EDISON

Is Private Equity

Update after H115 results

Facing economic headwinds

Investment companies

ISGSY targets capital appreciation and eventual realisation gains from its Turkish private equity investments, meanwhile seeking to pay attractive dividends. The half-year valuations of these were held at end-2014 levels and will be revalued at year end. Market conditions remain challenging for investee companies. We do not anticipate disposals from ISGSY's relatively immature private equity investments in the near term. Rather, management seeks opportunities to invest its large cash and liquid asset pool (45% of total assets, 46% of NAV). Earnings on financial investments more than covered the 2014 dividend. In 2015, lower market yields suggest this is unlikely to be the case, although historic earnings reserves would provide ample room to maintain the dividend.

To 30 June 2015	Price total return (%)	NAV total return* (%)	LPX Direct Index TR (%)	BIST 100 Index TR (%)
One year	(15.2)	1.4	23.8	7.5
Three years	34.5	65.4	131.2	39.8
Five years	109.3	123.9	217.5	66.8
Seven years	379.0	164.8	148.2	173.1

Source: ISGSY and BIST 100 Index TR from Bloomberg. Note: LPX Direct is a global index of listed private equity companies that pursue a direct private equity investment strategy. All data calculated in TRY. *ISGSY NAV is at fair value from 31 December 2012, see page 11 for calculation of historic series.

NAV at 30 June 2015

The valuation of its private equity investments (39% of total assets) was held constant at the end-2014 level and will not be revalued until the end of 2015. Income on the cash and liquid investment portfolio (45% of total assets) broadly covered investment company operating expenses. After dividend payments of TRY10.1m, the NAV (and NAV per share) fell 3%.

Investment flows: Acquisitions and disposals

ISGSY targets a holding period of three to seven years for its private equity investments and with a comparatively young portfolio (three of its five investments having been acquired in the last three years) exits in H115 were unlikely, especially in the volatile market conditions in the latter part of the period. In July 2015 it sold 3 percentage points of its holdings in Radore to an investor that has extensive experience in its sector and should contribute to Radore's development, booking a TRY0.764m profit. In Q315, ISGSY signed an SPA with the shareholders of Mika Tur, one of Turkey's leading tour operations, for the acquisition of a 20% stake in the company for TRY11.5m.

Valuation: Discount widened

ISGSY's current discount to NAV of 53% is above its average over the last nine years of 38% and some 30 percentage points more than global- and European-listed private equity companies, but the NAV may not reflect the current fair value of its assets.

29 September 2015

Price	**TRY1.63**
Market cap	**TRY122m**
NAV*	**TRY257m**
NAV per share*	**TRY3.44**
Discount to NAV	**53%**

*NAV at 30 June 2015.

FY14 dividend yield	8.3%
Shares in issue	74.7m
Free float	31.2%
Code	ISGSY
Primary exchange	BIST
Secondary exchange	N/A

Share price performance

52-week high/low	TRY2.3	TRY1.6

Business description

Is Private Equity (ISGSY) is a listed private equity fund that invests directly in Turkey's growing mid-cap private companies.

Next event

Q315 results	Estimated November 2015

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Edison profile page

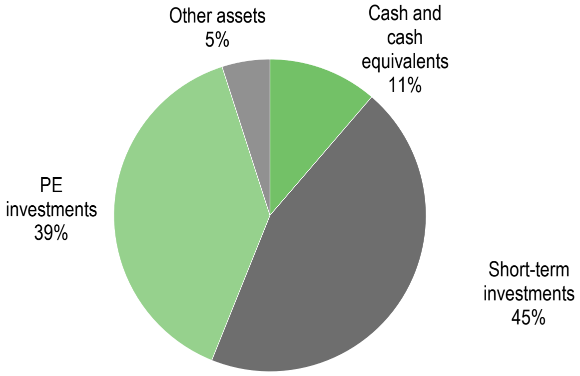
Is Private Equity is a research client of Edison Investment Research Limited

Exhibit 1: Is Private Equity at a glance

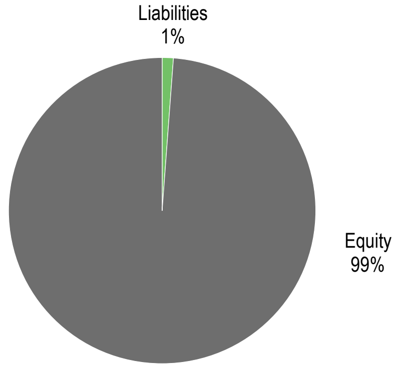
Investment objective and fund background	Recent news
Is Private Equity (ISGSY) was established in 2000 to invest in Turkey's growing mid-cap private companies.	December 2014: Investment in Radore January 2015: FY14 results April 2015: Q115 results July 2015: H1 results

Forthcoming announcements/catalysts		Capital structure		Fund details	
AGM	March 2016	P/E expense ratio	3%	Group	Is Private Equity
Q3 results	Est November 2015	Net gearing	Net cash	Manager	Murat Ozgen (CEO)
Year end	December	Annual management fee	N/A	Address	Iş Kuleleri Kule 2, Kat:2 - 34330 Levent, Istanbul, Turkey
Next dividend	March 2016 (est)	Performance fee	N/A		
Launch date	2000	Company life	Unlimited	Phone	+90 0212 325 17 44
Wind-up	N/A	Loan facilities	N/A	Website	www.isgirisim.com.tr/EN/

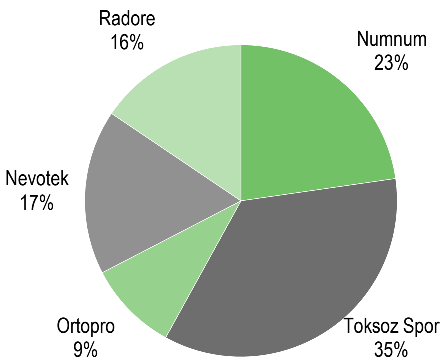
Assets at 30 June 2015



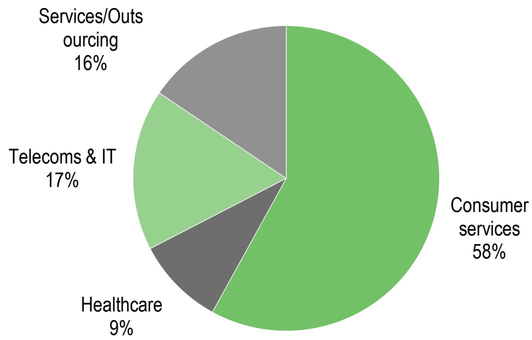
Equity and liabilities at 30 June 2015



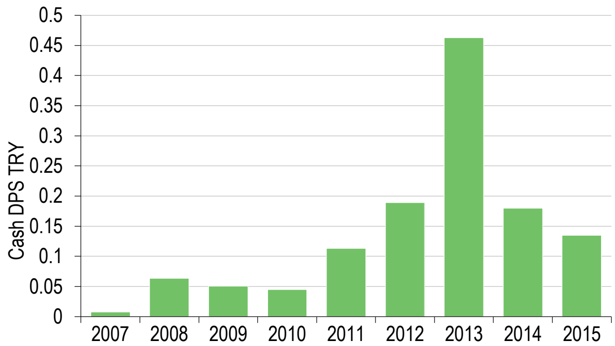
PE investments by company at 30 June 2015



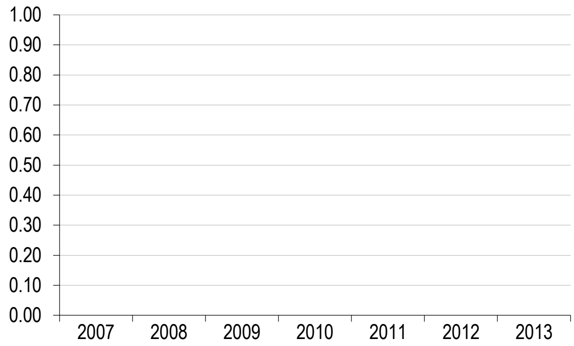
PE investment sector breakdown at 30 June 2015



Dividend paid history



Share buyback history



Source: ISGSY, Bloomberg, Edison Investment Research. Note: Dividend history has been adjusted to account for bonus issues, the last of which increased the share count from 66.6m to 74.7m and was announced at the AGM on 26 March 2014.

Company description

ISGSY is a private equity investor that acquires holdings in the equity of Turkish SMEs. It was founded in 2002 by Is Bank, one of the largest Turkish banks, which currently has over 1,300 branches, a market share of 13% and total assets of TRY268bn. ISGSY listed on the Istanbul Stock Exchange in 2004. Is Bank affiliates control around 57% of its shares.

ISGSY focuses on small private equity transactions where it faces less competition for deals from the large international private equity firms, which prefer larger transactions. The good reputation and reach of Is Bank gives it a competitive advantage in sourcing transactions.

Since its formation, ISGSY has made 16 investments with a total value of $127.3m and has made 11 exits, which have realised $155.7m. Along with dividend income from its investments, the company calculates that the IRR from its exits is 26.5% on a US dollar basis. Currently the company has five investments with an estimated value of TRY101.2m and TRY116.4m of other investments, mainly private sector and corporate bonds, on its balance sheet. The company has no debt, though of course, its investee companies do.

Investment case

An investment in ISGSY offers the following:

- access to the dynamic SME sector in Turkey not available on the Istanbul Stock Exchange, which has predominantly larger companies.
- an experienced management team with over 10 years' experience in Turkish private equity and a track record of success.
- the support of Is Bank, one of Turkey's largest banks which, along with its affiliates, controls around 57% of the company's shares. This connection enhances ISGSY's reputation, brings it business leads and provides a potential lender to its investee companies.
- ISGSY has plenty of resources on its balance sheet to make additional investments and benefit from the current uncertain economic environment. Private equity investments only account for around 40% of the company's total assets.
- ISGSY has an attractive valuation, trading at TRY1.63 per share, a c 50% discount to its estimated fair value NAV of TRY3.44, while the dividend paid in March 2015 amounts to over 8% of the current share price.

Investment strategy, process and resources

ISGSY's strategy is to invest in Turkish SMEs mainly through taking equity stakes in companies. Among the factors it looks for when making an acquisition are companies in an expansion stage or later, with excellent growth prospects, a strong management team and a sustainable competitive edge. It seeks to add value to these companies by sourcing acquisitions for them, enhancing operational efficiencies, facilitating expansion into new markets and formulating an optimal capital structure. It is sector agnostic and currently prefers transactions in the US$5-20m range.

ISGSY has 11 investment professionals with experience in project finance, consulting, strategic planning, research, corporate finance and the Turkish industry. Most have been at ISGSY for several years and the CEO, Murat Ozgen, has been with ISGSY for 13 years.

ISGSY screens approximately 150-200 opportunities per year and aims to achieve an IRR of 20-25% in US$ terms with an exit goal between three and seven years. After an initial screening, ISGSY undertakes a detailed assessment, which includes the following:

- sector research;
- competitor analysis and benchmarking;
- management quality reference calls; and
- financial analysis.

ISGSY employees prepare a report and present it to the investment committee, which makes a recommendation to the board of directors responsible for making the final decision. After a deal has closed, ISGSY monitors its investee company, and places representatives on the investee company board until finally a decision is made to exit.

The following exhibit shows ISGSY's investments and exits since its formation. Altogether it has made16 investments totalling US$127.3m; it has exited 11 and achieved an average IRR on its exits of 26.5% on a US dollar basis according to management calculations. Is PE invested US$72.5m on the investments it has exited and earned US$166.9m as exit proceeds, a 2.3x money multiple.

Exhibit 2: ISGSY investments and exits

		Sector	Investment $m	Exit date	Years owned	Exit $m	IRR	ROI
2002	ITD	Telecoms & IT	1.9	**2010**	8	4.2	11.8%	128.0%
	Probil	Telecoms & IT	3.2	**2011**	9	4.2	3.1%	31.0%
2003	Cinemars		11.5	**2006**	3	19.4	30.3%	69.0%
	Nevotek	Telecoms & IT	3.0					
2004	Step	Consumer	3.5	**2008**	4	6.8	19.0%	93.0%
2005	Tuyap	Consumer	7.0	**2007**	2	10.8	45.8%	54.0%
2006	Beyaz	Services	4.0	**2008**	2	8.8	58.7%	119.0%
2007	ODE		5.0	**2012**	5	10.5	17.0%	110.0%
	Ortopro	Healthcare	6.0					
	Turkmed	Healthcare	2.5	**2013**	6	0.2	N/A	-90%
2008	Dr Frik	Healthcare	13.4	**2011**	3	30.5	34.6%	128.0%
2009								
2010	Havas	Services	10.8	**2012**	2	19.7	26.7%	82%
2011	Aras Kargo	Services	9.8	**2013**	2	51.9	165.0%	428%
2012	Toksoz Spor	Consumer	15.9					
	Numnum	Consumer	15.0					
2013								
2014	Radore	Services	7.9					
	Total		**120.3**		**4**	**166.9**	**26.46%**	**130%**

Source: ISGSY, Edison Investment Research

ISGSY currently has five private equity investments, which we show in the following exhibit. The average value of its investments is around US$11m, so is within the current preferred investment range of US$5-20m. In two of the five investments ISGSY has a minority shareholding. It is prepared to consider taking minority positions if it can obtain management agreement and suitable exit provisions with the other shareholders. This gives it an advantage in sourcing deals compared with other firms that are not so flexible.

Exhibit 3: ISGSY Private Equity Investments at 30 June 2015

	Acquisition date	Fair Value TRY m	Ownership	Description
Nevotek Telecoms & IT	30 September 2003	17.3	81.24%	Nevotek, headquartered in Turkey, is a global player in IP convergence, covering IP telephony (IPT), IP TV and connected real estate technology for use in hospitality, healthcare, multi-tenanted real estate and public space management. Its platform allows the rapid development of unified applications across voice, data, video and building management. Nevotek has the largest client base in convergent IP with over 150 channel partners, 200,000 users and clients in 50 countries, including Holiday Inn, Crowne Plaza, Sheraton, US Air Force, W Hotels, Royal Caribbean, Le Meridien and SABIC.
Ortopro Healthcare	10 December 2007	9.5	32.50%	Ortopro is a Turkish orthopaedic implant company. It runs a modern production facility with 2,750m² of closed space in Izmir. In addition to sales of its own brands in Turkey and international markets, Ortopro serves as a contract manufacturer to global orthopaedic companies. In 2014 Ortopro exported to more than 20 countries, representing 55% of its total revenues. It now offers a complete product portfolio to local hospitals through its 66 retailers and direct sales to more than 50 hospitals. Ortopro creates barriers to entry in its manufacturing product groups from its cost advantages and R&D. The production provides significant cost benefits compared to US and European players due to lower employee costs. Production in Turkey also has the advantage of a skilled labour force and rapid delivery time compared to Far-Eastern players.
Toksoz Spor Consumer	13 November 2012	35.7	55.00%	Toksoz Spor is a leading sporting goods retailer and wholesaler in Turkey. It is the Turkey-region distributor of global sports brands like Arena, Head, Umbro and O'Neill. Wholesale customers include hundreds of dealers over all of Turkey's cities, department stores, other sports retailer chains, sports clubs, universities and sports federations. Toksoz Spor sells more than 100 brands in its 34 retail stores in 19 cities. It has become the multi-brand sports retailer with highest floor area (c 27,500sqm) in Turkey after the investment of Is Private Equity. The company's store number and store area rose by 79% and 69% respectively after ISGSY's investment. Retail outlets accounted for 65% of total revenue in June 2015, from 50% before Is PE's investment. The company also sells products under its own brand, Sportive. Sportive sales accounted for 12% of company's revenues in 2014.
Numnum (Istanbul Food and Beverage Group IFBG) Consumer	5 December 2012	23.0	61.66%	Istanbul Food and Beverage Group (IFBG) is a leading Turkish restaurant service and gastronomy company operating under five major brands: Mikla, Numnum, Trattoria Enzo, Terra Kitchen and Kronotrop. Mikla is an upscale fine dining restaurant, at the forefront of Istanbul's contemporary dining scene, serving new Anatolian cuisine in the historic Pera Region. Mikla's wine menu won an 'Award of Excellence' from the wine magazine *Wine Spectator* for four consecutive years between 2011 and 2014. Mikla has also been awarded the World's 96th best restaurant in June 2015. Numnum is a full-service casual restaurant chain, serving American/Italian cuisine. It operates nine successful stores, five in Istanbul (Levent Kanyon, Umraniye Meydan, Bagdat Caddesi, Brandium Atasehir, and Akasya Acıbadem) and four franchise restaurants in Ankara (Panora, Gordion, G.O.P. and Tepe Prime). Trattoria Enzo opened its doors in 2014 in an upscale shopping mall of Istanbul Akasya AVM, and serves 'homemade' Italian food. Terra Kitchen, a casual self-service concept has the motto 'eat well, feel good'. Kronotrop is an upscale speciality coffee roastery and bar in three different locations in Istanbul (Cihangir, Maslak Orjin, and Sultanahmet) and also operates a roasting facility, R&D and training centre in Maslak, Istanbul.
Radore Services	1 December 2014	15.7	28.50%*	Radore provides data centre services in Turkey, including co-location, dedicated cloud, web-hosting and domain sales. Established in 2004, it offers data centre solutions to over 2,000 clients, including both individuals and corporations, to meet the emerging requirements of the growing data processing and internet economy in Turkey. Radore made its first data centre investment in 2005. According to Deloitte Technology Fast 50 rankings, Radore was the fastest-growing data centre in Turkey in 2012, 2013 and 2014, and is also among the top 10 fastest-growing technology companies in Turkey in 2012 and 2013. It currently hosts more than 2,100 servers and the investment supports a capacity of up to 10,000 servers, Radore will be one of the largest independent data centre companies in Turkey, in terms of revenues. M Selcuk Sarac, former owner of another date centre company in Turkey, became 16% shareholder in Radore by purchasing shares from Is PE (3%), DGSK PE (3%) and founder Z Kubilay Akyol (10%). ISGSY expects the data centre market to expand with international demand in addition to the growing potential in Turkey. The growth in the sector is expected to be driven mainly through corporate companies' shift from internal data centres to external data centres. ISGSY aims to take Radore a step further in this rapidly growing sector by acquiring new customers and increasing its sales as a result of operational improvements, upgrading services/infrastructure, completion of ongoing investments and evaluation of new investment opportunities. With the new investments, Radore will be one of the largest independent data centres in Turkey, and consequently in a position to shape the growth in the sector.
Total		**101.2**		

Source: ISGSY, Edison Investment Research. Note: *After sale of 3% in July 2015, this has fallen to 25.5%.

Two of the company's investments, Nevotek (IP converge) and Ortopro (orthopaedic implants) have international exposure through their international sales, which amount to 98% and 55% of revenue respectively. They could in theory benefit from current economic conditions in which the value of the Turkish lira is declining as it could boost their competitiveness in international markets, but if those markets are also slowing down the increased competitiveness may not boost sales. It should be noted that the current estimate fair value of the private equity investments is higher than the initial investment cost in Turkish Lira terms.

The other three investments, Toksoz Spor (sports good retailing), Numnum (domestic restaurants) and Radore (Turkish data centres) are more domestic-focused but Radore generates 40% of its revenues in US$. The former are more exposed to consumer spending, so could suffer from the current slowdown in GDP growth in Turkey. Radore is more exposed to technology changes and, even though it is domestically-focused, is less sensitive to a slowdown in the economy.

ISGSY signed an SPA with the shareholders of Mika Tur, one of the leading tour operators in Turkey with a strong online sales channel. The company markets and sells its services under six general categories: domestic hotels, corporate travel organisations, outbound tourism, flight tickets, cultural tours and transport services. Mika Tur's main operation is its domestic hotel accommodation booking services; it has access to over 1,026 hotels as of 2014, of which it has exclusivity, guaranteed rooms or price contingencies. Mika Tur will be a co-investment for ISGSY; it plans to make the investment with another PE that has experience in the region and sector.

Private equity in Turkey

Economic background

Turkey has a population of 76 million and GDP per capita of c $11k according to World Bank data. It has been a successful emerging market economy over the last 10 years, achieving annual GDP growth per year of 4.3% per year according to OECD statistics, higher than the World average of 3.8%, the OECD average of 1.5% and two of the BRICs, Brazil (3.4%) and Russia (3.5%). However, from 2014 this growth has slowed; prospective annual GDP growth for 2015 is estimated at 3.1% and in Q115 it achieved 2.3%. Economic growth is still positive and its budget deficit/GDP ratio was just 0.7% in 2013 and 2014 (Turkish Ministry of Development), better than many EU countries. However, Turkey's economy is facing many short-term challenges, primarily:

- Turkey depends on overseas financing to funds its growth. It attracted plenty of funds when interest rates in the developed world were at all-time lows following the financial crisis. The prospect of US interest rates rising has created fears that these funds could leave Turkey for the improved returns on the developed world, to the detriment of Turkey's economy. Given the length of time that these fears have been around, however, it could be argued that the Turkish equity market may have already discounted a rise in US interest rates. The central bank has kept interest rates high to support the currency and suppress inflation, which was 7.2% in June and higher than the 5% target, but this is not conducive to economic expansion.
- The Turkish domestic political environment has increased economic uncertainty in the country. The parliamentary elections in June 2015 resulted in a hung parliament and another election will be held in November 2015. Lack of clear political leadership for a country facing many challenges undermines economic confidence.
- Turkey shares borders with many countries facing serious political and economic turmoil. These include Syria and Iraq to the south and Greece to the west whilst on the other side of its north coast is Ukraine, currently in dispute with Russia and suffering an economic downturn. Turmoil in these countries reduces the demand for Turkey's goods and services and in the case

of Syria and Iraq there are fears that Turkey could become more deeply involved in fighting with ISIS.

Private equity in Turkey

Turkey is an entrepreneurial, capitalist society with a history of family-owned businesses. Private equity activity in Turkey started in earnest around early 2000s and reached a peak in 2008 with investment as a percentage of GDP almost reaching 0.7% in that year, in excess of the European figure of 0.4% according to data from the World Bank, EVCA and Deloitte. Private equity investment in Turkey fell after the financial crisis, in line with activity elsewhere and from 2012 to 2014 has been around 0.25% of GDP, comparable to that of Europe but less than some other emerging markets such as India and China according to data calculated by EMPA (Emerging Markets Private Equity Association). Deloitte calculates that in 2013 and 2014 there have been 71 private equity investments with deal volume of around $4bn.

As elsewhere, private equity in Turkey is seen as an important way for businesses to obtain finance to grow and for new management to be introduced to an existing business. The attractiveness of Turkey as a private equity market has brought many participants to the market, including some of the large US private equity firms and Middle East funds. There are also local operators such as Turkven and Actera.

Since its formation, ISGSY has made 16 investments with a total market value of US$120.3m. During that period Deloitte estimates that there were 293 private equity investments in Turkey with a total value of US$18.3bn, giving ISGSY a market share of 0.8% by value and 5% by number. This emphasises how ISGSY's activities are concentrated in the smaller end of the market.

ISGSY is actively seeking to make additional investments but has found that competition from other private equity funds in Turkey, which now amount to around 40, plus a reluctance by owners to sell out at what they perceive as low prices in the current environment, have restricted its opportunities over the last two and a half years.

Financials

Balance sheet

ISGSY produces its accounts in accordance with Turkish Accounting Standards (TAS), which since 1 January 2014, have required it to value its private equity investments at fair value on its balance sheet with changes in its fair value recorded in the P&L account. This accounting practice brings ISGSY in line with private equity companies in most other countries. Previously, ISGSY was required to fully consolidate the results of its investee companies on an historic cost basis (as adjusted for inflation) and equity account for affiliates in which it had a minority interest.

The exhibit below shows ISGSY's balance sheet at the end of December 2014 and at 30 June 2015. At 30 June 2015, private equity investments were 39% of total assets with a larger proportion of the company's assets, 45%, invested in short-term investments, mainly private sector and government bonds. The latter are recorded at fair value in the balance sheet and are invested in short-term instruments to minimise fair value changes arising from Turkish bond market volatility.

The low proportion of its balance sheet invested in private equity means that ISGSY has the potential to make additional PE investments if it finds the right opportunities. The cash and short-term investments also produce a yield out of which the company can pay its operating expenses and dividend without depleting its capital.

Almost all the company's assets are funded by shareholder's funds; there is no borrowing at ISGSY, though there is some in its investee companies. The segmental accounts of ISMEN, an IS

Bank affiliate that owns 29% of ISGSY but consolidates ISGSY in its financials, including ISGSY's investee companies (Nevotek, Ortopro,Toksoz Spor, Numnum) shows that ISGSY's financial liabilities amount to around 28% of total assets to 30 June 2015. This illustrates the scale of borrowing at Nevotek, Ortopro, Toksoz Spor and Numnum.

Exhibit 4: ISGSY balance sheet at 31 December 2014 and 30 June 2015

TRYm	31 December 2014	30 June 2015	% Total 31 December 2014	% Total 30 June 2015
Cash and cash equivalents	**27.1**	**29.4**	**10%**	**11%**
Short-term investments				
Private sector bonds	64.1	62.3		
Governments bonds	36.2	27.0		
Investments funds	22.1	22.3		
Shares quoted on stock exchange	5.4	4.8		
	127.8	**116.4**	**47%**	**45%**
Other	0.7	2.5		
Current assets	**155.6**	**148.3**		
Long-term investments				
PE Investments	**103.1**	**101.2**	**38%**	**39%**
Other	10.4	10.4		
Non-current assets	**113.5**	**111.58**		
Total assets	**269.1**	**259.8**	**100%**	**100%**
Liabilities	4.7	3.0		
Equity	**264.4**	**256.8**	**98%**	**99%**
		-2.9%		
Equity and liabilities	**269.1**	**259.8**	**100%**	**100%**

Source: ISGSY, Edison Investment Research

Unquoted investment valuation

ISGSY's investments are unquoted so there are no market prices to use in the balance sheet valuation, and instead the fair value has to be estimated. ISGSY uses an independent advisory company, Ernst & Young, to determine the fair value of its investments, mainly through the use of discounted cash flow valuations and multiple comparisons. Its valuation models consider the present value of the expected payments, discounted using risk-adjusted discount rates. The expected payments are determined by considering the possible scenarios of forecast earnings before interest tax depreciation and amortisation (EBITDA), the amount to be paid under each scenario and the probability of each scenario. The following exhibit shows the discount rates and the terminal annual revenue growth rates by investee company. The EBITDA margins used are between 10.2% and 41.68%. On average, the portfolio is valued at an estimated 2015 EV/EBITDA of 8.3X. The valuations are carried out one per year for the full-year results.

Exhibit 5: ISGSY Valuation assumptions for investee companies

Company	Discount rate %	Ongoing revenue growth rate %
Toksoz Spor	17-18	2.9-3.9
Numnum	16.8-17.8	2.92-3.92
Nevotek	12.1-13.1	1.6-2.6
Radore	13.4-14.4	2.92-3.92
Ortopro	17.2-18.2	2.9-3.9

Source: ISGSY

ISGSY has provided some indication of the effects on the fair value of its investee companies from changes in revenue growth, EBITDA growth rate and the discount rate, which we show below. They show that a 1% decrease in revenue growth, a 0.5% decline in EBITDA growth and a 1% increase in the risk-adjusted discount rate would lower fair values by TRY15.8m, equal to around 16% of the fair values of the private equity investments.

Exhibit 6: Fair value* sensitivity of IGSY's Private equity investments		
TRY m	Increase	Decrease
Annual revenue growth 1% change	6.5	(5.6)
EBITDA growth rate 0.5% change	4.1	(4.1)
Risk adjusted discount rate 0.5% change	6.4	(5.9)

Source: ISGSY. Note: *Changes in fair value are recorded in the P&L account.

Profit and loss account

The following exhibit shows ISGSY's P&L account for 2014 and H115.

Exhibit 7: ISGSY P&L account

TRYm	H114	H214	2014	H115
Increase FV Toksoz Spor			4.7	
Decrease in FV Numnum			(5.0)	
Decrease in FV Ortopro			(0.7)	
Increase in FV Nevotek			0.2	
Increase in FV Radore			0.1	
Disposal and FV gains on PE Investments			**(0.7)**	**0.0**
Other financial income			23.5	6.8
Revenue	**14.6**	**8.1**	**22.8**	**6.8**
Administrative expenses	(4.0)	(4.1)	(8.1)	(4.3)
Other expenses (net)	0.0	(0.1)	(0.1)	(0.1)
Profit	**10.6**	**4.0**	**14.6**	**2.4**
Average cash and investments TRYbn	182	166	171	150
Average assets TRYbn	261	268	263	264
Yield on investments (annualised)			13.7%	9.1%
Average two-year Turkish T-bill rate			9.3%	8.9%
Administrative expense/total assets	3.1%	3.0%	3.1%	3.3%

Source: ISGSY, Edison Investment Research

ISGSY does not revalue its private equity investment in its interim accounts. Had it done so, the unwind of the discount used in its DCF valuation would have given a gain of around TRY8m, but we consider it likely that the deterioration in the prospects for the investments considering the economic and geopolitical turmoil currently affecting Turkey would have overwhelmed these gains.

Some insight into the current trading performance of ISGYS's investments can be gleaned from ISMEN's segmental accounts, which fully consolidate Nevotek, Ortopro,Toksoz Spor and Numnum, and equity account Radore. Exhibit 8 below shows ISGSY's consolidated results as they appear in ISMEN's segmental accounts. As the only corporate action between H114 and H115 was the acquisition of a stake in the associated Radore at the end of 2014, comparing H114 with H115 in these segmental accounts therefore includes a similar scope of consolidation. The accounts show expense growth exceeding revenue growth leading to a sharp fall in profits. The expense growth arises from the investee companies investing in the expansion of their businesses. Radore has increased data centre space over fourfold and has strengthened its sales team. Toksoz Spor has continued to open new stores while Istanbul Food & Beverage Group (Numnum) has opened more coffee houses and restaurants. Gearing, as measured by financial liabilities to total assets, increased from 25% at end December 2014 to 29% at 30 June 2015.

Exhibit 8: ISGSY's consolidated accounts per ISMEN segmental disclosure

TRYm	H114	H115	% change
Revenue	**104.0**	**112.3**	**8**
Cost of sales	(65.9)	(77.3)	17
Gross profit	38.1	35.0	(8)
Expenses	(37.2)	(42.9)	15
Operating profit	**0.9**	**(8.0)**	**N/A**
Associates	0.0	(0.2)	
Net finance income	2.2	(0.5)	(123)
Profit before tax	**3.1**	**(8.7)**	**(383)**

Source: ISMEN

Interest and other income from ISGSY's non PE investments was TRY6.1m in H115 and represented an annualised yield of 8.1%. This was lower than the average return achieved in 2014 of 13.7%, when interest rates were on average similar, but in 2014 market interest rates declined during the year, enabling mark-to-market gains on the bond investments to be earned. In H115 bond yields trended upwards and mark-to-market losses are likely to have arisen, which would have reduced the return.

Expenses in H115 rose 7.5% y-o-y, in line with Turkish inflation. Around half of the expenses consist of personnel costs. With average assets in H115 in line with those of H114, this resulted in administrative expenses as a percentage of average assets rising to 3.3% (annualised in H115).

Dividend policy

ISGSY's dividend policy is to distribute at least 30% of distributable profit as bonus shares and/or cash. The company has a reputation for paying high dividends. Turkey's national *Ekonomist* magazine ranked ISGSY as the highest-yielding listed stock in the country for the last five-year average in its publication of 8 February 2015. Distribution decisions are made by a general assembly of shareholders on proposals put by the board of directors. Among the factors it considers in making its proposals are the income demands of shareholders, the general profitability of the company, the capital requirements of the company to grow its activities and the desire to not prematurely exit an investment before the maximum return is achieved.

The exhibit on page two shows the company's dividend record since 2007. It has paid a cash dividend every year since 2007, with the 2013 dividend being particularly high as it distributed some of the large gains it made from selling its stake in Aras Kargo in that year.

ISGSY normally announces a dividend in March/April based on the profits of the previous calendar year, but when it makes a successful exit it also usually announces a one-off dividend. ISGSY also issues bonus shares as dividends. For instance, on 5 April 2013 it announced an issue of 15 shares for every 100 owned. As these only have the effect of increasing the number of shares outstanding and do not involve the payment of cash out of the company, we have not included them in our DPS exhibit below, though of course, our DPS history is adjusted for the higher number of shares.

On 18 March 2015 ISGSY announced a cash dividend payment of TRY0.135 per share (TRY10m), equivalent to 8.3% of the current share price, which it paid on 24 March. The payment of TRY10.1m represents 70% of its profit for 2014. If it pays a similar dividend in March 2016 it may have to utilise retained earnings as it is unlikely that profits for 2015 will be sufficient to maintain this level of payment. With retained earnings of TRY130m at the end of June 2015, this should be possible if it wished.

Valuation

ISGSY lacks a clear comparator peer group in Turkey, so we have chosen to compare it with a selected group of closed-end private equity funds in emerging markets, as we show in the following exhibit.

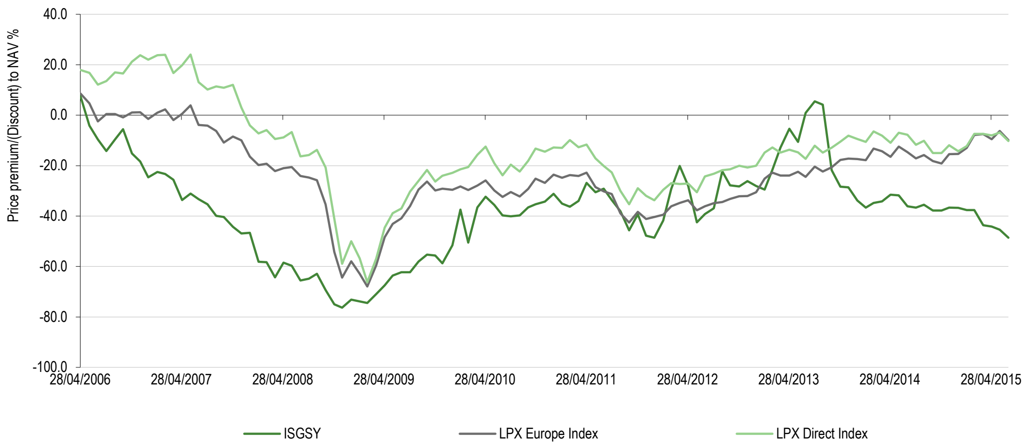
Exhibit 9: Selection of closed-end quoted emerging market private equity companies

Fund name	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Discount (ex-par)	Latest ongoing charge
Adamas Finance Asia	84.7	(4.6)	(84.9)	(84.9)	9.4	8.7
Arc Capital Holdings	39.8	(66.7)	(87.0)	(91.5)	129.8	9.6
China Assets	26.5	30.9	46.6	12.4	(80.8)	1.8
East Capital Explorer	111.7	(18.3)	(11.6)	(34.9)	(38.7)	2.8
IS Private Equity	**26.3**	**1.4**	**65.4**	**123.9**	**(53.0)**	**3.4**
Origo Partners	9.6	(39.5)	(74.3)	(75.6)	(70.5)	5.4
Symphony International Holding	237.0	3.9	23.9	57.5	(45.6)	1.9
Simple average	**76.5**	(13.3)	(17.4)	(13.3)	(21.3)	**4.8**
Weighted average		(6.9)	(7.6)	3.3	(25.0)	**3.9**

Source: Morningstar, Edison Investment Research. Note: Prices at 28 September 2015.

The discount to NAV at which ISGSY is currently trading is higher than the average in this selection, even though the growth in NAV over the last one, three and five years is noticeably better than most. The discount at which ISGSY is currently trading is higher than listed private equity companies in Europe and globally. In the chart below we show the LPX Europe Index discount and the LPX Direct Index discount; the former measures quote private equity discounts in Europe and the latter globally. ISGSY's current discount to NAV of 53% is higher than its 38% average over the last nine years and some 30 percentage points more than global- and European-listed private equity companies. However, ISGSY's NAV may not currently reflect its fair value so these measures may not give a reliable guide to relative value.

Exhibit 10: Discount to NAV persists



Source: LPX, Bloomberg, company data. NAV from 31 December 2012 is calculated using the fair value of the assets (including private equity investments). Before then NAV is on the 'solo' basis calculated by management that excluded the operating results of its investee companies, which it was required to consolidate by accounting standards then being applied. Although the fair value NAV for 2012 and 2013 differs from that published on a 'solo' basis by only 1% but before then, the 'solo' basis may only give an approximation to fair value.

Sensitivities

Current uncertainties around long-term Turkish growth

Emerging markets association

Turkey is an emerging market and investors are attracted for the long-term growth prospects that such a market brings. ISGSY offers investors not just the opportunities from being a private equity investor but also the potential from operating in an emerging market with superior long-term growth potential.

However, in the immediate future, Turkey's status as an emerging market has a negative connotation for investors. There are concerns that when developed world interest rates rise, investors based in such countries may withdraw money from emerging markets, including Turkey, because they were only attracted by the higher potential returns on offer there. Turkey has been described as one of the "fragile five" emerging markets, which are countries with large current account deficits that rely heavily on external financing, so Turkey has been particularly vulnerable to this sentiment. This would be negative for ISGSY, as it could make the development of its investee companies slower than would otherwise be the case, and it could make profitable exits from investments harder to achieve. On the other hand, a depressed market with firms having problems accessing funds could be in ISGSY's long-term interests because it may be able to acquire companies at a more beneficial price. It has ample resources to make investments as PE investments only account for around 40% of its balance sheet after Radore, with the rest invested in marketable securities.

The recent fall in the oil price will reduce the Turkish current account deficit and depress inflation, so is beneficial for the Turkish economy. Like other countries, Turkey will suffer from any global economic slowdown as a result of a decline in Chinese growth, but its main export markets are the EU, Russia and the Middle East. China accounted for just 2% of exports in 2014.

Political risks

Turkey is surrounded by countries in political conflict, including Russia and Ukraine to the north and Iraq and Syria to the south. ISGSY's PE investments do not have much trade with these countries, but their problems may spill over into Turkey and cause political and macroeconomic risks. There is a danger that Turkey could become increasingly involved in the ISIS conflict in neighbouring Iraq and Syria. In addition to these geopolitical risks, there are political uncertainties at home with the June 2015 national election producing a hung parliament and the likelihood of additional national elections in November 2015, which will extend the period of political uncertainty.

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