TSKB: Solid as a rock

The privately-owned development bank is a strong institution, more profitable than the sector, enjoying very strong asset quality. Most importantly, over half of its liabilities are guaranteed by the Turkish Treasury

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Credit highlights

- Türkiye Sınai Kalkınma Bankası (TSKB) is Turkey's leading development bank. It has established a niche franchise in Turkey, providing long-term loans mainly to corporate clients. It has a 3.6% market share in long-term FX corporate loans.
- TSKB has a proven track record of good asset quality (1Q18 NPL ratio: 0.2%), a comfortable liquidity position and good access to long-term funding from supranationals. Most of TSKB's long-term funding is guaranteed by the Turkish Treasury. TSKB's major shareholder is İşbank (50.65%), Turkey's largest private bank by assets.
- TSKB's net profit increased by 9% YoY to TRY159m in 1Q18, supported by brisk growth in net banking income (+32%). Net interest income, which makes up the vast majority of net banking income, increased 27% to TRY268m over the period, while NIM came in at 4.1%. TSKB has a solid capital position, boasting a capital adequacy ratio of 16.1% and a Tier 1 ratio of 11.6%.
- TSKB is rated Ba2/Stable (Moody's) and BB+/Stable (Fitch), in line with the foreign currency

debt ratings and outlooks of the Turkish sovereign, whose ratings constrain those of the banking industry.

Bank's profile

- Türkiye Sınai Kalkınma Bankası was founded in 1950. It is the first and only privately-held development and investment bank in Turkey. The bank is headquartered in Istanbul and has branches in Ankara and in Izmir.
- TSKB promotes the development of the Turkish economy by providing long-term funds for domestic and international investments by Turkish companies, primarily through loans denominated in foreign currency. TSKB also lends to SMEs under a specialised scheme known as APEX, under which it extends cheap credit-sourced from government-guaranteed debt to commercial banks, which then lend it on to the SMEs in question. The bank's major segments are corporate banking (47% of income in 1Q18), investment banking (47% of income) and Other (mainly dividends from subsidiaries – 6% of income).
- TSKB's market capitalisation stands at TRY 3.1bn. The main shareholder is İşbank, which holds a 50.65% stake. Vakıfbank holds 8.38%, while the remaining 40.97% of the shares are traded publicly on the Borsa İstanbul.

Earnings

- TSKB's 1Q18 net profit increased by 9% YoY to TRY159m, supported by strong revenue growth. In particular, net interest income rose 27% YoY (despite a 5% decline QoQ), driven by a 30bp rise in NIM to 4.1% and strong FX-adjusted loan growth of 12.6% YoY to TRY23.9bn. Net interest income makes up 89% of TSKB's Net Banking Income.
- Expenses are minimal, as evidenced by the extremely low cost/income ratio of 13.3%, due largely to the absence of a branch network. Increased revenues more than offset the effects of a 17% increase in operating expenses to TRY40m and a rise in provisions from TRY19m to TRY72m over the period.
- TSKB's provisioning charge equates to a very low cost of risk of just 33bp.
- Bringing all this together, TSKB achieved ROE of 17.4% in 1Q18, well above the sector average of 14.4%, which is impressive in an environment that favours high-return lending to small businesses for the commercial banks via the Credit Guarantee Fund.

Loan book and asset quality

- TSKB's TRY23.9bn loan book is of good quality, as demonstrated by the NPL ratio of 0.2% (sector average: 2.9%). We note that asset quality has always been strong – the worst NPL ratio at TSKB in recent times was the 0.6% it registered in 2009. Group II loans stood at 2.1% of total loans at end-FY17.
- TSKB has a policy of making 100% impairment provisions against non-performing loans. Other policies aimed at securing the quality of the loan book include: large credit exposures cannot exceed 8x TSKB's capital; the maximum risk-based credit limit for a single company is <25% of TSKB's capital; sector-specific credit risk cannot exceed 40% of the total credit portfolio for energy production and 25% for other industries; APEX lending to non-bank FIs must not exceed 35% of the bank's capital.
- The loan book has a medium-term focus and diversification by sector is decent (see chart below), although concentration risk is an issue: TSKB's top 20 clients account for multiples of

Tier 1 capital. TSKB focuses on infrastructure, renewable energy, energy and resource efficiency, sustainable tourism, PPPs mostly in healthcare and education sectors and SME loans. At end-1Q18, 74% of loans were investment loans, while working capital loans accounted for 19% and APEX loans comprised 7% of the book.

- TSKB's lending is heavily weighted towards foreign currencies. In 1Q18, just 9% of the book was denominated in TRY; 47% was in USD, with the balance of 44% in EUR.

Liquidity and funding

- TSKB is not permitted to collect customer deposits, and its principal sources of funding are loans from development organisations guaranteed by the Turkish Treasury. At end-1Q18, 51% funding was guaranteed by the Turkish State. The guarantees mainly cover loans from supranationals, the largest of which are IBRD (36% of Development Finance Institution funding), EIB (28%) and KfW (14%). 82% of DFI funding is guaranteed by the Turkish Treasury, and DFI funding makes up 68% of all long-term funding. Long-term DFI funding has an average maturity of 11 years.

51% Amount of funding guaranteed by the government

- Beyond the 51% of government-guaranteed funding, a further 11% was made up of unguaranteed long-term funding, and 19% was accounted for by securities in issuance, with subordinated debt comprising another 4%. Only 12% of funding was short-term.
- TSKB runs a securities portfolio that amounted to TRY3.8bn (or 15% of total assets) at end-1Q18, the vast majority of which consisted of Turkish government debt securities. 37% of the bonds were fixed, 40% CPI-linked and the rest floating rate instruments. The fixed and floating bonds had an average duration of 2.7 years, while the CPI bonds' duration was 4.3 years.
- The bank follows a match-funding policy to mitigate interest rate and currency risk: 79.1% of total assets are FX-denominated, while that held true for 82.3% of liabilities at end-FY17.

Regulatory capital and liquidity ratios

- TSKB has a solid capital position, posting a capital adequacy ratio of 16.1% and a Tier 1 ratio of 11.6% in 1Q18. The Tier 1 ratio declined by 90bp QoQ following a 12% increase in RWAs over the period due to loan growth and TRY depreciation.
- Liquidity Coverage Ratio (LCR) requirements came into effect for Turkish development banks in 2016. TSKB's substantial liquidity buffer and considerable share of long-term funding support compliance with the new standards. At end-1Q18, the bank's LCR stood at a very strong 234%, up from 168% at end-FY17 and 176% at end-FY16.