AK Securities

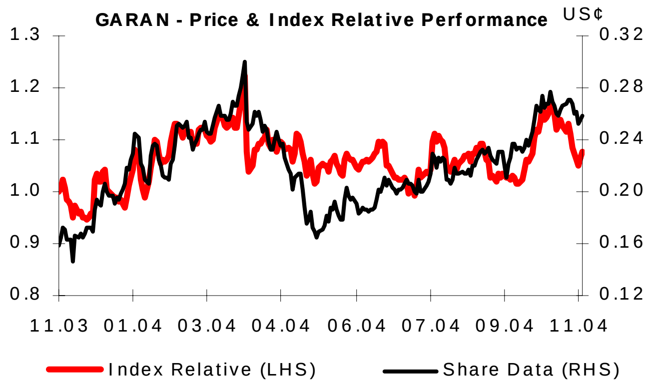
GARANTI BANK

Banking Sector

Market Performer

- To raise cash after the annulment of the Intesa deal, Dogus Group started to increase the float of the Bank through SPOs. At the first SPO, it liquidated 4.9% of Garanti and injected the bulk of proceeds into the Bank through acquiring Dogus Otomotiv. Recently the Group sold a call option on US$150mn worth of Garanti shares.
- The option deal has a cushion to prevent the holder (HBK) to divest its Garanti shares in bulk. According to the agreement, HBK can sell as much as 15% of the Bank's past one month trading volume worth of shares in one month.
- We use two major valuation tools to value Garanti, i. warranted equity approach, ii. residual income valuation. The average of two models provides us a target value of US$3,455mn that corresponds to an 11% upside potential. Via its current upside potential, Garanti deserves a 'Market Performer' rating.
- Garanti started selling its non core participations to Dogus Group starting with Dogus Otomotiv. We expect the Group to continue removing non core subsidiaries from Garanti's books.
- Although Garanti's cash capital is in the red it has the second highest ratio of free funds to assets (16%) thanks to a hefty demand deposit base. A huge 28% of the Bank's deposits comprise demand deposits, whereas the ratio is only 20% for the banking sector per se.
- Through a CAGR of 13% since 2001, Garanti has been displaying the highest growth rate in loans among the big-4 banks. The CAGR of the sector's loans in the same period was only 10%.
- The leading competitive advantage of the Bank is the credit card business. The Bank has a 21% market share in credit card loans as of the end of 2Q04 that rose from 9% at year-end 2000.
- The per branch and per employee efficiency figures of Garanti remain the best in the banking sector. In particular, branch efficiency figures, which are two times larger than that of the sector are highly impressive.

Price (TL / US¢)	3,760 / 0.26
Price Range (1 Year, TL/US¢)	2,141 / 0.15 - 3,939 / 0.30
Number of Shares (mn)	1,200,000
Market Cap. (US$mn)	3,110
Free Float	32%
Daily Vol. (3 Month, US$mn)	14.8
Ticker (Reuters, Bloomberg)	GARAN.IS, GARAN TI
ISE-100 Index (TL/US¢)	22,618/1.56



PERFORMANCE	1 Week	1 Month	3 Month	1 Year
US$	-3.4%	-1.6%	24.2%	63.3%
Index Relative	-0.6%	-3.4%	3.0%	7.9%

SUMMARY FORECASTS (IFRS Consolidated, US$mn) & VALUATION

	2002A	2003A	2004F	2005F
Assets	18,192	18,380	20,573	26,397
Sh. Equity	1,386	1,770	2,103	2,751
Net Profit	23	384	279	466
ROE	n.m.	24.4%	14.4%	19.2%
P/B	2.2	1.8	1.5	1.1
P/E	136	8	11	7

SHAREHOLDING STRUCTURE

Dogus Group	64%
Float	36%

November 10, 2004

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I. INVESTMENT THEME

Recently the Group sold a call option on US$150mn worth of Garanti shares

To raise cash after the annulment of the Intesa deal, Dogus Group started to increase the float of the Bank through SPOs. At the first SPO, it liquidated 4.9% of Garanti and injected the bulk of proceeds into the Bank through acquiring Dogus Otomotiv. Recently the Group sold a call option on US$150mn worth of Garanti shares. **We believe that the existence of a purchase option on such a large stake would somewhat limit the upside potential of the Bank. However, the option deal has a cushion to prevent the holder (HBK) to divest its Garanti shares in bulk. According to the agreement, HBK can sell as much as 15% of the Bank's past one month trading volume worth of shares in one month. Therefore, HBK can only sell up to a sum of US$46mn Garanti shares in a month.**

The average of two models provides us a target value of US$3,455mn that corresponds to an 11% upside potential

We use two major valuation tools to value Garanti, i. warranted equity approach, ii. residual income valuation. The average of two models provides us a target value of US$3,455mn that corresponds to an 11% upside potential. Since we upgraded our rating for Garanti on August 13, 2004 to 'Market Outperformer', Garanti Bank has risen by 31% in US$-terms and outperformed the index by 5%. Via its current upside potential, Garanti deserves a **'Market Performer'** rating. We also believe that the above-mentioned upcoming call option would also limit the Bank's upside.

We expect the Group to continue removing non core subsidiaries from Garanti's books

Garanti started selling its non core participations to Dogus Group starting with Dogus Otomotiv. We expect the Group to continue removing non core subsidiaries from Garanti's books. The operation would eventually support interest income, heal the free capital shortage and raise the profitability of the Bank.

Garanti has the second highest ratio of free funds to assets (16%) thanks to a hefty demand deposit base

Although Garanti's cash capital is in the red it has the second highest ratio of free funds to assets (16%) thanks to a hefty demand deposit base. A huge 28% of the Bank's deposits comprise demand deposits, whereas the ratio is only 20% for the banking sector per se. Expansion of the Bank into eastern and Southeastern parts of Turkey since 2000 is the main driver of the rise in the share of demand deposits from 19% levels.

Through a CAGR of 13% since 2001, Garanti has been displaying the highest growth rate in loans among the big-4 banks. The CAGR of the sector's loans in the same period was only 10%. In the same peer group, Garanti also has the highest share of non-related party loans in assets. The share of loans in Garanti's assets is 38%. We expect this ratio to climb to 45% at the end of 2006 fuelled by TL retail loans.

The Bank has a 21% market share in credit card loans as of the end of 2Q04 that rose from 9% at year-end 2000

The leading competitive advantage of the Bank is the credit card business. The Bank has a 21% market share in credit card loans as of the end of 2Q04 that rose from 9% at year-end 2000. Through two credit card schemes, namely Shop&Miles and Bonus, we expect the Bank to become the leader in high yield credit card loans and possibly in credit card spending volume in the following two quarters.

Garanti has a solid presence in alternative distribution channels

The per branch and per employee efficiency figures of Garanti remains the best in the banking sector. In particular, branch efficiency figures, which are two times larger than that of the sector are highly impressive. With a solid presence in alternative distribution channels (ADC), Garanti will definitely be one of the frontrunners in terms of efficiency. A huge 71% of Garanti's comparable transactions are realized through ADCs.

II. VALUATION

The average of two models provides us a target value of US$3,455mn, corresponding to an 11% upside potential for Garanti Bank.

We use two major valuation tools for banks, i. warranted equity approach (WEA), ii. Economic value added (EVA or residual income valuation). We have also bestowed international comparison as a supplement to our final conclusion. We do not credit the dividend discount model (DDM) for Garanti, which we believe is not applicable to companies with low or zero dividend distribution policies. Garanti has neither a sustainable dividend distribution policy, nor do we have any indication that it will be distributing cash dividends in the foreseeable future.

As one of the fastest growing players among large cap banks we believe that it will continue to retain the earnings. Also, since the banks hardly find financing due to investor preference for keeping savings in mutual funds and government bonds instead of deposits, they are forced to keep profits to achieve balance sheet growth. We expect the lack of deposit collection in the sector to persist in the coming years unless high withholding tax burden relative to alternative instruments is removed. **The average of two models provides us a target value of US$3,455mn, corresponding to an 11% upside potential for Garanti Bank.**

WEA

Our key model is WEA in which we use [(ROE-g)/(k-g)] as a benchmark P/B multiple. For the cost-of-capital (k) calculations we use an adjusted CAPM approach. We get to equity risk premiums via subtracting long-term US Government security's current yield from the sustainable yield on the long-term Turkish Government Eurobond. This risk premium spread can only be valid for bonds. The stock market is empirically 2.2 times more volatile (standard deviation) than the bond market.

Accordingly, we have multiplied the risk premium by the volatility coefficient and then added the beta multiplied outcome to the US long-term risk-free rate to arrive at a cost of equity for the Bank (k=RfUS+B*(RfTR-RfUS)*2.2). Subsequent to reaching a benchmark P/B multiple via the warranted equity approach, it is quite a straightforward process to reach a fair value using the adjusted target book value.

Warranted Equity Approach (US$mn)	
Sustainable Adjusted ROE	18%
g	3.0%
R_f Turkey (Sustainable LT Eurobond Yield)	8.5%
R_f US (30yr US Bond)	5.2%
B	1.2
Rf Turkey - Rf US	3%
k	14%
Benchmark P/B:	1.37
2005 Adjusted Sh. Eq.	2,557
Target Value	**3,511**
M.Cap:	3,110
Upside	**13%**

Source: Ak Securities Estimates

The difference between the market value of assets and their book values provided us a negative hidden value of US$194mn

To attain an accurate book value we have applied a haircut to shareholders' equity. The difference between the market value of assets and their book values provided us a negative hidden value of US$194mn. We applied one of the largest haircuts to Voyager Tourism, which has a shareholders' equity that is in the red, with the company continuing to generate losses.

We preferred to apply a 10% discount on real estates

We used to assume a 20% discount on the assets held for resale, however due to rising real estate demand in Istanbul, Ankara and Izmir where the majority of Garanti's real estates are located; we preferred to apply a 10% discount in this study. We also deducted the whole net deferred tax assets figure to remain on the conservative side even if this item may gradually be reversed in the coming years. Since the Bank started holding the bulk of its Eurobonds in a held to maturity portfolio that is not marked to market, we also considered their market values in our calculations.

Haircut Details	
Book value of Assets (US$mn)	**726**
(-) Voyager Tourism	112
(-) Tansas	33
(-) BV of tangible assets held for resale	398
(-) Net intangible Assets (Goodwill)	81
(-) Net Deferred Tax Assets (04F)	103
Market Value of Assets (US$mn)	**532**
(+) Voyager Tourism Market Value	0.5
(+) Tansas	90
(+) MV of tangible assets held for resale	358
(+) Net MtM gain on HTM eurobonds	84
Haircut (Net hidden value)	**-194**

Source: Ak Securities Estimates, Garanti Bank

EVA

In our EVA approach we discounted the residual income stream between projected net income and the income that would be earned on adjusted book value through an interest rate equal to the cost of capital. After discounting the incremental earnings we add up adjusted invested capital to get to a value for the Bank as a whole.

EVA - Residual Income Valuation (US$mn)

	2004F	2005F	2006F	2007F	2008F	2009F
R_f Turkey (30yr Eurobond)	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
R_f US (30yr Bond)	5.2%	5.2%	5.2%	5.2%	5.2%	5.2%
R_f Turkey - R_f US	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%
Asset Beta (B)	1.2	1.2	1.2	1.2	1.2	1.2
Cost of Equity (k)	14%	14%	14%	14%	14%	14%
Book Value (IFRS)	2,103	2,751	3,269	3,874	4,591	5,395
Average BV	1,936	2,427	3,010	3,572	4,232	4,993
Achievable return on Sh. Eq. (via k)	269	338	419	497	589	695
Net Income	279	466	546	643	766	805
Economic Profit	9	128	127	146	178	110
Discount Factor		1.07	1.22	1.39	1.59	1.81
g	3%					
Terminal Value of Economic Profit (PV)	574					
PV of Economic Profit (2004-2009)	501					
Economic Value	1,075					
Adjusted Book Value after Haircuts	1,908					
Fair Value of Bank	2,983					
12m Target Value	**3,398**					
M Cap	3,110					
Upside	9%					

Source: Ak Securities, Garanti Bank IFRS financials

Slightly Undervalued Relative to Emerging Peers

Even though a one-to-one comparison of emerging market banks may not be very meaningful without certain adjustments, we bestowed the figures just for a sanity check. To crop the higher and lower ends of the multiples we preferred using the geometric mean instead of simply removing the outliers.

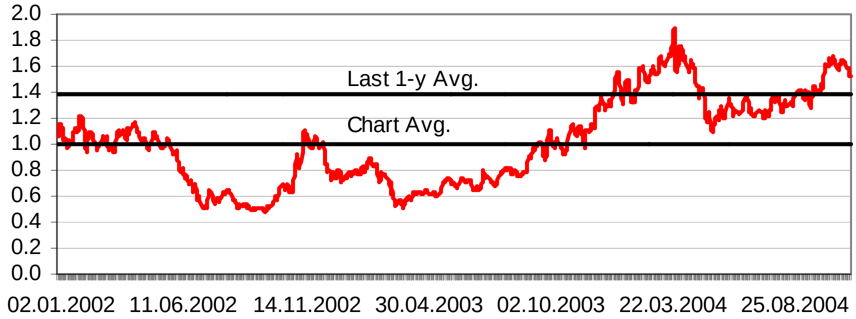
Consequently, Garanti Bank's multiples indicate a small upside to emerging market average figures. The Bank's forward looking P/B, on the other hand, is higher than its historical averages.

Emerging Banks Market Multiple Comparison

Name	Country	M Cap (US$mn)	P/B	P/E
Banco Do Brasil	Brazil	8,319	1.7	7.4
Banco Bradesco	Brazil	8,764	1.5	11.2
Banco Sudameris Brasil	Brazil	893	1.9	36.1
Banco Itau Holding Financeir	Brazil	12,970	2.6	9.6
Uniao De Bancos Brasileiros	Brazil	3,670	1.5	10.0
Privredna Banka Zagreb	Croatia	1,048	1.7	8.8
Zagrebacka Banka	Croatia	1,389	1.7	9.8
Komercni Banka	Czech	4,902	3.4	15.0
Hansabank	Estonia	3,241	3.5	15.3
OTP	Hungary	7,158	4.1	15.3
Israel Discount Bank	Israel	1,104	0.8	10.9
Bank Leumi	Israel	3,121	0.9	8.4
United Mizrahi Bank	Israel	778	0.9	8.4
Hapoalim	Israel	3,516	1.1	9.9
Bank Handlowy	Poland	2,414	1.4	20.7
BPH	Poland	3,962	2.5	24.6
Bre Bank	Poland	964	1.5	58.7
Ing Bank Slaski	Poland	1,502	1.7	27.2
BZ WBK	Poland	1,864	2.3	23.2
Bank Pekao	Poland	6,379	3.1	19.9
Sberbank	Russia	9,098	1.9	18.4
Vseobecna Uverova Banka	Slovakia	1,140	1.8	11.3
Akbank	Turkey	6,621	1.7	9.0
Isbank	Turkey	7,186	1.5	14.2
YKB	Turkey	1,785	0.6	17.9
Garanti Bank	**Turkey**	**3,029**	**1.5**	**10.6**
Emerging Banks Average (Geomean)			**1.7**	**14.4**

Source: Bloomberg, Ak Securities, BRSA GAAP Bank Only Financials

Historical P/B Chart



Source: Ak Securities, BRSA GAAP Bank Only Financials

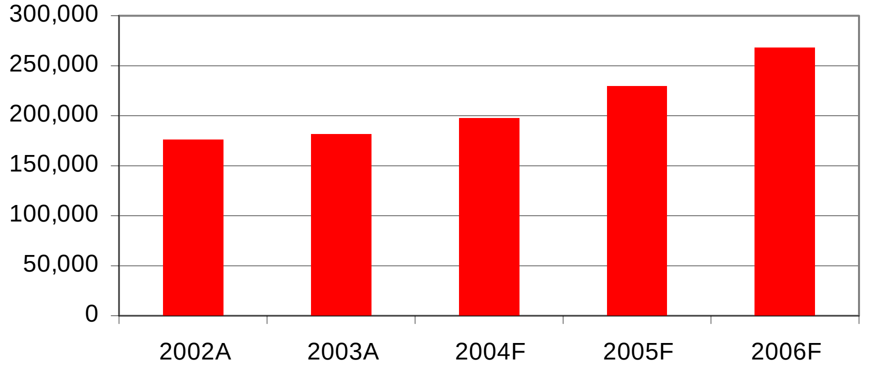
III. BANKING SECTOR OUTLOOK

Unsatisfactory Asset Growth

Around 40% of the banking sector balance sheet is FX-denominated

The banking sector balance sheet has not been displaying a satisfactory growth trend for the past couple of years due to lack of deposit collection. Another point, which is also a data-bug against healthy analysis, is the rise in the value of the TL against hard currencies. Around 40% of the banking sector balance sheet is FX-denominated, and strengthening of the TL pulls down the value of those assets in inflation-adjusted terms even though they remain stable.

Banking Sector Balance Sheet (inflation adjusted)



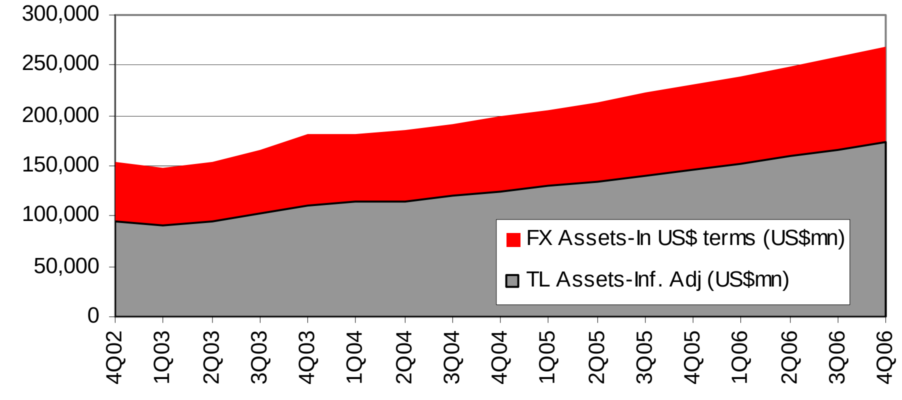
Source: Ak Securities Estimates, the BAT

The banking sector's asset size at the end of 1H04 was US$186bn

In the chart below, TL assets are adjusted through WPI inflation, whereas the FX assets are displayed in US$-terms. Therefore, the aggregate balance sheet before 1H04 is lower than the inflation-adjusted sum seen in the chart above. Hence, growth is relatively steeper in the adjusted new graph. The banking sector's asset size at the end of 1H04 was US$186bn. We estimate this figure rising to US$200bn at end-2004 and gradually climbing to US$270bn in 2006. In other words, banking sector asset size as a percentage of GNP will rise from 70% to 90% in the same period.

We also expect the share of FX assets in total to slide down to 35% as the banking sector leans more to TL assets earning higher interest. As we will analyze the details in the following pages, consumer and credit card loans will remain the chief driver of TL lending.

Banking Sector Assets (TL assets inflation adjusted, FX in US$ terms)



Source: Ak Securities Estimates, the BAT

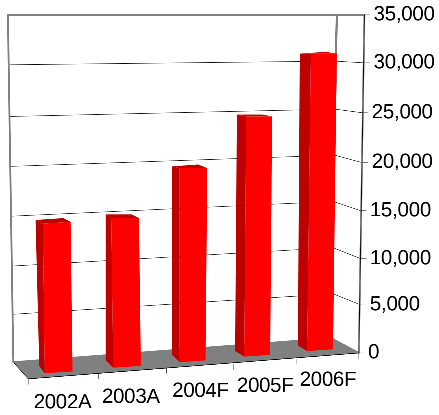
Foreign Borrowings to Climb

We expect the share of deposits in total assets to decline from 64% to 60% by the end of 2006

In our banking sector balance sheet growth analysis we lay emphasis on deposits and foreign borrowings. The main obstacle against deposit growth is high withholding tax rates coupled with attractive "default-risk-free" interest rates on government bonds that also bear significant tax incentives. The interest earned on FX deposits with less than 1-year of maturity has a withholding tax burden of 24%, TL deposits with less than 3 months of maturity on the other hand has an 18% withholding tax burden. Deposit rates are less than the bond yields, and bonds are tax free for individuals.

We expect the share of deposits in total assets to decline from 64% to 60% by the end of 2006. Although we still do not expect a strong deposit growth for upcoming years, the banking sector asset size should display more solid annual growth figures fuelled by augmenting foreign borrowings as the Country's sovereign rating improves. Increased EU prospects would further contribute to bank borrowings, both in terms of size and lower interest rates.

Banking Sector Borrowings (US$mn)



Source: Ak Securities Estimates, the BAT

The banks in our coverage securitized an additional loan sum of US$1.3bn in 2004

Foreign borrowings in the form of one-year syndicated loans and long-term asset backed securities gained pace in 2004. On top of rolling over existing loans, banks collected new syndicated loans paying around 20 basis points less than that of a year ago. The banks in our coverage securitized an additional loan sum of US$1.3bn in 2004 with a weighted-average maturity of 6 years. We expect more asset backed securities that pull down maturity gaps in the coming years. Banks made an additional US$2.1bn foreign borrowing in the first half of 2004. We expect total borrowings to increase from the 1H04 figure of US$18bn to US$31bn at the end of 2006.

To limit the profitability slide in a declining margin environment we expect the Banks to take higher risks

As FX denominated borrowings and TL lending speed up, FX short positions would once again start climbing. To limit the profitability slide in a declining margin environment we expect the Banks to take higher risks and widen their short positions. On the balance sheet, there are two major alternatives for the banks that want to close their short positions and remain profitable. The first one is FX-denominated project finance lending, while the other is long-term FX bonds. Profits would definitely slide for those Banks that prefer to cover their short positions via export financing and lending to blue-chip companies.

As real interest rates decline, the importance of a basis point yield increase will start to create huge differences. As seen in the table below, the spread between FX financing and TL allocation has the highest yield.

Short Position Creates the Highest Spreads	Spread Between FX Deposits and TL Bonds (in real terms)	Spread Between FX Deposits and LT Eurobond	Spread Between TL Deposits and TL Bonds (in real terms)
31.12.2001	24.5%	9.0%	-3.8%
31.12.2002	32.9%	8.3%	0.1%
31.12.2003	5.9%	5.2%	-3.0%
08.11.2004	7.1%	4.5%	-0.9%

Source: Ak Securities, the CB

we expect the share of TL loans in the overall lending book of the banks to climb from 58% of 1H04 to 67%

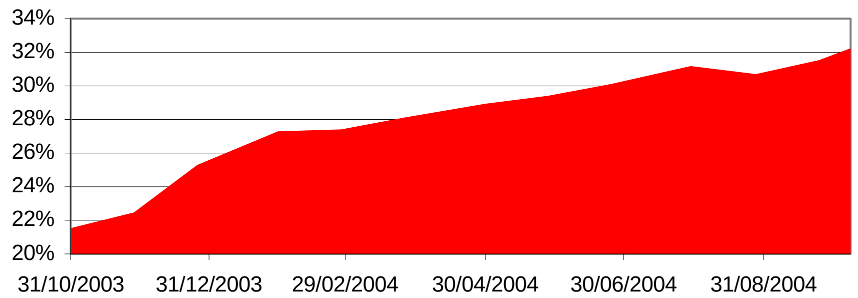
The spread between TL deposits (annually compounded 1m) and the benchmark TL bond on the other hand, has negative spread. However, as the average maturity of TL deposits is 2 months, whereas bonds have around one year of maturity, declining interest rates compensate for the negative spread. Banks can only make meaningful returns if they allocate TL deposits into consumer and credit card loans. Mainly driven by consumer loans and partially by the help of SME lending, we expect the share of TL loans in the overall lending book of the banks to climb from 58% of 1H04 to 67% at the end of 2006.

Switching from Corporates to Retail Lending

Retail loans are set to become the major source of income

To benefit from relatively high yields, banks have increasingly been emphasizing retail loans. The share of consumer loans (including credit card lending) that was only 17% in mid-2003 climbed to 32% in October 2004. If we take into consideration the consumer loans received by SMEs, the share of retail loans in the total lending book would climb to 38%. Retail loans are set to become the major source of income in the coming years. As the Banks start granting consumer loans through floating rates, mortgage lending with more than 10-year maturity and financed with long-term borrowings would further contribute to retail banking potential.

Retail Loans/Loans



Source: Ak Securities, the CB

As seen in the chart below, credit card loans offer the highest spread of up to 70%. The inflation-adjusted real interest rate on credit card loans on the other hand, is an incredible 85%. Garanti Bank, which grabs market share from its peers very fast is the primary winner in this precious segment. We expect Garanti to surpass YKB and become the market leader in credit card loans at the end of 2004, at the latest. Yet high real interest is not the only attractive aspect to banks' inclination towards credit cards; there is also fee income to consider

Annually Compounded Interest Rates	
Consumer Loans (TL)	32%
Credit Card Loans (TL)	104%
Deposits (TL)	20%
October 04-05 Inf.	10%
CL real interest	20%
CC Loans real interest	85%
CL/Deposit Spread	10%
CC Loans/Deposit Spread	70%

Source: Ak Securities, Big-4 Banks

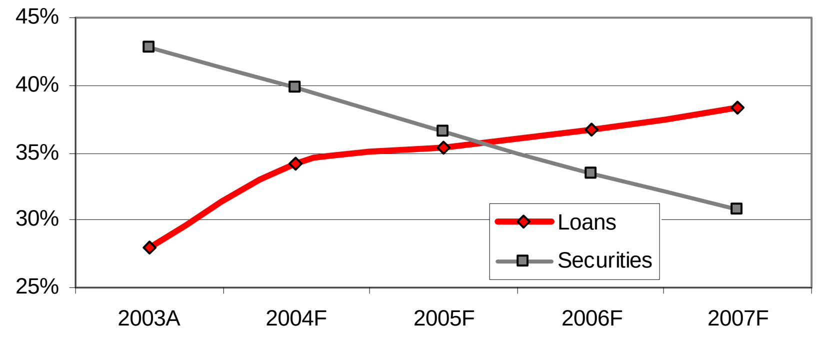
Our model indicates that the net fee income of the sector would rise by 26% in 2004

More than half of the banks' gross fee income stems from the credit card business. Our model indicates that the net fee income of the sector would rise by 26% in 2004, YoY. Consequently, we expect net fee income that hardly covers 25% of operating expenses at 2003-end to hike to 38% at the end of 2004, and further rise to 42% in 2006. To compensate for declining spreads, banks will have to focus on fee and commission generating businesses. Other than credit cards, fees charged per transaction and mutual fund sales will remain the other major non interest income sources.

We expect the banks to continue enjoying high marked-to-market gains on bonds until 2006

Banks decrease the level of securities. As the macro economic recovery continues we expect the banks to continue increasing the weight of loans in assets, and they would naturally refrain from securities as real rates settle below 10% levels. We expect the banks to continue enjoying high marked-to-market gains on bonds until 2006. After that, intensified competition would enforce the system for further consolidation particularly for the small and mid-sized players still unable to find a niche market to stick to. Consequently, the share of securities in assets is projected to decline from 42% to 33%, whereas the share of loans would rise from 33% to 37% from 1H04 to 2006-end.

Asset Breakdown

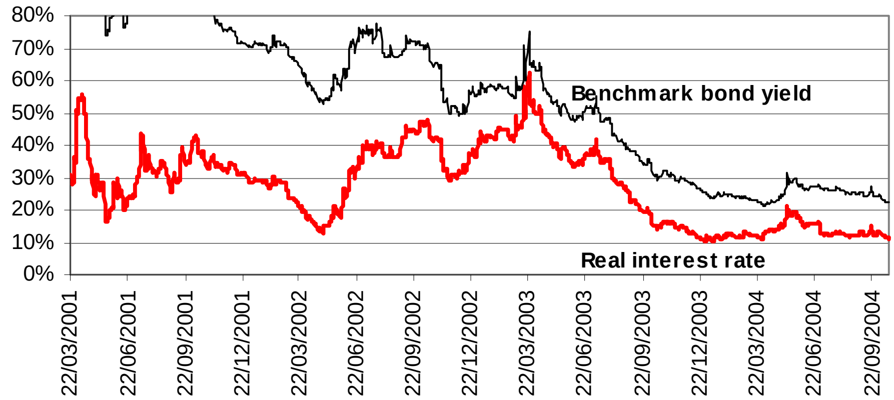


Source: Ak Securities Estimates, the BAT

We expect the TL benchmark bond yield to slide from its current level of 22% to 15% by the end of 2005

We expect the TL benchmark bond yield to slide from its current level of 22% to 15% by the end of 2005. For the 2030 Eurobond, we expect the yield to contract from 8.3% to 8% in 2005. Therefore, there is still room for TL bond holding banks to record marked-to-market returns on trading and available for sale securities. However, once again we want to underline the fact that banks will no longer be able to continue generating those hefty returns on bonds starting from 2006, in which we anticipate the real rate on the benchmark bond declining to 5% and continuing at that level thereafter.

Sliding Real Interest Rates



Source: Ak Securities, the ISET

Profit Margins are Set to Contract as Real Rates Slide

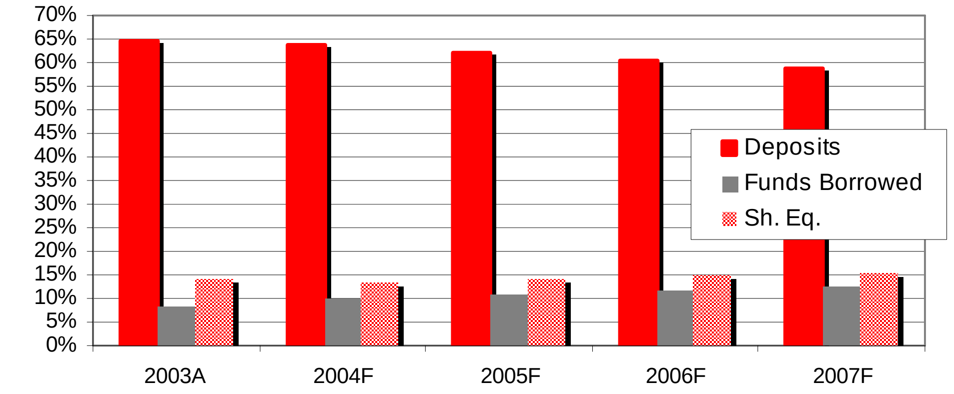
We expect volume growth and fee income to support interest earnings

We expect the sector's interest margin to decline from more than 7% levels to 6% at the end of 2006, and stick to a 16% sustainable ROE level. One of the major reasons why we are not more pessimistic about profitability is that we expect volume growth and fee income to support interest earnings. Also, upcoming huge non-banking asset sales of leading banks will be another major factor reinforcing profit. Even though margins decline, we expect to observe a gradual appreciation in profits as the expanding balance sheets will generate higher returns in absolute-terms.

Even if deposit growth lags behind our expectations due to investor preferences for allocating savings into mutual funds and directly into government securities, profits will still be on the rise as the banks will generate commissions on these intermediary activities.

From 2001 until the end of 1H04, banking sector deposits remained unchanged at around US$120bn. However, securities and funds held on behalf of customers leaped fivefold to US$75bn during the same period. On top of fee generating mutual fund sales and credit card activities, private pension and insurance policy sales are set to emerge as the leading sources of non-interest income.

Breakdown of Liabilities&Sh. Eq.



Source: Ak Securities Estimates, the BAT

Shareholders' equity will also be one of the main contributors to the balance sheet

On the back of gradually growing bottom-lines, shareholders' equity will also be one of the main contributors to the balance sheet. We estimate the share of shareholders' equity in assets climbing from 13% to 15% in the same period. The declining share of government securities in total assets and rise in loans with full risk weighting will also bring about the need for this increase in the percentage of shareholders' equity. Beyond 2006 is a huge question mark, especially in terms of shareholder equity and CARs. After 2006, we will feel the heavy load of the Basel II accord. Banks will have to set aside significant amounts of additional capital to compensate for the augmented risk weighting of government bonds.

Turkish government bonds that have zero risk weighting for OECD member Turkey under Basel I will have 100% risk weighting under the second accord. With the current capital structures only a few banks would have CARs higher than 8%. We are eagerly awaiting signs of the BRSA's attitude towards settling the serious challenges Basel II would bring.

IV. GARANTI BANK

While we have always liked Garanti in terms of retail strategies, internet banking and management talent, non financial subsidiary sales of Dogus Group to the Bank have prevented us from adopting a more positive stance on the Bank in the past. However, right after the collapse of stake sale negotiations with Intesa, Dogus Group took a positive step to clean up the Bank's books, and Dogus Insaat acquired 20% of Dogus Otomotiv from Garanti for US$80mn. This was the moment things started to go positively for Garanti, and it was also the time we upgraded the Bank to 'Market Outperformer'. From August 13, 2004 until November, Garanti Bank rose by 31% in US$-terms, outperforming the index that generated a 25% return.

We downgraded Garanti to 'Market Performer' at the beginning of November

Taking into account the limited upside potential of the Bank and believing that the call option written on US$150mn Garanti Bank shares would create uneasiness on the stock, we downgraded Garanti to 'Market Performer' at the beginning of November. However, should Dogus Group acquire non banking assets (ie. Tansas shares) using the US$150mn sum collected from HBK Master Fund, then it would ease tension on Garanti shares to a large extent. Duly, at that point we would review the Bank for a possible upgrade. However, since HBK has the option to take its payment from Dogus Group in 18-m if the stock price remains below the exercise price, we question the control of the Group on this US$150mn sum.

Failure of Intesa Deal and Latest Developments

In the recent attempt, Intesa was to be pay US$800mn for a 40% stake plus the profit to be generated until conclusion of the deal sheet

Dogus Group and Intesa could not agree on a majority stake sale of the Bank in July 2004 after negotiating for five months. It was Intesa's second attempt to acquire Garanti. Intesa had abandoned an earlier effort after the terrorist attacks of Sept. 11, 2001, due to a worsened outlook for international business at the time. In the recent attempt, Intesa was to be pay US$800mn for a 40% stake plus the profit to be generated until conclusion of the deal, multiplied by a certain coefficient. The parties could not conclude the deal due to discrepancies in certain ownership issues. Currently, although Dogus Group is not eagerly looking for a foreign bank to sell Garanti, they are still open to negotiations. And in the context of becoming a regional bank within the following five years, the Bank is to pursue possible opportunities.

Dogus Insaat sold a total of 40bn shares corresponding to 4.9% of the Bank on the stock market for US$120mn

Following the failure of the stake sale to Intesa, Dogus Insaat sold a total of 40bn shares corresponding to 4.9% of the Bank on the stock market for US$120mn. With this sale, the Bank's free float rose to 36% from 31%, and the Group generated a significant amount of cash without losing control of their Bank. We do not find these SPOs directly negative for the Bank as the cash is consequently injected into the Bank, also, SPO backed rise in daily trading volume increases the weight of Garanti in stock market indices that creates further demand for the stock.

Dogus Holding also agreed on selling call options on US$150mn Garanti Bank shares

With the majority of the proceeds obtained from the stake sale, Dogus Insaat acquired 20% of Dogus Otomotiv Shares from Garanti. Divesture of non core assets has a positive effect on the free capital shortage of the Bank. The interest margin will rise as the Bank's free capital approaches positive territory. We consider Dogus Group's move to pull out non core assets from the Bank a very constructive move. Dogus Holding also agreed on selling call options on US$150mn Garanti Bank shares (US$125mn Garanti and US$25mn Tansas is another option) to Hbk Master Fund. It is worth reminding investors that Garanti Bank deposited 3.9% of Garanti Bank shares to Custody to sell to the stock market in the following 2 years. However, those shares will literally be a part of the free float after November 12th, the day Hbk makes the whole payment. Should call options remain out-of-money throughout the 18-month period, then Hbk would have the option to get the US$150mn sum back from Dogus. The US type call option will be valid for 18 months.

Option price on Garanti will be determined with a 12% additional premium

Option price on Garanti will be determined with a 12% additional premium. Roughly, we can say that the option will be at-the-money when Garanti shares appreciate by 12% from the weighted-average price on November 9, 10 and 11. Hbk also has an additional purchase option on 30% of 'Garanti shares initially subject to option' paying a price 7% higher than that of the initial option (US$150mn*30%*1.07=US$48mn). The option will be in-the-money when market price exceeds the strike price.

The option deal has a cushion to prevent the holder (HBK) to divest its Garanti shares in bulk. According to the agreement, HBK can sell as much as 15% of the Bank's past one month trading volume worth of shares in one month. Therefore, HBK can only sell up to a sum of US$46mn Garanti shares in a month.

if Dogus Group starts acquiring non-core assets (such as the 24% stake of Tansas) in Garanti with the majority of the US$150mn sum to be collected on November 12th, then it would considerably ease tension on Garanti shares.

On the Intesa side nothing is over regarding their plans in Turkey. In the main context of enhancing its presence in the region and meeting its business plan requirements, Intesa is still looking for an acquisition candidate. Intesa wants a strong domestic bank with solid market shares in key areas. Intesa does not have a wide variety of choices in this respect.

Demand Deposits Compensate for Free Capital Deficit

We expect the free capital to improve to a deficit of US$39mn at the end of 2004

The sale of Dogus Oto definitely supported free capital. However, the Bank has more distance to cover before turning its free capital from red to black. In the first half bank only books, Garanti had a free capital shortage of US$341mn. We expect this figure to improve to a deficit of US$39mn at the end of 2004, whereas the Bank management states that the figure would even move up to positive territory. Likely non-core asset sales and increasing profit will be the leading catalysts to support the cash capital recovery. Garanti expects to generate up to US$75mn from real estate sales in 2004. The Bank realized US$40mn worth of fixed asset sales in the first nine month period of this year.

The Bank would generate around US$30mn from the forthcoming 35% IPO of its financial subsidiary Garanti Leasing

The Bank would generate around US$30mn from the forthcoming 35% IPO of its financial subsidiary Garanti Leasing. However, the major liquidation that would contribute to interest income would be the sale of its 24% share in retail market chain Tansas that continuously drained capital, rather than contributing to Garanti's shareholder value. The Dogus Group verbally committed in 3Q04 to acquiring the Tansas stakes from Garanti within 1 year. Therefore, we would expect the deal to be concluded by October 2005.

The Group creates the financing to take out the non core assets from Garanti's books through increasing the Bank's float. It would be very practical for a foreign direct investor to acquire a bank that is free of non-core assets. After the completion of the option backed SPO, we do not expect further public offerings of Garanti since Dogus Group would like to keep the remainder of the Bank's shares for a likely foreign strategic partner.

Only 20% of the banking sector's deposit base is made up of demand deposits, whereas this ratio is a huge 28% for Garanti (2001:19%, 2003:26%), which is the highest ratio in the banking sector. Even though the Bank's free capital is in the red, by partially financing the frozen assets via this strong demand deposit base, the Bank continues operating with adequate interest margins. Thanks to a solid demand deposit base, the 16% total free funds to assets ratio of the Bank is the second highest after Akbank among the large banks at the end of 1H04.

The major reason behind a rising demand deposit base is the Bank's entry in the east and Southeastern parts of the country

The major reason behind a rising demand deposit base is the Bank's entry in the east and Southeastern parts of the country after year-2000. Cash management activities such as check and bill collection and salary payments in those regions contributed to low cost financing. Demand deposit activity gained further pace with the Bank's strategy of reaching SME and retail clients. We expect demand deposits' share in the total deposits ratio to be sustained at this level, as the Bank's branch network spending declines and retail segment competition heats up.

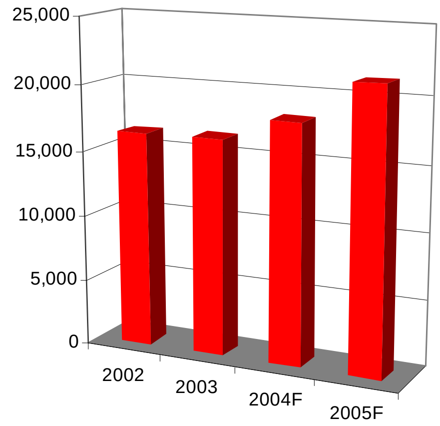
Foreign Borrowings Fuel Balance Sheet Growth

The share of deposits in total assets is likely to fall from 65% to 62%

Although we estimate the Bank's market share in deposits climbing from the 1H04 level of 9.2% to 9.7% in 2006, the share of deposits in total assets is likely to fall from 65% to 62% owing to investor preference for moving to alternative financial instruments, and due to the rising share of foreign borrowings. We expect the share of foreign borrowings in the balance sheet to climb from 13.5% to 17% during the same period due to the country's increasing sovereign rating-backed sliding interest rates, longer maturity of foreign borrowings, and low levels of deposit penetration.

However, the cost of international loans starting from 2007 is dubious because of forthcoming Basel II practices. And yet, we expect increasing sovereign rating of Turkey to compensate for the increasing borrowing costs to some extent. At this point Garanti would use its flexible operating structure to switch to deposits from foreign borrowings.

Garanti Bank's Balance Sheet (US$mn)



Source: Ak Securities Estimates, Garanti Bank

Garanti Bank has received US$675mn worth of asset backed securitization loans maturing from 2008 to 2012

During the one year period since 3Q03, Garanti Bank has received US$675mn worth of asset backed securitization loans maturing from 2008 to 2012. We expect new securitizations in the upcoming quarters as long-term financing lowers the maturity gap and makes the bank more solid against funding outflow in times of economic downturns. Since income from a certain asset is dedicated to a securitization payment, the costs are lower than a syndicated loan or a bond issue of the same size and maturity.

The Bank, also obtained US$1bn of syndicated loans to be used in trade financing

The Bank, also obtained US$1bn of syndicated loans to be used in trade financing. Garanti, which finances 17% of Turkey's total external trade, is the leader in export financing. The latest one-year syndicated loan of €450mn received in July 2004 bears an all-in interest rate of Euribor+140 basis points, which has 60bp lower cost than the €400mn loan of the previous year. Garanti is currently in the market to arrange a US$500mn loan to roll a US$450mn amount received in November 2003.

Although the risk premium of the loan is decreasing, we wish to note that one-year Euribor increased by 30 basis points from the July 2003 level of 2.0%. Since the majority of FX loans are floating and linked to Libor, the net effect of the rise is positive for the Bank.

Can Long Term Foreign Financing Restore Maturity Gap?

Parallel to that of the sector Garanti has about an 8-month maturity mismatch

Currently Garanti Bank's assets have a weighted-average maturity of 10 months, and these assets are financed through deposits of 2-month maturity. Parallel to that of the sector Garanti has about an 8-month maturity mismatch, which eventually causes liquidity risk unless a bank has a significant amount of free capital. Although we expect the Bank's free capital to enter the positive territory in 2005, it is currently in the red.

Garanti Bank does not expect the mortgage system to become effective at least in the following three years

We believe the share of long term foreign borrowings in the balance sheet to further increase however the maturity of assets would also rise with increasing consumer lending coupled with the upcoming mortgage scheme. That would limit the shortening of the gap. Although we expect the mortgage scheme to start in 2005, Garanti Bank does not expect the mortgage system to become effective at least in the following three years.

An economic downturn would not only hurt the banks with wide maturity gaps in terms of liquidity

Therefore, unless consumer confidence rises dramatically forcing investors to allocate their savings in deposits with more than 3-m of maturity, a squeezing of the maturity gap is not likely. In a declining interest rate environment in which funding costs continuously decline and return on IEA remains relatively stable, the maturity gap works in favor of banks. However, an economic downturn would not only hurt the banks with wide maturity gaps in terms of liquidity, but it would also cause interest rate risk. Maturity gap does not directly indicate interest rate risk, but gives an impression, since for the assets earning floating interest, the re-pricing period gets shorter.

Bottomline Growth to Persist

A squeeze in Garanti's interest spread and margin is inevitable in the upcoming low real interest operating environment

A squeeze in Garanti's interest spread and margin is inevitable in the upcoming low real interest operating environment. However, **i.** by switching to higher yield TL denominated retail loans, **ii.** with volume growth, **iii.** cost control, **iv.** divesture of non core assets and **v.** increased fee generation capabilities, we expect the slide to be limited. We project the bank-only interest margin sliding gradually from 5% levels of 2004 to 4.6% at the end of 2006. The Bank management on the other hand does not expect a decline in margins due mainly to asset divestures and increasing share of high yield earning assets in the balance sheet. We project the Bank's stated unconsolidated sustainable ROE to settle at 15%, whereas our sustainable adjusted (for non-core assets) IFRS sustainable ROE target in consolidated terms is a solid 18%. We bestowed the details on shareholders' equity adjustments in the valuation section of this report.

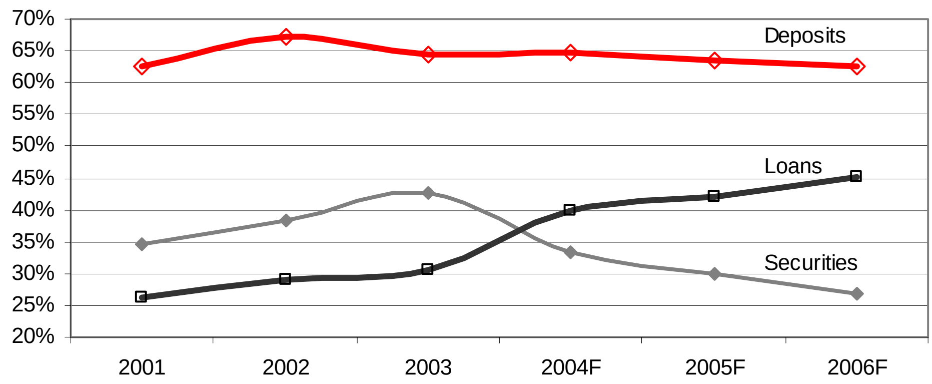
Therefore, even though the interest spread and interest margin are likely to decline, bottomline growth would continue. In our projections, we expect a 14% net profit CAGR for the foreseeable future. Interest earned on loans that constitute 41% of gross interest income in 2Q04, on the other hand, would climb to 65% in 2006 on the back of squeezed returns on bonds and be fuelled by the high yield on TL-denominated retail lending that will be thoroughly analyzed in the following pages.

Impressive Loan Expansion

Garanti's lending book has been growing through a CAGR of 13%, whereas the CAGR of banking sector loans is 10%

Starting from the end of 2001, after completion of the Ottoman Bank merger, Garanti has been the fastest growing member of the big-4 in terms of loans. Mainly driven by short-term SME and consumer loans, Garanti's lending book has been growing through a CAGR of 13%, whereas the CAGR of banking sector loans is 10%. We expect the trend to continue, and Garanti's market share to rise from 10.4% at the end of 1H04 to 11.5% in 2006.

Breakdown of Garanti's Balance Sheet

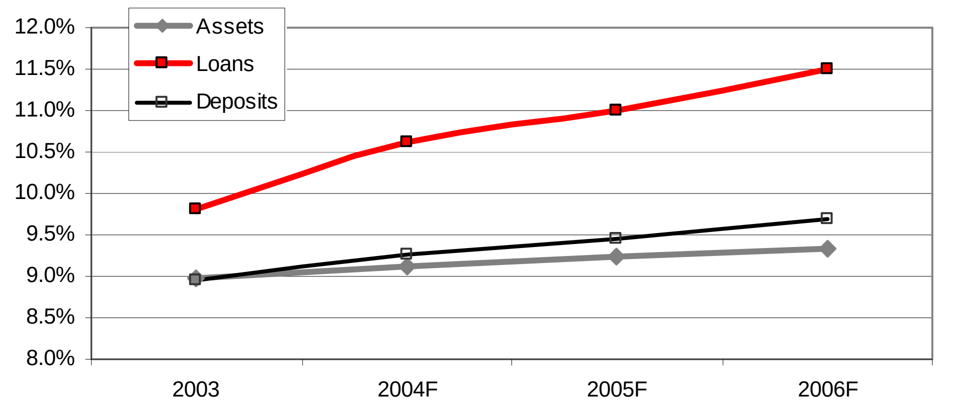


Source: Ak Securities Estimates, Garanti Bank

Loans comprise 38% of the balance sheet, whereas this ratio is 34% for the sector

Garanti has the highest share of non-related party loans in its balance sheet among the major banks. Loans comprise 38% of the balance sheet, whereas this ratio is 34% for the sector. We expect the share of the lending book in Garanti's assets to climb to 45% at the end of 2006, whereas the share of securities is likely to slide from the current level of 34% to 27% in the same period.

Market Share of Garanti in Key Balance Sheet Items



Source: Ak Securities, the BAT

Garanti targets to realize loan growth through higher yield consumer and SME loans

A huge 58% of Garanti's loans are FX denominated due to strong export financing facilities, however the ratio is only 42% for the sector that emphasize more on retail lending. Garanti targets to realize loan growth through higher yield consumer and SME loans in the following years.

Fast lending growth pulls down the NPL ratio, in other words fast lending defers the true status of asset quality. Only 3.4% of the Bank's loans are problematic according to 1H04 results. We expect the asset quality of Garanti to deteriorate slightly and the NPL ratio to climb to 4.3% in 2006 especially due to defaults on consumer loans.

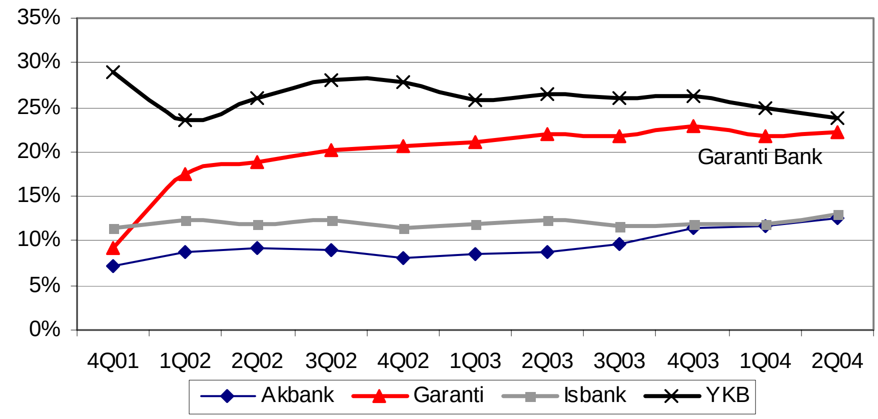
Power of Credit Cards

High-yield consumer loans and credit card loans make up a huge 31% of Garanti's total loan book

The Bank is rapidly increasing its retail banking presence, especially in credit cards very rapidly. High-yield consumer loans and credit card loans make up a huge 31% of its total loan book. This ratio is parallel to that of the sector; however the majority of the sector's retail lending is made up of core consumer loans. A huge 70% of Garanti's retail loans, on the other, hand are to credit cards (versus 36% of the sector).

Credit card loans are relatively better than consumer loans since i. a bank can build a loyal client base with cross selling opportunities in the credit card business; however individuals get consumer loans from the bank that offers the lowest rate. ii. interest rate exposure is higher for consumer loans that have a fixed rate and around 1-year maturity. iii. Interest earned on credit cards is incomparably higher than that of consumer loans, iv. Credit card business generates higher commission and fee income relative to consumer loans.

Market Shares in Credit Card Lending



Source: Ak Securities Estimates, the BAT

The Bank has a 21% market share in credit card loans as of the end of 2Q04 that rose from 9% at 2000 year end

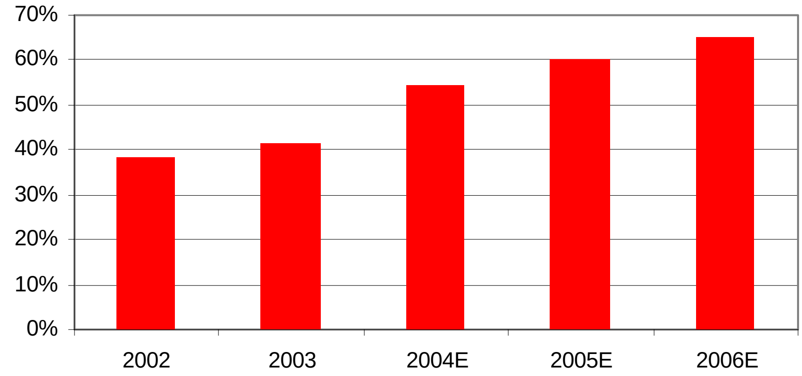
The Bank has a 21% market share in credit card loans as of the end of 2Q04 that rose from 9% at 2000 year end. We expect the Bank's market share to surpass that of YKB in the following two quarters if Garanti maintains its growing trend and YKB continues to lose market share.

It is not only the high yields that make credit cards attractive for Banks, but also transaction volume and number of cards that contribute to fee generation. Besides issuing, the credit card acquiring business also supports non-interest revenues. Fees received from credit card issuing and acquiring businesses constitute 53% of Garanti's gross fee income. Although Garanti's net fee income is as yet far from covering its operating expenses, the ratio is likely to climb significantly in the coming years.

The share of Garanti's alternative distribution channels in comparable transactions is a huge 71%

We expect the ratio of net fee income to operating expenses to hike from the 2Q04 level of 55%, which is the highest ratio in the peer group, to 65% in 2006. As well as increasing fee income, alternative distribution channels backed closely controlled operating expenses also support the ratio. It is worth mentioning that the Bank is still the leader in terms of low cost internet banking transactions portion in total comparable transactions with a 46% share. The share of Garanti's alternative distribution channels in comparable transactions is a huge 71%.

Net Fee Income/Operating Expenses



Source: Ak Securities Estimates, the BAT

The Bank's market share in credit cards has been increasing relatively fast on the back of the Bonus Card scheme. Bonus brand cards make up 83% of the Bank's credit card total.

Number of Credit Cards (30/09/2004)

Credit Cards	**3,856,829**
Bonus	*3,220,500*
Shop&Miles	*278,085*
Other	*358,244*

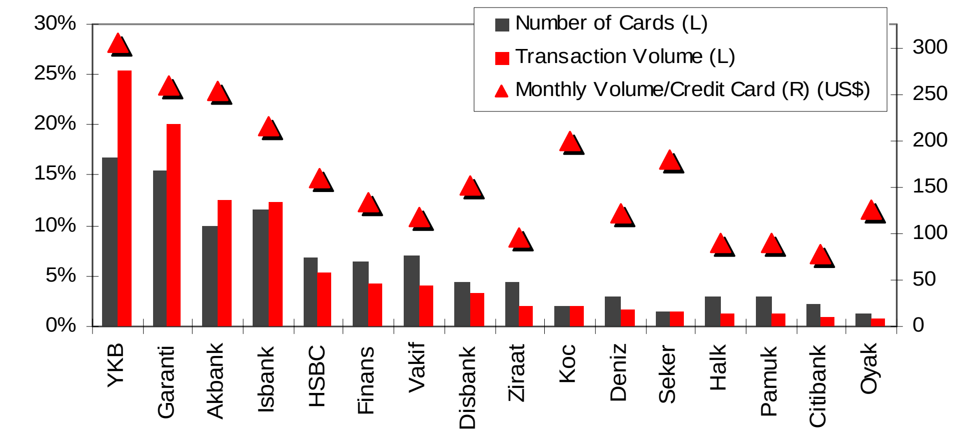
Source: Garanti Bank

As well as moving towards the leading position in lucrative credit card lending Garanti also has the second highest market shares in the number of credit cards, credit card transaction volume and monthly credit card spending. As seen in the chart below, both Garanti and the other members of the big-four have credit card '**transaction volume'** market shares higher than the '**number of credit cards'** market shares.

Solid merchant store network is very important to make a card the primary one in consumers' wallets

In contrast, small and medium-sized banks have higher market shares in number of cards, but lower market shares in credit card spending volume. This means that per card efficiency of larger banks is higher than the rest. Therefore, reckless credit card distribution does not generate volume, and solid merchant store network is very important to make a card the primary one in consumers' wallets. The large banks with higher card penetration definitely find merchant stores that are eager to provide attractive promotions for that specific card. Those promotions trigger consumer demand to have that card and the cycle continues. Through a US$259 monthly spending volume per credit card, Garanti again holds one of the leading positions.

Market Shares in Number of Cards & Transaction Volume vs Monthly Credit Card Spending (2Q04)



Source: Ak Securities Estimates, Banks

Continues to Operate Efficiently

Garanti's per branch and per employee efficiency figures remain the best in the banking sector

Garanti's per branch and per employee efficiency figures remain the best in the banking sector. In particular branch efficiency figures, which are twofold that of the sector, are highly impressive. Even if we adjust the figures for the side branches that are parts of the larger ones, Garanti is still the top in that respect. The BAT announces the branch network of Garanti as 335, whereas taking into consideration the small side branches, Garanti reveals a network of 378 branches. That is why the personnel per branch figure of Garanti look higher than the sector average. The figure normalizes when we take the side branches into consideration.

As margins decline, cost control will be one of the sector's major concerns

Even though the cost to income ratio lags behind that of the sector, it's improving trend is very impressive. We expect the ratio to slide below 50% in 2006 and remain around this level thereafter. And as margins decline, cost control will be one of the sector's major concerns. The Banks need to motivate staff via granting efficiency-based bonus payments rather than higher salaries. Garanti Bank uses the EVA system to motivate the staff. Around 30% of sales staff salaries are linked to their performance. Ad spending, on the other, should gain pace owing to credit card and fund management businesses as fee generation will gain importance in a low margin environment.

Alternative distribution channels that we detailed in the previous sections of this report will also be very important in a low margin environment. With a solid presence in internet banking, Garanti will definitely be one of the front-runners in cutting back on operational costs.

Efficiency Indicators of Garanti

	2001	2002	2003	2004F	Pr. Comm. Banks
Cost/Income	89%	73%	63%	51%	49%
Branches	295	304	313	335	3,692
Employees	5,981	7,407	8,145	8,874	75,540
Employee/Branch (US$mn)	20	24	26	26	20
Deposit/Employee (US$mn)	1.8	1.5	1.3	1.3	0.9
Loan/Employee (US$mn)	0.8	0.6	0.6	0.8	0.5
Deposit/Branch (US$mn)	37	36	34	35	18
Loan/Branch (US$mn)	16	16	16	22	11

Source: Ak Securities, Garanti Bank, the BAT

V. FINANCIALS & FORECASTS

IFRS Financial Statement (US$mn)	2002A	2003A	2004F	2005F
Assets				
Cash and cash equivalents	1,703	1,177	2,111	2,831
Financial assets held for trading	1,233	682	616	693
Loans and advances to banks	915	957	1,240	1,828
Loans and advances to customers	6,204	6,959	9,903	13,179
Other assets	784	911	668	852
Security investments	5,439	5,818	4,529	5,303
Investments in equity participations	153	283	171	211
Tangible assets, net	1,274	1,171	1,161	1,329
Intangible assets, net	102	86	72	70
Deferred tax assets	385	335	103	101
Total assets	**18,192**	**18,380**	**20,573**	**26,397**
Liabilities				
Deposits from banks	575	651	894	1,120
Deposits from customers	12,027	11,662	12,397	15,534
Obligations under repurchase agreements	883	1,158	1,366	1,743
Loans and advances from banks	2,305	2,312	2,901	4,085
Bonds payable	62	0	0	0
Current tax liability	33	22	20	25
Deferred tax liabilities	75	3	0	0
Other liabilities and accrued expenses	688	657	754	962
Total liabilities	16,647	16,464	18,332	23,469
Minority interest	159	146	139	177
Shareholders' equity	**1,386**	**1,770**	**2,103**	**2,751**
Total liabilities, minority interest and shareholders' equity	**18,192**	**18,380**	**20,573**	**26,397**

Income Statement	2002A	2003A	2004F	2005F
Interest income	2,019	1,786	1,971	2,525
Interest expenses	-2,041	-1,574	-1,207	-1,496
Net interest income/(expenses)	-22	211	764	1,028
Net fee and commission income	277	279	357	502
Operating income	938	1,333	1,444	1,978
Operating expenses	-1,035	-1,031	-1,104	-1,430
Income/(loss) from operations	-97	302	340	548
Gain/(loss) on net monetary position, net	40	-2	4	3
Income/(loss) before tax	-57	300	344	551
Taxation credit	54	44	-114	-165
Income/(loss) after tax	-2	344	231	386
Minority interest	25	40	48	80
Net income for the period	**23**	**384**	**279**	**466**

Source: Garanti Bank, Ak Securities

Unconsolidated Inflation Adjusted BRSA US$mn

	2002A	2003A	2004F	2005F
BALANCE SHEET				
Cash And Balances With The Cb	920	367	1,016	1,408
Trading Securities (Net)	1,150	601	496	514
Banks And Other Financial Institutions	535	229	205	278
Money Market Securities	-	-	-	-
Investment Sec. Available For Sale (Net)	906	3,070	2,696	2,905
Loans	4,743	5,055	7,218	8,975
Investment Sec. Held To Maturity (Net)	4,203	3,339	2,879	2,977
Investments And Associates (Net)	186	208	180	199
Subsidiaries (Net)	821	946	894	1,014
Reserve Deposits	810	817	957	1,227
Miscellaneous Receivables	32	82	39	46
Accrued Interest And Income Receivable	703	491	392	500
Property And Equipment (Net)	1,004	936	922	976
Intangible Assets [Net]	23	19	17	19
Other Assets	361	312	241	267
Total Assets	**16,399**	**16,473**	**18,149**	**21,304**
Deposits	11,034	10,594	11,747	13,544
Interbank Money Market	927	1,265	1,173	1,348
Funds Borrowed	2,146	2,127	2,594	3,361
Miscellaneous Payables	39	36	40	56
Other External Resources	485	357	382	402
Taxes And Other Duties Payable	28	29	24	35
Finance Leasing Payables (Net)	8	15	14	16
Accrued Interest And Expenses Payable	157	175	120	158
Provisions	167	73	81	115
Shareholders' Equity	**1,407**	**1,803**	**1,973**	**2,268**
TOTAL LIABILITIES	**16,399**	**16,473**	**18,149**	**21,304**
INCOME STATEMENT				
I. INTEREST INCOME	2,556	1,545	1,944	1,805
1.1.Interest on loans	808	790	931	1,079
1.2.Interest received from reserve deposits	48	47	37	42
1.3.Interest received from banks	124	19	11	11
1.4.Interest received from money m. transactions	91	6	0	-
1.5.Interest received from marketable sec. portfolio	1,444	652	932	648
1.6.Other interest income	41	31	33	25
II. INTEREST EXPENSE	1,990	1,504	1,108	1,035
2.1.Interest on deposits	1,689	1,246	935	865
2.2.Interest on money market transactions	5	150	91	72
2.3.Interest on funds borrowed	290	107	77	93
2.4.Interest on securities issued	-	-	-	-
2.5.Other interest expense	5	1	5	5
III. NET INTEREST INCOME (I - II)	566	41	836	769
IV. NET FEES AND COMMISSIONS INCOME	234	264	335	398
V. DIVIDEND INCOME	2	0	1	1
VI. NET TRADING INCOME	(18)	524	(26)	3
6.1.Profit/losses on trading account securities (Net)	254	410	65	18
6.2.Foreign exchange gains/losses (Net)	(272)	114	(91)	(15)
VII. PROFIT/LOSS FROM HELD TO MATURITY M. S.	-	-	-	-
VIII. OTHER OPERATING INCOME	53	86	77	110
IX. TOTAL OPERATING INCOME (III+IV+V+VI+VII+VIII)	837	915	1,223	1,282
X. PROVISION FOR LOAN LOSSES OR OTHER REC. (-)	141	94	193	206
XI. OTHER OPERATING EXPENSES (-)	609	637	619	661
XII. NET OPERATING INCOME (IX-X-XI)	87	184	411	415
XIII. PROFIT/LOSSES FROM ASSOCIATES AND SUBS.	47	17	12	13
XIX. NET MONETARY PROFIT/LOSS	(22)	35	(1)	(7)
XIV. INCOME BEFORE TAXES (XII+XIII)	113	237	422	421
XV. PROVISION FOR TAXES ON INCOME (-)	10	15	136	126
XVI. NET OPERATING INC./EXP. AFTER TAXES (XIV-XV)	103	222	286	295
XX.NET PROFIT/LOSS	**103**	**222**	**286**	**295**

Source: Bank Financials, Ak Securities

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