

FTSE

ISSUE 52 • JUNE 2011

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Inward investment flows into Turkey are firming up; data from the Turkish treasury suggests that longer term investment is beginning to replace short term speculative flows. Foreign direct investment (FDI) inflows into Turkey jumped to \$2.8bn in March, up substantively from the inflows worth \$525m in March last year. While FDI inflows, worth \$3.953bn in the first quarter (Q1) 2011 were up 254% over the same period in 2010. Moreover, there are signs that the domestic debt markets might be beginning to take off.

Investment takes a firm turn

THE TURKISH CENTRAL Bank implemented an experimental policy by cutting benchmark rates and raising reserve requirements for banks as 2010 came to a close. Signs are that the government is getting serious about encouraging long term capital inflows into Turkey. According to Mehmet Sağıroğlu, chief executive officer at IEG-Global in Istanbul. "Significant for the markets right now is the new commercial code, which is also set to be particularly beneficial for foreign investors by saving them from double taxation. The new code is the most extensive reform within the government's efforts to harmonise Turkey with the EU by securing compliance of trade law with the EU. Once the bill becomes a law, foreign investors will feel more secure as foreign investors prefer to be involved in a system that complies with the laws of their own country. I think the law will alter the foreign outlook towards Turkey, though I still have worries about the impact of this growing current account deficit and how the external world sees Turkey in this regard."

The move is significant for Turkey, given that foreign investment inflows have tended to flow through the national stock exchange (foreign institutional funds are reckoned to account for over 63% of the Istanbul Stock Exchange) and flow directly out again, depending on market conditions. Creating stable pools of investment capital is fundamental to establishing the



Seniz Yarcın, senior executive vice president of treasury, investment banking and international relations at TSKB. "Since there is still no requirement for independent ratings of locally issued bonds, it can be difficult for investors to analyse credit risk. That has created a particular market where banks act as market makers for their own bonds," she says. Photograph kindly supplied by TSKB, May 2011.

country (in this instance, read Istanbul) as a long term viable financial centre. According to Ertunc Gurson, head of sales at TEB Securities Services, a joint venture with BNP Paribas which provides securities services to international investment firms active in the country. "Developments such as the new trade law and continuing liberalisation of the Turkish financial markets feed into a broadening of sources of

investment funds flowing into the country. We are increasingly seeing funds coming in not only from our traditional markets of the EU and the US, but also now investment inflows from China, Singapore, Japan and South Korea," he says.

Sağıroğlu sees significant growth potential across three main segments: debt capital markets (DCM), equity capital markets (ECM) and M&A, which play both to the country's growth story and which provide opportunity for foreign investors to enter the market. For its part, the recently established 50-50 German/Turkish IEG-Global joint venture, hopes to capitalise on these trends offering M&A, advisory and services in financial strategy, with a particular focus on the growth companies in the SME segment. The revitalisation of the country's stop-start privatisation programme should constitute a substantial element of the spur to the country's M&A and capital markets' segments. "Two years ago, these markets were dominated by local investors interested in opportunities to build market share through participation in the privatisation sell offs. Now I think it is the right time for foreign investors to take a new look at the market, which could be worth as much as \$20bn per annum over the medium term."

Sağıroğlu points to existing projects in the transportation segment; particularly around Istanbul's port, as well as new opportunities emerging in health care, consumer focused industries and electrical distribution, either through private sales or official auctions. "The range is quite varied and includes firms such as Milipiango, the national lottery franchise which is also up for privatisation."

Any number of privatisation projects is in train; including the road trans- ▶▶

portation projects and some toll bridges. Moreover, gas distribution projects serving key cities, such as Istanbul and Ankara are also on the bloc. A possible highlight of 2012 could be the sell-off of a portion of Turkish Airlines, though the precise structure this sale might take is not yet clear.

Certainly, holds Sađirođlu, opportunities also abound in the private sector where: "local family firms are increasingly ready to accept foreign partners. There is a growing realisation that if these family entities do not expand their shareholding to include foreign partners and import expertise, some of them will eventually wind down and disappear."

Even so, he acknowledges that the development of an active local debt market will be integral to the sustainability of the country's M&A market. It will not be achieved overnight. Traditionally, it has been difficult to establish a deep domestic capital market. For some years, high levels of government borrowing in the domestic market tended to crowd out domestic private sector bond issuance. However, Seniz Yarcan, senior executive vice president of treasury, investment banking and international relations at TSKB, says that as government spending is reined in, it should open up the domestic market to private firms seeking capital.

Yarcan thinks that local banks have an important role to play in deepening the local market and educating institutional investors. "Since there is still no requirement for independent ratings of locally issued bonds, it can be difficult for investors to analyse credit risk. That has created a particular market where banks act as market makers for their own bonds. Even so, volume is increasing. Through 2010 we had TRY3m in domestic private sector bonds issued; and in the first quarter of this year, the volume was exactly the same, so that is a positive trend. More banks are entering the market, issuing bonds and they are now helping to create a secondary trading market in the securities," she says.

In this regard, Gurson sees enormous potential from the establishment of new



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institutions in the country that encourage risk management and points to plans by derivatives trading platform TurkDex to offer single stock futures on the ISE National 100 index as an example of a move in the right direction. "If the market can offer a range of investible product, it will deepen the pools of money available for investment as investors need not move money out of the country to manage their exposure to risk," says Gurson.

TSKB's Yarcans thinks the markets should not expect a huge flow of fund raising deals, either in the debt or equity markets. "We will see some PPP transactions close, particularly those with international bank participation, and energy is a sector that is always highlighted in this market: it is natural given our large import requirement in this segment. There will, however, be some loosening after the elections," she says.

Yarcans also thinks that FDI will likely coalesce around the country's key growth sectors, which include energy, real estate, logistics, infrastructure, health, education and the textile sector, "which is actually recovering quite well. However, health and education will need quite hefty levels of investment."



Mehmet Sađirođlu, CEO at IEG-Global in Istanbul. "Local family firms are increasingly ready to accept foreign partners. There is a growing realisation that if these family entities do not expand their shareholding to include foreign partners and import expertise, some of them will eventually wind down and disappear," he says. Photograph kindly supplied by IEG-Global, May 2011.

She also points to the jitters that have beset the country's stock market this year, which has caused a number of high profile offerings to be postponed. TSKB itself closed three IPOs last year, accounting for around one third of the total volume of offerings for the year. "The markets were anticipating a robust \$10bn IPO calendar to be posted this year. However, many offerings have been postponed, some to the latter part of the year, others perhaps next year. Some quite high profile transactions have been withdrawn because of testing global market conditions. The participation of foreign investors is paramount to the success of any offering and so conditions have to be right."

Key to sustaining both the ECM and DCM markets in Turkey holds Gurson is a substantial local fund industry which can mobilise significant levels of investment in the domestic market. However, he acknowledges that this is still some way away. The domestic fund industry accounts for a relatively modest 3% of GDP, he says. "Until we develop big aggregations of domestic assets the market will remain dependent on foreign investment inflows," he says. ■