INVESTING IN TURKEY

Aditya Bothra ◆ *Marc Baudry*

Dana Fennessey ◆ *Demetri Karagas*

Shashin Khanna ◆ *Prerna Sarda*

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Executive Summary

Despite turmoil caused by the global financial crisis during 2008, we believe Turkey presents several attractive avenues for investment today. Overall, the Turkish economy is well positioned to benefit from an improved macroeconomic picture and growth fundamentals in the coming years. The companies that we have selected allow investors to directly bet on Turkey's long-term growth story.

Investment Highlights:

Turkey

- Turkey's strategic location between the Middle East and Europe should allow the country to further take advantage of the increasing pace of globalization. The significance of its location will only appreciate over time due to increase integration.
- Turkey has experienced high and persistent inflation for more than twenty years, but it recently fell to a 39-year low and is expected to remain below the 7.5% projected rate for 2009.
- Turkey has a young and rapidly urbanizing population. The average age in Turkey is 27 years. The urban population accounted for 70% of the total in 2007.
- Combination of lower food and fuel prices, public sector wage hikes, lower taxes, and interest rate cuts will boost overall consumer demand.

Anadolu Efes

- The company's beer operation is distinct in that it has a strong brand name, high customer loyalty, expansive distribution capacity, and innovative product offerings.
- Anadolu Efes is the leading soft drink producer and seller in all markets in which it currently operates, with the exception of Jordan and Pakistan.
- Experience and expertise has enabled Efes to develop successful marketing strategies. It is positioned in the fastest growth area in alcoholic drinks, beer.
- The company has a strong balance sheet that should allow it to continue focusing on growing its core businesses. The company maintained gross profit margins of 50.4% and an EBITA margin of 26.3%.

Garanti Bank

- Garanti's large and sound balance sheet, high asset quality, and strong ROE (18.49% in 2008) makes it an ideal investment in the increasingly profitable banking sector.
- Garanti has high liquidity and consistent profitability that has allowed it to weather the 2008 financial storm fairly well.
- The bank is the market leader in credit cards, which gives them additional ability to increase revenue.
- The company has a well-diversified business model that spans commercial and investment banking.

Based on our comprehensive top-down research, we suggest investing in Turkey via investments in Garanti Bank and Anadolu Efes. Both companies' sound financials and vast growth potential make them solid long-term value buys in the Turkish market.

Country Overview

History

The present boundary of Turkey was drawn in the Treaty of Lausanne, signed on July 24, 1923 after the Turkish War of Independence. Mustafa Kemal was appointed Turkey's first president and moved the country toward a more secular mode of government. To achieve this result, President Kemal abolished the Islamic infrastructure. Over the next several decades, Turkey continued to see a steady movement towards modernization and liberalization. Beginning in the 1950s and continuing well into the 1990s, Turkey experienced several military coups and was wracked by political unrest. The 1999 elections, won by the Demokratik Sol Parti (DSP), led to much needed economic reforms and began what would be period of growth. Turkey experienced a series of economic shocks in 2002 which served as the catalyst for a political power shift, putting religiously conservative party Adalet ve Kalkınma Partisi (AKP) in power, a position in which they remain today.

Demographics

Turkey has a relatively young, homogenous, and educated population. Key demographic statistics include:

Population	Total: 75 Million	Growth: 1.3%	Median Age: 27.7
Ethnicity	Turks: 75%	Kurdish: 18%	Other: 7%
Religion	Muslim: 99.8%	Sunni Muslim: 70-80%	Other: 0.2%
Literacy	Men: 95%	Women: 70%	
Tech Penetration	Mobile: 85%	Internet: 35%	

Government and Politics

Turkey's parliamentary republic was established in 1923 shortly after the fall of the Ottoman Empire. However, it did not become a multiparty state until the 1950s. Unique amongst most Islamic countries, Turkey's government was created as and remains a secular state. The government is characterized by Kemalism, an ideology governed by six pillars: republicanism, nationalism, populism, secularism, statism, and revolutionism. The Turkish military, with its strong popular support and established position as a trusted state institution, views itself as the guardian of Kemalism and maintains a strong influence over the country's politics. The military's main vehicle of political power, the *Milli*

Güvenlik Kurulu (MGK), or National Security Council, was formed in 1960 after a military coup and works to increase stability in the nation.

Similar to the U.S., Turkey has a constitution which acts as the supreme law of the land. In addition to laying out the main principles of government, it establishes essential liberties such as freedom of expression and freedom of press. The Turkish government has three branches: the executive branch, legislative branch, and judicial branch. The executive branch is governed by the President, although he or she primarily retains a ceremonial role. Real power is held and exercised by the Prime Minister, who is usually the head of Turkey's most powerful parliamentary party, the military, and the Council of Ministers. The judiciary has a tiered system of courts like the United States.

The legislative branch is represented by Turkey's unicameral parliament, the Grand National Assembly. The parliament has 550 members, each elected to a five-year term. While there are over 50 political parties in Turkey, only a few make it to the national stage. Turkey follows a system of proportional representation where only parties that receive at least 10% of the votes cast win representation. In 2002, this led to only two parties having representation, and in 2007, only three. Turkey's three largest parties are the Justice and Development Party, the Republican People's Party, and the Nationalist Movement Party, who together garnered 82% of the popular vote in the 2007 elections. All of these parties' views are right of center, resulting in a more conservative government. Voting rights in Turkey mirror that of many Western countries. Men and women have had universal suffrage in Turkey since 1933.


A political cartoon depicting Turkey juggling its relationships with various world and regional powers.

Foreign Policy

Turkey plays a significant role on the international stage. It is an active member of NATO, the OECD, the WTO, and the G-20. In addition, Turkey is currently seeking to become a member of the European Union (EU). Since 1963, Turkey has been an associate member of the European Community, the predecessor to the EU. Turkey has also found itself an attractive niche in the international sphere as a bridge between East and West due to its Westernized, non-secular government and large Muslim population.

In 1999, Turkey officially became a candidate for EU membership. Not until 2005 did official conversations regarding ascension begin. The EU established a Customs Union with Turkey in 1995, aligning many Turkish trade and economic policies with EU ones. As demonstrated by several Eastern European countries, entry into the EU results in numerous economic opportunities, particularly the opening of borders to the free movement of both people and goods. The EU accounts for more than half of Turkey's trade today and is a major source of foreign direct investment (FDI), totaling almost €9 billion, or two thirds of total FDI in 2007.

However, Turkey has not yet managed to secure a spot in the organization, and it is not clear if and when it will be allowed to join. The unresolved disputes with Greece, a current EU member, over Cyprus and surrounding territories in the Aegean Sea and the prominent role of the military within the Turkish government stand as the two major foreign policy obstacles to Turkey membership in the EU. A third, albeit lesser, concern is the fact that some European Union members do not consider Turkey a part of Europe.

This cultural gap between Turkey and the countries of "traditional" Europe has implications not only for Turkey's EU aspirations, but for the future of Turkish foreign policy as a whole. Turkey's unique location between Europe, the Middle East, and Asia affords the country numerous opportunities to align itself with several of the world's existing and emerging power centers, but also presents specific cultural, political, and economic challenges. Turkey's handling of its situation and position in the geopolitical sphere is closely interrelated to its economic situation and should be closely monitored by anyone considering investing in the country.

Current Situation

Despite the recent global recession, Turkey has managed to weather the current crisis relatively well. This is distinct from the recession in 2001, when the country suffered from high inflation, a near-collapse of its currency, and a weak banking sector with poor regulation that suffered from speculative trading and foreign debt. The fragility of Turkey's financial system has often been cited as a crucial element that hindered the country's ascension as one of the leading emerging economies. The Turkish economy has experienced structural problems in both politics and regulation as well as a decline in export volume. Compared to its Western counterparts, the financial system has emerged relatively unscathed.

Turkey benefited from the International Monetary Fund's (IMF) initiatives to control inflation, and the banks were well-capitalized relative to their foreign competitors. Additionally, Turkey has opened its economy and received a surge in foreign direct investments (FDI), increasing from $1.1 billion in 2001 to $22 billion in 2007. The recent governmental reforms imposed to meet the EU ascension demands have further improved the country. The government lowered corporate taxation, tightened intellectual property rights, and established an agency to promote investments. It also proposed other reforms such as women's rights in order to meet the developed nations' standards.

Turkey's unique position as the East-West bridge between Europe and Asia has spurred the development of an expansive transportation network comprised of roads, railways, airports, and seaports. Turkey has a well developed physical infrastructure that will continue to expand with the country's economic growth. Turkey's superior technological infrastructure relative to its Muslim peers has increased its sphere of cultural influence.

The Istanbul Stock Exchange is up by more than 70% this year and the lira has risen more than 20% vs. the dollar since March. However, some investors remain cautious about Turkey due to the Islamic roots of the current Justice & Development Party and tax problems that recently fined Turkey's media conglomerate $2.5 billion for taxes. Nevertheless, Turkey is headed in the right direction in terms of overall development and the country continues to work towards its goal of attaining EU membership.

Turkish Capital Markets

In Turkey, the Istanbul Stock Exchange (ISE) operates the country's capital markets system. Founded in 1985, the ISE trades a wide variety of products, including stocks, bonds, funds, indices, and exchange traded funds. From an organizational standpoint, the ISE is comprised of three main markets: the stock market, the bonds and bills market, and the foreign securities market.

In total, the ISE has created 61 different indices for investors in the stock and bonds markets. The main benchmark index in Turkey is the ISE National 100 Index, which includes 100 stocks most representative of the state of the Turkey economy. Other main indices in Turkey include the ISE National 50 Index, the ISE National 30 Index, the ISE Corporate Governance Index, ISE City Indices, ISE Second National Market Index, and various Sector and Sub-Sector Indices.

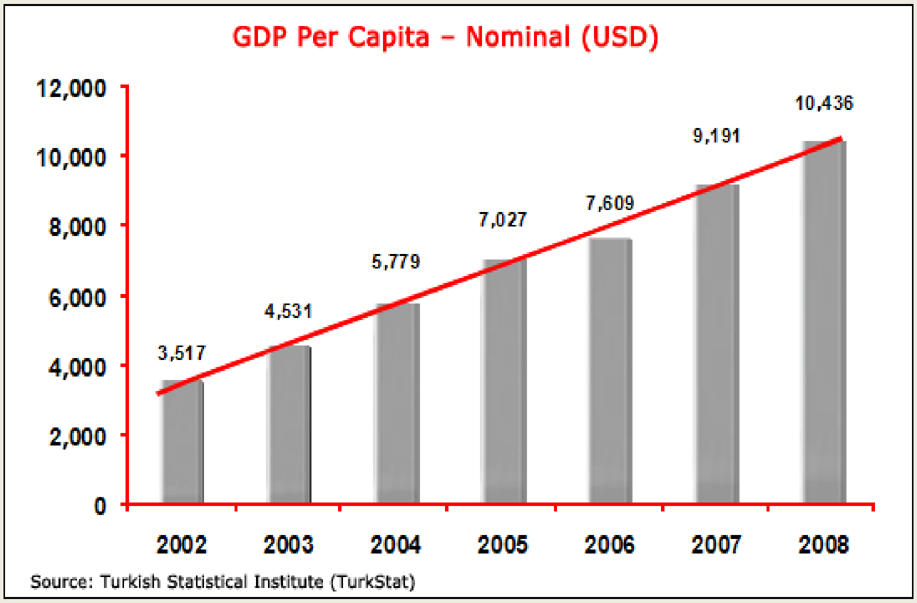
As of November 6, 2009, the value of the benchmark index, the National 100, was at 46,969.89, with 2009 YTD growth of 74%. The National 30 index, as of the same date, was valued at 59,398.24, with 2009 YTD growth of 90%. These growth levels are expected after dramatic 2008 decreases due to the global economic crisis. The ISE National 30 Index is most comparable to the United States' Dow Jones Index, which comprises 30 stocks with high market capitalizations and which best represent the state of the country's economy across various sectors. The following industries are represented in the ISE National 30 Index: 16 financial services firms, three transportation, telecommunication, and storage companies, eight manufacturing companies, one construction and public works firm, and one wholesale and retail trade, hotels and restaurants firm.

The regulatory authority which oversees the Istanbul Stock Exchange in Turkey is the Capital Markets Board of Turkey. Their mission is to oversee and supervise all legal and operational aspects on the capital markets system in Turkey. The law which governs over Turkey's capital markets is the Capital Markets Law (CML), which was created in 1981. The CML was enacted to "regulate and control the secure, fair and orderly functioning of the capital markets and to protect the rights and benefits of the investors." One of the other legal decrees put in place in Turkey to protect the capital markets system and investors is Decree No. 32, which "aims at further liberalization of the financial system and allows not only nonresidents to invest in the Turkish securities, government bonds and Treasury Bills, but also permits the outflow of domestic capital into foreign securities etc. through financial intermediaries authorized by the [Capital Markets Board]."

Economic Background

Economic Overview

Turkey is the world's 17th largest economy according to the most recent list released by the IMF with a nominal GDP of approximately $800 billion and per capita income of approximately $10,500. Turkey's modern and vibrant economy is a mix of industry, commerce, and agriculture. The two largest industrial sectors are textiles and clothing, which account for approximately one-third of total industrial employment. Other high-growth emerging sectors within the economy include automotive, shipbuilding, electronics, and banking. The country has a strong and growing private sector, but the government maintains a strong interest in the following industries: banking, transportation, and communication. The country has shown a commitment to gradual privatization with the creation of the Privatization Board of Turkey.



The increasing pace of privatization efforts has brought in approximately $44 billion in the past six years and future inflows will be used to finance budget deficit and pay back outstanding foreign debt. The Turkish current account deficit fell year over year (YoY) by 8.7% ($869 million) in September 2009 and the foreign exchange reserves of the Turkish Central Bank stand at a healthy $71.6 billion. The official unemployment rate according to most recent available date stood at 13.4% in the July-September 2009 period, but is expected to decline during 2010 given the overall improvement of the national and global economic landscape. The current unemployment rate is not far from long term average unemployment rate of 10%.

Economic Growth

Turkey has faced significant economic headwinds due to the global financial crisis as GDP contracted by 7% YoY in the second quarter of 2009, which was the third consecutive quarter of negative annual growth. The contraction in the past year was primarily due to frozen domestic lending market, limited FDI inflows, and declining exports and internal consumption. All these factors have significantly improved over the past year on the back of sharp declines in benchmark rates, increased capital inflows and new fiscal stimulus measures.

The European Commission has forecasted a contraction of 5.8% in the gross domestic product for Turkey for this year and forecasted a 2.6% and 3.6% growth for 2010 and 2011 respectively. We expect that lower interest rates, increased consumption, business confidence, and government expenditure ahead of the 2011 general election will give further boost to recovery in 2010-11. The primary risk associated with these projections is that Turkish growth may decrease substantially if global risk appetite were to decrease due overall global economic deterioration.

Inflation Risk

Inflation rates in Turkey have been a matter of key concern for foreign investors and central bankers as the country grabbles with inflation and seeks to maintain healthy economic growth. Until 2009, Turkey experienced high and persistent inflation for more than twenty years. It recently fell to a 39-year low on the back of negative GDP growth, falling demand, and the recent decline in global commodity prices. According to the Turkish Central Bank's most recent report, inflation rates were relatively low at 5.3% and are expected to remain below the 7.5% projected for 2009. The intermediate term forecast for inflation as released by the central bank forecast inflation rates below 6.5% in 2010, 5.5% in 2011 and a further decline to 4.8% by the third quarter of 2012. The decline in inflation levels is in line with the rest of developing world as the Turkish economy continues to operate below capacity and domestic demand remains relatively flat.

A key cause of concern going forward is the monetary loosening employed by the central bank to stimulate growth and pull the economy out of recession. Benchmark interest rates have decreased by 10 percentage points to 6.75% since November 2008, and there are expectations of further decline. The Central Bank is expected to keep the Benchmark rates low for much of 2010-11.

Currency

The Turkish lira is the official currency of Turkey. The lira has strengthened significantly over the past six months on the back of an overall increase in global risk appetite and inflow into Turkish bonds in expectation of further decrease in benchmark rates. After significant declines and increased volatility in the fourth quarter of 2008 and first quarter of 2009, the Turkish lira rose to a 12 month high against the dollar at 1 Turkish lira = 0.663922 U.S. dollars. Current forecasts from the Economist

Intelligence Unit project the lira at 1.55/$1 levels in 2009 and moderate strengthening to an average of 1.50/$1 in 2010 and 2011. Future lira volatility and fluctuation will be governed by the pace of economic recovery and the global financial markets' stability.

Turkey's Country Risk

Turkey: risk assessment

Sovereign risk	Currency risk	Banking sector risk	Political risk	Economic structure risk	Country risk
B	BB	BB	BB	B	B

According to the EIU, key Turkish risk parameters include Sovereign Risk, Currency Risk, Banking sector risk, Political Risk, Economic Structure Risk, and Investment risk.

Sovereign Risk (Grade B)

- European contraction in 2009 will increase Turkey's deficit and GDP will decrease
- Turkey expected to sign an IMF stand-by-accord to ease concerns about default risk
- The $45 billion lending program on public spending will provide much needed financial assistance to prevent a debt-default and currency crisis

Currency Risk (Grade B)

- In 2009, the lira depreciated in value as investors deterred from global risk exposure
- The lira has partly recovered as investors have increased their global risk appetite

Banking sector risk (Grade BB)

- Turkey has sought to improve its banking sector through consolidation and reforms
- Focus on foreign borrowing rather than domestic saving has delayed deleveraging

Political Risk (Grade BB)

- Role in Middle Eastern affairs as a mediator in conflicts rather than a participant
- Strong tradition of secularism and adherence to parliamentary democracy limit the appeal of extremist groups
- Divisions between the moderate Islamist government and secular institutions have frequently delayed the policy making process in the past

Economic Structure Risk (Grade B)

- Public debt/GDP ratio has started to rise for the first time since 2001, which leaves the country vulnerable if another financial crisis were to begin
- On the positive side, the current account deficit has fallen sharply

Investment Risk (Grade B)

- Turkish equity markets declined 64% in 2008 due to the challenges of financing the external deficit in a deleveraging global financial system
- Turkey is currently one of the cheapest markets in its peer group, trading at a P/E of just 5.6x based on 2009 expected earnings
- Fundamental weaknesses of the economy are already priced in so investors with a long term perspective should start investing now

Overall Country Risk (Grade B)

After careful analysis, there are many positive indicators for Turkey. The sharp decreases in GDP in earlier periods will eventually balance and show some upside in YoY improvement. Another key indicator is that domestic demand is increasing. We are seeing lower food and fuel prices, public sector wage hikes, lower taxes, and interest rate cuts, the combination of which is boosting overall consumer demand. In the risk assessment shown above, there are clear hurdles that Turkey has to surpass in each category. That being said, there is opportunity in every challenge. Turkey will be among the best performing emerging European economies in 2010 and beyond. It will particularly benefit from a strong banking sector, which will help to incite credit growth as international credit markets start to stabilize in the coming years.

Anadolu Efes Group

Industry Overview: Soft Drinks

Turkey's consumer market has grown substantially with its economy over the past decade. As a segment of the consumer market, the beverage industry benefited significantly from Turkey's improving economic conditions. Increased affluence and disposable income throughout Turkey has led the country's consumer oriented population to raise their consumption of discretionary items, such as beer and soft drinks. An expansion in the young population and urbanization led to further growth in urban areas, where higher disposable incomes led to increased consumption. Euromonitor forecasts that the soft drink market will continue to experience healthy growth, albeit at a slower rate due to market saturation.

In addition to consistent economic growth, innovative product lines will become increasingly important as the young population becomes more demanding of fresh and unique, new products. As a result, the industry has released a slew of new product offerings and developed increasingly sophisticated advertising techniques. Multinationals such and Coca Cola and Pepsi have contributed to the development of the industry by bringing their product portfolios and marketing expertise to Turkey through partnerships with local companies. For example, Coca Cola and its local partner introduced Cappy Prebiotki, a pre-biotic product that helps the digestive system in 2008. The company unleashed an extensive advertising campaign touting the beverage's health benefits. In addition to the large MNCs, Turkey has a number of competent domestic players. One of these, Anadolu Efes, is Coca Cola's local partner and the market leader. Analysts, including Euromonitor, forecast that the factors discussed above will lead to sustained growth in the beverage sector over the next few years.

Industry Overview: Beer

Despite having a predominantly Muslim population, the growth in Turkey's beverage industry is not limited to non-alcoholic drinks. Turkey has one of the most robust alcohol and beer industries in the Muslim world. Alcohol in general is widely consumed, and, according to Euromonitor, beer "accounts for the highest share of alcoholic drinks production and consumption." Over the last year, beer sales increased by 11% in total volume to reach over one billion liters. The beer sector's growth potential remains strong with total sales volume expected to grow by 74% to over 1.8 billion liters by 2013.

While many factors contribute to the recent growth in beer's popularity, the beverage's relatively low price is a primary reason for the population's favoring of the beverage. At the same time, the recent introduction of several domestic premium beers has been quite successful. According to recent statistics, the market for premium beer grew by 12% in total volume, slightly higher than the industry as a whole, over the past year. While this trend may signal a shift towards more expensive beverages, price still plays a major role in consumers' purchasing decisions.

In addition to price, Turkish consumers prefer drinking large quantities while socializing, so the lower alcohol content in beer is viewed as a positive. In 2008, the industry also benefited from tax increases applied to alcoholic drinks based on their alcoholic content. Because beer has the lowest ABV (alcohol by volume), it was less affected by this legislation than other alcoholic drinks. Beer's low alcohol content now gives the beverage a relative social and economic advantage against beverages with higher alcohol content. As a whole, Turkey's largely secular population (in practice if not in name) and growing middle class have fueled the growth in the country's beer industry.

Company Profile

Anadolu Efes is the holding company of Efes Beverage Group, a group of companies with interests in beer, malt, and soft drinks. Efes Beverage Group is the beverage arm of one of Turkey's leading conglomerates, Anadolu Group. The company started its first brewery in 1969 and since then has rapidly expanded to become the largest brewer in Turkey and Europe's fifth largest beer company based on sales volume. The company primarily produces and markets beer in Turkey, Russia, Serbia, Kazakhstan, and Moldova with a total production capacity of 34 million hectoliters.

The company dominates the Turkish beer market. According to 2007 date (the most recent available), Efes held a 68% share in terms of alcoholic beverage sales by volume and a 79% share in terms of beer sales by volume in the country. The company has increased its sales volume by an average 8% per annum. The company is able to maintain and expand this dominance by leveraging its experience and expertise as a first-mover in the industry and by strategically investing in innovative beer offerings, such as premium lagers. The company's beer operation is distinct from potential competitors due to its strong brand name, high customer loyalty, extensive distribution capabilities, and diverse product offerings across beer categories. The company also owns Russia's biggest beer producer, Kransy Vostok, and produces foreign premium lagers such as Miller, Beck's, and Foster's under license. Foreign beers are not popular in the Turkish market, so the company does not face significant threats from large international competitors in the intermediate term. Religious beliefs and high excise duties remain the primary barriers to growth in the domestic market, but these factors have done little to halt

Anadolu Efes' growth so far. Globally, Anadolu Efes holds the leading position in Moldova and Georgia; ranks second in Kazakhstan, and fourth in Russia.

Anadolu Efes also has extensive soft drink operations with Coca Cola and operates in seven countries via 12 bottling plants. The company is the largest shareholder (50.3% stake) in Coca Cola Icecek, which manages the soft drink business in Turkey and international markets.

Anadolu Efes' Position in Selected International Markets

Country	# of Breweries	08 Volume (in mhl)	Recent market share & Position
Russia	5	11.1	9.3%; #4
Kazakhstan	2	1.4	30.9%; #2
Moldova	1	0.9	71.9%; #1
Georgia	1	0.6	47.4%; #1

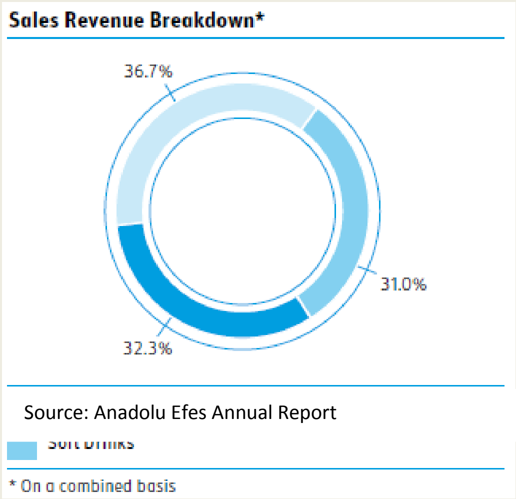
Source: FinasInvest

Internationally, Anadolu Efes is the leading soft drink producer and seller in all markets it operates in, with the exception of Jordan and Pakistan, where it occupies the second position. It is the sixth largest bottler within the Coca Cola system and the current CEO and President of Coca Cola, Muhtar Kent, is the former top executive of Anadolu Efes.

The soft drink group supplies consumers with core brands such as "Coca Cola," "Coca-Cola Light," "Fanta," and "Sprite." It also provides other brands such as "Sensun" and "Schweppes" in the carbonated soft drink segment, "Cappy" and "Fruita" in the fruit juice segment, "Turkuaz" in the purified water segment, "Powerade" in the sports drink segment, "Burn" in the energy drink segment, and "Nestea" and "Nestea Light" in the iced tea segment. The soft drink group aims to continue focusing on quality and volume as it expands within Turkey, Southern Eurasia, and the rest of the Middle East.

Financial Analysis

While undoubtedly impacted by the economic downturn, Anadolu Efes' stable cash flows and consistently improving operational efficiency have allowed the company to remain profitable throughout the recession. EBITA, which increased from TRY 720 million in 2007 to TRY 832 million in 2008, is forecasted to increase further to around TRY 930 million in 2009. Sales volume for beer and soft drinks is up 3.5% YoY in 2009. In addition, the company continues to experience success in beer markets outside of Turkey. The company expects to continue outgrowing the overall market in nearly all the international markets it operates in.



In terms of profitability, Anadolu Efes offset increases in input prices with continued improvements in operational efficiency. This allowed the company to maintain consolidated gross profit margins of 50.4% and an EBITA margin of 26.3%. Despite increased sales and solid gross margins, net profits are expected to fall to TRY 293 million in 2009 from TRY 310 million in 2008. This fall is attributed primarily to foreign exchanges losses and the higher costs of debt financing in the wake of the financial crisis. We expect Anadolu Efes' will maintain these robust operating margins and increase its net income as a result of the industry's high barriers of entry, the company's dominance of the industry, and its proven ability at controlling costs.

Proper management of Anadolu Efes' capital structure is critical if the company is going to continue increasing profits through international expansion. Its ability to expand may be constrained if it takes on excessive levels of debt, particularly due to recent increases in the cost of debt. With a debt to equity level of about 1.14 as of September 2009, the company is moderately levered. The company has about TRY 958 million in short-term borrowing backed by over TRY 2.1 billion of current assets, of which TRY 942 million are cash. After reducing its long-term debt level by more than TRY 100 million in the past nine months, Anadolu Efes now has TRY 902 million in long-term borrowing. The company has a strong balance sheet that should allow it to continue focusing on growing it core businesses.

As of November 30, 2009, Anadolu trades at TRY 16.00. This is near the top of its 52-week range of TRY 9.11 to TRY 18.1. This gives it a market capitalization of over TRY 7 billion, making it one of Turkey's largest companies in terms of market value. Given this price, Anadolu is trading at approximately 20x current earnings. This is higher than the 13x earnings at which its international peers trade, but we feel Anadolu Efes' market dominance in Turkey and its successful international initiatives puts it in a unique position that warrants the higher valuation. While it may trade at a premium to companies that are somewhat similar, Anadolu Efes' strong fundamentals and valuable product portfolio lead us to maintain a *long-term* bullish stance on the stock.

Investment Strengths

-Dominant player in the beer market & high barriers to entry

As mentioned earlier, Anadolu Efes has a dominant market share in Turkey where beer consumption makes up a majority of the alcoholic beverage market. Efes beer brands are deeply rooted in Turkish social life. The company's position as the industry leader is virtually unthreatened as the firm continually meets the shifting demands of consumers and invests heavily in advertising. Also, because the operation benefits from high economies of scale, barriers to entry are high.

-Growth in the regional soft drinks market

The soft drink business operates in ten countries, such as Kazakhstan and Azerbaijan, with strong growth potential. These countries have young populations and the sparkling beverage sector is not yet penetrated, meaning that Anadou Efes can potentially capture a large share of the market. Even the domestic Turkish market has a relatively low consumption rate in contrast to Eastern European and Mediterranean countries. Anadolu Efes' presence in these markets will contribute to the sustained growth of its beer operations.

-Diversified business model

Instead of relying heavily on one line of business, Anadolu Efes has a balanced revenue stream. Turkish beer, international beer, and soft drinks all contribute to the group's revenues. This is important because the business model makes the company's revenues relatively stable. Given the diversified revenue stream, a sudden deterioration in one business will not damage the group's overall revenue.

-Ambitious and Strategic Vision

From a qualitative perspective, the company's leadership has a clear vision to transform Anadolu Efes into a leading player in the international beer and soft drink markets. The firm has grown organically and through several successful strategic acquisitions, such as in Russia in 2006. Its established presence in Eurasia and knack for expanding into international markets should help it achieve its ambitious expansion plan.

Investment Risks

- Increase in Taxes

In recent years, there have been a number of consumption tax increases on alcoholic beverages in Turkey. Additional tax increases in any of Anadolu Efes' key markets could decrease profitability and hamper growth. The Russian government is planning to raise the excise tax on beer, which would hurt

Anadolu Efes' Russian business (which contributes 78.2% to international beer volumes and 46.8% of total beer volumes).

-GDP Growth

Beverage sales are sensitive to GDP growth. Deteriorating economic conditions in any of the company's more significant markets could affect performance of the stock.

-Current Valuation Level

The company is currently trading at 20x current earnings and a correction can be expected in the near-term. The stock price will likely fall to a level where the firm's P/E ratio is more in line with its peer group. Stocks across emerging markets may be overvalued at their current levels and a healthy correction is in order if earnings to not increase substantially in the next quarter.

Investment Conclusion

Short-Term: Hold

Long/ Intermediate-Term: Buy/Accumulate

Reasoning: Anadolu Efes' operations today reach nearly 500 million consumers globally via its expansive soft drinks and beer distribution network. Efes Beer Group is strategically positioning itself to become the strongest independent, regional beer company in the world by developing a diverse brand portfolio and the soft drinks group aims to continue focusing on quality and volume as it expands within Turkey, Southern Eurasia, and the rest of the Middle East. The company seeks to drive long term, sustainable profit growth by expanding into new markets organically and via value-enhancing acquisitions and then outperforming the overall volume growth in these markets. As a result of the stock's recent rally, we recommend that investors hold the stock in the near-term until the company reaches a valuation comparable with its peer group. As one of the largest listed companies in Turkey, Anadolu Efes has considerable upside potential for value investors as the company continues to maintain strong profit margins while expanding per-capita consumption of soft drinks and beer in its home market of Turkey and the international markets it expands into. It can be expected that Anadolu Efes will continue to leverage its first-mover advantage, strong brand name, high customer loyalty, strong distribution capacity, and diverse and innovative offerings to give investors consistent dividend growth and price appreciation.

Garanti Bank

Industry Overview: Banking

Macroeconomic conditions have improved in Turkey since 2002. This improvement was fueled by the recapitalization and restructuring of the banking sector as well as an increase in the country's appeal to foreign investors. Preparation for the implementation of Basel II, a set of recommendations on banking regulation, further improved the financial stability of Turkey's banking sector.

Prior to 2002, the Turkish banking sector was populated by poorly managed public banks and "had serious deficiencies, such as unstable foreign currency, high interest rates, and significant liquidity risks." In addition, weak financial regulation led to several banking crises and a decline in Turkey's international economic reputation. In 2001, Turkey's government engaged in an overall restructuring of the banking sector. This initiative aimed to improve the public's perception of the banking sector, increase the efficiency of public banks, and expand the role of private banks. By 2008, the Turkish banks had increased their capital to a level safely in excess of legal requirements. In addition, regulators reformed governance and risk management techniques which further stabilized the sector. Turkish banks have now returned to the traditional banking role of encouraging economic growth through loans rather than financing obscene fiscal deficits, which they had focused on prior to reform.

The total asset size of the financial sector in Turkey grew by 24% during 2008, reaching TRY 828 billion. Turkey lost only one bank during the economic crisis, decreasing the total number of banks in the country from 50 to 49. The banking sector grew by 3% in nominal terms and 1.9% in real terms during the first quarter of 2009. Turkish banks are now some of the best capitalized in the world, which put them in a relatively good position to weather the recent economic downturn. The Capital Adequacy Ratio (CAR) for Turkish banks was at 18.5% in March of 2009, well above the legal limit of 8%. It is also above Turkey's desired minimum ratio of 12%, far exceeding that of many emerging markets. Foreign currency lending represents only 29% of total lending in Turkey at year end 2008. These low levels of foreign currency lending further insulated the banking sector during the recent financial downturn.

Deposits, considered a stable and low cost source of financing, represent around 60% of total funding for Turkish banks. Compared to banks in other emerging European markets, Turkish banks fund their portfolios with a higher percentage of deposits. The Central Bank of Turkey controls lira liquidity, which allows it to tighten or loosen markets in response to currency flow fluctuations.

Company Overview

Garanti Bank is a commercial bank with an investment banking arm. The company was founded in 1949 and acquired by the Dogus Group in 1983. The company continued to grow throughout the decade until it went public in 1990. Garanti Bank has been an industry leader since its establishment; the company developed Turkey's first cash management account in 1995. Also, the Bank began providing real-time online services and online banking during the 1990s as the Internet boom was growing. For its commercial banking side, Garanti created both the Bonus Card and FlexiCard. During 2001, Garanti merged with a subsidiary of the Dogus Group, Ottoman Bank. Having established itself as a technologically-forward company, Garanti began providing services in 2005 through mobile devices. Lastly in 2005, General Electric became a primary investor in the bank along with the Dogus Group.

Garanti's Major Products

-Retail banking
-Deposits
-Investment products
-Credit cards
-Overdraft facilities
-Liquidity management accounts
-Commercial banking
-Loans
-Letters of guarantee
-Import and export transactions
-Investment credit and services
-Corporate banking services
-Insurance services

Garanti Bank is now "Turkey's second largest private bank" with consolidated assets of over $104 billion, and is "Turkey's largest lender" providing cash and non-cash loans of over $44 billion. The bank has a vast distribution network consisting of nearly 730 branches, over 2,600 ATMs, and four international representative offices. Garanti operates five foreign branches in Luxembourg, Malta, and Cyprus, two banking subsidiaries in The Netherlands and Russia, and is also the first Turkish bank that has a representative office in China. Garanti has further developed its brand image by supporting numerous projects in areas such as culture, arts, environment, education, and sports.

Garanti Bank is managed by a highly educated senior executive team. According to Garanti Bank's Investor Relations section, Ergun Özen, Garanti Bank's CEO and President, studied Economics at New York State University, and later graduated from Harvard Business School's Advanced Management Program. Mr. Özen also serves on several boards: the Banks

Association of Turkey, the Turkey Industrialists' and Businessman's Association, the Institute of International Finance, amongst others.

Garanti Bank has two major competitors within Turkey: Turkey IS Bankasi and AkBank. Bankasi is Turkey's first public bank and premiere national financial institution. AkBank is another profitable bank that is a major player in terms of loan volume. During 2008, Garanti had a larger net profit and market cap than both of its key competitors. The bank has maintained a high ROE primarily as a result of strong trading gains and declining costs of funding. As credit begins to flow more freely, Garanti should be able to remain highly profitable and maintain a impressive ROE.

Financial Analysis

Since 2007, Garanti Bank has adopted a more conservative business model, indicated by a focus on asset quality, liquidity, and retail and commercial loans. As a result, Garanti Bank weathered the global economic crisis well and has produced impressive financial results thus far in 2009. Garanti Bank has earned net profits of TRY 712.4 million and total assets have increased 6% to TRY 105 billion. Total deposits rose 10% to TRY 63.6 million. Garanti Bank has also seen growth in market share in two key areas: cash loans and foreign currency loans; with the former increasing to 15.1% and the latter increasing to 21.9%.

Over the five years spanning 2004 to 2008, Garanti Bank grew quickly while maintaining high levels of profitability. Earnings per share have nearly quadrupled during this period to TRY 0.46, and Book Value per Share has grown to TRY 2.35, up from TRY 0.91 in 2004. Other key statistics have also increased. The bank's net profit margin increased from 11.87% in 2004 to 19.02% in 2008. Return on equity is up from 12.63% in 2004 to 19.40% in 2008 while return on assets now stands at 1.95% in 2008, up from 1.30% in 2002. Unfortunately, the 2008 values are drastic reductions from 2007 highs. However, they have yet to sink to 2004 levels and early 2009 results signal the return of positive ratio growth.

The stock is trading within a 52-week range of TRY 1.85 and TRY 6.40. The stock price has increased substantially in 2009 to a level of TRY 5.20. Increasingly positive indications from the company's recent results lead us to believe that this upward trend will continue.

Investment Strengths

"Despite risks to the EU accession process, Turkey is still a major 'convergence play' for investors." It offers diversified investment opportunities, including those in a booming banking sector. Turkey's reform program is expected to benefit Turkish banks, such as Garanti Bank. Recent structural reforms intended to increase transparency and liquidity in Turkish banks have achieved just that. Garanti is a prime example of a “best of breed” Turkish bank. It has a strong franchise and brand, the backing of both GE Capital and the Dogus Group, consistent profits delivered by its commercial and corporate banking operations, a liquid asset mix with a liquidity ratio of 38%, and a strong corporate governance system.

The last two years have seen the bank steal market share from competitors and rapidly become one of the success stories emerging from the economic crisis. It is Turkey’s second largest bank by assets and one of the most profitable. It has a large-scale network including 730 branches and 2,600 ATMs. From 2007 to 2008, Garanti saw its deposit base rise 33%, its overall assets grow by 52%, its loan portfolio increase 38%, and an 18.4% growth in customers. Garanti’s market share of the commercial banking sector is now 17%, and its demand deposit growth is triple that of other firms in the sector. Additionally, it has been named “The Best Bank of Turkey” by Euromoney for nine years in a row along with numerous accolades from other publications.

Investment Risks

While overall outlook on the banking sector in Turkey is positive, investing in this area still poses several risks. According to the BMI report on Turkey’s banking sector, there are several macroeconomic issues which face the country. Turkey is geographically in an area of great instability, highlighted by tensions in the Middle East and a potential dispute with Greece over Cyprus. Also, there is the risk of further decrease in loan issuances. Due to the global economic crisis, Turkey also is dependent upon other countries to support it fiscally. Turkey’s “reliance on foreign direct investment inflows to support its balance of payments highlights risks it faces in the event of a global economic downturn.”

Specific to Garanti Bank, the company is “still exposed to any sharp deterioration in investor appetite for Turkish risk.” Overall, the company has seen great growth and is profitable, and these trends are expected to continue for years to come. But while the company may be quite sound, it is still affected by Turkey’s overall economic performance, and the risk of further market decline will negatively impact the company. This may in fact be the most significant factor to affect the stock performance of Garanti Bank.

Investment Conclusion

Short-Term: Buy/Accumulate

Long/Intermediate-Term: Buy/Accumulate

Reasoning: Garanti Bank **has a large array of diverse product offerings. The company managed to gain market share and focus on improving asset quality during the recent economic downturn.** The bank will continue to produce solid financial results due to an increase in loan demand, effectively managed portfolios, and trading gains. In the 2008 global financial crisis, Garanti continued to lend and is now the top bank in Turkey in terms of loan volume. Garanti's deposits far exceeded the average for the banking sector, which reflects the trust in the company's brand image. Overall, the bank has a solid business model, strong retail base, and a healthy balance sheet. As credit markets continue to loosen, Turkey will be a relative outperformer in the region, and Garanti Bank will be a major outperformer amongst its peers.

Garanti Bank’s Headquarters

Final Remarks

We believe that the Turkish stock market and our specific stock selections will outperform their peers in the intermediate- to long-term. Turkey's strong growth potential and relative stability make it a prime choice for emerging markets investing. Although Turkey suffered in previous crises, it has shown resilience in the recent global meltdown. In addition, the country is striving to gain membership in the EU.

For investors looking to capitalize on the available investment opportunities in Turkey, we strongly recommend investing in Anadolu Efes and Garanti Bank. The beer component of Anadolu Efes is attractive due to its strong brand name, high customer loyalty, strong distribution capacity, and innovative offerings across beer categories. Domestic market growth, selective international expansion, and strong company fundamentals make Anadolu Efes an exceptionally promising long-term investment. Garanti Bank's large and sound balance sheet, high asset quality, and strong ROE makes it an ideal investment in the increasingly profitable banking sector. As credit markets improve in the upcoming quarters, Turkey will be uniquely positioned to outperform in its region and furthermore Garanti will gain prominence in the sector. As with any investment opportunities, there are risks, but we conclude that the benefits will significantly outweigh these risks.

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