strong dividend income, NPL recoveries, backdated tax rebate and normalization of tax rate.

The bank reported 32% ROAE on its banking business in Q3, bringing the 9M ROAE to 18%.

### ■ *High reward with moderate growth*

Net interest income also displayed some improvement in Q3 2007, despite moderate loan growth, thanks to the improvement in net interest margins to 4.4% in Q3, up from 3.8% in Q2.

"To let unprofitable clients go to the competitors" was the driving force behind higher margins. We welcome the bank decision to stop irrational pricing in the deposit market. This strategy has indeed worked well in terms of profitability, but beware of heavy market share losses.

### ■ *Market share losses due to exorbitant deposit costs*

After a rapid growth period, with all cylinders in fire, İşbank has become a laggard player in 2007, in terms of asset growth. The bank lost 0.8% market share in loans, and 2% share in deposits.

Irrationally high deposit costs due to fierce competition by state banks was the key reason behind the loss of market share in deposits.

The bank has tried to fund loan growth by increasing its money market funding and by downsizing its government securities. But that was not enough to cover the loss of high-cost deposits. This led inevitably to a loss of market share in loans.

### ■ *Switch in the product mix in favour of high yield loans*

Loans book increased 8% in the first nine months, against 17% growth in the overall sector. İşbank management has adopted a more retail oriented and diversified loan structure in 2007. The bank put the brake on loan expansion, particularly in low yield corporate segment. The share of consumer credits in the loan book increased from 29% in 2006 year end to 33% in September, thanks to strong growth (45%) in general purpose loans.

ISCTR	2004	2005	2006	2007E	2008E	2009E
Net Income	635	1,162	1,109	1,501	1,963	2,142
Total Assets	38,513	63,754	75,204	79,625	98,496	112,602
Total Deposits	24,320	37,221	46,399	48,707	56,494	66,661
Total Equity	7,640	9,288	9,410	10,708	11,789	12,355
ROA	1.8	2.3	1.6	1.9	2.2	2.0
ROE	9.6	13.7	11.9	14.9	17.4	17.7
P/E (x)	31.9	17.4	18.3	13.5	10.3	9.5
P/Deposits	0.8	0.5	0.4	0.4	0.4	0.3
P/BV (x)	2.7	2.2	2.2	1.9	1.7	1.6

\*All figures are in TRY

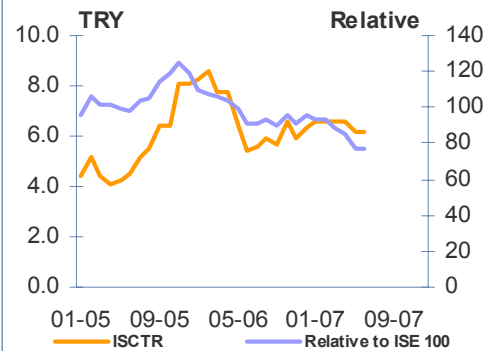
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Stock Data	TRY	US\$
Price at 09 Nov 2007	7.35	6.18
12-Month Target Price		
Mcap (mn)	20,261	17,096
Float Mcap (mn)	6,159	5,197
No. of Shares Outstanding		2757 mn
Free Float (%)		30.40
Avg.Daily Volume (3M, mn)	234.6	189.9

Market Data	TRY
ISE 100	53,689
US\$ Spot Rate	1.1851
US\$ 12-Month Forward	1.2925

Price Performance (%)	1 Mn	3 Mn	12 Mn
TRY	-12	20	19
US\$	-12	36	45
Relative to ISE-100	-5	7	-11

### Price / Relative Price



52 Week Range (TRY) 5.67 8.65

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İşbank (BRSA Solo) TRY Million	2006/09	2007/09	YoY Chg	2006/12	2007/03	2007/06
Net Interest Income	1,957	2,046	5%	2,521	680	1,316
Commission Income	829	962	16%	1,154	296	627
Operating Expense	-1,337	-1,536	15%	-1,858	-482	-1,001
NPL Provisions	-874	-643	-26%	-909	-249	-555
Net Income	717	1,360	90%	1,109	367	766

Source: Is Investment

İşbank (BRSA Solo) TRY Million	2006/09	2007/09	YoY Change	2006/12	2007/03	2007/06
Banks	5,319	5,465	3%	6,454	6,406	6,288
Loans	27,948	32,125	15%	29,818	30,542	31,138
NPLs	1,104	1,359	23%	1,164	1,265	1,438
Provisions	1,104	1,359	23%	1,164	1,265	1,438
Securities	23,827	24,464	3%	26,319	27,494	25,899
Deposits	43,682	43,499	0%	46,399	49,542	46,912
Foreign Funding	11,462	10,480	-9%	10,530	10,167	11,005
Shareholders' Equity	9,477	11,004	16%	9,410	9,666	10,083
Total Assets	70,161	76,460	9%	75,204	78,570	76,889

Source: Is Investment

#### *Irrationally high deposit costs, a blip or a structural issue?*

Deposit collection declined 7% in the third quarter, against 1% growth in the overall sector. Irrationally high deposit costs due to fierce competition by state banks was the key reason behind the loss of market share.

The recent turmoil in global market has played some role behind the recent burst of competition in deposit market. But the real culprit was irrationally high deposits rates offered by state banks in an effort to raise their market shares ahead of the privatization.

Last but not the least, beware that high deposit costs is also a structural issue. The soft belly of the Turkish banking system is the uneven distribution of savings. 20,000 high net worth individuals and corporate clients, mostly based in large cities, dominate 39% of total deposits. Too many banks chasing too few clients lead to bursts of competition in the deposit market from time to time, when some players - state banks this time- want to increase their market share.

İşbank (BRSA Solo)	2006/09	2007/09	2006/12	2007/03	2007/06
Loans/Total assets	40%	42%	40%	39%	40%
Loans/Deposits	64%	74%	64%	62%	66%
TL Loans/TL Deposits	78%	86%	79%	75%	78%
Securities/Total assets	34%	32%	35%	35%	34%
Non-core assets/Total assets	7%	7%	6%	6%	6%
Fixed assets/Total assets	3%	2%	2%	2%	2%
Equity/Total assets	14%	14%	13%	12%	13%
Borrowed funds/Total assets	16%	14%	14%	13%	14%
Gross NPL ratio	4%	4%	4%	4%	5%
Loan-loss provisions	100%	100%	100%	100%	100%

**Focus on profitability rather than volume**

Isbank managed to increase its net interest income by 15% q-o-q in Q3, despite sluggish loan growth, thanks to the improvement in net interest margins to 4.4% in Q3, up from 3.8% in Q2.

Shift in product mix in favor of high yield loans , and the decline in deposits were the key drivers behind higher net interest margins.

Interest on securities portfolio declined by 4% due to the shift from government securities to loans. Interest income on loans increased by 10% in Q3 despite a moderate 3% growth in the loan book, thanks to the shift in loan mix towards high yield retail loans.

Deposit costs declined by a moderate 2% despite 7% contraction in the deposit base, signaling that the decision to get rid of high-cost clients have been taken late in the quarter.

**Improvement in NPLs continues**

The bank's NPL stock decline by TRY 82 mn in QIII thanks to an agreement with SDIF regarding its receivables from a debtor. The NPL ratio declined to 4.2% down from 4.5% in Q2 with 100% provisioning coverage. Isbank recorded TRY 71mn provision loss in QIII down from TRY 305mn in QII, despite TRY 120mn free provision allocated.

**Backdated recoveries boosted the bottom line**

Isbank recorded TRY 115 mn net trading gains in QIII, down from TRY 122 mn in QII. Decline in trading gains was mainly due to FX loss of TRY 69mn in QIII. Other income, on the other hand, reached TRY 225 mn in QIII, up from TRY 152 mn in QII thanks to a backdated tax recovery of TRY 153mn and continuing NPL recoveries. Last but not the least TRY 120mn free provisions drag down the bottom line

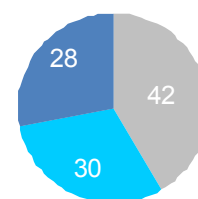
Separately, normalization of tax rate at 19%, down from extraordinarily high 39% in 2006 supported the y-o-y bottom line growth.

**Operating expenses inched up due to annual rise in personnel salaries**

Operating expenses inched up by 3% in QIII due to the rises in salaries. Cost ratio, on the other hand, continued to improve thanks to the boost in banking revenues.

**Scale factor is still a potential to kick in**

Isbank's operating recovery is closely linked with the macro environment. The bank is expected to be one of the main beneficiaries of a low interest rate - low risk environment. The scale factor will likely kick in once the rates gets lower especially in commercial and SME segments. We will be revising our estimates for the bank soon. Currently our net income estimates for 2007 and 2008 stand at 1.5 TRY bn and TRY 2.1 bn respectively.

**Shareholder Structure (%)**

■ T. Is Bank. A.S. Munzam Vakfi  
 ■ Float  
 ■ CHP(Republican People's Party)

	2006/09	2007/09	Δ Chg
ROE	10.4%	17.8%	7.4%
ROA	1.4%	2.4%	1.0%
Leverage	10.9	9.7	-1.2
Adjusted NIM	2.7%	3.5%	0.8%
Yield on earning assets	12.9%	13.6%	0.6%
Cost of funds	8.6%	10.1%	1.5%
Spread	4.3%	5.1%	0.8%
Cost/income ratio	53.4%	47.7%	-5.7%
Cost/Average assets	2.7%	2.7%	0.0%
Banking revenues/AIEA	5.6%	5.2%	-0.4%
Fees and commissions/Opex	62.0%	62.6%	0.6%

Source: Is Investment

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