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Horrible to bad

Stocks in America are richer because the president-elect is great. He himself is sufficient cause for high valuations throughout his trophy domain. Still—for now—Donald Trump stands athwart only one continent. The paucity of opportunity in the rest of the world is what may properly concern the value-seeking investor.

Now in progress is a survey of the equity opportunities in what our forebears designated "waste places," but which we ourselves more sensitively call emerging markets. Turkey, a world investment pariah (see *Grant's*, Aug. 12, 2016 and Dec. 9, 2016), is our point of focus. In preview, we are bullish on it.

Let us first acknowledge that widows and orphans should commit to this ultra-contrary idea only a reasonable portion of their irreplaceable capital. Things are never so bad that they can't get worse, and this publication has been known to be early. Our conviction is that things in Turkey will be better—its stocks higher, its yields lower—in three years' time. We have no conviction that this is the bottom.

Anyone can see that it isn't the top. Turkey is beset by terrorism, a collapsing currency, inflation, a humanitarian crisis in neighboring Syria, a current account deficit reckoned at 4.4% of GDP, an 11.16%-yielding sovereign 10-year note, the after-effects of last summer's failed military coup and a president who, post-coup, has detained, discharged or otherwise harried 120,000 people, including *The Wall Street Journal*'s Istanbul leg, Dion Nissenbaum. Reader Russell Napier, a student of currency crises, observes that the anti-creditor rhetoric of President Recep Tayyip Erdogan recalls the things that Malaysian Prime Minister Mahathir bin Mohamad was saying on the eve of the imposition of Malaysian capital controls in 1998. Capital controls in Turkey would likely create more investment value than even we value investors would welcome.

Contrary to popular belief, timing isn't everything in investing. In the context of deep value in far away places, solvency is everything. Napier says that Turkish borrowers owe $392 billion in currencies other than their own. At the current spot rate of the lira, that's 68% of Turkish GDP. "The constant refrain in 1996 into 1997 was, 'Why should we worry about it, because it is so cheap anyway?'" Napier recounts of the run-up to the Asian financial crisis. "The P/Es are very low and the yields are very high. The problem was the foreign currency debt. It turned out that there wasn't any equity. . . . From picking stocks, where you start and finish is analyzing the foreign currency debt. Is this corporation owned by equity owners or owned by the debtors? In local terms, usually nothing changes dramatically. But, when you have foreign currency debt, it can change very dramatically indeed."

For a long-distance survey of Turkish value opportunities, colleague Evan Lorenz got on the phone with Haydar Acun, a 46-year-old Benjamin Graham acolyte and CEO of Istanbul-based Marmara Capital Asset Management. Acun is the portfolio manager of a $10 million open-end mutual fund, Marmara Capital Equity Fund (SRMDSMH on Borsa Istanbul). Into this compact vessel, large positions in Turkey's cheapest equities can easily fit. The fund, in lira terms, since its 2014 inception, has delivered a compound annual return of 75.4%, against 15.3% for the Borsa Istanbul 100 Index. The fund holds 19 positions and levies a 1.75% per annum management fee.

A Turkish sampler
Ten largest companies in Turkey by market cap

Name	P/E	P/B	Div. yield
KOC Holding A.S.	9.0x	1.4x	2.2%
Turkiye Garanti Bankasi A.S.	6.5	0.9	1.8
Akbank T.A.S.	6.4	0.9	2.0
Turkiye Is Bankasi	5.4	0.7	3.3
Enka Insaat ve Sanayi A.S.	14.1	1.4	0.6
Turkcell Iletisim Hizmetleri A.S.	12.9	1.5	5.3
Haci Omer Sabanci Holding A.S.	7.5	0.8	1.7
Turk Telekomunikasyon A.S.	10.6	3.8	4.7
Tupras Turkiye Petrol Rafinerileri A.S.	9.9	2.3	9.1
Eregli Demir ve Celik Fabrikalari T.A.S.	17.1	1.4	6.0

source: The Bloomberg

Acun says that he's been making the rounds: "I've been to Europe, London, Sweden, U.S.," he tells Lorenz. "Everyone says they like our fund's performance, but when you say 'Turkey,' people are so scared. That's a good thing, probably. As a value investor, you should have the guts to invest when everyone runs away." He points out that the Moscow bourse, another pariah market, was up by 52% in dollar terms last year. Turkey was down by 9.7% (Acun's fund gave up basis points in dollar terms, gained percentage points in lira).

After all, Acun goes on, "How much worse can it get from here? Two-thousand-sixteen was a horrific year for Turkey. Almost every month something happened. A bomb. A terror attack, either from the PKK [the Kurdistan Workers' Party] or ISIS. It was a terrible year. We started terribly in 2017. In the early hours there was an attack in a night club in Reina. But, I'm still hopeful for the rest of the year. My major hope is coming from Syria. I hope that the Turkish government has a better understanding of the importance of ending this conflict. It seems like they are working in close collaboration with Russia and they're guaranteeing the peace process. If there is a stabilization, I think it would change the perception of Turkey quickly, both for tourism and consumer confidence. That's the key to watch in 2017."

On, then, to the stocks, some of which we list nearby. The cheapest are the tiniest. "Consider," Lorenz suggests, "Dogan Sirketler Grubu Holding A.S., the Turkish conglomerate whose businesses span newspapers and publishing to the Trump Tower Istanbul. The conglomerate is loss-making, pays no dividend and trades at 0.8 times book value. In his post-election call with Erdogan on Nov. 9, the American eponym of the great and very beautiful Trump Tower Istanbul mentioned the chief of the Dogan company by name, calling him a "close friend." A lot of good that did Dogan Holding. On Jan. 5, authorities detained Erem Turgut Yucel and Yahya Uzdiyen, the company's chief legal officer and former CEO, sending the Dogan share price down by 2.5%."

The three banks on our list trade at an average of six times trailing earnings and 0.8 times book value, though neither do they—Turkiye Garanti Bankasi A.S., Akbank T.A.S., Turkiye Is Bankasi—come without political strings attached. "All banks should cut rates to let entrepreneurs and business people invest in a much more comfortable manner," Erdogan declared in a Jan. 4 speech at the presidential palace. "If there is investment, there will be production. This will enable all of us to overcome these difficult days with success. . . . All lenders, including the state-run banks and mainly the central bank, need to cut interest rates." We will see about that. A rise in the benchmark one-week repo rate, now 8%, is widely expected when the central bank meets next, on Jan. 24. On Tuesday, Bloomberg ran a bulletin on a new Mumbai-based ETF dedicated to lira-denominated bonds. The headline sounded a sardonic note—"Timing Couldn't Have Been Worse to Start a Turkey Bond ETF"—and the story closed with a bearish comment from a Paris-based analyst: "In the current environment, local Turkish bonds are not attractive at all."

Four at a glance

Company	Ticker	Market cap (mns)	Price chg. y.o.y in $
Dogan Gazetecilik A.S.	DGZTE	$69.1	-20.8%
Gunes Sigorta A.S.	GUSGR	80.2	-41.8
Akenerji Elektrik Uretim A.S.	AKENR	160.6	-26.7
Turkish Airlines	THYAO	1,768.4	-46.8

source: The Bloomberg

"To find commanding, absolute value," Lorenz goes on, "you have to dive into the extreme shallow end of the Turkish investment pool. Take, for example, Dogan Gazetecilik A.S. (DGZTE on Borsa Istanbul), the publicly traded newspaper, magazine and publishing subsidiary of the aforementioned Dogan Holdings. Dogan Gazetecilik shows net cash of $44 million and owns real estate worth $50 million. This compares to a $69 million market cap. By Acun's estimates, the newspaper-and-publishing company offers a 14.2% dividend yield and trades at five times 2016 earnings."

It would be a better investment if an institution could actually buy it. Alas, the parent, Dogan Holding, owns 93% of shares outstanding; the public stub, in the dollar amount of $5 million, trades an average of $130,513 worth of shares a day. Acun's fund holds a position in the company equal to 9.4% of AUM, which works out to 19% of the public float.

Gunes Sigorta A.S. (GUSGR on Borsa Istanbul), a multi-line insurer that writes fire, marine, accident, construction, hail and life policies, is not so obviously cheap as Dogan Gazetecilik, though it offers a comparable margin of safety. Against an $80 million market cap, Gunes owns "property worth more than $50 million and various subsidiaries, such as a 37% stake in its pension company, which we think is worth more than its market cap," says Acun. "The company incurred significant losses last year due to one-off regulations requiring a substantial increase in provisions and a loss-making [auto] segment. This year we expect a turnaround in financials due to [the] absence of such regulations, the company taking steps to shrink the [auto] business and a completed rights issue."

Neither is Gunes an easy stock to buy (or to sell). Turkiye Vakiflar Bankasi T.A.O. owns 48% of the shares. The Marmara Capital Equity Fund owns 1.1%—they represent a 9.4% position.

Arjun Divecha, the manager of GMO's emerging markets funds, is wont to contend that, in the case of an emerging market, it's better to go from horrible to bad than from good to better. As that aphorism pertains to Turkey, Divecha tells *Grant's*, the question is whether Turkey is going from horrible to bad, or from horrible to worse. "I am skeptical that we have actually reached the bottom," he says. "Having said that, the fact is that the markets are really cheap. The issue always as a value manager is you always get in too early. That's the question."

Divecha adds that Erdogan—not unlike Vladimir Putin—has earned himself high marks for fiscal rectitude. Since his coming to power in 2003, Turkey's ratio of public debt to GDP has fallen to 31.7% from 67.7%. Still, by the lights of neither Moody's nor S&P is Turkey an investment credit. The lira-pay 10.6s of Feb. 2026 change hands at a price of 96.55 to yield the aforementioned 11.16%. Turkey is one bond sell-off away from edging out Brazil (whose 10-year bond fetches 11.24%) from first place in the

EM high-yield debt sweepstakes (we except Venezuela.) For comparison, the local-currency-denominated sovereign 10-year bonds of Russia, Ukraine and South Africa are priced to deliver yields of 8.04%, 8.28% and 8.76%, respectively.

"Turkey isolated as investors run for cover" was the headline that hung like crêpe over a dispatch in Tuesday's *Financial Times*. "With investors wary of committing money," said the text, "the rehabilitation trade that has supported bonds, equities and currencies in four of the so-called 'Fragile Five'—Brazil, South Africa, Indonesia and India—eludes Turkey."

Rehabilitation happens in its own good time, provided, of course, that there is actual investment value to be rehabilitated and that macroeconomic policy is not actively malign. The Aug. 7, 2015 issue of *Grant's* featured a bullish review of a basket of EM stocks and bonds: Moscow Exchange, Sberbank of Russia, Avianca Holdings S.A., Grupo Nutresa S.A., and the 10% dollar-denominated perpetuals of General Shopping Brasil S.A. Since publication, each has delivered a satisfactory gain but not before (in more than one case) having dealt a harrowing loss. Thus, in dollar terms, and excluding dividends and coupon income, the aforecited investments have returned 75%, 131%, 28%, 16% and 45%, respectively. As a test of the character of the would-be Benjamin Grahams and Warren Buffetts, Mr. Market caused the prices of the Moscow Exchange, Sberbank and Nutresa to suffer pullbacks of 16%, 17% and 22%, respectively, within three weeks of our going to press. By that time, the *Financial Times* was reporting, "Capital is cascading out of emerging markets as investors, companies and financial institutions lose confidence in developing countries. The outflows, which have risen towards $1 trillion over the past 13 months, hold a significance that extends well beyond the frailties of the countries themselves. The dynamism of developing nations helped restore the world to growth in the aftermath of the 2008–09 financial crisis." The *FT* was as right as rain about the mood of the market, but it was the mood (and, to be sure, the facts that informed the mood) that created the value.

For a bet—a bet, mind you—on things getting less horrible, Acun mentions Akenerji Elektrik Uretim A.S. (AKENR on Borsa Istanbul), a Turkish electric utility with a market capitalization of $161 million. CEZ A.S., the Czech utility group, and Akkok Holding A.S., a Turkish conglomerate, hold 37.4% and 20.4% of Akenerji's shares outstanding, respectively. With net debt footing to 10.9 times trailing EBITDA, Akenerji is highly leveraged and is currently loss-making. "It has suffered non-cash losses due to its high FX leverage," says Acun. "The electricity prices in the spot market increased 30%–40% due to power cuts and we believe the company will turn around to profit in the absence of a major devaluation this year." Akenerji is another one of Marmara Capital Equity Fund's chunky positions; it constitutes 6.9% of AUM.

For any with a still higher risk tolerance, there's Turk Hava Yollari Anonim Ortakligi (THYAO on Borsa Istanbul), otherwise known as Turkish Airlines. Terrorist attacks and the next-door civil war have done nothing good for passenger counts. Net income was negative $234 million in the 12 months ended Sept. 30, versus positive $1.1 billion in the 2015 fiscal year. To buy planes, the airline borrows in U.S. dollars, so the collapse in the lira exchange rate has pressured leverage ratios. The company's ratio of net debt to EBITDA thus jumped to 10.1 times in the third quarter 2016 from 4.1 times in 2015.

Acun is dogged: "There are hopes that Syria can get better," he says. "Maybe there are some peace efforts. If there is a stabilization there, Turkish Airlines would be interesting to look at for investors. You try to buy when everyone is shying away and concerned and afraid. That's why I bought it for my portfolio in the last two days." While Dogan and Gunes pass Napier's foreign-currency debt test, Akenerji and Turkish Airlines would likely flunk it. Which is to say that the latter two stocks are enormously leveraged to a bullish reversal in the lira exchange rate (and just as enormously leveraged to continued depreciation).

"A doughty American investor can buy Turkey through a number of different securities," Lorenz winds up. "There is the U.S.-listed iShares MSCI Turkey ETF (TUR on the NYSE Arca), which, however, holds the larger and less value-laden Turkish securities—the fund's average price to earnings ratio is 9.1 times. (The MSCI Turkey ETF fell by 10.7% and 33.1% in dollar terms in 2016 and 2015, respectively.) And while American investors can directly purchase Turkish stocks, many of Turkey's smaller companies don't report in English. As for the value-seeking Acun, he relates that, as of Dec. 31, 2016, 14% of the investors in his Marmara fund were U.S.-based."

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