Is Private Equity

Continuing to weather the storm

Full-year results

Investment companies

During a turbulent year for the Turkish financial markets and economy, the 1.2% increase in NAV per share reported by Is Private Equity (ISGSY), supported by good growth in real terms by investee companies, is a very positive outcome. With some calm returning to Turkish markets, a further moderation in inflation and interest rates would be positive and a pick-up in M&A activity may provide opportunities for the capital recycling that ISGSY targets.

To 31 December 2018*	Price total return (%)	NAV total return** (%)	LPX Europe Index TR (%)	BIST 100 Index TR (%)
One year	17.2	1.2	16.7	-18.1
Three years	26.7	1.9	119.9	39.0
Five years	0.7	5.8	218.7	53.7
Ten years	640.7	160.3	1052.9	333.0

Note: *Last published NAV. ISGSY and BIST 100 Index TR from Bloomberg. Note: LPX Europe comprises the 30 largest listed private equity companies listed on a European stock exchange. All data are calculated in TRY. **ISGSY NAV is calculated at fair value.

Investee growth protects valuation

Despite the challenging environment, NAV increased marginally to TRY260.0m (2017: TRY256.9m) or TRY3.48 per share (2017: TRY 3.44). ISGSY reports that the six Turkish SME investee companies generated aggregate revenue growth of more than 30%, well ahead of average inflation of c 15%, and sufficient to substantially offset a sharp increase in the risk adjusted discount rate applied by the external portfolio valuation. Aggregate net fair value fell just 0.2%, or TRY0.4m. Although lower year on year as a result of follow-on investment, cash and short-term investments continue to represent 26% of the total assets, adding strength and flexibility to the balance sheet and generating short-term investment income that substantially covers the cost base (14% lower than in 2017).

Improving environment

2018 was a turbulent year for the Turkish economy and financial markets, including escalating weakness in the currency that drove inflation to a high of 25%, leading interest rates sharply higher. The main BIST 100 equity index fell by just over 40% in US dollar terms, although in local currency the decline in the index value (excluding dividends) was kept to 21%. M&A activity, in aggregate, was supported by a small number of large transactions but private equity activity was modest and the environment was not conducive to the exits from mature investments that ISGSY continues to target. There are signs of improvement, with recent gains in the TRY and moderating inflation providing scope for an eventual easing of interest rates. The BIST 100 has risen more than 10% in the year to date.

Valuation: Slightly narrower discount

The discount to NAV has reduced over the past year to c 5%, and especially since the publication of the robust FY18 results. This is lower than the c 40% average discount over the past 10 years, but below the 2013 premium of 5%, and implies that investors may be anticipating economic recovery. With a liquid balance sheet, successful exits could provide scope for dividends.

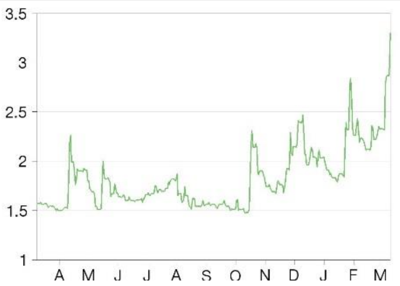
14 March 2019

Price	**TRY3.30**
Market cap	**TRY246m**
NAV*	**TRY260m**
NAV per share*	**TRY3.48**
Discount to NAV	**5.2%**

*NAV at 31 December 2018

FY17 dividend yield	0%
Shares in issue	74.7m
Free float	31.2%
Code	ISGSY
Primary exchange	BIST
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	28.7	20.1	82.8
Rel (local)	29.9	10.8	109.9
52-week high/low		TRY2.9	TRY1.5

Business description

Is Private Equity is a listed private equity fund that invests directly in mid-cap private Turkish companies. It has six investments in the consumer, leisure, IT and healthcare sectors.

Next events

Q119 results	April 2019

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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

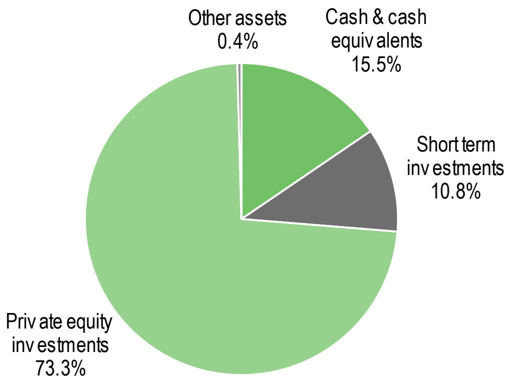
Is Private Equity (ISGSY) is an internally managed private equity fund listed on the Instanbul Stock Exchange and 58% owned by İşbank affiliates. It was established in 2000 to invest directly in Turkey's growing mid-cap private companies and has six investments in the consumer, leisure, IT and healthcare sectors.

Recent news

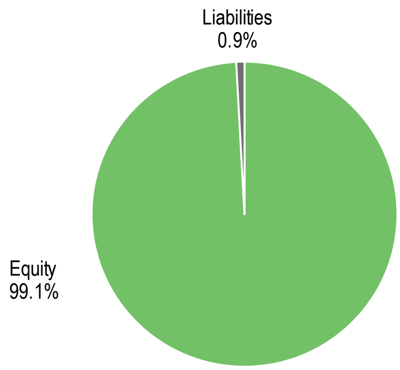
- February 2019: FY18 results.
- November 2018: Payment of TRY5.8m Nevotek capital increase, taking stake to 93.46% from 89.72%.
- February 2018: payment of TRY4.75m capital increase to Ortopro, committed in 2017.

Forthcoming announcements/catalysts		Capital structure		Fund details	
AGM	March 2019	Expense ratio	3.5%	Group	Is Private Equity
Q119 results	April 2019	Net gearing	Net cash	Manager	Murat Özgen (CEO)
Year end	December	Annual management fee	N/A	Address	Iş Kuleleri Kule 2, Kat:2 - 34330 Levent, Istanbul, Turkey
Next dividend	N/A	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/

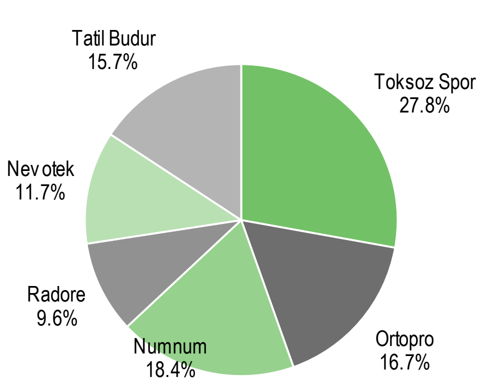
Assets at 31 December 2018



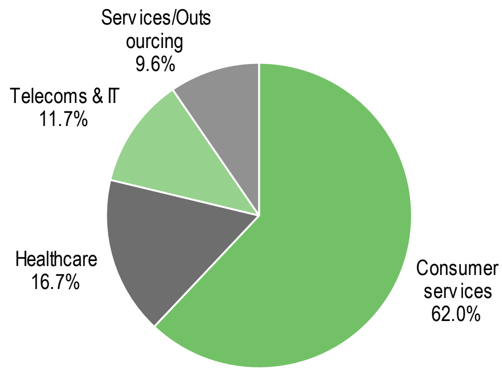
Equity and liabilities at 31 December 2018



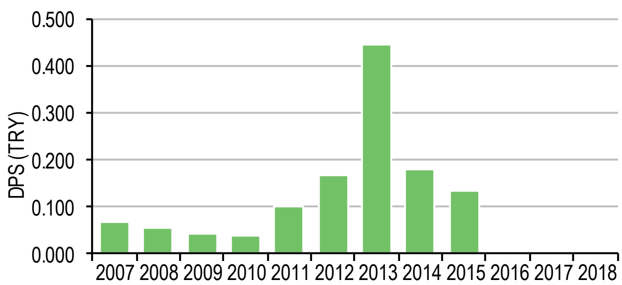
PE balance sheet value by portfolio company at 31 December 2018



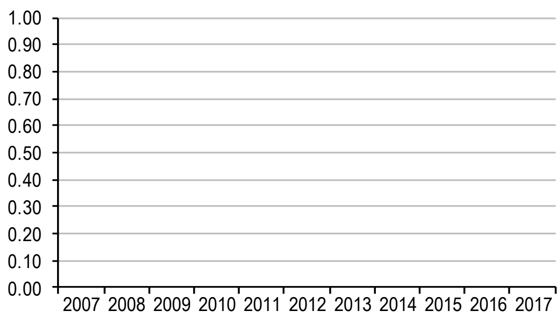
PE investment sector breakdown at 31 December 2018



Dividend paid history



Share buyback history



Source: ISGSY, 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 and summary of investment case

Is Private Equity (İş Girişim Sermayesi, ISGSY) is a well-established Turkish private equity investor, focusing on lower/mid-market sized private equity transactions within the Turkish small and medium-sized enterprise (SME) corporate segment. It was established in 2000 by one of the largest Turkish banks, Turkiye İş Bankasi (Işbank) as a way to invest in and support the development of Turkish SMEs with high growth potential. ISGSY listed on the Borsa Istanbul in 2004, when shares representing 37.7% of the company were offered in an IPO, and İşbank affiliates still control 58% of the shares, representing a valuable and supportive core shareholder base with extensive business connections.

Following a period of initial fund raising, ISGSY made its first two investments in 2002, and it has now made 17 investments in total since inception, with an aggregate investment volume of US$150.7m (based on the TRY/US dollar exchange rate at the point of investment). There have been 11 exits to date (the last being in 2013), realising US$166.9m (again using the prevailing exchange rate at the time of the transactions) from total investment in those assets of US$72.5m, which ISGSY estimates to represent an IRR of 26.4% on a dollar basis. The current portfolio comprises six investments with a fair value of TRY192.2m (c US$36.3m) at 31 December 2018. Including significant cash and other short-term investments, total assets at the same date were TRY262.2m. The company itself has no debt, although investee companies do have debt.

Turkish economic and social development since 2000 has been strong and beyond the current financial stresses its young and well-educated population provides the potential for growth to resume. Within Turkey, ISGSY is focused on lower/mid-private equity transactions where it faces less competition for deals from the large international private equity firms, which prefer larger transactions. SMEs are the backbone of the Turkish economy, accounting for more than 90% of all enterprises by number, more than 50% of GDP and providing more than three-quarters of all jobs.

In a relatively fast-developing economy, access to capital is an important issue for these companies and private equity investors, such as ISGSY, make an important contribution by providing permanent capital commitments and strategic support. ISGSY aims to help its investee companies expand into new markets and compete, not only in Turkey, but also in international markets where appropriate, and to grow organically or through acquisition.

Private equity investment generally has a long-term time horizon as it typically takes from three to seven years for investee companies to implement their strategies, but long-term industry returns, compared with listed equity investment, have generally been attractive.

In summary an investment in ISGSY represents:

- access to the dynamic middle market in Turkey not available on the Istanbul Stock Exchange (which has predominantly larger companies), an experienced management team with almost 20 years' experience in Turkish private equity and a track record of success;
- considerable balance sheet resources and no debt, reducing risk and providing flexibility at a time of uncertainty that may present opportunities; and
- a discount of c 5% to the last published NAV of TRY3.48, of which 26% represents cash and short-term investments, equivalent to TRY0.92 per share, or 28% of the TRY3.30 share price. Excluding cash and short-term investments from both the market capitalisation and the net assets, the adjusted P/NAV multiple c 0.93x.

Investment strategy, process and resources

ISGSY targets investment in Turkish SMEs with solid prospects for sustainable growth, market share gains and operational improvement and that have the potential to become a significant player in their sector, where possible, with some exposure to foreign markets. It is primarily an equity investor, although convertible debt or a structured mix of debt and equity are considered.

Investments mainly take the form of growth capital and buyouts, but may be project-based restructuring transactions. The typical features that ISGSY looks for when committing to an investment include:

- average investment size of TRY10–50m;
- operational profitability and realistic growth forecasts;
- a strong and committed management team, which can make decisions quickly;
- a business plan with genuinely differentiated products or services;
- sustainable competitiveness and market share; and
- identifiable exit opportunities.

ISGSY does not target any sector or weighting but instead focuses on niche opportunities that offer the potential for growth supported by structural drivers and long-term trends. Examples within the current portfolio include investment in data centre services and an online travel agency. It tends to take majority stakes to establish control (it owns more than 50% in four of the six current investments), but will also consider taking a significant minority stake where a secure exit strategy exists and where it can be certain of having sufficient influence to ensure that any decisions taken in running the investee company are in line with its own plans and strategy. Co-investment is also considered if the size of the required investment is above its preferred range, as is the case with Radore and Tatil Budur. Although ISGSY seeks to establish control of investee companies, including board representation, its aim is not to become directly involved in day-to-day management but apply its experience in determining strategy and create the most suitable capital structure for the company. Day-to-day operations are left to the investee company management teams, with strong management one of the investment selection criteria. However, ISGSY will use its influence to support the strengthening and deepening of management, replacing management where necessary.

The investment team comprises eight investment professionals, collectively providing broad experience in consultancy, strategic planning, corporate finance, and industry. Based on the investment criteria noted above, the team screens large numbers of potential investment opportunities in a typical year (c 2,800 in aggregate between 2000 and 2018). Where the screening process identifies a company that appears to meet ISGSY's investment criteria and financial hurdles a far more detailed assessment and due diligence is carried out, including an analysis of the wider sector and competitors. The investment return target is for an IRR of 15–20% in US$ terms over a three- to seven-year investment horizon. Following satisfactory due diligence, the investment team makes an investment proposal to the investment committee, which may in turn decide to make a recommendation to the board of directors, that has ultimate responsibility for investment decisions. After a deal has closed, ISGSY proposes representatives to the investee company's board, enabling it to provide support and monitor its investment until a decision to exit is made and executed.

ISGSY has a successful track record of exits

As noted above, ISGSY has made 17 investments to date and has exited 11 of these, with the last from Aras Kargo in 2013. We show details of the exited investments in Exhibit 2, with proceeds amounting to US$166.9m from US$72.5m of invested capital, a money multiple of 2.3x. The current investments, discussed in the next section, have a carrying value of TRY182.6m, equivalent to c US$48m.

Exhibit 2: Summary of exited investments

Investment date	Company	Sector	Investment ($m)*	Exit date	Period owned (years)	Exit value ($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	Consumer	11.5	2006	3	19.4	30.3%	69.0%
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	Services	5.0	2012	5	10.5	17.0%	110.0%
	Turkmed	Healthcare	2.5	2013	6	0.2	N/A	-90.0%
2008	Dr Frik	Healthcare	13.4	2011	3	30.5	34.6%	128.0%
2010	Havas	Services	10.8	2012	2	19.7	26.7%	82.0%
2011	Aras Kargo	Services	9.8	2013	2	51.9	165.0%	428.0%
Total/average			**72.6**		**4**	**166.9**	**26.46%**	**130%**

Source: ISGSY. Note:*Investments in TRY converted to US dollars at historical exchange rates.

Working towards further exits from maturing investments

The current portfolio, comprising six private equity investments, is well spread by investee company. The largest investment by fair value (the sporting goods wholesaler and retailer, Toksoz Sporand) represents c 28% of the total, and the largest sector exposure (62% of the total fair value) is to consumer services, split between restaurants (Numnum), sports goods (Toksoz Spor) and tourism (Tatil Budur).

During 2018 ISGSY completed a TRY4.75m follow-on investment into Ortopro agreed in 2017 (and included in the end-2017 shareholding of 90.63%) and invested further into Nevotek (TRY5.8m), increasing its stake from 89.72% to 93.46%. The proceeds of the Ortopro investment were to support general corporate purposes and reduce debt while the proceeds of the Nevotek investment will mainly support the US expansion of its affiliate (Exhibit 3).

Exhibit 3: Follow-on investment

	ISGSY ownership/voting power			Investment (TRYm)		Investment (US$m*)	
	2018	2017	2016	2018	2017	2018	2017
Toksoz Spor	88.27%	88.27%	55.00%		27.5		7.7
Ortopro	90.63%	90.63%	83.64%	4.8	12.8	1.3	2.9
Numnum	83.57%	83.57%	83.57%				
Radore	25.50%	25.50%	25.50%				
Nevotek	93.46%	89.72%	81.24%	5.8	5.0	1.1	1.5
Tatil Budur	20.00%	20.00%	20.00%				
Total				**10.6**	**45.3**	**2.3**	**12.1**

Source: ISGSY. Note: *Converted at exchange rate at time of investment.

Exhibit 4 provides an overview of the current portfolio investments. By the standards of a typical private equity investment lifecycle, the portfolio is relatively mature. The most recent investment was made in 2015 (Tatil Budur) and the most seasoned investment is the 2003 investment in Nevotek. ISGSY indicates its main priority is to continue to support the investee companies towards a successful exit, and in the current environment it is in no rush to commit capital towards new investments. In the following sections we will review the economic and market environment as these will have a significant influence on ISGSY's targeted exit activity.

Exhibit 4: ISGSY private equity investments at 31 December 2018

	Date of investment	Fair value (TRYm)	Ownership (%)	Description
Nevotek Telecoms & IT	30/9/2003	22.5	93.46	Nevotek, headquartered in Turkey, is a global player that specialises in the interconnection of internet protocol (IP) telephony, 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. In 2019, Nevotek will enhance its current product portfolio with cloud-based solutions. Nevotek has a large, international customer base and in 2018 its US-based affiliate, Koridor commenced operations, with a platform that allows hotel guests to self-select their specific room, potentially upgrade their room type, or purchase ancillary services prior to arrival. ISGSY expects that, as a result, in 2019 Koridor will expand its customer base and generate increased revenues. Group revenues rose 16% in 2018.
Ortopro Healthcare	10/12/2007	32.2	90.63	Ortopro is a Turkish orthopaedic implant company that operates 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 2018 revenues grew by 40% versus 2017 and 60% of the revenues were generated from exports markets.
Toksoz Spor Consumer	13/11/2012	53.5	88.27	Toksoz Spor is a leading sporting goods wholesaler and retailer in Turkey. In its wholesale activities it is the Turkey region distributor of global sports brands and in 2017 added Puma to its list, which includes Arena and Everlast. The company also sells products under its own brands Sportive and Mountrex. Wholesale customers include department stores, other sports retailer chains, sports clubs, universities and sports federations. ISGSY says that online sales grew 45% in 2018 and Toksoz Spor management expects more than 50% growth in this segment in 2019. Total revenues grew by 18% in 2018.
Numnum (Istanbul Food and Beverage Group) Consumer	05/12/2012	35.4	83.57	Istanbul Food and Beverage Group 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 that was voted number 44 in a 2018 list of the best 50 restaurants in the world, compiled by "The World's 50 Best Restaurants". Numnum is a full-service casual restaurant chain, Trattoria Enzo serves 'home-made' Italian food, Terra Kitchen is a casual self-service concept with the motto 'eat well, feel good', and Kronotrop is a third-wave coffee roastery and shop. The group opened two new Numnum restaurants and six new Kronotrop coffee shops in 2018, which contributed to overall revenue growth of 23%.
Radore Services	01/12/2014	18.4	25.50	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 3,500 clients, including both individuals and corporations, and with capacity to support up to 10,000 servers to meet the emerging requirements of the growing data processing and internet economy in Turkey. Radore made its first data centre investment in 2005 and was the fastest growing data centre in Turkey according to the 2012/13, 2013/14 and 2014/15 Deloitte Technology Fast 50 survey. ISGSY reports that Radore continues to grow in terms of revenue (up 36% in 2018), capacity utilisation and client numbers.
Tatil Budur (Mika Tur, incorporating Tatil Budur) Consumer	06/11/2015	30.2	20.00	ISGSY invested in Mika Tur, which incorporates Tatil Budur, one of the leading tour operators in Turkey, alongside MCI Private Ventures. Tatil Budur is focused on the domestic market and distinguishes itself from many other tour operators with sales offices across Turkey and a broad product offering including domestic hotels, corporate travel organisations, outbound tourism, flight tickets, cultural tours and transport services. In 2018 the company established an in-house customer reservation system. Revenues grew 40% in 2018, with the company benefitting from robust internal tourism sector and a strong new management team.

Source: ISGSY

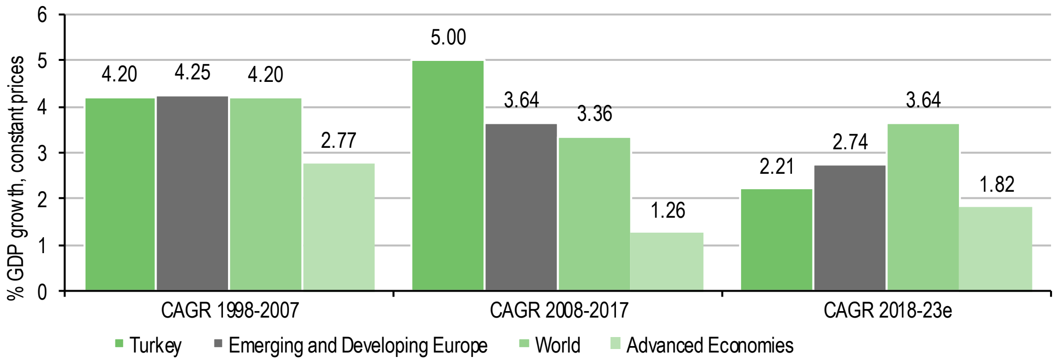
The market environment

Strong economic growth record but near-term challenges

The Turkish economy has a good historical record of growth and benefits from a number of positive features such as a relatively young and well-educated workforce and its unique position bridging Europe and Asia. However, the strong recovery of the economy from the failed coup attempt in 2016 was punctuated in the second half of 2018 by escalating weakness in the currency that drove inflation to a high of c 25% in October, leading interest rates sharply higher. Q318 GDP fell by 1.1% on the previous quarter, taking the annual growth rate to 1.6%, with indications that it possibly contracted further in Q4 representing a short-term technical recession. With inflation moderating and monetary policy held tight, there has been a recent improvement in sentiment in the FX and financial markets, but most forecasters expect growth in the current year to be modest as a recovery takes time to work its way through.

The historical absolute and relative strength of Turkish economic growth can be seen in Exhibit 5. This is particularly evident in the years going into and out of the global financial crisis (2008–2017), despite negative impacts on the business environment resulting from protracted geopolitical tensions, including war in neighbouring Syria and the failed coup attempt in July 2016.

Exhibit 5: Comparison of historical and forecast Turkish economic growth



Source: IMF World Economic Outlook, October 2018

In the aftermath of the failed coup attempt, 2016 GDP growth slowed noticeably to 3.2% from 6.1% in 2015 but rebounded strongly in 2017 to 7.4%. The IMF forecast for 2019 is for growth of 0.4% before recovery in 2020. This is below government targets, which look for 2.3% in 2019 and a recovery to 5% pa growth from 2021. Several measures have been introduced in recent months that are designed to support economic growth, including a temporary lifting on the purchase of cars and white goods and the transfer of TRY37bn of Central Bank profits to the Treasury. To protect real incomes and consumer demand, the minimum wage was increased by a quarter.

Exhibit 6: Turkish GDP and inflation performance and forecast

	2016	2017	2018	2019e	2020e	2021e
GDP	3.2	7.4	3.5	0.4	2.6	2.1
Inflation	8.5	11.9	20.0	15.5	14.0	13.0

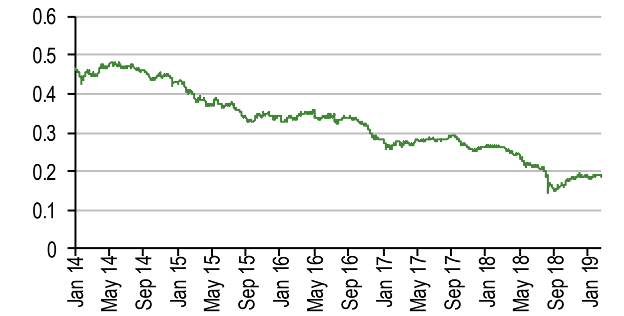
Source: IMF World Economic Outlook, October 2018

With a relatively low public debt to GDP ratio of c 28% and an annual budget deficit of less than 2% of GDP, the Turkish government has some flexibility to support the economy. This is not the case with monetary policy, a significant factor given the relatively high private sector debt burden built up since the financial crisis, much of which is foreign currency-denominated debt. Investor concerns that the Central Bank was too focused on maintaining economic growth and too slow in tightening monetary policy appears to have played an important role in the 2018 weakening of the Turkish lira. The Central Bank's official lending was eventually increased to 24%, where it has remained despite a softening in the rate of inflation to c 20%, but any suspicion that interest rates are being eased prematurely, before inflation has been adequately tamed, has the potential to unsettle the FX markets again. With municipal elections to be held in March, investors are likely to be especially sensitive; however, with corporate lending rates of more than 25% currently, the economy has much to gain from an eventual reduction in borrowing costs.

Financial markets were turbulent but appear to be stabilising

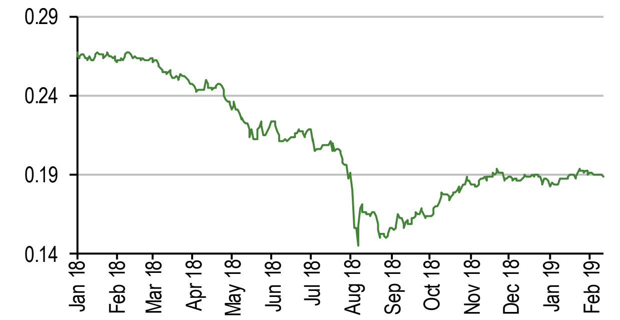
The TRY has been on a downward trend versus the US dollar for several years and between the start of 2014 and the end of 2017 it depreciated in value by a little more than 40%. During the late summer of 2018 the currency began a further sharp downward move, which appears to be the result of domestic and internal factors. Given a relatively low domestic savings rate, the strong economic growth since the global financial crisis had been accompanied by growing corporate indebtedness and a widening current account deficit, made possible by capital inflows from overseas. The gradual tightening of US monetary policy increased investor concern at Turkey's reliance on overseas capital inflows and relatively high inflation. This concern was made worse by the perception of some investors that the Turkish Central Bank was slow to tighten monetary policy. The TRY fell sharply, reaching a low in August 2018, but has since made a partial recovery and has shown increasing signs of stability.

Exhibit 7: TRY versus US dollar – five years



Source: Bloomberg

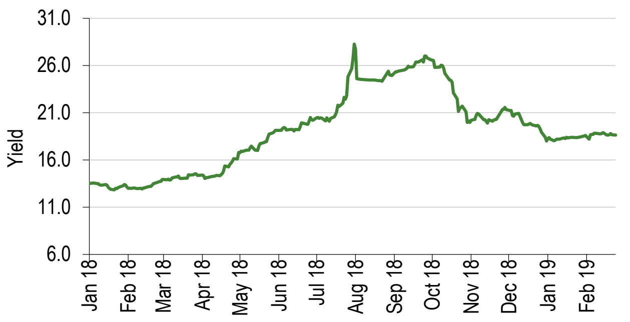
Exhibit 8: TRY versus US dollar – one year



Source: Bloomberg

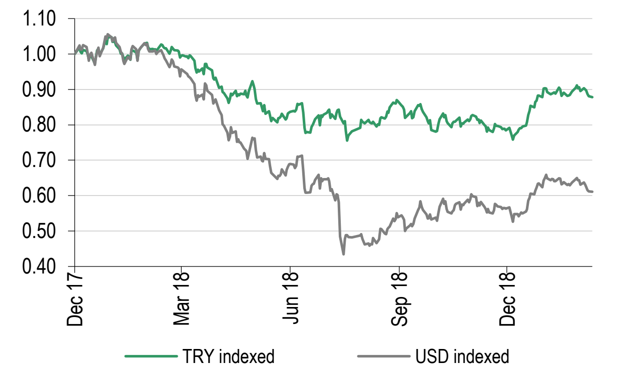
As the TRY fell, two-year government bond yields rose to a high of more than 28% and were later followed by an increase in the Bank of Turkey's official interest rate to 24% in September, the trigger for the TRY to stabilise and start to recover. The two-year bond yield has since reduced to c 18%.

Exhibit 9: Turkish two-year government bond yield



Source: Bloomberg

Exhibit 10: Turkish BIST 100 equity index



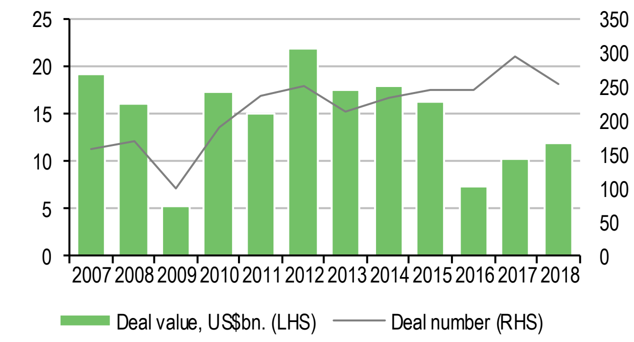
Source: Bloomberg

The main Turkish equity index, the BIST 100, was more than 50% lower in US dollar terms at its worst point during 2018 before recovering. However, in TRY the market was more resilient, recognising the competitive benefits for exporting companies from the TRY decline, ending the year with a decline of just more than 20%.

Turkish M&A markets showed a mixed picture

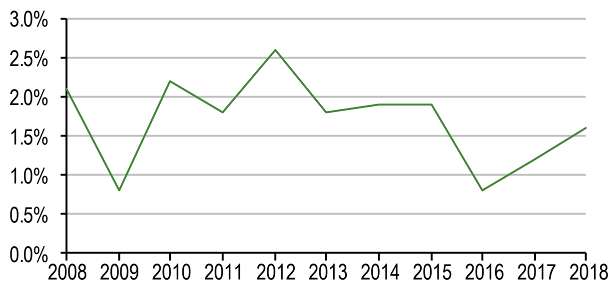
As noted above, with a maturing investment portfolio ISGSY's main near-term strategic focus is on supporting investee companies towards a successful exit. Capital recycling is a common feature of private equity, whereby IRRs may be optimised by divesting mature investments to enable reinvestment in new opportunities. However, it is under no pressure to accelerate exits in the way that a typical limited partnership private equity fund may be, because it operates with a permanent capital base. As a barometer of the market potential for exits, we track the level of activity in M&A.

Exhibit 11: Further increase in Turkish M&A deal value



Source: Deloitte Annual Turkish M&A Review 2018

Exhibit 12: Deal volume still low as a % GDP



Source: Deloitte Annual Turkish M&A Review 2018

Despite the economic and market challenges of the past year, increasing uncertainty and reducing deal appetite, Deloitte estimates that M&A deal volume rose by c 17% to US$12.0bn (2017: US$10.3bn), with the growth driven by a small number of large, strategic transactions undertaken by foreign investors. Although for the past two years it has been recovering from very weak 2016 performance, deal volume remains below the 10-year average of c US$14.1bn and well below the 2012 peak of US$22.0bn. Deloitte estimates the number of deals at 256, lower than the 2017 all-time high of 295, but well above the 10-year average of c 227.

Deal numbers were driven by multiple small and mid-market transactions, including a particularly strong contribution from early-stage M&A. In contrast to deal volume, the share of foreign investors in overall deal numbers remained relatively modest (less than a third). Financial investor activity, including private equity (PE) investors was modest and close to 10-year lows.

For ISGSY it is the level of activity represented by smaller transactions that is most relevant, rather than the volumes of larger transactions. Although the 2018 number of transactions was lower, it is not particularly surprising given market conditions and the multi-year trend is upwards. The 2018 ratio of deal volume to GDP was 1.6%, up from 1.2%, and not far below the 10-year average of 1.7%. At face value this suggests a fairly healthy level of activity despite the continuing challenges and uncertainty, although it remains well below the global average of 5.2% (Deloitte), perhaps a better measure of the medium-term upside potential.

Financials

Small increase in NAV very positive given market conditions

ISGSY reports according to Turkish Accounting Standards, as per the Turkish Commercial Code, and is IFRS compliant. The financial statements prepared on an historical cost basis with the exception of investment securities, which are measured at fair value. The investment securities measured at fair value include the private equity investments, although in four of the six investee companies ISGSY's ownership is above 50%, as well as the liquid asset investments, the bond and investment fund holdings, and a small amount of listed investments (together 'the short-term investments'). Changes in the fair value of these assets are taken through the profit and loss account, in line with practices in most other countries.

The NAV at 31 December 2018 was TRY260.0m, an increase of TRY3.1m, or a little more than 1%, compared with the prior year (31 December 2017: TRY256.9m). With no change in the number of shares outstanding, NAV per share increased by a similar amount to TRY3.48 (2017: TRY3.44)

Income earned on cash and the short-term investments reduced during the year, although higher short-term market rates offset much of the negative effect of lower average balances held (resulting from reductions to fund the follow-on private equity investments). Income on cash and short-term investment reduced by 21% to TRY10.5m but was more than sufficient to cover administrative expenses (TRY8.9m) and a small negative (TRY0.4m) fair value movement in respect of the PE investments. Administrative expenses were very well controlled and fell by 14% compared with 2017 despite the end-2018 consumer price index being c 20% above the year earlier level. The cost control was spread across most expense items, including personnel expenses. The overall headcount at end-2018 was 13 compared with 14 a year earlier.

The TRY1.9m positive contribution from other income/expense substantially reflects foreign exchange gains in respect of certain current financial investments.

Exhibit 13: Income statement summary

TRYm unless stated otherwise	2018	2017	2018/2017	2016
Interest income from private sector and treasury bonds	2.5	3.5	-29%	6.6
Net fair value gains on investment securities	0.5	3.2	-83%	3.3
Bank deposit interest	5.8	3.7	57%	3.1
Net trading income from investment securities	0.4	1.9	-77%	0.8
Dividend income	1.0	0.6	50%	0.6
Reverse repo and Takasbank interest income	0.4	0.5	-22%	0.3
Sub-total	**10.5**	**13.3**	**-21%**	**14.8**
Change in fair value of PE investments	(0.4)	(2.0)	-79%	(3.5)
Total revenue	**10.1**	**11.3**	**-11%**	**11.3**
Administrative expenses	(8.9)	(10.4)	-14%	(10.3)
Other operating income/(expense)	1.9	(0.0)		0.1
Net profit	**3.1**	**0.9**	**225%**	**1.1**
Actuarial gains/(losses)	(0.0)	(0.2)		(0.0)
Total comprehensive income	**3.0**	**0.8**	**299%**	**1.1**
Weighted average number of shares (millions)	74.7	74.7		74.7
Earnings per share (TRY)	0.04117	0.01267		0.01420
Total comprehensive income/(loss) per share (TRY)	0.04075	0.01021		0.01413

Source: ISGSY

The balance sheet remains liquid

The balance sheet saw a c TRY10m increase in non-current assets, mainly reflecting net new investment in existing PE investments, funded by retained income and a c TRY7m reduction in current assets.

Exhibit 14: Balance sheet development

TRYm unless stated otherwise	2018	2017	2018/2017	2016
Cash & equivalents	40.6	29.4	38%	45.7
Current financial investments:				
Private sector bonds	11.3	19.7	-42%	23.6
Government bonds		1.5	-100%	22.5
Investment funds	12.3	20.3	-39%	21.8
Stock-market listed shares	4.7	4.9	-4%	5.0
Total short term investments	28.4	46.4	-39%	72.9
Other current assets	1.1	0.9	12%	0.8
Total current assets	**70.0**	**76.8**	**-9%**	**119.4**
PE investments	192.2	182.6	5%	139.3
Other non-current assets	0.1	0.0		0.1
Total non-current assets	**192.2**	**182.6**	**5%**	**139.4**
Liabilities	(2.3)	(2.5)		(2.6)
Net assets	**260.0**	**256.9**	**1%**	**256.2**
Number of shares (millions)	74.7	74.7		74.7
Net assets per share (TRY)	**3.48**	**3.44**	**1%**	**3.43**

Source: ISGSY

As noted above, during the year, ISGSY made follow-on investment of TRY10.6m into Ortopro and Nevotek, partly offset by a TRY0.6m cash recovery from the vendors of Tatil Budur in respect to a performance clause within the agreement. This was a significant reduction from the 2017 aggregate follow-on investment of TRY45.25m (into Nevotek, Ortopro and Toksoz) funded by a reduction in the liquid asset investments.

The share of private equity investments in end-2018 total assets increased to 73% (2017: 71%; 2016: 54%). Cash and short-term investments in aggregate reduced slightly, to 26% of total assets compared with 29% in 2017, but within this the weighting of cash and equivalents increased to 16% (2017: 11%). ISGSY has no debt at the company level (the small long-term liability relates to employee benefits provisions), although there is an undisclosed amount of operational debt within the investee companies, and reflected in the external valuation of the portfolio. As such, the positive balance of cash and short-term investments continues to provide ISGSY with considerable flexibility to undertake further long-term investment as it identifies suitable opportunities.

External DCF valuation method

As in previous years, the PE investments were valued externally. For 2018 the external valuation was carried out by KPMG using a discounted cash flow (DCF) methodology. The DCF applies a risk-adjusted discount rate to a stream of potential cash flows (EBITDA), which in turn is estimated using a range of possible scenarios, each with a probability attached.

The 2018 external valuation included an increase in the assumed revenue growth rate for four of the investee companies, with one held unchanged and one reduced. The company indicates that a change in annual revenue growth is generally accompanied by a directionally similar change in EBITDA and cash flow. Although the revenue growth rates are quoted in nominal terms and appear quite modest compared with current Turkish inflation, they reflect the valuer's longer-term assessment of inflation prospects. For both 2017 and 2018, the Nevotek growth rate assumption is quoted in US dollar terms, reflecting its underlying operations and lower expected US dollar inflation. For the first time in 2018 the Ortopro growth rate is also quoted in US dollars, which the valuer considers is a better reflection of its underlying sales.

Exhibit 15: External growth rate assumptions

	2018	2017	2016*	2015*
Toksoz Spor	6.8%	5.5%	5.5%	5.0%
Numnum	6.8%	5.5%	5.5%	5.0%
Nevotek	1.9%	1.9%	1.8%	2.1%
Radore	6.8%	5.5%	5.5%	5.0%
Ortopro	1.9%	5.5%	5.5%	5.0%
Tatil Budur	6.8%	5.5%	5.5%	8.5%

Source: ISGSY. Note: *2015 and 2016 are mid-point of previously disclosed ranges.

The risk-adjusted discounted rates used in the 2018 valuation increased for five of the investee companies, in most cases quite noticeably, and reduced for one. The increases were greatest in respect of the four valuations conducted on a Turkish lira basis, although the Nevotek discount rate (US dollar) also rose. The decline in the Ortopro discount rate reflects the shift to a US dollar-based valuation.

Exhibit 16: External discount rate assumptions

	2018	2017	2016*	2015*
Toksoz Spor	30.3%	18.6%	17.9%	17.1%
Numnum	32.4%	20.3%	17.4%	17.3%
Nevotek	17.7%	14.6%	12.0%	12.1%
Radore	31.5%	19.9%	15.5%	14.6%
Ortopro	14.8%	20.9%	17.6%	19.6%
Tatil Budur	35.4%	20.7%	19.6%	19.0%

Source: ISGSY. Note: *2015 and 2016 are mid-point of previously disclosed ranges.

ISGSY has also provided an updated sensitivity analysis, showing the effect of changes to the assumptions on the value of the investments. An increase of 0.5% in the revenue growth assumption would add TRY6.3m to fair value (2017: TRY6.3m), an increase of 0.5% in the assumed growth of EBITDA would add TRY11.5m to fair value (2017: TRY10.2m), and a 0.5% reduction in the risk rate would add TRY15.8m (2017: TRY13.4m). Changes to the assumptions in the opposite direction are anticipated to have broadly symmetrical impacts.

Exhibit 17: End-2018 fair value sensitivity of ISGSY's private equity investments

TRY	Increase	Decrease
Annual revenue growth rate (0.5% change)	6,337,274	(5,845,660)
EBITDA growth rate (0.5% change)	11,535,900	(11,356,449)
Risk adjusted discount rate (o.5% change)	(14,498,814)	15,787,946

Source: ISGSY

Fair values were very robust

As noted above, the value of the PE investments increased as a result of TRY10.6m of new investment in Ortopro and Nevotek, partly offset by the TRY0.6m of cash received in respect of Tatil Budur, and a small net negative fair value adjustment of TRY0.4m. The net fair value adjustment represented just 0.2% of the opening fair value (2017: negative TRY2.0m or 1.4% of the opening value) with four of the investee companies seeing positive fair value adjustments and two seeing reductions.

Exhibit 18: 2018 change in value of PE investments

TRY	Opening value	Capital increase*	Change in fair value	Closing value	Change in fair value as % opening value
Toksoz Spor	51,810,454		1,682,931	53,493,385	3.2
Ortopro	22,755,545	4,750,000	4,649,938	32,155,483	20.4
Numnum	37,762,151		(2,317,607)	35,444,544	-6.1
Radore	17,943,585		417,690	18,361,275	2.3
Nevotek	23,832,898	5,838,315	(7,208,462)	22,462,751	-30.2
Tatil Budur*	28,476,400	(589,100)	2,352,700	30,240,000	8.3
Total	**182,581,033**	**9,999,215**	**(422,810)**	**192,157,438**	**-0.2**

Source: ISGSY. Note: *ISGSY received a cash payment in respect of Tatil Budur, from the vendor, under a performance clause in the investment agreement.

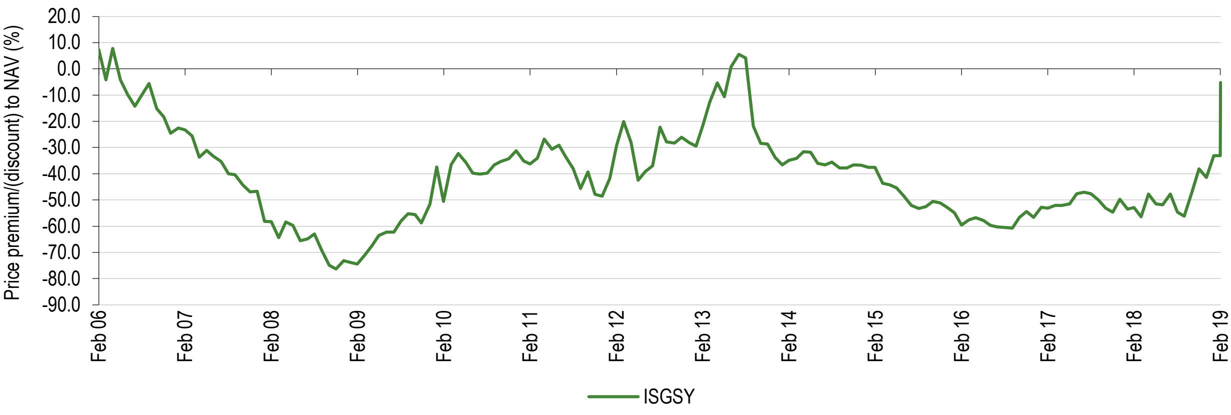
Although the economic and geopolitical environment was challenging, ISGSY reports that the investee companies saw 2018 aggregate revenue growth of more than 30%, well ahead of the average inflation for the year of 15%.

Valuation

ISGSY trades at a discount of c 5% to its end-2018 NAV. The discount has been narrowing since the failed coup attempt in 2016 and this narrowing has accelerated in recent weeks following publication of ISGSY's robust FY18 results. Although no dividends have been paid since 2016 (in respect of the 2015 financial year), the company has a reputation for paying high dividends, particularly when realising gains from the disposal of investments. Dividend policy is to distribute at least 30% of distributable profit as bonus shares and/or cash.

Exhibit 19 shows the ISGSY P/NAV history dating back to before the global financial crisis. During this period the P/NAV fell from a premium of c 7% in early 2006 to a discount of c 75% in 2008 as the financial crisis hit. During the strong post global financial crisis recovery enjoyed by the Turkish economy, a premium to NAV (c 5%) was again achieved in 2013. More recently, in the wake of the failed coup attempt (2016) the P/NAV again fell to a discount of c 60%. Since then the discount has been narrowing and in 2018 the share price increased by 17.2% compared with the 1.2% increase in NAV per share. Although the NAV per share increase was modest, it is a very positive result compared with the weakness of Turkey-listed shares and Turkish bonds. Moreover, ISGSY benefits from a strong and liquid balance sheet. More recently the discount has closed to c 5%, below the average c 40% for the whole period covered in Exhibit 19.

Exhibit 19: P/NAV history



Source: Company data, Bloomberg.

Sensitivities

Although the domestic political environment has become more settled since the failed coup in 2016, geopolitical tensions have increased, most noticeably with the US, and war in the region continues. These all represent risk factors beyond the control of management that may have a significant impact on both the business and trading environment of investee companies and the market valuation of Turkish assets.

A lack of visibility to the look-through performance of the underlying (private) assets is a feature of the private equity industry and valuations are inevitably subjective, not being based on traded prices. In this respect, ISGSY can point to a track record of profitable exits and the fact that its portfolio valuations are independently and externally produced.

Economic conditions are challenging and volatile market conditions are unfavourable for exits. However, the increase in revenues across the portfolio and robust fair value performance are positive indicators for the performance of the existing asset portfolio, and raise the prospect of exits for some of the mature assets. ISGSY's balance sheet remains liquid, providing the resources for new investment as opportunities arise.

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