HSBC Global Research

Turkish Food Retail

Structural growth to overcome near term challenges

EQUITIES
CONSUMER BRANDS & RETAIL

Turkey

- Lucrative growth potential still exists based on consolidation and growing share of modern retail
- But challenges such as rising employee costs will remain under the spotlights going forward
- Our highest conviction call is Migros (Buy, TP TRY22.5), which benefits from recovery in TRY. We reiterate Buy for BIM

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In this report we try to dig deeper into the Turkish organised food retail market. We touch base on ongoing sector trends and impacts from currency devaluation, high food inflation, rising share of employee costs, weak consumer confidence and consolidation. In order to better reflect and compare the trends in the Turkish food retail we have also included peer analysis including Russia and South Africa.

The Turkish food retail space has grown at an astounding rate of c12% CAGR over the last 5 years. We think it continues to offer a host of opportunities for food retail players with relatively low c40% share of modern retail and only c18% market share for the top 5 players. At the same time, we think that the sector has its own challenges to tackle. The ratio of employee costs to sales has been increasing at an alarming pace in last 3 years. Turkish Retailers are currently facing a tougher challenge to sustain margins with the Government's plan to hike the minimum wage level in the country by 30% in FY16. However, Turkish Retailers (especially leaders of their segments BIM and Migros) have so far successfully improved gross margins by putting more pressure on suppliers and kept other costs under control to compensate for this pressure.

We find Migros to be our favourite stock among the covered Turkish food retail players. Migros not only benefits from faster expansion and higher LFL traffic growth but also is one of the most exposed to currency risk due to its EUR based loans; therefore recent strength in TRY against EUR based on a more positive outlook should be a positive catalyst for the shares. We also argue that Migros is likely to be one of the strongest candidates for consolidating smaller players in the sector in the long run.

BIM's high growth rate supported by strong LFL numbers and space expansion make it one of the clear winners in the industry for the next 2-3 year period. Its potential success in its new supermarket format and investments outside of Turkey might extend its high growth prospects to further years. Bizim benefitted from cost restructuring and growth driven by higher tobacco sales in FY15; however we think low like for like in main category sales remains as an issue and wage hikes in FY16 have the potential to delay the long awaited margin recovery.

Turkey Food retailers

Stock	Ticker	Rec	CP	TP New	TP Old	Upside/ downside
BIM	BIMAS TI	Buy	55.65	61.0	64.0	10%
Bizim	BIZIM TI	Hold	13.15	13.9	14.0	6%
Migros	MGROS TI	Buy	17.70	22.5	23.0	27%

Source: HSBC estimates and Thomson Reuters Datastream
Closing price in TRY as on 24 Nov 2015. Target prices in TRY.

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Contents

Structural growth to overcome challenges

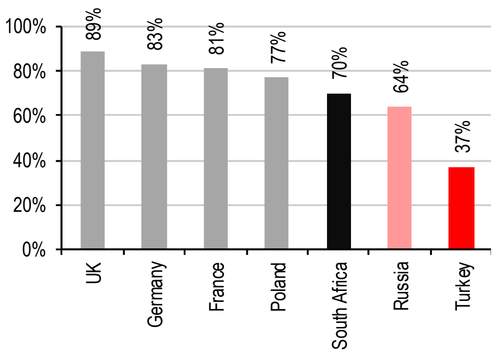
- Turkish food retail fundamentals remain strong supported by low penetration level of modern retail
- Stronger sales growth likely in Turkey as food inflation remains high and like for like traffic increasing especially for selected players
- Margin pressure from rising employee costs as well as intensifying competition are the key challenges for the industry

Lucrative growth in Turkey if you can manage the challenges well

In this report we try to dig deeper into Turkish organised food retail market and find out the reasons behind the changing industry landscape. We touch base on ongoing sector trends and impacts from currency devaluation, high food inflation, potential significant wage hike in FY16, rising share of employee costs, weak consumer confidence and consolidation. Apart from our coverage universe - BIM, Bizim and Migros - we expand our analysis to include other names to get a comprehensive view of organised food retail in Turkey. Further in order to better reflect and compare the trends in the Turkish food retail we have also included peer analysis taking Russia and South Africa as they have gone through a similar phase of currency devaluation and high food inflation cycle.

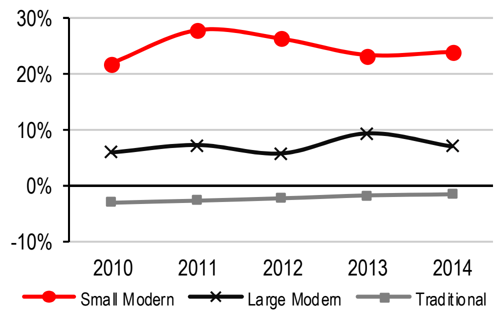
Challenges may mask the sector attractiveness at times but what truly matters is the long-term potential that is based on the fundamental drivers of the sector. Here, we are revisiting the potential and opportunities that the food retail sector in Turkey has to offer in the longer-run and we try to evaluate whether problems are serious enough to challenge growing modern retail.

Lower penetration of modern food retail in Turkey compared to peer countries (FY14)



Source: Euromonitor, HSBC calculations , company reports

Value growth across broader food retail formats



Source: Euromonitor, HSBC calculations

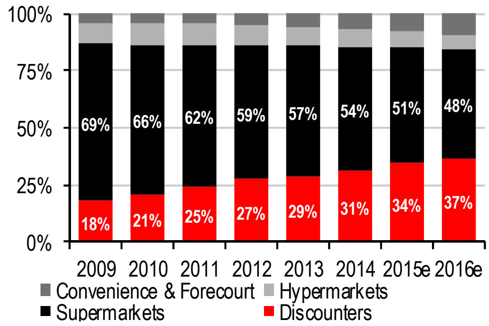
First, we looked at the modern retail penetration level in Turkey which we believe is still very low and has some way to go before it catches up with that of peer countries like Russia and South Africa. This implies Turkey should continue to see higher growth in organised retail along similar lines to what we have witnessed in the last 5 years. At a 5-year CAGR of 24.5% small format stores (discounters and convenience) continue to expand rapidly across the country driving up the growth in modern food retail. Euromonitor estimates the penetration level to reach 42% by 2016e (from 37% currently) and further to 48% by 2019e. This clearly highlights the significant growth potential that exists in this sector.

Supermarket players like Migros and CarrefourSA are focusing on smaller formats convenience to make a foot-hold in this growing market

Second, within modern food retail, discounters and convenience stores are the fastest growing formats in Turkey. Discounters form 31% of the total modern retail as of FY14 (from 21% in 2010) and are challenging the supermarket share in the organised market. Though supermarkets continue to have a bigger piece of the pie, their overall share has fallen from 66% of the organised market (in 2010) to 54% in 2014. On the other hand, convenience stores form a small fraction of the organised market (less than 10%) but have gained importance over the last three years with y-o-y growth rate averaging even higher than discounters. Supermarket players like Migros and CarrefourSA are increasingly focusing on smaller format convenience stores to gain a foot-hold in this growing market.

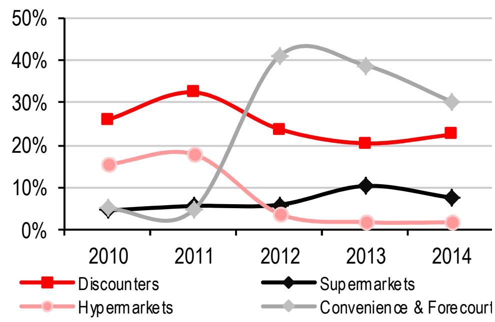
However, as we pointed out earlier in our 21 October 2014 report *Four By Four in 2020* we believe discounters will continue their dominance of Turkish food retail in coming years, before the rising income level drives up the consumer towards greater choices and better shopping experiences. Even then we believe the discounters would adapt and diversify their network into convenience or supermarket formats based on location and income levels. Leading discounter BIM's entry into discount supermarket stores called 'FILE' is a welcoming sign of the same.

Modern food retail breakdown by formats



Source: Euromonitor, HSBC estimates

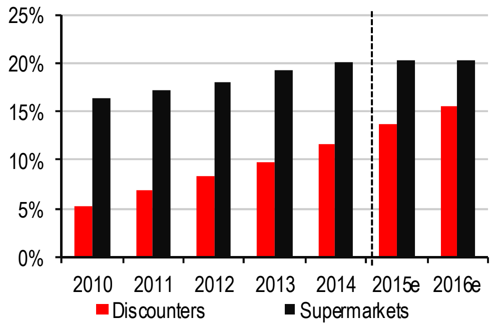
Value growth in modern food retail formats



Source: Euromonitor, HSBC calculations

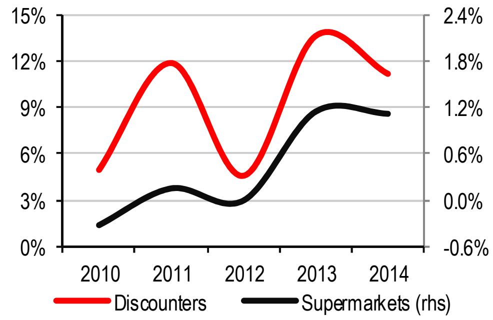
Discount stores preferred by consumers due to lower pricing, location and quality private label products

Market share movement of discounters and supermarkets



Source: Euromonitor, HSBC estimates

Sales per outlet growth trend for discounters and supermarkets



Source: Euromonitor, HSBC calculations

Third, between supermarkets and discounters it is quite evident that discounters have grown by leaps and bounds in Turkey whereas supermarkets struggle to keep up. The attractiveness of discounters to customers becomes clear if we look at their increasing sales per outlet. Discounters sales per outlet have grown at a y-o-y rate of over 10% in the last two years compared to 1% for supermarkets. We see discount stores being preferred by consumers due to factors like lower pricing (10-20% lower than supermarkets), location (generally in high population density areas) and high quality private label products.

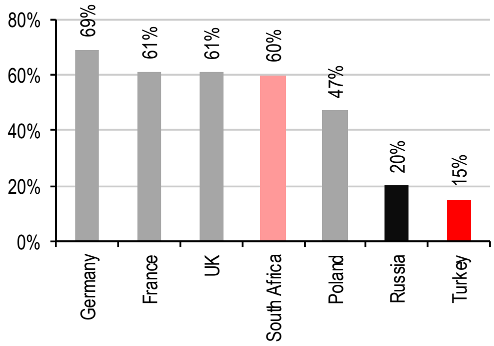
15%

Market share of top 5 players in Turkey

Turkey's top 5 have one fourth of their peers' market share in developed countries

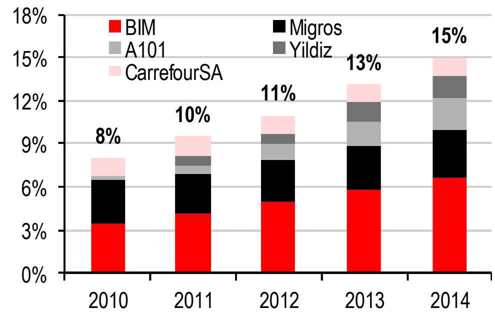
Fourth, the fragmented nature of the Turkish food retail sector makes it highly attractive for growth via consolidation. The top 5 players in Turkey have a market share of only 15% as compared to +60% in western countries and South Africa. The top 5 players have nearly doubled their market share since 2010 via expansion of store network (like BIM and Migros) and acquisitions (like Yildiz Holding and Carrefoursa). We believe there is ample scope for these players to further increase their market share via both the above mentioned channels.

Top 5 players form only 15% of organised food retail in Turkey (2014)



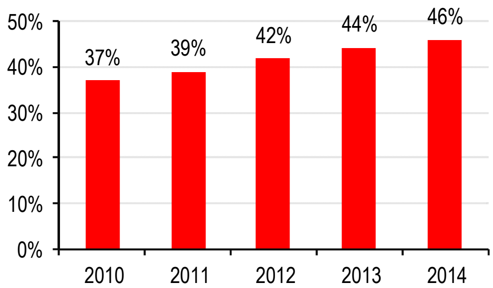
Source: Euromonitor, HSBC estimates , Company reports

But top 5 players growing much faster than any other segment in Turkey Retail



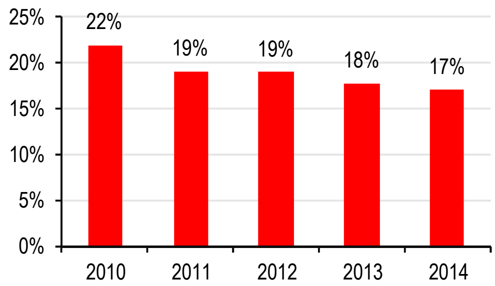
Source: Euromonitor, HSBC estimates

Among Top 5, BIM market share increased in Turkey



Source: Euromonitor, HSBC calculations * BIM, A101, Migros, Yildiz, CarrefourSA, Kipa and Anadolu; ^ Kiler share included in CarrefourSA

Share of alcohol selling retailers declining in organised retail market



Source: Euromonitor, HSBC calculations

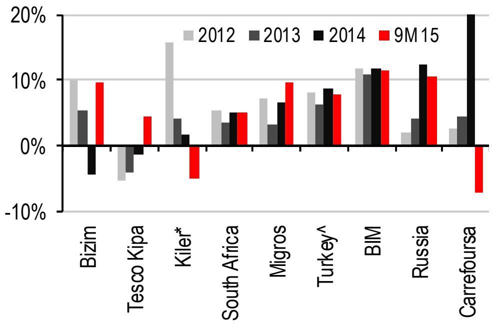
To further test our point on consolidation we analysed the movement in market share of big market players. We see that the big players in market now forms c.46% of the organised retail market, up by 9 pp from 2010 level. Yes, most of the movement is due to the aggressive expansion by these players but acquisitions like that of DIA and SOK by Yildiz also have a role to play. Interestingly the share of major alcohol selling retailers in the organised market has gone down over the years. This we believe is a result of non-alcohol selling players like BIM and A101 (discounters) capturing market share faster than the alcohol selling players (mostly supermarkets and hypermarkets). Another factor could be that foreign players have formed the major alcohol selling retailers in Turkey and they have been finding it increasingly difficult to match the pace of expansion of domestic retailers. A few have exited the Turkish market or cut their shareholding level or are considering doing so, thus bringing down the share of alcohol selling retailers. This implies that non-alcohol selling retailers have better growth prospects as organized segment capture share from traditional segment, which is less focussed on alcohol products, especially in eastern part of Turkey.

Having taken a look at the key fundamental factors shaping the Turkish food retail landscape, we dig into the recent trends observed among the food retail companies in Turkey. We look at key drivers for growth, margins and consolidation in the industry below.

Recovery in LFL growth

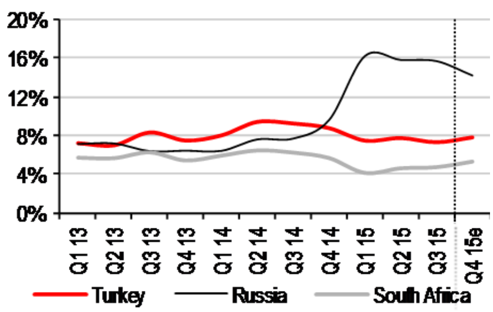
Like-for-like metrics show a holistic view of the growth patterns of a food retail company. In 2014 we have seen a stronger LFL growth for most of the food retailers predominantly due to favourable impact from high food inflation level. Among peer countries, Russia leads the way with LFL at 12.5% (rising from 4.3% in 2013) followed by Turkey which registered an 8.8% LFL growth compared to 6.3% in 2013. South Africa also shows an improvement from 3.6% in 2013 to 5.0% in 2014. Trends in 9M15 results were also similar with inflation zooming ahead in Russia and slightly moderating in Turkey and South Africa. Therefore, in our view 2015 will see an even stronger LFL growth for food retailers in general.

LFL growth trends



Source: Company, HSBC calculations

Quarterly inflation trend



Source: Datastream, HSBC estimates

Within Turkey LFL growth was strongest for CarrefourSA in 2014 marked by a successful turnaround of its operations. The Company had to post negative growth in FY15 also because of a strong base. Among the covered companies, BIM continues to show a strong LFL number after a marginal dip in 2013. As we argued earlier in our report *Four for Four in 2020* that discounters are the best format for growth in Turkey, we believe BIM as well as other discounters will have a stronger growth prospect over other food retailers in Turkey. The 11.5% LFL growth during the first nine months of 2015 supports our point of view. Furthermore, it's interesting to note that despite pressure from increasing competition (A101 and Sok), higher space growth (c.500 store openings in 2014) and related cannibalisation of sales, the company has been able to sustain a robust real LFL growth trend over the last 2 years.

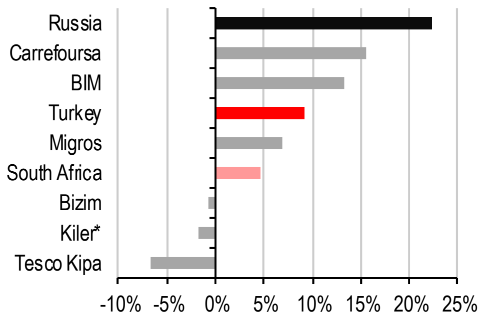
Migros started focusing more and more on smaller format stores and expanded rapidly

For Migros it was the change in strategy that helped the company to post better growth numbers. The company started focusing more and more on smaller format stores (Mjet) and expanded rapidly, capitalising on the convenience market space opportunity. Its supermarket stores also performed in-line with last year capitalising on the trust that it has built over a long history in Turkey together with strong improvement in product portfolio and competitive pricing strategy especially on SKUs that are available in discounters. Together with increasing space growth, the Company started posting +15% top line growth levels in recent quarters, which is quite a success within the supermarket universe.

Bizim on the other hand fared poorly during the last year due to restrictions on credit card transactions and overall tougher environment for wholesalers. However, the company has since then bounced back with a stronger LFL growth of 9.5% in 9M15. Exceptional growth in tobacco business along with marginal recovery in main category sales has been the primary driving force for Bizim this year.

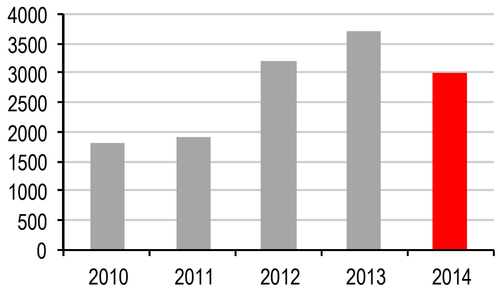
LFL alone is not sufficient to measure the overall growth trend of food retailers. It's equally imperative to focus on the trends in selling space metrics also. If we look at selling space growth, Russia witnessed the strongest growth as top food retailers expanded aggressively in the country. Turkey, though relatively lower in space growth as compared to Russia, has seen strong expansion from key players like BIM and A101 in discounters, Migros and Carrefoursa in convenience supermarket and Bizim in wholesale market over 2012-14. On average, every year more than 3000 stores have been added to the modern retail segment in the last three years and the pace continues to increase during YTD 2015.

Average space growth (LTM %)



Source: HSBC estimates, * acquired by CarrefourSA in FY15

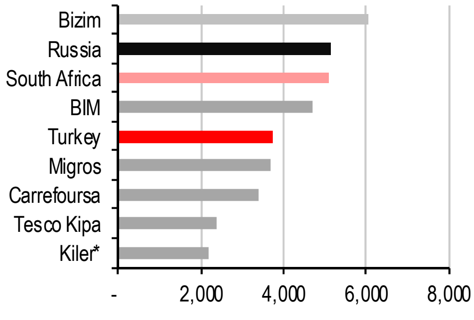
Number of stores added in modern retail space in Turkey



Source: Euromonitor

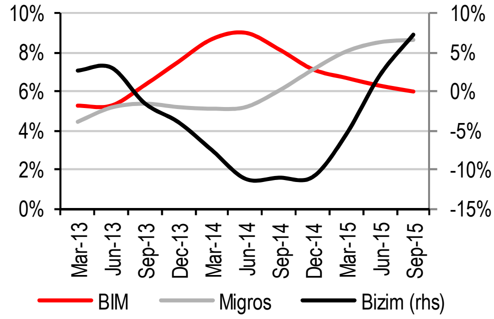
However, average sales per sqm Turkey continues to lag behind that of Russia and South Africa as the basket size and value of goods are comparatively higher in these countries as Turkey's modern retail is now more skewed towards discounters. In the Turkish market Bizim has higher sales per sqm as it realizes much higher volumes due to its wholesale business model. Higher sales per sqm vs. supermarkets outline the popularity of BIM among Turkish customers as well as effectiveness of its format. In general, discounters SKUs are priced considerably lower than supermarkets but due to higher volumes and smaller space requirement they see higher sales revenues per sqm of their space. Within supermarkets clearly Migros leads with a higher sales per sqm compared to peers. Its dominant position in supermarket space along with increasing contribution from smaller format convenience stores are the key factors that supports Migros sales number. More importantly both BIM and Migros achieve 7-8% sales per sqm growth, which is almost equal to internal inflation of these companies, indicating a healthy space expansion strategy.

LTM Sales per sqm (USD) (6M 2015)



Source: HSBC estimates, * acquired by CarrefourSA,

Sales per sqm growth (LTM)



Source: HSBC calculations

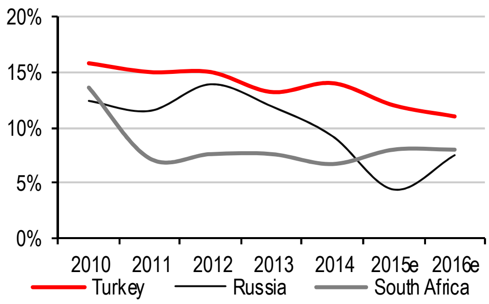
In our opinion discounters should see the highest space growth in the next 2-3 years closely followed by convenience operators. Within our coverage stocks, we believe BIM has a clear advantage due to its strong pricing power (thanks to higher private label share) and faster store expansion in the market but Migros also well positioned for convenience format growth.

Rising staff expenses a concern…

Turkey's nominal wage inflation in 2014 was 14% and remained high at c12% in 2015 yoy

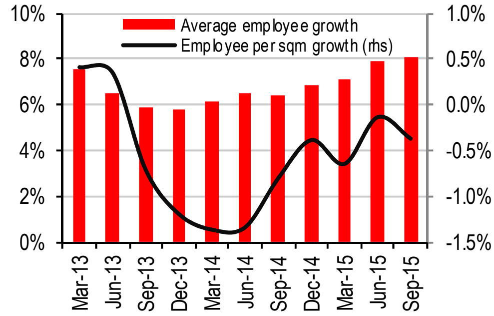
Over the last three years average employee cost to sales for Turkish food retailers has increased considerably and currently stands at c.8% of sales. One of the primary factors that are driving up the growth in employee cost is the high wage inflation level prevailing in the country as well as lack of enough personnel to hire. Turkey's nominal wage inflation in 2014 was 14% and remained high at c12% in 2015. The high inflation rate along with minimum wage hike as seen in 2014 and 2015 have continuously put pressure on the employee cost for food retailers in the region. We believe the trend will continue to play out in the medium term and could mean further increases in staff cost over the next 2-3 years.

Wage inflation (nominal)



Source: HSBC estimates

Employee growth trends in Turkish Retail

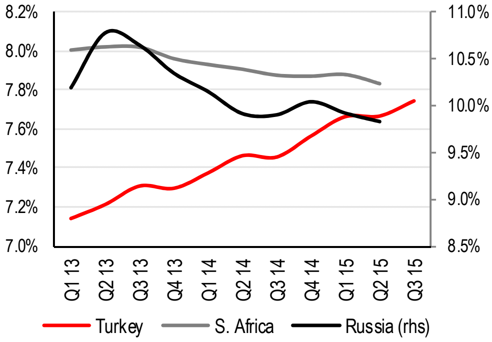


Source: HSBC calculations

Employees per thousand sqm continues to decline since mid of 2013….

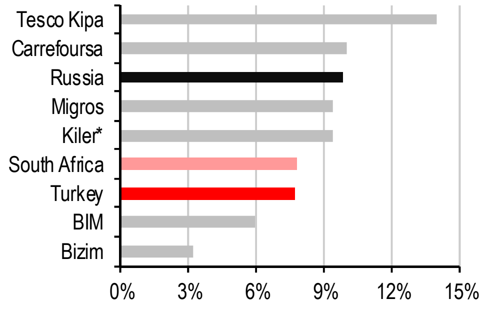
…though the rate of decline has slowed down a bit, we believe with greater pressure from wage inflation the trend should continue in medium term

Employee costs to sales – Turkey growing faster than others



Source: HSBC calculations

Employee cost to sales (LTM)



Source: HSBC calculations, * acquired by CarrefourSA,

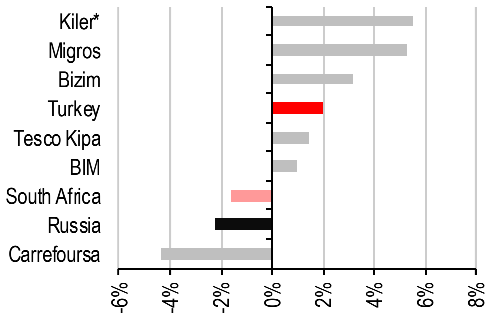
However, wage inflation is not the only thing that is putting pressure on margins here. The heightened expansion of stores in Turkey from all the major players is also adding to the cost side pressure. More than 3,000 stores were added in Turkey in 2014 with a similar number expected to come online in 2015. This has led to a significant increase in demand for store personnel's over the last 2 years. We saw a c.9% increase in employees in the Turkish food retail market during LTM (June 2015) with the majority of it resulting from the high rate of expansion from players like BIM, Migros and Carrefoursa. As we are continuing to see a higher number of stores opening up each year, we believe food retailers could find it increasingly difficult to hire store personnel at inflation-adjusted wage levels.

The third trend which we would like to highlight is the employees per thousand square metre of food retail space in Turkey. Employee per thousand sqm continues to decline since mid of 2013 due to rapid expansion in the industry leading to higher space growth. Though the rate of decline has slowed down a bit, we believe with greater pressure from wage inflation the trend should continue in medium term. With another minimum wage hike in news, we believe the retail players would focus on increasing their employee efficiency and could lead to a further drop in employees per sqm level.

If we look at the peer country level, South Africa has shown a relatively stable employee cost to sales ratio which is more or less explained by the steady wage inflation in the country. On the other hand Russia shows a declining employee cost to sales supported by drop in real wage inflation level and store personnel optimisation by some of the players. This is in contrast with Turkey where this metric shows a consistent increase over the years.

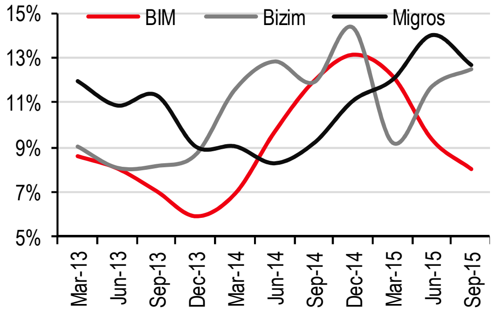
Within Turkey itself, there are different growth patterns in employee costs which we believe is dependent on the pace of expansion and the store formats of the companies. Bizim for example have a lower staff cost to sales on account of it being in wholesale business where volumes are much higher than supermarkets and discount stores. On the other hand BIM has seen one of the strongest growth rates in number of personnel's which directly maps to its higher opening of stores in last two year. In order to compare the growth in staff cost we looked at per employee costs (inflation adjusted) for food retailers in the country. To our surprise CarrefourSa emerged as the best performer in this metric but we believe this to be a temporary blip as the company has been actively involved in acquisitions recently which have skewed the data points for the first half of 2015.

Per employee cost growth (inflation adjusted LTM average)



Source: HSBC calculations

Per employee costs growth trend (LTM)



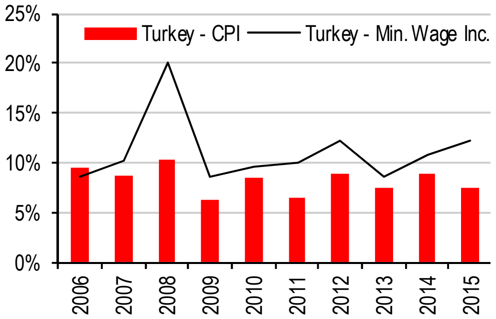
Source: HSBC calculations

From the point of view of our covered stocks, BIM remains the winner by far, which, despite continued store expansion has managed to control its costs structure. BIM per employee costs growth (inflation adjusted) was limited to c.1%, better than Turkey's average of 1.5%. Migros on the other has a slightly higher employee costs growth due to its store formats (supermarkets has a higher cost structure for employees) and rapid expansion across Turkey.

Minimum wage in Turkey might increase sharply…

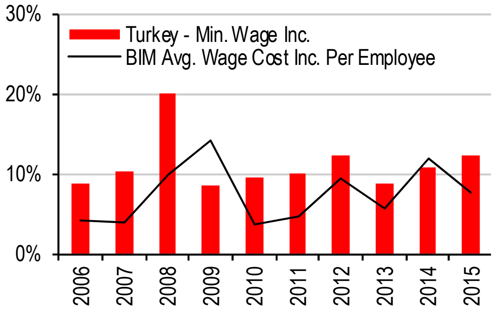
The Turkish Government is planning to a significant rise in minimum wage at a degree of 30%, which is more than triple of the average CPI in the country, as a result of the pledges given to the public ahead of the recently realized general elections. While we have assumed c17% rise for employee wages for FY16e, if the Government looks for an imminent 30% rise in January 2016, we think retailers will feel further impacts on their margins. We think they will be reflecting the cost increases to their prices after a period of time. However, FY16 margins may be negatively affected by this. As demonstrated in the charts on next page we think that an additional 20% increase in wages (compared to our base case), will have the potential to cut 25% and 32% of FY16 EBITDA estimates for BIM and Migros, respectively.

Minimum wage increasing much faster than CPI for the last 10 years …



Source: Turkstat

…BIM's average wage costs do not reflect this precisely but still feel the pressure

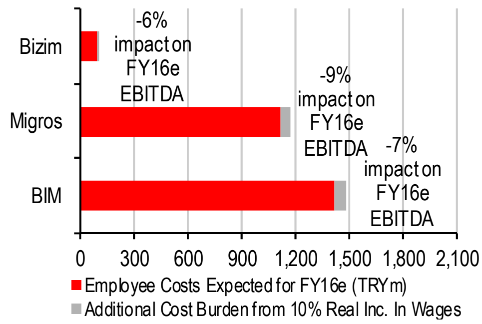


Source: Turkstat and BIM reports

BIM EBITDA margin was down by 91bps in FY08 when minimum wage was increased by 20% - almost double of the inflation in that year

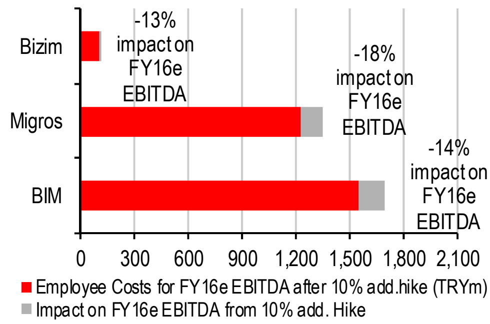
Source: Turkstat and BIM reports

Impact of 5% additional wage hike on Turkish food retailers EBITDA*



Source: Company reports and HSBC estimates * assuming that companies do not increase prices to reflect the cost push

Impact of 10% additional wage hike on Turkish food retailer EBITDA*



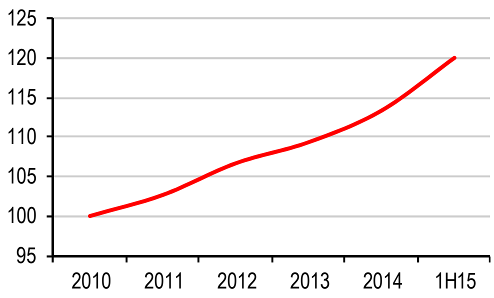
Source: Company reports and HSBC estimates * assuming that companies do not increase prices to reflect the cost pus

Rent expense pressure is comparatively limited in Turkey…

Over the last few years we have seen increase in rental expenses for food retailers in all the three countries - Turkey, South Africa and Russia

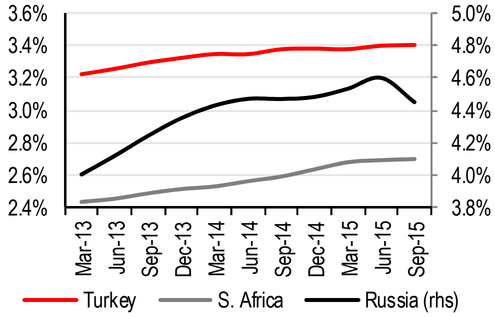
Over the last few years we have seen increases in rental expenses for food retailers in all the three countries - Turkey, South Africa and Russia. However, on a comparative scale Turkey stands out and has witnessed a modest rate of increase in rental expense to sales ratio. Average rental expenses to sales for food retailers in Turkey grew marginally from 3.3% in Jun-2013 to 3.4% in Jun-2015. In contrast average rental expenses to sales in Russia moved from 4.1% to 4.6% during the same period.

Rising retail rental costs in Turkey



Source: JLL, HSBC **calculations** (**rebased to 100**)

Weighted average rent to sales trend



Source: HSBC calculations

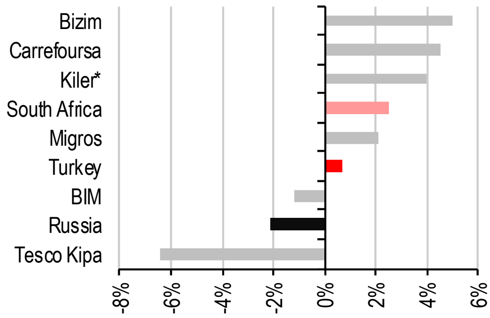
Russian food retailers have seen the strongest growth in absolute rental expenses primarily due to the pressure from the expansion of store network by bigger retailers like Magnit in prime locations. Matured real estate market in Russia meant increased competition among these retailers leading to higher rental costs. Some of the growth is also the result of the USD bases rent structure of companies in Russia which surged forward due to currency depreciation.

Rental rate increases in South Africa have been fairly stable at around 6-7% pa for some time now; ongoing expansion is placing pressure on average rental costs/sqm with new stores typically attracting much higher rentals. Shoprite’s new stores for example would cost ZAR80/sqm, vs ZAR50/sqm in the case of old stores. This, coupled with slower growth in trading densities (as a result of weaker LfL sales growth and the impact of arguably undue space expansion) has meant rising rent/sales ratios.

In Turkey, the proportionate increase in revenues, ample scope of expansion and successful renegotiation of contracts by some retailers has kept a check on the rental expenses

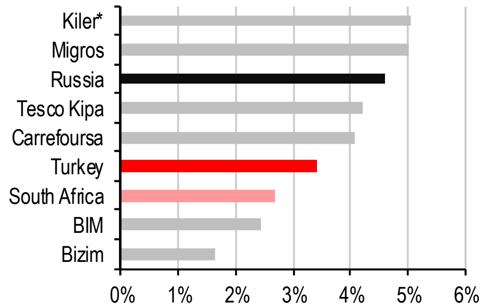
Turkey, on the other hand has seen both increasing retail real estate costs (higher inflation) as well as rapid expansion of stores across the country. Nonetheless, the proportionate increase in revenues, ample scope of expansion (Turkey is still underpenetrated w.r.t modern retail) and successful renegotiation of contract by some retailers has kept a check on the rental expenses incurred by Turkish retailers. Though we believe that the trend will not be stable for long and is bound to increase with time, in the short-run Turkish retailers seem to have enough manoeuvrability to manage the rental pressure.

Rent per sqm growth (inflation adjusted LTM average)



Source: HSBC calculations *recently acquired by Carrefoursa

Rent to sales (average)



Source: HSBC calculations *recently acquired by Carrefoursa

Rent cost to sales in Turkey is influenced by a number of factors like store size, format, location and rental currency. It's quite obvious that supermarkets will have a higher rental cost attached compared to a discounter due to their larger size and prime locations. Within Turkey the trend is more or less the same with Bizim and BIM leading due to their nature of operations (wholesaler and discounter respectively). Migros has a higher rent to sales ratio due to nature of the business but also because a substantial part of its rental cost is denominated in hard currency (c22%).

We further looked into rent per sqm and adjusted it for the inflation in Turkey. The results were quite as expected. BIM stands out from the rest with inflation adjusted rent per sqm actually dropping by 1.2% over the LTM time frame of our analysis. This shows that the company has been successful in contracting new space for its store network expansion and also kept a strict tab on its rental expenses. In supermarkets, Tesco Kipa showed declining trend mainly due to a higher base effect whereas CarrefourSA witnessed the highest rises in rent.

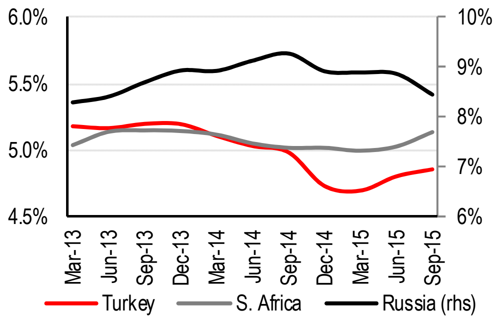
We believe rental costs for food retailers in the short run will be influenced by the macro weakness (lower consumer confidence) and are likely to remain stable. However, given the expansion of organised retail in major cities, we feel that it's a matter of time before the costs start soaring up. Food retailers are most likely to find prime properties increasing costly to rent and competition in discounter space (with increasing number of Migros convenience stores and rise of other discounters like A101, Sok etc.) means demand for neighbourhood store locations could push up the current rental rates.

But pressure on margins continues

EBITDA margins for food retailers in Turkey has been under pressure in recent times mainly due to increasing competition

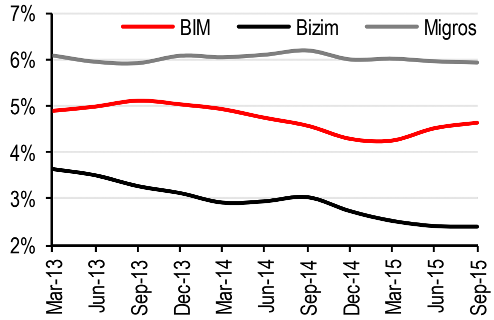
For food retailers EBITDA margins depend on two main functions i.e. pricing power and cost control. A company's pricing policy often involves discounts, promotions and competitive pricing which have a bearing on the margins of that company. While for cost control, we have already seen above how food retailers in Turkey are managing their rent and employee cost (biggest expenses for food retailers).

Weighted EBITDA margins for the peer countries (LTM)



Source: HSBC calculations, Company Data

EBITDA margins of Turkish food retail stocks (LTM)



Source: HSBC calculations, Company Data

It's clear from the above chart that EBITDA margins for food retailers in Turkey have been under pressure in recent times despite a recent recovery. We believe one of the reasons for the decline in margins is increasing competition in the market. Not only are the discounters expanding at an unprecedented pace, they have kicked in a strong retaliation from other formats, specifically supermarkets and hypermarkets. Challenged by increasing number of discounter stores, supermarkets are now putting in measures to defend their share of pie. Measures undertaken includes diversification of formats (like into convenience space in case of Migros), refurbishing of stores for increasing customer appeal, higher store discounts, matching pricing of discounters and heightened promotional activities. In our opinion the competitive landscape of Turkey is not going to ease anytime sooner and should continue to put pressure on EBITDA margins in the medium run. Over the longer horizon we believe consolidation of fragmented players will be a key factor which should bring about scale of operations and help support margins.

Migros was able to hold on to its EBITDA margins whereas both BIM and Bizim have shown declining trends in the last two years

As we have seen above, rising employee expenses (from minimum wage hikes and increasing stores network) is also one of the major elements which has extended considerable pressure on EBITDA margins. Within the covered stocks, Migros is the only one which has been able to hold on to its EBITDA margins whereas both BIM and Bizim have shown declining trends in the last two years. Migros control on its cost structure has been fairly well managed and has benefitted the company with stable margin trends in 2013 and 2014. However, in recent quarters we have seen increasing opex cost for Migros mainly from increase in employee costs (due to accelerated expansion of store network) and increase in rental expenses (from depreciation of TRY against USD as Migros has c22% of its rental agreement in FX terms). This has put some pressure on the EBITDA margin of the company in 9M 2015.

EBITDA Margin (LTM)

Company	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Average
BIM	4.9%	4.7%	4.6%	4.3%	4.2%	4.5%	4.5%
Bizim	2.9%	2.9%	3.0%	2.7%	2.5%	2.4%	2.8%
Migros	6.0%	6.1%	6.2%	6.0%	6.0%	6.0%	6.0%
Turkey^	5.1%	5.0%	5.0%	4.7%	4.7%	4.8%	4.9%
Russia	8.9%	9.1%	9.3%	8.9%	8.9%	8.9%	9.0%
South Africa	5.1%	5.1%	5.0%	5.0%	5.0%	5.0%	5.0%

Source: HSBC calculations, company information

In the cases of Bizim and BIM, higher employee costs have been the key factor for the decline. However, it's worth noting that BIM came back strongly so far this year with an improvement in EBITDA margin. The company exercised its buying power and was able to negotiate favourable terms with its suppliers thus helping to gather some support to its gross margin base. We believe BIM's current gains on margins are sustainable in the long run and are further supported by normalisation of the extreme wage hikes seen last year.

Overall, the Turkish food retail sector is marked by declining margins which is quite a contrast with the significant growth we are seeing in revenue numbers. In our opinion the competitive landscape and fragmented market structure is to blame for the same. A pricing war within the industry (including discounters and supermarkets) has made scope for margin recovery look bleak. However, we believe the industry is going through an expansion phase and should mature in the next 3-5 years. In medium term we should see some stabilisation of cost structure and a better control on margins by the food retailers. However we would like to point out that a steep hike in minimum wage rate poses the greatest risk to food retail margins.

The biggest of the transactions in the sector recently was BC Partners selling off half its stake in Migros to Anadolu Group

Growth and exit - consolidation in the industry plays on

We have seen earlier that the Turkish retail market is highly fragmented and offers significant scope for consolidation. In recent times there have been a number of acquisitions in this space and we observe two distinct trends which are highlighted below:

1) Exit of foreign players – Weaker macro-economic environment, depreciating currency, and problems in their home countries as well reaching desired return rates has led many foreign players to exit Turkey food retail market in the recent past. The biggest of them was BC Partners selling off half its stake (40.25%) in Migros to Anadolu Holding at USD800m. Recently in Sep-2015, Tesco Kipa sold 10 of its stores to Begendik group and is also contemplating selling off its Central and Eastern European units which includes its Kipa stores in Turkey.

2) Domestic players remain bullish – The recent acquisitions in supermarkets including that of Kiler by CarrefourSA (major shareholder Sabanci Holdings) shows that local players remain bullish on the growth potential of the Turkish food retail market. Anadolu Holding's (controlled by Yazicilar Group) acquisition of a stake in Migros also points out to the emergence of domestic powerhouses in this sector.

Recent major mergers and acquisition in food retail space of Turkey

Deal Date	Acquirer	Target	Stake	Number of stores	Deal Value (USD mn)
14-Jun-15	Begendik	Real Hypermarkets (Metro Group)	100.0%	12	NA
14-Dec-15	Anadolu Endustri Holding	Migros	40.3%	1,352	799.2
2-Feb-15	CarrefourSA	Ismar stores	100%	26	10.8
13-Mar-15	CarrefourSA	Stores at Antalya Market	100%	29	12
15-May-15	CarrefourSA	Kiler	85.0%	202	260.9
7-Sep-15	Begendik	Part of Tesco Kipa stores	-	10	13.2

Source: HSBC, Bloomberg

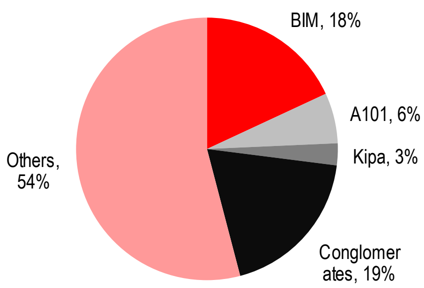
Yildiz Holding acquired the Diasa and Carrefour sold some of its stake in Turkish subsidiary to Sabanci Holding

Carrefoursa recently acquired local supermarket Kiler

Taking a walk through the timeline we see the consolidation and exit of foreign players as a continuation of the trend that started in 2013. That year Yildiz Holding acquired the discounter chain Diasa from its Spanish parent DIA and Carrefour sold some of its stakes in Turkish subsidiary to Sabanci Holding, making Sabanci as the majority shareholder. Last year Anadolu Holdings (68% owned by Yazicilar Holdings), which also controls Ekomini franchise chain of stores under its banner announced the acquisition of 40.25% stake in Migros from BC Partners. This year by acquiring Kiler supermarkets, CarrefourSA further consolidated its market share in the fragments space of Turkish food retail. On a combined basis, the above three conglomerates control c19% of organised food retail market in Turkey, 1% higher than BIM's share of 18% in 2014.

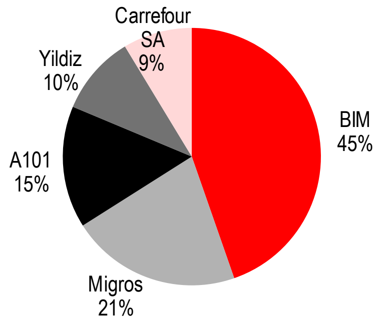
Furthermore, with the acquisition of 12 Real hypermarkets from Metro in 2014 and 10 Tesco Kipa stores in 2015, we are seeing the emergence of another domestic player – Begendik. This takes the total store count of Begendik to 69 out of which 13 are hypermarkets and the rest are supermarkets. In our view Turkish market should continue to see more consolidation going forward with local players looking to acquire scale and established players trying to expand their presence in the growing market.

Modern retail market share breakdown (2014)*



Source: : Euromonitor, HSBC calculations; *Conglomerates includes Migros and Ekomini (Yazicilar Holding), CarrefourSA and Kiler (Sabanci Holdings), Sok (Yildiz Holding)

BIM holds c.45% weight among the top 5 players (9M2015)



Source: Euromonitor, HSBC calculations

Company Section

BIM

- Strong like for like growth and gross margin expansion boost EBITDA but employee wages will be a key factor to watch in FY16e
- 3Q15 EBITDA margins improved to 5.2% thanks to better pricing strategy and stronger buying power
- Cut DCF based target price to TRY61.0 (from TRY64.0) and maintain Buy

Investment thesis

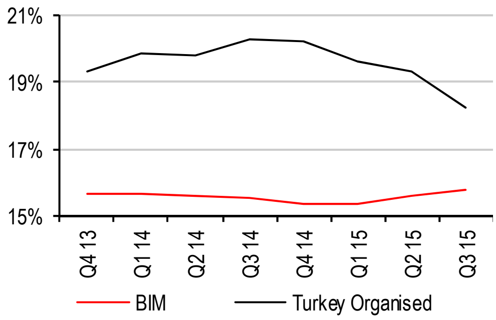
BIM's rapid expansion in Turkey and its low price discounter formats are the key growth drivers of the company. We believe BIM will continue to see higher growth rates in medium term as the 1,000 stores opened during 2014 and 2015 matures. In addition we expect BIM's expansion to continue with addition of another 500 store in 2016 as Turkey still offers ample scope being an under penetrated market (in modern food retail formats). BIM success factor of having a strong and higher percentage (c.70%) of private label brands helps it to be ahead of competition in terms of pricing. In our view BIM's affordability (3% lower than nearest competition and 15%-25% lower than supermarkets), availability (strong store network of over 5,000 stores) and quality private label products are the differentiating factor which should lead to positive traffic growth for some time.

In terms of margin BIM has played on very well till now in 2015. Supported by strong negotiating power with its suppliers (gaining suppliers discount) and greater capability in pushing higher food inflation to consumers (selective price increases) BIM has seen some strong margin expansion of 100bps in 2Q14 and followed by 50bps in 3Q15. We believe the gains to be sustainable and should lead to a sharp recovery in EBITDA margin to 4.8% in 2015 (from the low of 4.3% in 2014). In our view the bulk purchasing of commodities, higher private label share and limited SKU's provides BIM a better control on its costs of goods and hence the gross margins. Furthermore, we think the improved gross margin level in the overall organized retail industry supports upside potential on the margins both in the short and the long term. However on a cautious note, a minimum wage rate hike in Turkey would add pressure on margins which would be true for all the players in the industry including BIM.

BIM offers +40% ROE, a visible and strong growth rate, and a relatively lower risk profile with no FX short position. We believe this deserves premium valuation and that outperformance relative to the Turkey Index should continue in the long term. Downside risks include higher cannibalization and pressure on margins going forward.

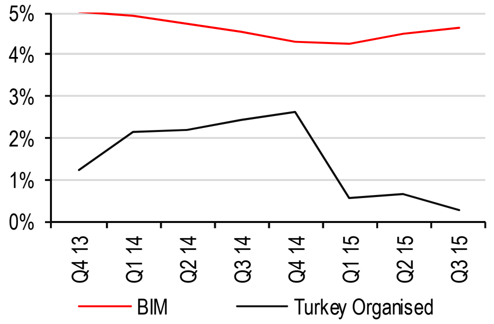
Key Trends to look-out for in BIM

Gross margin* recovered in recent quarters despite a fall in the sector



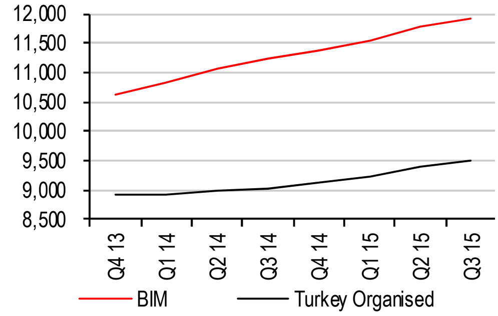
Source: Company reports * Gross margin (LTM)

EBITDA margin* also on a recovery trend despite a fall in the organized segment



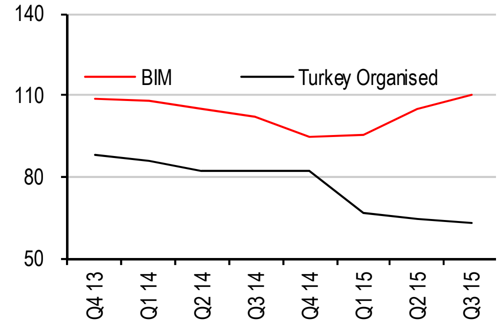
Source: Company reports * EBITDA margin (LTM)

Sales per sqm growing healthily – significantly faster than the sector



Source: Company reports *Sales per sq m (TRY, LTM)

EBIT per sqm averages started to recover in FY15



Source: Company reports * EBIT per sq m (TRY, LTM)

BIM continues to show a strong LFL number after a marginal dip in 2013. We believe BIM as well as other discounters will have a stronger growth prospect over other food retailers in Turkey in the upcoming years. The 11.5% LFL growth during the first nine months of 2015 supports our view point. Furthermore, it's interesting to note that despite pressure from increasing competition (A101 and Sok), higher space growth (c.500 store openings in 2014&2015) and related cannibalisation of sales, the company has been able to sustain a robust real LFL growth trend over the last 2 years. Despite increasing pressure from rising wages, we think ongoing gross margin expansion will continue to drive strong growth rates in EBITDA in the upcoming quarters.

3Q15 Results

50bps EBITDA margin gains in 3Q15

BIM's 3Q15 results were in line with our expectation delivering a strong LFL revenue growth of 11.2%. Thanks to positive growth in LFL traffic (+1.8% in 3Q15) and continued expansion (added 56 stores in Turkey during the quarter), BIM posted stronger growth numbers (+18.5% in 3Q15) despite having 2 lesser trading days (vs. 3Q14). BIM was also successful in retaining the margin gains seen in 2Q15. EBITDA margins reached 5.2% in 3Q15 implying an expansion of 50bps over the comparable period. Selective price increases across SKUs and better supplier terms has led to margin gains for the company in the last two quarters. A growth of 46% in net profit was really surprising and was driven by two factors - operational (EBITDA growth of 31%) and a one-off (FX gains of TRY23m from credits provided to operations in Egypt and Morocco).

Estimate Changes

BIM – changes to estimates

Key items (TRYm)	2015e Old	2015e New	2015e Chg.	2016e Old	2016e New	2016e Change	2017e Old	2017e New	2017e Change
Sales	17,516	17,470	-0.3%	20,998	21,651	3.1%	25,097	26,102	4.0%
EBITDA	837	846	1.1%	1,020	1,010	-1.0%	1,261	1,281	1.6%
Net profit	551	564	2.3%	667	650	-2.4%	831	835	0.5%
EBITDA margin	4.8%	4.8%		4.9%	4.7%		5.0%	4.9%	

Source: HSBC estimates

We revise our estimates marginally after the 3Q15 results. Our EBITDA and Net profit numbers for 2015e are revised upwards reflecting the strong margin expansion and one off FX gains in 3Q15. We slightly cut our long term margin expectations for the group and now see stronger revenue growth. Margin cuts are due to higher wage increases we assumed for FY16e and FY17e due to Government's plans to increase minimum wage by 30% in FY16e.

Valuation and risks

Our DCF-based target price of TRY61 for BIM is based on a WACC of 11.8% (from 12.8%), a risk-free rate of 8.5% (from 9.5%), an ERP of 5.5% and beta of 0.60 (both unchanged). This leads to a fair value target price of TRY61.0 (from TRY64.0). The cut in our target price reflects the changes to our estimates. Our target price implies upside of 10%, and we reiterate our Buy rating based on BIM’s strong growth potential.

Risks

The main downside risks include lower-than-expected store expansion and like-for-like sales growth. Also, an increase in minimum wage in Turkey, a possible failure in the international expansion and/or in the FILE stores could create pressure on the margins and bottom line.

HSBC

Financials & valuation: BIM

Buy

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (TRYm)				
Revenue	14,463	17,470	21,651	26,102
EBITDA	619	846	1,010	1,281
Depreciation & amortisation	-137	-166	-206	-247
Operating profit/EBIT	482	680	804	1,035
Net interest	17	12	17	25
PBT	512	723	834	1,071
HSBC PBT	512	723	834	1,071
Taxation	-117	-159	-183	-236
Net profit	395	564	650	835
HSBC net profit	395	564	650	835
Cash flow summary (TRYm)				
Cash flow from operations	569	853	1,013	1,246
Capex	-410	-450	-491	-543
Cash flow from investment	-394	-450	-491	-543
Dividends	-243	-237	-338	-390
Change in net debt	84	-166	-184	-313
FCF equity	144	375	512	694
Balance sheet summary (TRYm)				
Intangible fixed assets	5	6	7	8
Tangible fixed assets	1,264	1,547	1,833	2,129
Current assets	1,812	2,204	2,740	3,425
Cash & others	325	492	675	988
Total assets	3,238	3,915	4,737	5,719
Operating liabilities	2,056	2,407	2,916	3,453
Gross debt	17	17	17	17
Net debt	-308	-474	-658	-971
Shareholders' funds	1,150	1,476	1,788	2,233
Invested capital	699	859	988	1,120

Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	22.1	20.8	23.9	20.6
EBITDA	3.8	36.8	19.4	26.9
Operating profit	-0.7	41.1	18.2	28.7
PBT	-2.7	41.2	15.4	28.4
HSBC EPS	-4.3	42.6	15.4	28.4
Ratios (%)				
Revenue/IC (x)	24.1	22.4	23.4	24.8
ROIC	61.9	68.1	67.9	76.6
ROE	36.8	42.9	39.8	41.5
ROA	13.3	15.8	15.0	16.0
EBITDA margin	4.3	4.8	4.7	4.9
Operating profit margin	3.3	3.9	3.7	4.0
EBITDA/net interest (x)				
Net debt/equity	-26.8	-32.1	-36.8	-43.5
Net debt/EBITDA (x)	-0.5	-0.6	-0.7	-0.8
CF from operations/net debt				
Per share data (TRY)				
EPS Rep (diluted)	1.30	1.86	2.14	2.75
HSBC EPS (diluted)	1.30	1.86	2.14	2.75
DPS	0.80	0.78	1.11	1.29
Book value	3.79	4.86	5.89	7.36

Valuation data

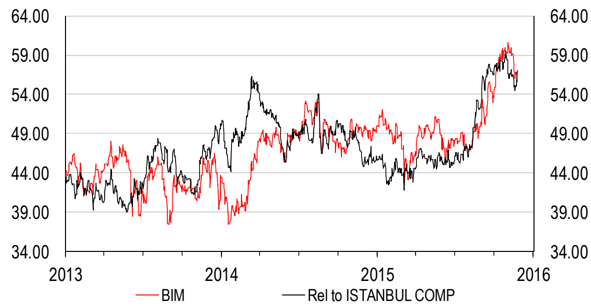
Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	1.1	0.9	0.7	0.6
EV/EBITDA	26.6	19.2	15.9	12.3
EV/IC	23.5	18.9	16.3	14.1
PE*	42.7	30.0	26.0	20.2
PB	14.7	11.4	9.4	7.6
FCF yield (%)	0.9	2.2	3.1	4.1
Dividend yield (%)	1.4	1.4	2.0	2.3

* Based on HSBC EPS (diluted)

Issuer information

Share price (TRY)	55.65	Free float	55%
Target price (TRY)	61.00	Sector	Multiline Retail
Reuters (Equity)	BIMAS.IS	Country	Turkey
Bloomberg (Equity)	BIMAS TI	Analyst	Bulent Yurdagul
Market cap (USDm)	5,880	Contact	+90 212 3764612

Price relative



Source: HSBC

Note: Priced at close of 24 Nov 2015

Bizim

- Significant recovery in like for like rates in 9M15 is a result of growth in low margin businesses
- Increasing share of lower margin tobacco sales continues to keep EBITDA margin under pressure (10bps contraction in 3Q15)
- Cut DCF based target price to TRY13.9 (from TRY14.0) and reiterate Hold

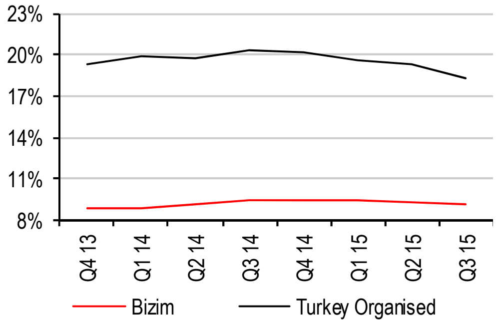
Investment thesis

Bizim growth story in 2015 has been structurally very different. A major part of the revenue growth in the first nine month of 2015 has been driven by higher tobacco sales and addition of franchise business. Crackdown on illegal tobacco trade by the authorities has pushed the tobacco sales upwards for Bizim by c.34% in 9M15. In our view it possesses two challenges for Bizim. First is the change in sales mix diluting the margins (tobacco profitability are much lower) and the second is the question of sustainability of such an unprecedented growth. In context of franchise, it has been a mixed performance so far. Bizim was able to reach breakeven EBITDA level much earlier than anticipated but at the same time it failed to ramp-up its franchise network to the targeted level. Management pointed out that they are focussing on the right franchise partners and have closed some of the stores from the initial count of 196 at the time of acquisition. In our view in medium term tobacco sales should return back to normalised level and revenue growth would mostly be driven by increasing franchise network and sales. The company expects to have 600 franchise stores by 2018 with a revenue base of c.TRY800m and a penetration level of 75 to 80%.

Although we see Bizim growing in terms of revenues, its margins are a cause of concern. Increasing share of tobacco mix in Bizim's revenue and start-up costs of the low margin franchise business are expected to keep EBITDA margin under pressure in coming quarters. We believe the above impact should be mitigated to some extent by improvement in main category gross margin, increasing focus on profitable channels like HoReCa (Hotels, Restaurants and Cafes) and cost savings initiatives (as seen in 9M15). This would at best keep the EBITDA margin from contracting any further and hence, we see limited opportunities for any significant margin improvement in the medium term unless share of tobacco comes down sharply (which would hurt top line growth rate). Additionally we would also like to point out that any increase in minimum wage in Turkey would add to the margin pressure and would be potential negative catalysts for Bizim.

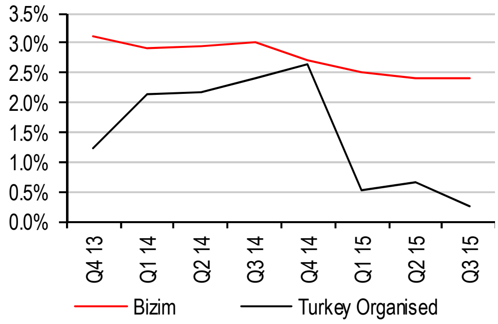
Key Trends to look-out for in Bizim

Gross margin under pressure due to wholesale format and high tobacco sales



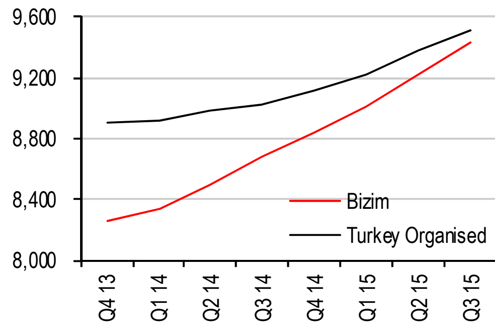
Source: Company reports * Gross margin (LTM)

EBITDA margin remains weak despite efforts for focus on cost structure



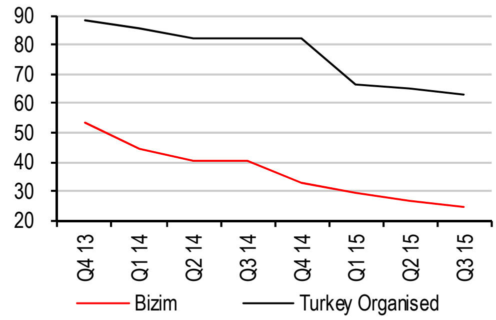
Source: Company reports * EBITDA margin (LTM)

Sales per sqm rising much better than the sector growth rate in FY15



Source: Company reports * Sales per sqm (TRY, LTM)

But EBIT per sqm continues to decline in last few years



Source: Company reports * EBIT per sqm (TRY, LTM)

Bizim fared poorly during FY14 due to restrictions on credit card transactions and the overall tougher environment for wholesalers. However, the company has since then bounced back with a stronger LFL growth of 9.5% in 9M15. Exceptional growth in tobacco business along with marginal recovery in main category sales has been the primary driving force for Bizim this year. If we assume that the growth in tobacco sales may be temporary then this level of growth in LFL numbers may not be sustainable in the near future. However, due to good cost control and restructuring of the business, the Company might be benefitting from increasing margins in the main category business as well as franchise business going forward. Consolidation in the general retail market could be positive for Bizim's growth while it could also be an acquisition target with its very well positioned store network throughout the country and its first entry advantage to franchise business.

3Q15 Results

Revenue growth driven by higher tobacco sales

Bizim's growth rate continued to be robust with 9.9% increase in revenue during 3Q15. Its performance is mainly driven by higher tobacco sales which registered +37.4% (LFL of 35.5%) growth whereas main category sales remains subdued at 1.1% (LFL of +1.0%). Although the company improved its gross margin in the main category by 40bps from focusing on profitable channels, lower margin tobacco sales weighed on the overall gross margin which declined to 8.7% in 3Q15 (vs. 9.2% in 3Q14). However, the company managed to recover some of the margins from a tighter opex management and c.8.0m of costs savings, resulting in an EBITDA margin of 2.8% (vs. 2.9% in 3Q14). Management expect the current opex level to be sustainable and guided for a margin of 2.7% for 2015, which we believe to be achievable. Some slowdown in franchise expansion was also observed as Bizim added only 11 net franchises during the quarter. Management also lowered the year-end guidance for franchise stores to 270 and revenue contribution to TRY120m (from 300 stores and TRY140m revenue previously).

Estimate Changes

BIZIM – changes to estimates

Key items	2015e			2016e			2017e		
(TRYm)	Old	New	Change	Old	New	Change	Old	New	Change
Sales	2,550	2,550	0.0%	2,906	2,924	0.6%	3,295	3,304	0.3%
EBITDA	65	68	4.0%	78	75	-3.9%	89	89	-0.4%
Net profit	10	13	23.8%	16	14	-12.7%	22	22	1.2%
EBITDA margin	2.6%	2.7%		2.7%	2.6%		2.7%	2.7%	

Source: HSBC estimates

We revise our estimates for Bizim after the 3Q15 results. We revise our short term forecast (for 2015) upwards based on management guidance of 2.7% EBITDA margin and net profit growth of 25%. In medium term we see slightly lower revenues mainly from lower franchise contributions but in our view a tighter opex via costs savings should keep margins stable and contribute to net profit growth. Margin cuts are due to higher wage increases we assumed for FY16e and FY17e due to Government's plans to increase minimum wage by 30% in FY16e.

Valuation and risks

Our DCF-based valuation produces a fair value target price of TRY13.9 (from TRY14.0) using a WACC of 11.8%, a risk free rate of 8.5%, an ERP of 5.5% and a beta of 0.70 (all unchanged). The cut in our target price reflects the changes to our estimates. Our target price implies 6% upside from the current price and we reiterate our Hold rating on the stock as we see medium-term margins to remain under pressure from increasing share of low margin business like franchise and tobacco.

Risks

The main upside risks are better than expected like-for-like sales growth and higher penetration levels in franchise business. Key downside risks include increase in minimum wage rate in Turkey, weakness in like-for like growth and management’s inability to efficiently execute the new store franchising plans.

HSBC

Financials & valuation: Bizim Toptan

Hold

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (TRYm)				
Revenue	2,279	2,550	2,924	3,304
EBITDA	63	68	75	89
Depreciation & amortisation	-17	-20	-25	-30
Operating profit/EBIT	46	47	50	59
Net interest	-10	-12	-12	-10
PBT	14	16	17	27
HSBC PBT	14	16	17	27
Taxation	-3	-3	-4	-6
Net profit	11	13	14	22
HSBC net profit	11	13	14	22
Cash flow summary (TRYm)				
Cash flow from operations	55	36	42	54
Capex	-24	-30	-46	-49
Cash flow from investment	-47	-30	-46	-49
Dividends	-13	-4	-5	-5
Change in net debt	27	-2	8	0
FCF equity	21	25	16	26
Balance sheet summary (TRYm)				
Intangible fixed assets	27	29	33	37
Tangible fixed assets	112	120	136	152
Current assets	384	448	495	571
Cash & others	26	48	40	60
Total assets	531	605	672	767
Operating liabilities	380	424	482	541
Gross debt	11	31	31	51
Net debt	-15	-17	-8	-8
Shareholders' funds	134	143	153	170
Invested capital	117	125	143	159

Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	1.4	11.9	14.7	13.0
EBITDA	-9.2	8.0	10.8	18.9
Operating profit	-18.1	3.2	4.5	19.5
PBT	-70.9	18.2	8.2	57.1
HSBC EPS	-72.7	18.2	8.2	57.1
Ratios (%)				
Revenue/IC (x)	21.9	21.1	21.9	21.9
ROIC	35.1	31.2	29.5	31.2
ROE	8.0	9.3	9.4	13.6
ROA	2.2	2.3	2.2	3.0
EBITDA margin	2.7	2.7	2.6	2.7
Operating profit margin	2.0	1.9	1.7	1.8
EBITDA/net interest (x)	6.5	5.5	6.2	8.6
Net debt/equity	-11.0	-11.6	-5.4	-4.9
Net debt/EBITDA (x)	-0.2	-0.2	-0.1	-0.1
CF from operations/net debt				
Per share data (TRY)				
EPS Rep (diluted)	0.27	0.32	0.35	0.55
HSBC EPS (diluted)	0.27	0.32	0.35	0.55
DPS	0.32	0.10	0.11	0.12
Book value	3.36	3.59	3.82	4.25

Valuation data

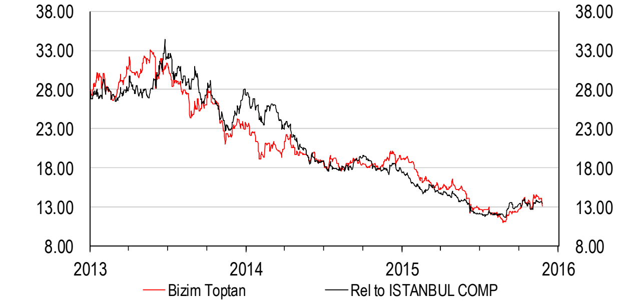
Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	0.2	0.2	0.2	0.2
EV/EBITDA	8.2	7.5	6.9	5.8
EV/IC	4.4	4.1	3.6	3.2
PE*	48.3	40.9	37.8	24.0
PB	3.9	3.7	3.4	3.1
FCF yield (%)	4.0	4.7	3.1	5.0
Dividend yield (%)	2.4	0.7	0.9	0.9

* Based on HSBC EPS (diluted)

Issuer information

Share price (TRY)	13.15	Free float	40%
Target price (TRY)	13.90	Sector	Specialty Retail
Reuters (Equity)	BIZIM.IS	Country	Turkey
Bloomberg (Equity)	BIZIM TI	Analyst	Bulent Yurdagul
Market cap (USDm)	183	Contact	+90 212 3764612

Price relative



Source: HSBC
Note: Priced at close of 24 Nov 2015

Migros

- High LFL rates as well as expanding gross margins are positive indicators
- Robust margin of 6.7% in 3Q15 but higher FX losses and one time impairment weighed on the bottom-line
- Cut target price to TRY22.5 (from TRY23.0) and reiterate our Buy based on increasing stronger expansion of Mjet formats

Investment thesis

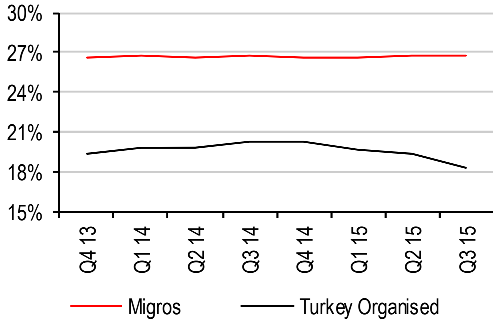
Migros has a mostly EUR based debt profile which with a depreciating local currency (TRY vs EUR) has kept the bottom-line under pressure in recent quarters. However, given the result of the general election in Turkey, political uncertainty should dissipate and the TRY should strengthen (see HSBC FX's piece: TRY: Post-election rally: USD-TRY to move lower on surprise large AKP majority, 1 November 2015). In this context we see the pressure on Migros bottom-line (and hence the equity) easing-off to a great extent in the last quarter of the year. Furthermore, we expect the volatility in exchange rate to reduce helping the company to minimise any non-cash losses from FX movements. We believe that with political uncertainty and currency volatility diminishing, the stock's fundamental value should become a key driver of performance.

We believe Migros' shift in strategy to focus on smaller format Mjet stores has really paid-off as the company has seen some consistent strong growth rates since the beginning of 2014. Expansion across Mjet format has been remarkable with the company adding 155 stores to date in 2015 (vs adding 129 stores in 2014). In 3Q15 management revised the total store opening target to 225+ for 2015 (from 175-200 previously) which is positive for the company. In our view management will continue to invest in smaller formats with overall space addition of c.6%-7% y-o-y in medium term. We believe higher number of stores and increasing focus on traffic growth should drive revenue CAGR of c13% in 2014-2017e. Furthermore we believe the conversion of c.170 Tansas stores into Migros is a positive move. In 3Q15 conference call, Management has pointed out that profitability of Migros brand is better than that of Tansas. In our view this would support the brand value of Migros and should drive-in higher traffic for the company.

On the margin side, the company surprised in 3Q15 with gains in gross margin nearly offsetting the pressure from increasing rental and employee costs. We expect this pressure to remain for some more time as the company continues to expand its store network but better gross margins from increased price competitiveness of Migros should provide some relief. Further with TRY gaining back on USD/EUR we believe the rental pressure will ease off considerably (the company has c.22% of its rental cost in foreign currency - USD and EUR based). Though we see positive trends supporting margin upside we maintain caution as recent news on minimum wage hike could depress Migros' margins in the coming year.

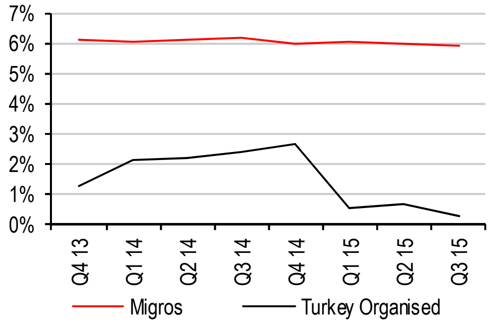
Key Trends to look-out for in Migros

Gross margin is very strong and even improving slightly in recent years



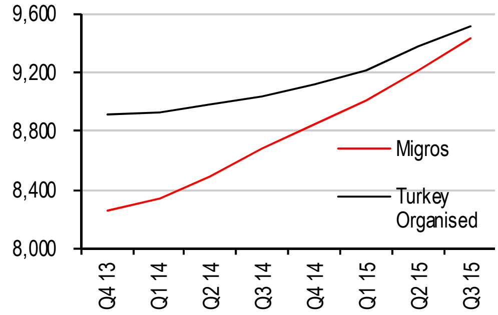
Source: Company reports * Gross margin (LTM)

EBITDA margin again stable – differentiating sharply from the sector



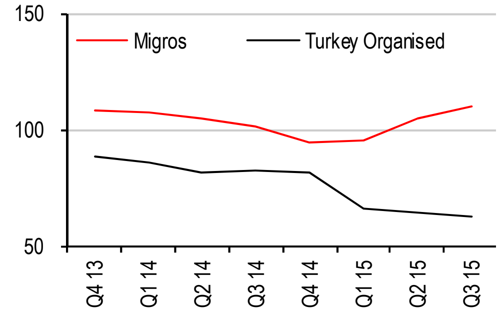
Source: Company reports * EBITDA margin (LTM)

Sales per sqm boosted in recent years with optimization of the formats



Source: Company reports * Sales per sq m (TRY, LTM)

EBIT per sqm gives more healthy signals in recent quarters



Source: Company reports * EBIT per sqm (TRY, LTM)

For Migros it was the change in strategy that helped the company to post better growth numbers recently rather than a major pickup in growth rates in supermarket segment. The company started focusing more and more on smaller format stores (Mjet) ahead of the sector and expanded rapidly, capitalising on the convenience market space opportunity. Its supermarket stores also performed strong capitalising on the trust that it has built over a long history in Turkey together with strong improvement in product portfolio and competitive pricing strategy especially on SKUs that are available in discounters. Together with increasing space growth, the Company started posting +15% top line growth levels in recent quarters, which is quite a success within the supermarket universe. Following the takeover of part of management control by leading conglomerate Anadolu Group this year, we think Migros might be even more successful in supplier contracts. Together with consolidation of the market, gross margins might continue to expand offsetting potential negative impacts from rising employee or rental costs. We argue that Migros might be a consolidator of the sector in the upcoming years with its strong shareholder base and successful branding and product portfolio in the supermarket segment.

3Q15 Results

Store expansion target for 2015 revised upwards to 225+

Migros' strong EBITDA margin of 6.7% in 3Q15 came as a surprise against our expectation for a margin of 6.3%. Robust revenue growth of +15.2% and 30bps improvement in gross margin provided support to the EBITDA margin. We believe management's initiative to increase the price competitiveness of Migros and investment in private label brands has led to margin stabilisation. Strong revenue growth continued in 3Q15 with higher than expected store network expansion (Migros adding c.224 stores in the last 12 months). However, due to FX losses on its EUR denominated debt and a one-time impairment of TRY111.5m (on its Tansas trademark) brought down the company net loss to TRY342m in 3Q15 (against our expectation for a net loss of TRY269m). The impairment resulted from the conversion of c.170 Tansas stores into Migros brand this year. Nonetheless, the store expansion target revision to 225+ in 2015 (from 175-200 previously) is clearly a positive for the company in our view.

Estimate Changes

Migros – changes to estimates

Key items	2015e			2016e			2017e		
(TRYm)	Old	New	Change	Old	New	Change	Old	New	Change
Sales	9,399	9,408	0.1%	10,509	11,006	4.7%	11,643	12,531	7.6%
EBITDA	549	577	5.2%	624	6.34	1.6%	694	743	7.1%
Net profit	-60	-150	NM	77	85	9.9%	218	257	18.2%
HSBC net profit	66	87	31.4%	158	166	4.8%	218	257	18.2%
EBITDA margin	5.8%	6.1%		5.9%	5.8%		6.0%	5.9%	

Source: HSBC estimates

We revise our sales and margin estimates slightly upwards after the 3Q15 results due to higher than expected expansion in Mjet stores. Our cut in net loss for 2015 from –TRY60m to –TRY171m reflects the one-off impairments made by the company on its Tansas brand in 3Q15. Margin cuts are due to higher wage increases we assumed for FY16e and FY17e due to Government's plans to increase minimum wage by 30% in FY16e.

Valuation and risks

Our DCF analysis, using a risk-free rate of 8.5%, an ERP of 5.5%, a beta of 0.95 and a WACC of 11.3% (all unchanged), produces a fair value target price of TRY22.5 (from TRY23) per share. The cut in our target price reflects the changes to our estimates. Our target price implies 27% upside from the current price and we reiterate our Buy rating on the stock. We believe the success of smaller format Mjet stores and a rapid expansion of store network should drive stronger revenue growth for the company in medium term.

Risks

Downside risks include FX losses as Migros has significant EUR denominated debt that could adversely affect profitability. Management inability to keep-up with the increasing competition from discounters and other convenience store operators would mean loss of market share and could be a potential downside risk for the company. Further an increase in minimum wage rate in Turkey could impact margins negatively.

Financials & valuation: Migros

Buy

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (TRYm)				
Revenue	8,123	9,408	11,006	12,531
EBITDA	490	577	634	743
Depreciation & amortisation	-162	-178	-195	-215
Operating profit/EBIT	328	399	439	528
Net interest	-15	-300	-251	-138
PBT	184	-111	106	322
HSBC PBT	184	-111	106	322
Taxation	-85	-40	-21	-64
Net profit	99	-150	85	257
HSBC net profit	20	87	166	257
Cash flow summary (TRYm)				
Cash flow from operations	462	61	455	681
Capex	-232	-228	-250	-268
Cash flow from investment	-226	-228	-250	-268
Dividends	0	0	0	-25
Change in net debt	-221	167	-204	-388
FCF equity	293	37	274	471
Balance sheet summary (TRYm)				
Intangible fixed assets	2,501	2,534	2,571	2,605
Tangible fixed assets	1,335	1,352	1,371	1,389
Current assets	1,729	1,730	2,077	2,439
Cash & others	689	532	680	860
Total assets	5,593	5,645	6,047	6,462
Operating liabilities	2,203	2,398	2,772	3,162
Gross debt	2,353	2,363	2,306	2,099
Net debt	1,664	1,831	1,626	1,239
Shareholders' funds	918	768	853	1,085
Invested capital	2,673	2,686	2,567	2,411

Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	14.0	15.8	17.0	13.9
EBITDA	12.7	17.8	9.8	17.3
Operating profit	12.5	21.8	9.8	20.4
PBT		-160.2		203.1
HSBC EPS		339.0	90.5	55.0
Ratios (%)				
Revenue/IC (x)	3.0	3.5	4.2	5.0
ROIC	6.4	20.2	13.4	17.0
ROE	2.3	10.3	20.5	26.6
ROA	1.7	-2.7	1.5	4.1
EBITDA margin	6.0	6.1	5.8	5.9
Operating profit margin	4.0	4.2	4.0	4.2
EBITDA/net interest (x)	32.2	1.9	2.5	5.4
Net debt/equity	181.0	238.1	190.5	114.1
Net debt/EBITDA (x)	3.4	3.2	2.6	1.7
CF from operations/net debt	27.8	3.3	27.9	55.0
Per share data (TRY)				
EPS Rep (diluted)	0.55	-0.85	0.48	1.45
HSBC EPS (diluted)	0.11	0.49	0.93	1.45
DPS	0.00	0.00	0.00	0.14
Book value	5.16	4.31	4.79	6.09

Valuation data

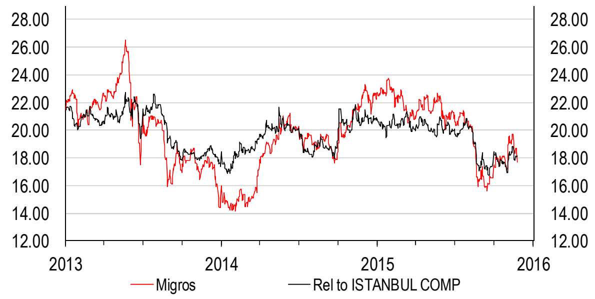
Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	0.6	0.5	0.4	0.4
EV/EBITDA	9.8	8.6	7.5	5.9
EV/IC	1.8	1.9	1.9	1.8
PE*	158.7	36.2	19.0	12.2
PB	3.4	4.1	3.7	2.9
FCF yield (%)	9.3	1.2	8.7	14.9
Dividend yield (%)	0.0	0.0	0.0	0.8

* Based on HSBC EPS (diluted)

Issuer information

Share price (TRY)	17.70	Free float	19%
Target price (TRY)	22.50	Sector	Food & Staples Retailing
Reuters (Equity)	MGROS.IS	Country	Turkey
Bloomberg (Equity)	MGROS TI	Analyst	Bulent Yurdagul
Market cap (USDm)	1,097	Contact	+90 212 3764612

Price relative



Source: HSBC
Note: Priced at close of 24 Nov 2015

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Bulent Yurdagul

Important disclosures

Equities: Stock ratings and basis for financial analysis

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations and that investors utilise various disciplines and investment horizons when making investment decisions. Ratings should not be used or relied on in isolation as investment advice. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations and therefore investors should carefully read the definitions of the ratings used in each research report. Further, investors should carefully read the entire research report and not infer its contents from the rating because research reports contain more complete information concerning the analysts' views and the basis for the rating.

From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC's rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

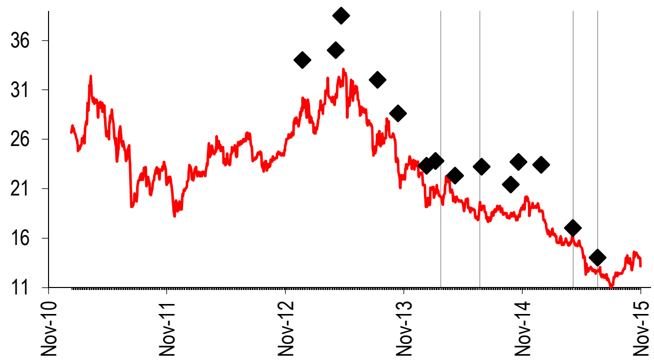
As of 25 November 2015, the distribution of all ratings published is as follows:

Buy	46%	(31% of these provided with Investment Banking Services)
Hold	40%	(29% of these provided with Investment Banking Services)
Sell	14%	(17% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities

Bizim Toptan (BIZIM.IS) Share Price performance TRY Vs HSBC rating history



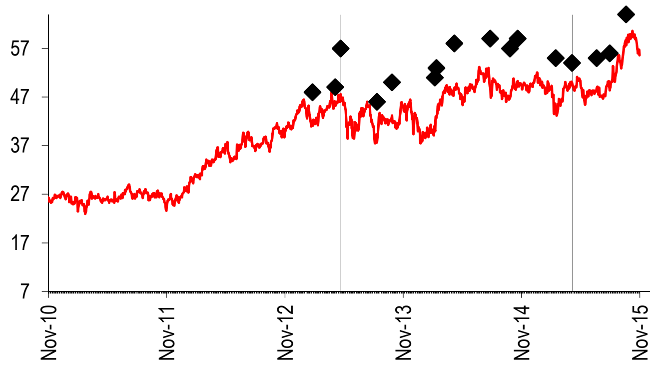
Source: HSBC

Recommendation & price target history

From	To	Date
Overweight	Neutral	18 March 2014
Neutral	Overweight	16 July 2014
Overweight	Buy	30 April 2015
Buy	Hold	15 July 2015
Target Price	**Value**	**Date**
Price 1	34.00	16 January 2013
Price 2	35.00	29 April 2013
Price 3	38.50	15 May 2013
Price 4	32.00	05 September 2013
Price 5	28.60	07 November 2013
Price 6	23.30	03 February 2014
Price 7	23.80	03 March 2014
Price 8	22.30	02 May 2014
Price 9	23.20	23 July 2014
Price 10	21.40	20 October 2014
Price 11	23.70	13 November 2014
Price 12	23.40	22 January 2015
Price 13	17.00	30 April 2015
Price 14	14.00	15 July 2015

Source: HSBC

BIM (BIMAS.IS) Share Price performance TRY Vs HSBC rating history



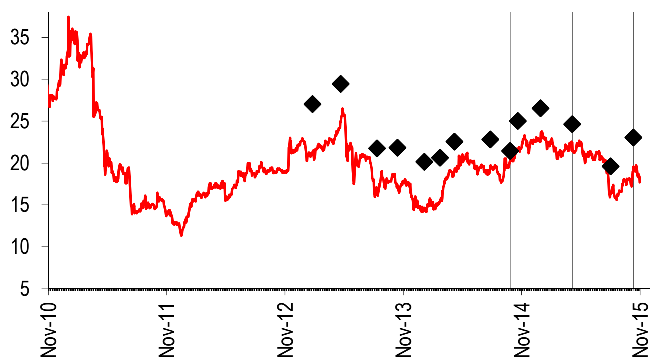
Source: HSBC

Recommendation & price target history

From	To	Date
Neutral	Overweight	15 May 2013
Overweight	Buy	30 April 2015
Target Price	**Value**	**Date**
Price 1	48.00	18 February 2013
Price 2	49.00	29 April 2013
Price 3	57.00	15 May 2013
Price 4	46.00	05 September 2013
Price 5	50.00	21 October 2013
Price 6	51.00	03 March 2014
Price 7	53.00	07 March 2014
Price 8	58.00	02 May 2014
Price 9	59.00	20 August 2014
Price 10	57.00	20 October 2014
Price 11	59.00	13 November 2014
Price 12	55.00	11 March 2015
Price 13	54.00	30 April 2015
Price 14	55.00	15 July 2015
Price 15	56.00	24 August 2015
Price 16	64.00	14 October 2015

Source: HSBC

Migros (MGROS.IS) Share Price performance TRY Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight	Neutral	20 October 2014
Neutral	Hold	30 April 2015
Hold	Buy	04 November 2015
Target Price	**Value**	**Date**
Price 1	27.00	18 February 2013
Price 2	29.40	15 May 2013
Price 3	21.70	05 September 2013
Price 4	21.80	07 November 2013
Price 5	20.10	29 January 2014
Price 6	20.60	18 March 2014
Price 7	22.50	02 May 2014
Price 8	22.80	20 August 2014
Price 9	21.40	20 October 2014
Price 10	25.00	13 November 2014
Price 11	26.50	22 January 2015
Price 12	24.60	30 April 2015
Price 13	19.60	26 August 2015
Price 14	23.00	04 November 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BIZIM TOPTAN	BIZIM.IS	13.15	24-Nov-2015	7
MIGROS	MGROS.IS	17.70	24-Nov-2015	6, 7

Source: HSBC

1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
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