

No crisis of faith

Despite a long-running battle between the government and the army over Turkey's religious and political future, foreign investors continue to flood the country with capital. That means plenty of business for foreign and domestic investment banks, and for a new wave of small but ambitious boutiques.

Lawrence White reports

AS AN INDICATION of investors' confidence in Turkey's rehabilitation, the success of the Halkbank IPO in the middle of a political crisis could hardly be more telling. As the army threatened another coup and a million secularists took to the streets to protest against the perceived Islamist agenda of the government, Goldman Sachs and local firm Is Investment managed to fill the book for the TL2.5 billion (\$1.86 billion) state bank privatization with more than \$12.5 billion of orders.

"Just three days after the beginning of the Halkbank roadshow," says İlhami Koc, general manager at Is Investment, "the Turkish market was hit by political tensions. But we, together with Goldman Sachs as the global bookrunner, did not step back. At the end of a successful offering campaign, investors oversubscribed the Halkbank IPO, the largest privatization IPO in Turkish history, by around eight times."

The international investment community seems not to be unduly concerned by the dispute between the secularist army and the Islamic AK party, and the resulting flow of capital is fuelling a strong IPO market. Foreign banks that have traditionally covered the market from overseas are either opening offices in Istanbul or investing in one of the increasing number of local brokers. Houses such as Is Investment that are affiliated to a LEADING commercial bank now face competition from smaller boutiques, often formed by teams of bankers jumping ship from the traditional players. There's plenty of business to be won.

"IPOs and privatization deals have always been hot issues in Turkey," says Koc. "All the bulge-bracket investment banks are part of the game. Demand for Turkish assets is on a rising trend thanks to a successful turnaround in economic fundamentals, the start of EU accession talks and favourable conditions in international financial markets. Apart from the IPOs and privatization, M&A activity has also increased sharply in recent years, in line with the global trends. We see an ever-increasing appetite for private equity and M&A activity: between 2004 and 2006, a total of 530 deals took place, worth about \$62 billion."

Not everyone is convinced that Turkey is as safe an investment as this rising tide of investment suggests. Writing about the political crisis in May in a note entitled *Turkey: twilight zone*, Morgan Stanley analyst Serhan Cevik expressed his concerns.

"Turkey has suffered a major blow to institutional credibility – in my view the Turkish military's unexpected venture into politics has altered the country's political and institutional landscapes so that no

one really knows what is going to happen next."

Cevik is careful to underline his faith in the "fundamental strength of the Turkish economy" but worries that the risks are not being adequately priced in. "It seems," he continues, "that market participants do not much care about deteriorating institutional credibility. Some of the key assumptions market participants have had about Turkey's future direction are now, to say the least, weaker and questionable. But asset prices reflect no change after recent events: the lira is as strong as ever and interest rates are back to the level before the political turmoil."

Local bankers, of course, are more positive: their businesses rely to a great extent on the trade that results from foreign investment.

Breathe the air

"If you only read the international press you will get a much blacker picture of what is going on in Turkey than if you were to come here, breathe in the air and see what's going on for yourself," says Bertan Yordem, a partner at Daruma Corporate Finance. "I'm just back from a trip to New York where I met with a number of banks and hedge funds, all of which expressed a keen interest in what's going on in Turkey. Interest in new transactions is not slipping. It would not be fair to say that everything is absolutely fine, but if you look at the recovery of the stock and FX markets it's clear that Turkey is much more resilient now than before. Banks are better capitalized, foreign ownership has in many cases increased stability and management is much improved."

Daruma is one of an increasing number of smaller boutiques aimed at servicing the needs of middle market and upper market Turkish corporates, many of which are looking for foreign investment. There has been a dramatic increase, Yordem says, in the number and diversity of foreign firms looking to make strategic investments in the country.

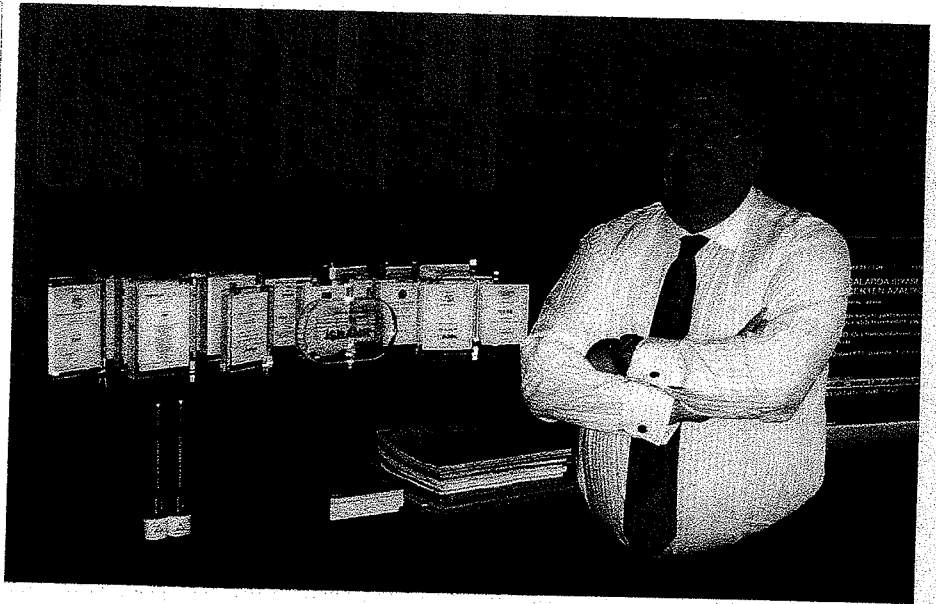
"As an example," he says, "we had a sell-side mandate for a mid-sized company in 2002 where there were only three bids from private equity players. We're arranging a similar deal now and we've had 16 private equity bids already. We're seeing names bidding now that we've never seen before in the market, both as a result of the global liquidity situation and I think because of an increasing level of interest in Turkey."

Most of this interest comes from banks, private equity firms and hedge funds looking to make strategic acquisitions or form partnerships; there's no real corporate debt market to speak of.

Emerging Europe

"There are a lot of private equity firms looking at Turkey now, and whereas in an IPO the investors become shareholders in direct investment, the emphasis is much more on management"

Mehmet Sagiroglu, Fidelity Capital



"Companies are still cautious about tapping the bond market," says Yamac Berki, CEO of Yatirim Finansman Securities, "since real interest rates for local currency are still high and the treasury's borrowing requirements are still a strong influence."

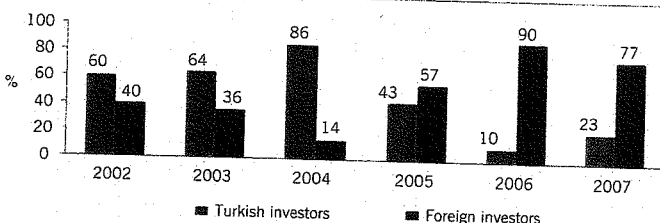
It's something of a Catch-22, says Yordem: "In order to be able to sell corporate debt in Turkey, the issuer would need a good reputation but in order to have a good reputation you can't afford to issue debt at the moment when rates are so high."

Foreign investors looking for long-term Turkey exposure tend therefore to concentrate on acquiring equity. Foreign banks have been steadily buying their way into a commanding share of Turkey's retail banking market but investment banks have been slower to commit themselves. The financial services market is fragmented and that means there's plenty of room for smaller local firms to compete for the M&A and equity offering mandates that result from the growth of the economy and the inflow of capital.

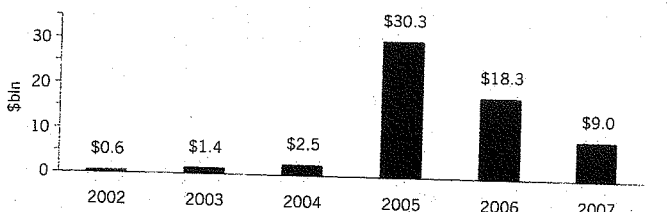
"We established ourselves as a corporate finance boutique a year

TRENDS IN TURKEY'S M&A MARKET

THE SHARE OF TURKISH AND FOREIGN INVESTORS



AND TOTAL TRANSACTION VOLUMES



Source: Fidelity Capital

and a half ago," says Mehmet Sagiroglu, managing director at Fidelity Capital, "bringing together a group of professionals with a great deal of experience in the international corporate finance markets. Previously in Turkey you had only the brokers owned by the large commercial banks, such as Is Bank, Akbank or Garanti, but now as the demand for direct investment in Turkey grows you are seeing more boutiques like ourselves enter the market."

The larger securities firms affiliated to commercial banks tend to run the big Turkish IPOs, often in conjunction with a foreign bank. After a long period of inaction and poor performance – Turkish stocks were among the very worst performers in 2006 – these headline-making offerings are back. Is Investment, for example, was domestic coordinator and bookrunner for the Halkbank deal, and Garanti Securities worked with HSBC and Credit Suisse to underwrite the February IPO of airport operator TAV that valued the firm at \$1.7 billion. For boutiques such as Fidelity, there's little point in competing: the aim is to get in on smaller deals where bulge-bracket banks and the larger local brokers hold less of a natural advantage.

"We have an advantage in the mid-market, especially in M&A, where being independent gives you much more credibility. Most of our mandates are on the sell side, advising Turkish companies that want to make strategic partnerships. That said, we are working at the moment on a buy-side mandate for a Turkish company that is looking to make an overseas acquisition – something that I think we will see a lot more of in the near future."

The number and range of Turkish companies hoping to catch the eye of a foreign suitor is increasing, and the investment banking sector is unlikely to miss out.

Catching the public eye

Having shown off what it could do, Is Investment was first out on to the dance-floor. "Just one week after the Halkbank IPO," says Koc, "Is Investment went public and, as of May 2007, was the only investment banking institution traded on the ISE. We are not worried about the entry of foreign investment banks into the market. Most of the bulge-bracket investment banks have been active players in the Turkish market for several years. The Turkish brokerage business is an overcrowded