İŞ GAYRİMENKUL YATIRIM ORTAKLIĞI A.Ş. (ISGYO)

Rating Summary

27 August 2018

Credit Rating

Rating (National): Long Term

(TR) AA

Outlook:

Stable

Rating (National): Short Term

(TR) A1+

Outlook:

Stable

İş Gayrimenkul Yatırım Ortaklığı A.Ş.
İş Kuleleri, Kule 2, Kat: 10-11 34330 Levent, Istanbul

İş Gayrimenkul Yatırım Ortaklığı A.Ş. ("the Company") was founded on August 6, 1999 by conversion of İş Gayrimenkul Yatırım ve Proje Değerlendirme A.Ş. to a real estate investment trust following the taking over of all assets and liabilities of İş Gayrimenkul Yatırım ve Proje Değerlendirme A.Ş. and Merkez Gayrimenkul Yatırım ve Proje Değerlendirme A.Ş., which were both established in 1998 and operating separately. The main shareholder of the Company is Türkiye İş Bankası A.Ş. ("İş Bank").

The Company is a capital market institution, which can invest in real estate, real estate backed capital market instruments, real estate projects, real estate backed rights and capital market instruments and engage in other activities that are allowed in the Capital Markets Board ("CMB") regulations, within the framework of principles and procedures set forth in CMB regulations on real estate investment trusts. The Company's operating principles, portfolio investment policies and management restrictions are based on compliance with CMB regulations and the relevant legislation.

Following our comparative analysis of the sector and examination of financial/operational risks carried by the Company, as well as its domestic market position, IS GYO received a long term rating of (TR) AA and a short term rating of (TR) A1+.

Previous rating:	(August 25, 2017)	Long Term	(TR) AA
		Short Term	(TR) A1+

Outlook

As of June 30, 2018, 54% of the Company's real estate portfolio is composed of office buildings, 24% of shopping centers, 8% of projects, 8% of inventory, 5% is land and 1% is hotel. The properties, where rent and right of construction income are obtained, are mainly composed of office and shopping center investments and the distribution of said investments on a fair value basis is 68% office buildings, 31% shopping centers and 1% hotel. As of the first half of 2018, 78% of the revenues of İş GYO consist of housing sales revenues. The majority of the total rental income is from Tuzla Technology and Operation Center, İş Towers and Kanyon shopping mall. Advances received from customers account for 34% of short-term liabilities. The high level of advances recorded on the balance sheet is the key indicator of confidence in the Company. Since these advances correspond to the sale price of the houses which will be built, advance sales of planned units can be achieved without generating cash outflow. Thus, resource costs are managed effectively by low-cost funding.

The course of the exchange and interest rates determine the performance of the real estate sector. Turkey's young population demographic structure and investment and residential preferences for real estate investments, plus the demand for additional housing created by the immigration from neighboring countries lead to a demand-oriented potential in the construction sector. Nevertheless, increase on construction costs due to the depreciation of the TL against other currencies may affect the performance of the sector. Moreover, the recent increase in the interest rates on mortgage loans and the decreasing housing demand therefore may affect the performance of the sector negatively.

Considering these factors, the Company's outlook is considered to be Stable.

Economic Outlook

According to the evaluations of international institutions such as the International Monetary Fund (IMF), the World Bank and the OECD, the short-term risks to the global economy are relatively low and cyclical recovery and financial conditions may be further strengthened in the short-term. In line with this forecast, international institutions have revised up their global growth expectation for 2018 and 2019 to around 4%. These upward revisions, particularly toward US economic growth, highlighted expectations that global growth will accelerate and changes in US tax policy will encourage investment.

At the meeting held in June, the Federal Reserve (FED) raised its policy interest rate by 25 basis points as expected, to 1.75 - 2% range. The European Union (EU) economy showed the fastest growth performance in the last 10 years with an annual rate of 2.5% in 2017. As a matter of fact, the unemployment rate in the region has backed to its lowest level since the global crisis, while the manufacturing and services purchasing managers index (PMI), which is a leading figure, has reached the summit of the last 7 years and confirmed that economic activity displayed a positive outlook. Positive expectations for the Euro Zone economy have led to an uptick in the EURO/USD parity in the recent period and it has tested the all-time high of the last four years as per the forecast of the European Central Bank (ECB) that the normalization period of monetary policy could accelerate. However, the recent relative increase in the price indexes in the US economy is reviving expectations on FED’s interest rate increase. As a result, the EURO/USD rate is again showing a downward trend. As the dollar began to strengthen, a deeper depreciation of all developing country currencies began to take place.

Following the coup attempt of July 2016, Turkey's growth figure of 7.4% registered in 2017 mainly shows that the incentives launched by the government to revive the economy, particularly on employment and the Credit Guarantee Fund (CGF), has been effective. In 2017, the added value of the agriculture sector as a chain-linking volume index increased by 4.7%, the industrial sector by 9.2% and the construction sector by 8.9%. The added value of the services sector, which is composed of trade, transportation, accommodation and food service activities, increased by 10.7%.

Since the beginning of May, the Central Bank of Turkey (CBT) has taken measures by using interest and non-interest instruments in order to be able to provide financial stability and to prevent the reflection of the sharp rise in exchange rates on prices. In this context, the CBT decided to strengthen monetary tightening in June in order to support price stability, raising the policy rate of one week repo auction rate from 16.5% to 17.75%. Consumer prices increased by 0.55% in July and the annual inflation rose by 0.46 percentage points to 15.85%. The most significant contribution of the rise in inflation came from basic goods with high exchange rate transitivity. A spread throughout the subgroups was observed. The annual rate of increase in food prices has been on the rise with the pace decelerating. The vibrant course in the tourism sector supports price increases in related groups. Annual inflation and main trends of core indicators have risen considerably within this framework. As highlighted above, pressure on exchange rates across developing countries is also felt in Turkey and a rapid upward trend of the USD and EURO exchange rates is observed. The course of the exchange rates is expected to continue to be an important risk factor in the upcoming period.

The construction sector grew by 5.2% in the 1st quarter of 2017, by 5.5% in the 2nd quarter, by 18.6% in the 3rd quarter and by 5.8% in the 4th quarter of 2017, reaching to an annual growth rate of 8.9%. Significant support such as VAT discounts, discounts on interest of housing loans and fees along with civil works had a considerable impact on the rapid growth in the construction sector. The Construction Turnover Index, an important sector-wide data, increased by 12.7% in the 4th quarter of 2017. In the January-December period of 2017, surface area of buildings which got Construction Permits, increased by 31.8%. Also the area of buildings for which Occupancy Permits was given during the same period increased by 6.6%. The total area of the buildings was 161.1 million sq. m; of which 94.2 million sq. m were residential, 35.7 million sq. m were non-residential and 31.2 million sq. m were common usage areas.

According to TURKSTAT data, housing sales in 2017 amounted to 1,409,314 units in Turkey, an increase of 5.1% compared to the previous year. 473,099 of them were mortgaged sales. In June 2018, the public banks withdrew their interest on the mortgage loan to 0.98%/month. As a result of the decline in interest rates, housing sales in Turkey increased by 22.4% in June 2018 compared to the same month of the previous year, reaching to 119,413 units. For the first sales in Turkey, June 2018 housing sales increased by 25.6% to 57,064 units compared to the same month of the previous year.

Company Overview

İş Bank owned İş Gayrimenkul Yatırım Ortaklığı A.Ş. was originally founded on August 6, 1999 as a result of the merger of two real companies: İş Gayrimenkul Yatırım ve Proje Değerlendirme A.Ş. and Merkez Gayrimenkul Yatırım ve Proje Değerlendirme A.Ş. The Company has completed its initial public offering within the same year and began trading on BIST.

The Company shares are traded under "ISGYO" code at BIST Outright Purchases - (Among Qualified Investors), Collective and Structured Products Market and İş GYO is a constituent of BIST 100 (XU100), BIST All Shares (XUTUM), BIST 100-30 (XYUZO), BIST Real Estate Investment Trusts (XGMYO), BIST Dividend 25 (XTM25), BIST Dividend (XTMTU), BIST Financials (XUMAL) and BIST Corporate Governance (XKURY) indices.

As of December 31, 2017, the Company represents approximately 4.6% of the real estate investment trusts sector with a market value of TL 1.243 million. About 45% of the Company's portfolio investments consist of offices, 27% of projects, 20% of shopping centers, 2% of inventory, 4% of land, and 2% of cash and capital markets instruments.

The issued capital of the Company is TL 958,750,000. All of the shares are registered and total value of the Group A shares is TL 1,369,642.817 while Group B shares are worth TL 957,380,357.183. A Group shares have the privilege of nominating candidates for the election of members of the Board of Directors. One member of the Board of Directors shall be elected from among the candidates nominated by the Group B shareholders and all other members shall be elected from among the candidates nominated by the A Group shareholders. The capital structure of İş GYO as of the report date is as follows:

Capital Structure		
Shareholders	**Share Value (TL)**	**Share %**
Türkiye İş Bankası A.Ş.	422,932,626.58	44.11
Anadolu Hayat Emeklilik A.Ş.	68,151,714.29	7.11
Other	467,665,659.13	48.78
Total	958,750,000.00	**100.00**

The division of tasks on the İş GYO Board is as follows:

ISGYO Board of Directors	
Name	**Title**
ÖMER KARAKUŞ	Chairman of the Board
SÜLEYMAN H. ÖZCAN	Vice-chairman
AYSEL TACER	Board Member
Prof. Dr. ARZU ERDEM	Independent Board Member
HALUK BÜYÜKBAŞ	Independent Board Member
NİHAT UZUNOĞLU	Independent Board Member
İ. HAKKI AKŞENER	Board Member
MEHMET TÜRK	Board Member
MURAT DOĞAN	Board Member

As per the resolution reached at the Ordinary General Shareholders' Meeting held on March 21, 2018 and within the framework of a dividend distribution proposal of the Board of Directors on the 2017 profit, out of TL 221,768,688.61 of net profit as per legal records dated December 31, 2017 pursuant to the Tax Procedure Law, TL 45,000,000 will be distributed as bonus share and TL 68,531,250 will be distributed as cash dividend.

Balance Sheet and Income Statement of İş GYO (TL)

Key Balance Sheet and Income Statement Items (TL '000')	2017	2016
Current Assets	967,988	322,950
Cash and Cash Equivalents	83,118	127,262
Trade Receivables	47,443	28,770
Fixed Assets	4,343,959	4,564,070
Investment Property	3,834,871	3,714,669
Total Assets	5,311,947	4,887,020
Short Term Liabilities	873,323	188,453
Long Term Liabilities	1,158,047	1,537,221
Equity	3,280,577	3,161,346
Total Liabilities	5,311,947	4,887,020
Total Financial Liabilities	1,185,483	1,054,661
Income	439,659	404,533
Gross Profit	177,835	194,804
General Administrative and Marketing & Sales Distribution Expenses (-)	(35,822)	(37,119)
Net Income-Loss from Other Operations	83,777	336,772
Operating Profit	225,791	494,457
Net Profit for the Year	179,957	420,511

Ratio Analysis

Main Financial Ratios	2017	2016
Return on Equity (Pre-tax Profit / Shareholders' Equity)	0.05	0.13
Net Profit / Total Assets	0.03	0.09
Operating Profitability (EBIT / Total Assets)	0.04	0.10
Economic Profitability (EBIT / Total Liabilities)	0.11	0.29
Net Profit / Net Revenue	0.41	1.04
Liquid Assets / Total Liabilities	0.04	0.07
Cash Ratio (Liquid Assets / STL)	0.10	0.68
Short Term Receivables / Total Assets	0.01	0.01
Interest Coverage (EBIT / Net Financial Gain - Loss)	4.78	6.63
Receivables Turnover Rate (Net Revenue / Trade Receivables)	9.27	14.06
Net Foreign Currency Position / Total Assets	(0.04)*	(0.04)
Net Foreign Currency Position / Equity	(0.07)*	(0.07)
Financial Leverage (Shareholders' Equity / Total Debt)	1.61	1.83
Short Term Liabilities / Total Liabilities	0.16	0.04
Fixed Assets / Total Debt	2.14	2.64
Total Financial Debt / Total Assets	0.22	0.22
Tangible Fixed Assets + Investment Properties / Total Assets	0.73	0.77

* As of December 31, 2017, the Company has hedging derivative transactions amounting to USD 53 million.

In 2017, sales revenues increased by 9% compared to 2016. The Company's net profit for the period in 2017 decreased by 57% compared to the previous year and was realized as approximately TL 180 million. A decrease of 45% in the value of investment property during the same period affected the net profitability. Rental income in 2017 was TL 197.1 million, including the right of construction. Rental income recorded an increase of 3% on an annual basis. The growth of rental income was limited due to the vacancy rate in İş Towers Tower-3 along with the lack of rent income from branch offices and hypermarket buildings sold in 2017. 14% of total financial liabilities are shorter than 1 year, thanks to the Company management creating an appropriate liquidity risk management for short, medium and long term funding and liquidity requirements. İş GYO has TL 215.1 million (USD 48.1 million and EURO 7.5 million foreign exchange short position as of December 31st). However, following the derivative transaction on the Company's USD-denominated credit, the short foreign exchange position has significantly declined. As a result, the Company's short position was TL 10.7 million as of June 30, 2018. The net debt of the Company is TL 1.1 billion, up 18.86% from TL 927 million at the end of 2016. We think that debt is manageable due to the Company's cash generating capacity and foreign exchange based revenues derived from certain assets.

The Company has sold its bank office buildings in its portfolio in 2017 at Kızılay, Ankara and Antalya for a total of TL 81.4 million including VAT and also sold a hypermarket building in Istanbul Esenyurt for TL 140 million including VAT. Ankara İş Tower, which had a very low occupancy rate in 2017, reached 100% occupancy rate after the lease operation in the first quarter of 2018, affecting the Company's total income positively. Rental income from Ege Perla Shopping Center, which started operation in 2017, will also contribute to the total rental income of the Company. According to June 2018 figures, 10% of rental income is in USD and the remaining 90% is in TL. As far as financial liabilities are concerned, 80% is in Turkish Lira, 17% is in US Dollar and 3% is in Euro. Furthermore, 79% of the Company's total debt is fixed and 21% has floating rate.

Corporate Governance

The Company has provided substantial compliance with the Capital Markets Board's (CMB) Corporate Governance Principles and has implemented all of the necessary policies and measures. Management and internal control mechanisms have been created effectively and are in operation. All of the corporate governance risks are identified and managed actively. The rights of shareholders and stakeholders are respected in a fair manner and public disclosure and transparency is at superior levels. Structure and operation of the board of directors is in the category of best practice. There are almost no weaknesses in these areas.

Methodology

SAHA's credit rating methodology is composed of quantitative and qualitative sections contributing to the final grade with specific weights. The quantitative analysis components consist of the Company's performance compared to industry peers, analysis of the financial risks, and the assessment of cash flow projections. Comparative performance analysis determines the relative position of the Company as compared with industry peers' financial performances and industry averages. The financial risk analysis of our methodology covers the evaluation of the Company's financial ratios on the basis of objective criteria. Liquidity, leverage, asset quality, profitability, volatility and concentration are treated as sub-headings in this analysis. Finally, scenario analysis evaluates the Company's performance with respect to its capability to fulfill its obligations under the future projections of a base and a stress scenario.

The qualitative analysis covers operational issues such as industry and company risks as well as administrative risks in the context of corporate governance practices. The industry analysis evaluates factors like the nature and rate of growth of the industry, its competitive structure, structural analysis of customers and creditors, and sensitivity of the sector to risks at home and abroad. The company analysis evaluates market share and efficiency, trends and volatilities in key performance indicators, cost structure, service quality, organizational stability, access to domestic and foreign funding sources, off-balance sheet liabilities, accounting practices, and parent / subsidiary company relationships if any.

Corporate governance plays an important role in our methodology. The importance of corporate governance and transparency is once again revealed in the current global financial crisis we witness. Our methodology consist of four main sections; shareholders, public disclosure and transparency, stakeholders, and board of directors. The corporate governance methodology of SAHA can be accessed at www.saharating.com.

Rating Definitions

Our long-term credit ratings reflect our current view of medium to long maturities over one year, while our short-term credit rating reflects our view for a period of up to one year. Our long-term credit rating results start from AAA showing the highest quality grade and continue downward to the lowest rating of D (default). Plus (+) and minus (-) signs are used to make a more detailed distinction within categories AA to CCC.

Companies and securities rated with long-term AAA, AA, A, BBB and short-term A1 +, A1, A2, A3 categories should be considered "investment worthy" by the market.

Short Term	Long Term	Rating Definitions
(TR) A1+	(TR) AAA (TR) AA+ (TR) AA (TR) AA-	The highest credit quality. Indicates that ability to meet financial obligations is extremely high. For securities, it is an indication of no more than a slight additional risk as compared to risk-free government bonds.
(TR) A1	(TR) A+ (TR) A	Credit quality is very high. Very high ability to fulfill financial obligations. Sudden changes at the company level and/or economic and financial conditions may increase investment risk, but not significantly.
(TR) A2	(TR) A- (TR) BBB+	High ability to fulfill financial obligations but may be affected by adverse economic conditions and changes.
(TR) A3	(TR) BBB (TR) BBB-	Sufficient financial ability to fulfill its obligations but carries more risk in adverse economic conditions and changes. If securities; has adequate protection parameters, but issuer's capacity to fulfill its obligations may weaken in face of adverse economic conditions and changes.

Companies and securities rated with long-term BB, B, CCC, and short-term B, C categories should be considered "speculative" by the market.

(TR) B	(TR) BB+ (TR) BB (TR) BB-	Carries minimum level of speculative features. Not in danger in the short term but faces negative financial and economic conditions. If securities; below investment level, but on-time payments prevail, or under less danger than other speculative securities. However, if the issuer's capacity to fulfill its obligations weakens, serious uncertainties may unfold.
(TR) C	(TR) B+ (TR) B (TR) B-	Currently has the capacity to fulfill financial obligations, but highly sensitive to adverse economic and financial conditions. If securities; there is a risk in due payment. Financial protection factors can show high fluctuations depending on the conditions of the economy, the sector, and the issuer.
(TR) C	(TR) CCC+ (TR) CCC (TR) CCC-	Well below investment grade. In considerable danger of default. Fulfillment of its financial obligations depends on the positive performance of economic, sectoral and financial conditions. If securities; there are serious uncertainties about the timely payment of principal and interest.
(TR) D	(TR) D	Event of default. The company cannot meet its financial obligations or cannot pay the principal and/or interest of the relevant securities.

Disclaimer

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