



# Turkey Private Equity Overview

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**I. PE in General**

**II. Turkish PE Market**

**III. Challenges for PE Funds in Turkey**

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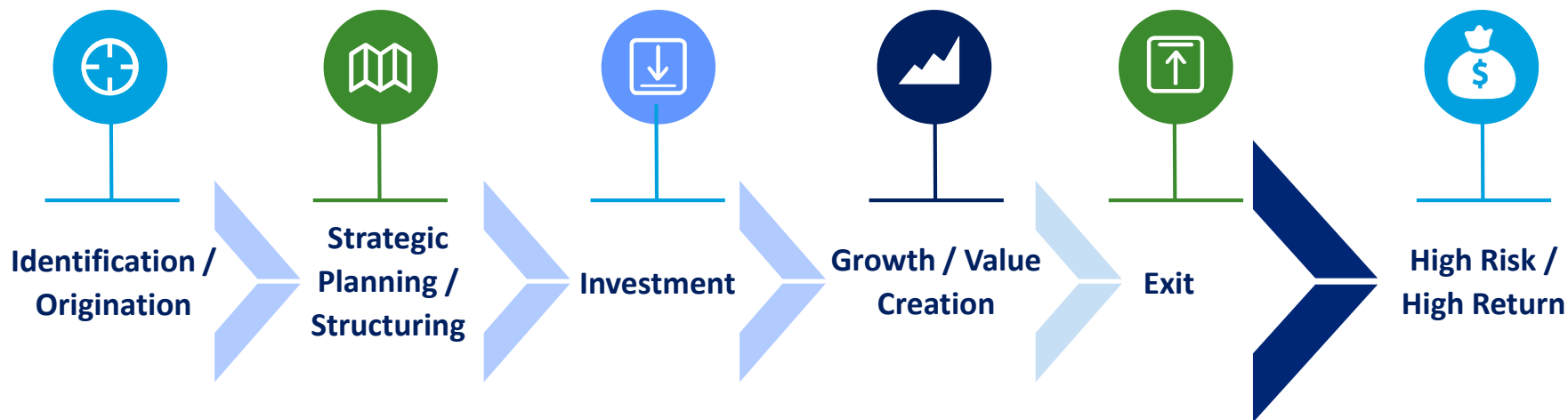
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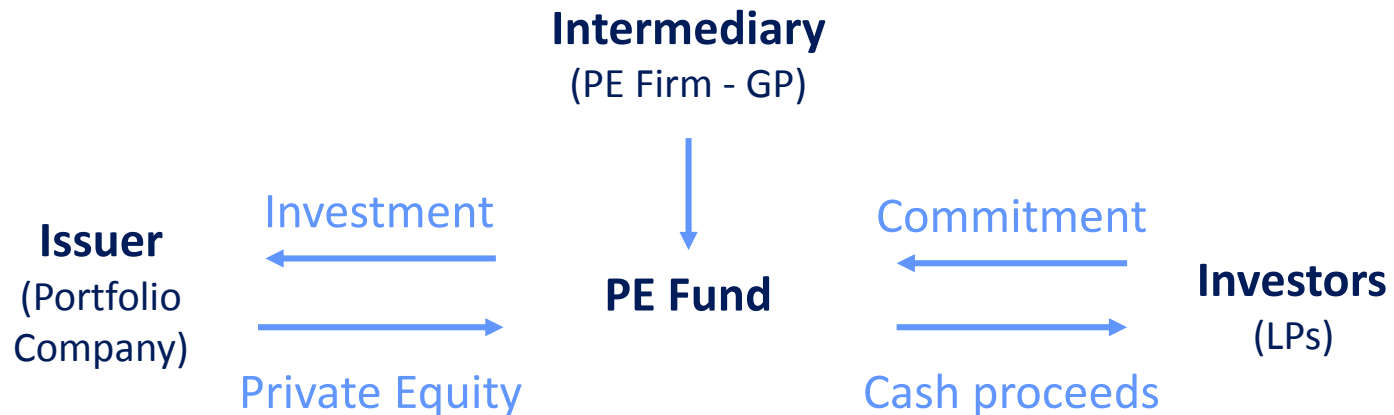
# What is Private Equity?

- » **Private Equity (PE)** refers to equity that is not registered with the relevant securities regulator (e.g. Capital Markets Board in Turkey)
- » PE investment comes primarily from institutional investors and accredited investors, who can dedicate substantial sums of money for extended time periods.
- » PE investors invest into companies, add value to these companies in terms of growth and corporate development, and exit within the planned period of time by aiming to make profit out of the investment



# Private Equity Market Structure – Intermediaries

- » Extensive knowledge is needed to analyze huge numbers of potential investment candidates, to assess value, and to monitor/manage the investments (portfolio companies)
- » Specialized "**intermediaries**" – **PE Firms** are at the core of the PE market providing their expertise
- » Even the largest and most sophisticated institutional investors generally invest through such intermediaries, not on their own



# Private Equity Market Structure – Complexity

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- » A PE fund is organized as a partnership, in which a PE management firm serves as the **general partner (GP)**
  - These firms are quite small, with very little “overhead”
  - The GP might provide a small percentage of the total capital of the fund



- » Institutional and individual investors will be **limited partners (LPs)** in the fund
  - Silent partner, liability is limited to the amount of their investment in the fund



- » A fund might typically have a life of 10 years
  - As much as two years might be spent raising the fund
  - An investment portfolio will be assembled, with each investment requiring its own structuring
  - The GPs will monitor/manage the investments with an eye to eventually “exiting” them via an M&A deal or IPO
  - While one fund is still in existence, another one might be raised



- » The GPs will receive both a management fee and a “carried interest”
  - Annual management fees run 1%-to-2% in most cases (of funds invested)
  - GPs typically receive 20% of the profits of the fund

# Private Equity Market Structure – PE vs. Public Equity

Private Equity vs. Public Equity: It depends on whose perspective



From the point of view of the  
**investors**

- Much less liquid—effectively no liquidity
- Costlier in terms of investment expenses
- A blind trust – picking an intermediary who will then pick investments
- Higher risk and higher reward



From the point of view of the  
**intermediary**

- The due diligence process is much more challenging
- The investment requires a “hands-on” approach
- As in the case of the ultimate investor, there is less liquidity
- The fees are very attractive



From the point of view of the  
**issuer**

- The cost of equity is higher
- There are only a few outside investors, not thousands of them
- You get to choose who will invest in your company
- You gain the value of the expertise of your investors

# Private Equity Value Creation Levers

## Financial Engineering ( $\beta$ )

Impact of Leverage

Multiple Expansion

Contractual Rights

- Leverage needs to be handled with care during times of economic volatility in order to maintain a robust balance sheet
- Multiple expansion is usually unpredictable
- Enforcement of contractual rights is difficult

Beta opportunities are very limited on competitive and volatile markets like Turkey

## Real Value-Add ( $\alpha$ )

Hands-on Management

Top-Line Growth

EBITDA Improvement

- Understand sector and the company
- Identify potential and risks comprehensively
- Deal structuring
- Multiple expansion through value creation

Different forms of Value Creation is available throughout all stages of the investment life cycle



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# Sources of Private Sector Financing

## Internal Sources

### Shareholders' Equity

- » Companies usually established with limited equity
- » Capital accumulation is low

**TRY 316k**

The average paid-in capital of newly established companies in 2018

### Internal Cash Generation

- » EBITDA / Cash conversion ratios in most sectors are poor mainly due to low margin business and working capital need
- » Lack of operationally sound business models and strategies to sustain profitable growth
- » Carrying forex risk on their balance sheets in terms of loans, trade payables, etc.

» **Internal and external sources are inadequate to finance the desired growth for private companies in Turkey - Private Equity is a viable financing alternative**

## External Sources

### Loans

Turkish banks are reluctant to provide long-term loans with favorable conditions to finance investments for growth, although short term working capital loans are available  
 → Tangible collateral requirement  
 → Non-recourse loans not available

**TRY 472bn**

Total SME Loans as of 2018

**20%**

The ratio of SME Loans to total loans as of 2018

### Capital Markets

- » BIST has high quotation standards for most SMEs. In addition, 17 SMEs trade on the newly established BIST Emerging Companies Market platform
- » IPO market has lost its appetite for mid market listings

**414**

**Companies**

# of listed companies in BIST National Market (397) and Emerging Companies Platform (17) as of Dec 2018

**74**

**Companies**

The number of publicly traded companies among the top 1,000 Turkish companies according to ICI

### Corporate Bonds

- » Limited but growing corporate bond market is emerging
- » Short-term structure
- » Costly than T-bill

**252 Issuances**

**(TL 18.1bn)**

# of non-financial corporate bond issuances between 2012-2016

### Mezzanine

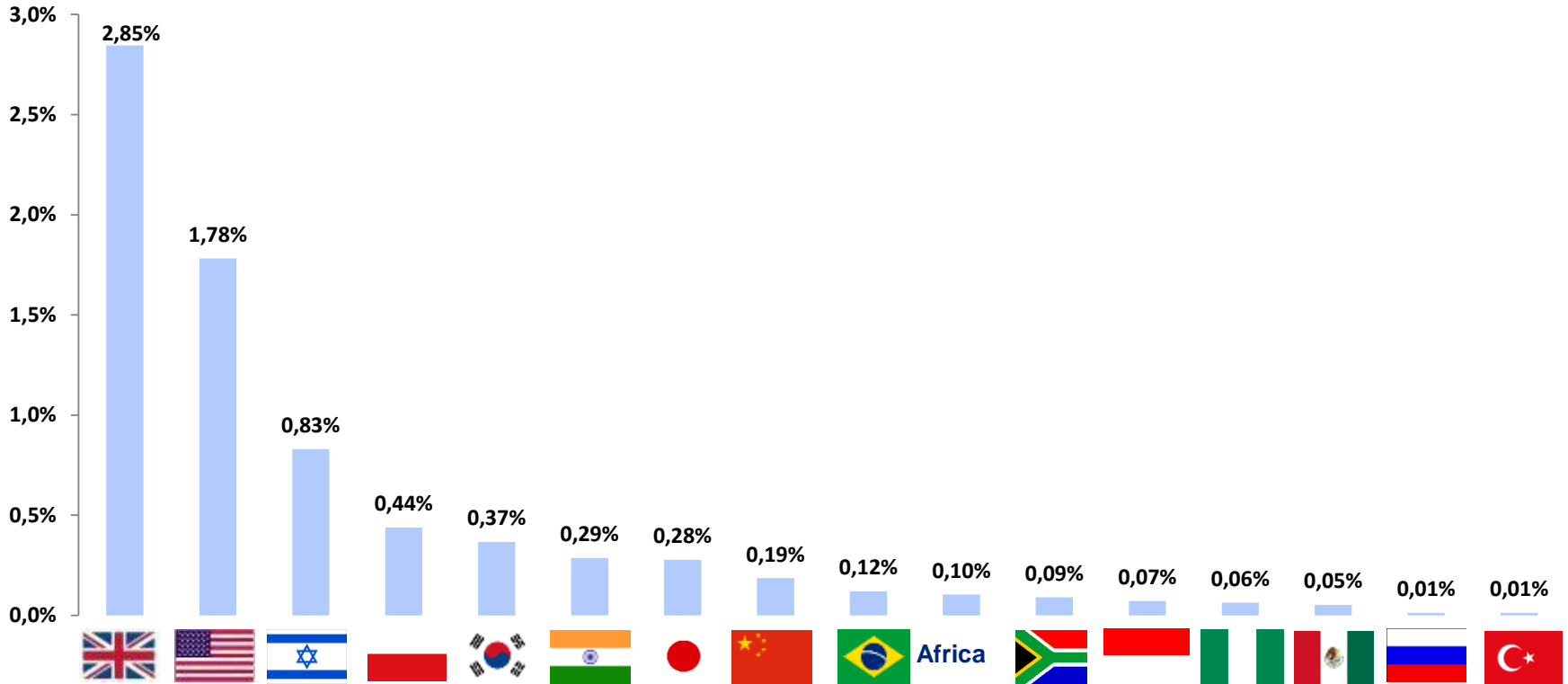
- » Similar to senior loan with collateral
- » Distressed companies
- » Bridge financing
- » Growth financing for companies which are not eligible for (further) senior loans >>>> the growth should be high enough to absorb the cost of mezzanine

**25+ Deals**

# of Mezzanine deals completed in Turkey

# PE/VC Activity in Turkey

## Share of PE Investments in GDP (2017) - Comparison Across Countries



**PE penetration in Turkey remains relatively very low**

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# Local Challenges for PE Funds in Turkey

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- » **Accessing Proprietary Deal Flow**
  - Foreign funds' need to utilize intermediaries to generate deal flow → creates an “auction” environment, high competition resulting in increase in entry prices and less proper due diligence process
- » **Completion / Execution Risk**
  - Lack of local know-how and presence → Lack of understanding of market dynamics, target companies' value propositions and shareholder expectations
- » **Determining Past Performance of Companies – Due Diligence / Industry Information**
  - Macroeconomic history of high inflation, fluctuating FX rates and volatility
  - Lack of accounting and IT infrastructure
  - Inadequate or inconsistent industry data; immature market research and intelligence industry
- » **Business Culture / Corporate Governance and Transparency**
  - Family owned companies reluctant to have an outside shareholder – Has been changing since 2001 crisis
  - Minority/Majority issues
  - Complicated shareholding structures, hard to identify “related-parties”
- » **Human Capital / Management Recruiting and Retaining**
  - Scarcity of result-oriented management talent that can deliver PE expectations
  - Management backgrounds relatively difficult to reference
  - Difficult to find qualified mid-level managers
- » **Legal Environment / Market Regulation**
  - Restructuring the companies (recently updated regulation)
  - Competition Authority Issues
  - Necessity for complicated shareholding agreements
- » **Availability of Multiple Exit Options**
  - Volatility of ISE
  - Access to the right buyer
  - Acquisition financing has only been available recently

# Valuation

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## Valuing a Business

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graph TD; A[Valuing a Business] --> B[Asset Based Approach]; A --> C[Market Based Approach]; A --> D[Earning Based Approach];
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### Asset Based Approach

- The most rudimentary method for valuation
- It may not adequately take into consideration the intangibles, especially in asset light businesses

### Market Based Approach

- Public Company Comparables
  - based on the market trading multiples of comparable companies
- Precedent Transactions
  - Based on earnings multiples paid for comparable companies in recent transactions

### Earning Based Approach

- Present value of forecasted future free cash flows
- Captures the intrinsic value of the business