Turkey's Akbank shows signs of strain

Akbank (AKBNK), Turkey's flagship corporate lender, is starting to show signs of strain. The first quarter was particularly difficult for the bank, as a number of large Turkish corporates requested loan restructurings. Capital ratios are weakening in the face of a depreciating currency but earnings hold up

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Results highlights

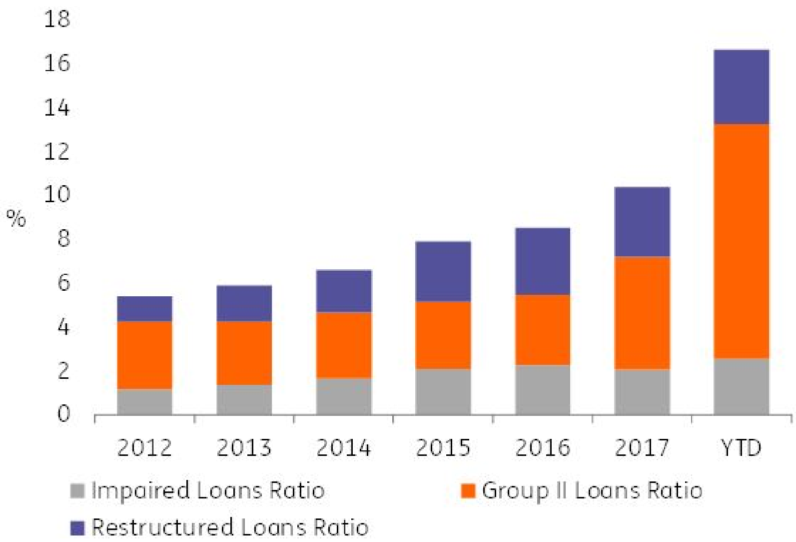
- AKBNK reported strong 2Q18 earnings, beating consensus with net profit of TRY1.6 billion. For 1H18, this number was TRY 3.3 billion, up 8.5% YoY. Its main profit drivers were loan growth (+16.5%) and improved margins (+0.72%, and up 0.6% QoQ).
- Asset quality declined. The non-performing loan ratio rose from 2.1% to 2.6% HoH, driven in particular by a well-collateralised business loan. Consumer and Credit Card asset quality, however, continued to improve. The Group II Loan ratio also rose QoQ from 9.9% to 10.7%, of which 3.4ppt was attributable to Otas, while the cost of risk rose to 183bp, of which 63bp was due to Otas.
- The total coverage ratio remains ample at 142%, while capitalisation is also solid (Tier 1 ratio: 13.3%, one of the strongest in the sector but down 90bp YoY and 30bp QoQ on TRY weakness).

- We note that loan growth was concentrated in Commercial and Other Business banking as well as higher-risk GPLs, though overall lending is up only 6% YTD after a slow H1.
- We also note that the TRY loans/deposits ratio has risen from 133% to 147% since 1Q17. This has undone much of the previous good work undertaken to rebalance the funding position, though it is somewhat inevitable as the economy moves away from reliance on FX loans while depositors simultaneously seek shelter in USD deposits. The Credit Guarantee Fund (CGF) accelerated this phenomenon in 2017. A corresponding drop in the FX ratio to a very strong 73% left the headline number slightly stronger at a healthy 100%. FX deposits have grown and now comprise 60% of total deposits.

Earnings in detail

- AKBNK reported an 8.5% YoY increase in 1H18 net profits to TRY3.3bn. Net interest income rose 36.0% YoY to TRY7.2bn as loan volumes improved 16.5% YoY. However, they grew just 0.7% QoQ, testifying to the economic slowdown we believe is taking place. NIM was up 35bp on the year (after swaps) at 3.80%, and rose 10bp QoQ as loan repricing offset higher funding and swap costs (a function of the dollarization of the Turkish deposit base, higher wholesale funding costs and higher CBRT rates). Moving on from NII, Fees & Commissions enjoyed another solid half year, rising 21.9% to TRY1.7bn, while the adjusted cost/income ratio remained extremely competitive at just 32.5%.
- Asset quality was more mixed. The headline NPL ratio deteriorated from 2.1% to 2.6% HoH, driven particularly by one large well-collateralised item that increased the Business NPL ratio from 1.4% to 2.1% over the period. By contrast, Consumer and Credit Card NPL ratios declined. Overall, the bank remains comfortably ahead of the sector average of 3.0%.
- The cost of risk also rose significantly, increasing from 49bp at end-2017 to 183bp in 1H18. 63bp of this was due to Otas (34bp increase in coverage, 29bp due to the currency impact), 46bp was due to increased IFRS 9 provisions, while a further 74bp was caused by the impact of various commercial loans.
- In a further sign that the formerly benign backdrop for Turkish asset quality metrics has changed, the Group II loans ratio increased significantly from 5.4% in 2017 to 10.7% in 1H18 (1Q18: 9.9%), of which 3.4ppt were due to Otas. We are not surprised that the Group II loans are rising following the 1Q headlines concerning Yildiz and Dogus Holding; AKBNK, as a significant lender to large corporates, is likely to be affected if more large businesses attempt to restructure their loans. We expect to see this trend appearing in GARAN and ISCTR's numbers too, as they are also major lenders to the Turkish large corporate sector.

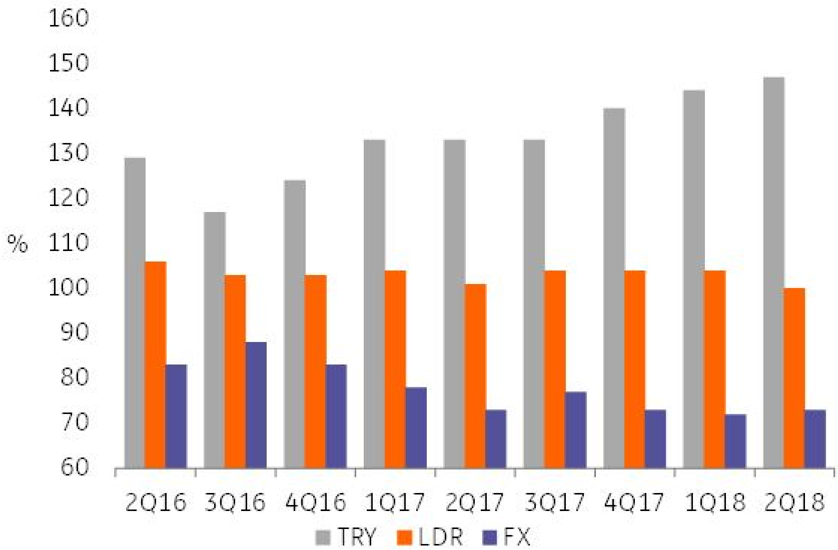
Asset Quality Development



Source: Company data, ING

- Turning to liquidity and capitalisation, the loans/deposits ratio improved to a strong 100% (sector average: 120%), while the bank unsurprisingly showed more stretched liquidity metrics in TRY than in FX, which is a feature common to the sector. Not only have TRY deposits been declining as depositors switch to USD, but the demand for TRY loans has increased as a result of the Credit Guarantee Fund. In AKBNK's case, the loans/deposits ratio in TRY was 147% (up from 138% at end-FY17), while in FX it is 73% (down from 78% at end-FY17).
- Meanwhile, the Tier 1 ratio declined 90bp YoY to 13.3%, though this remains one of the strongest numbers in the sector. The fall was largely due to currency movements, which outweighed retained earnings and the boost provided by CGF loans' 0% risk weighting, while current lending has reverted to the usual rules. Total CAR stood at a healthy 15.5%, down 50bp YoY. AKBNK's two USD Tier II debt issues provide a partial hedge for CAR against currency volatility. We expect the bank to aim to expand its capital base in the coming quarters if TRY stabilises, as underlying potential organic capital generation remains strong at around 60bp per quarter.
- As for the loan book, a clear slowdown in lending has occurred. The 6% YTD increase in loans to TRY224bn is due entirely to the fall in TRY. FX loans are down 7% in USD terms, while the TRY book is flat. Within that, AKBNK's lending numbers show a clear preference for riskier, more profitable lending (smaller businesses over large corporates, GPLs over mortgages), though that could also reflect the slowdown in the housing market and in demand for credit from the large firms. Within the TRY book (TRY132bn), Business Banking loans were flat YTD (Corporate -2%, Commercial +2%, Other Business -4%), while Retail loans rose by just 1% (Consumer +2%, boosted by 9% growth in the unsecured lending book, offset by Mortgages -8%; Credit Cards rose +2%). Meanwhile, FX loans fell by 7% in USD terms due to weak demand. Corporate loans were down 7%, Commercial loans fell 4% and the small book of leasing receivables declined 17%. Business loans accounted for 80% of AKBNK's total loan book, little changed YoY.

Loans/Deposits Ratio



Source: Company data, ING

- We note that AKBNK's assets and liabilities remain reasonably well matched by currency, although the lack of TRY funding remains a concern. On the asset side, FX securities comprised 52% of the total, while FX loans accounted for 41% of total loans. Meanwhile, FX deposits made up 60% of total deposits, much higher than the low point of 47% at end-3Q16, as re-dollarisation continued.
- For 2018, AKBNK is assuming GDP growth of around 4.5% and CPI inflation of about 11.0%, revised up from 9.0%. Loans and deposits should both grow at 13-15% (1H18 annualised result: +11% for loans and +16% for deposits). The bank expects NIM to fall back slightly to 3.5%, the loans/deposits ratio to remain anchored below 105% and NPLs to be stable at 2.1%. So far, NIM and the loans/deposits have exceeded guidance, while the NPL ratio has disappointed. It is hard to see these trends reversing in H2.