FUND LAUNCHED	FUNDS UNDER MANAGEMENT	NET ASSET VALUE PER SHARE
2005	**£521.0** MILLION	**365.3%** SINCE INCEPTION*

UTILICO Emerging Markets Trust plc

Turkish elections in May – a turning point for the economy and Turkish equities?

March 2023

Türkiye is currently experiencing one of its most significant humanitarian crises in this century. With over 50,000 casualties and over 26 million people directly affected in the region[(1)], the earthquake's immense human tragedy and economic damage have put the timing and outcome of the simultaneous presidential and parliamentary elections currently scheduled for May 14 into question. Given the stark contrast between the ruling "Justice and Development" (AKP) party and the opposition, these elections could prove pivotal for Türkiye's political and economic path for the next five years and beyond. We at Utilico Emerging Markets Trust plc ("UEM") have been watching the local developments closely and see a range of opportunities in Türkiye's listed utilities, telecoms and transport infrastructure companies.

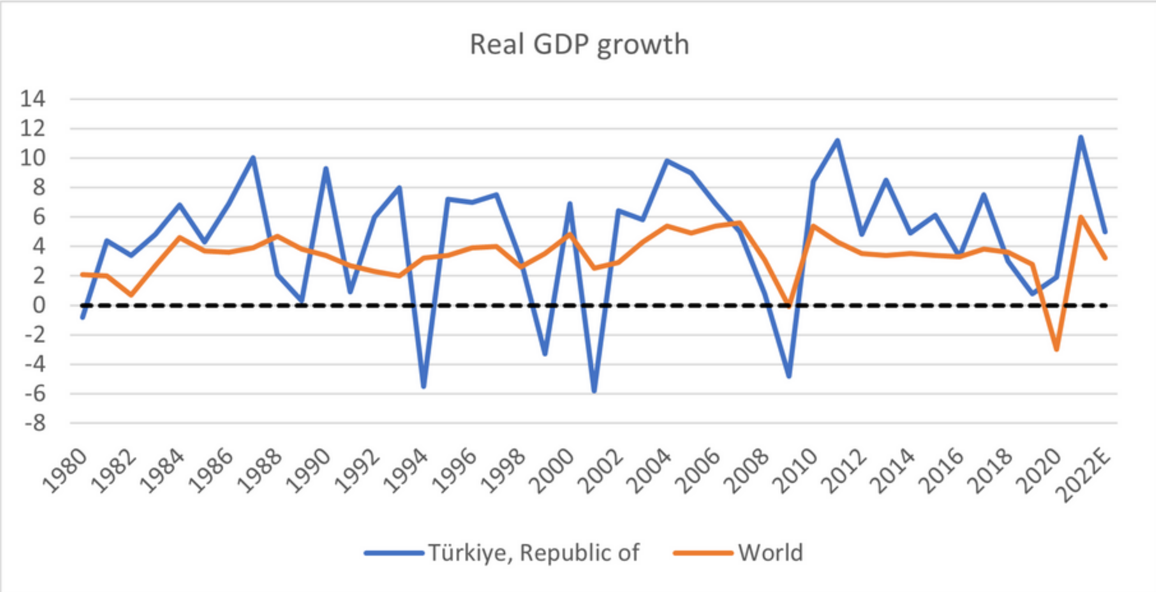
Kahramanmaras earthquake economic impact

It is still too early to assess the true extent of the earthquake disaster, but the World Bank estimates that the direct damage was $34bn, 3.8% of GDP. The recovery efforts will likely lead to a surge in government spending and investments in infrastructure in the short-term, offsetting some of the economic losses and helping GDP growth remaining positive in 2023. Looking at the longer term, the country benefits from several structural drivers such as a growing young population, nearshoring activities that lead to growing export-led industries and a strong tourism sector. This is continuously driving growing energy consumption, cargo and passenger traffic and telecom infrastructure networks. Yet the Turkish government's economic policies in the last two decades have been very volatile and often contradictory, leading to mixed macro performance.

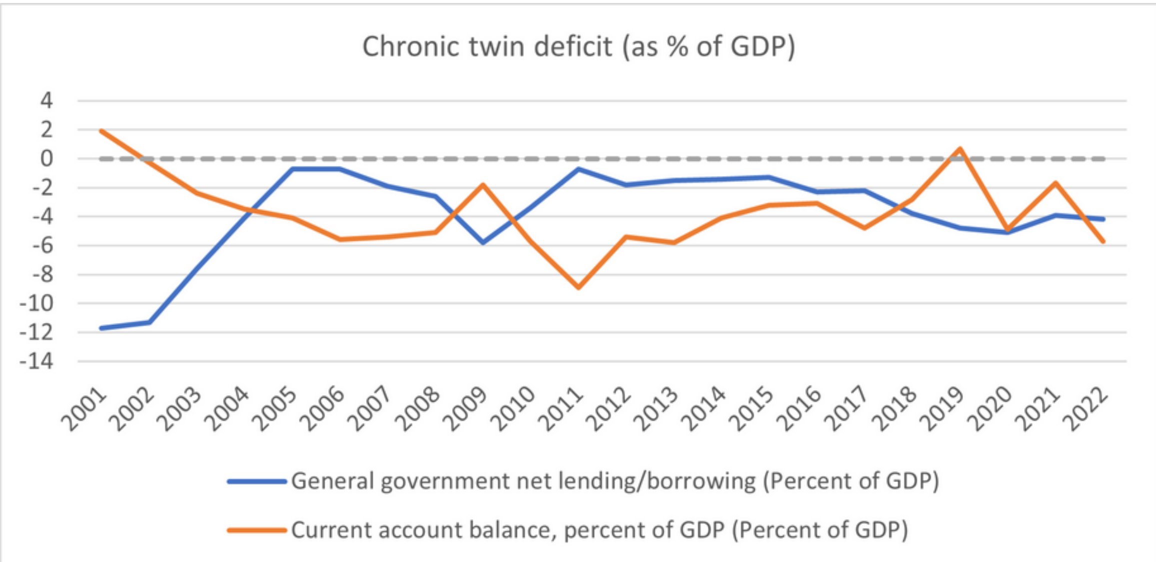
Government policy exacerbates economic imbalances

President Erdogan first assumed leadership of the country as prime minister in 2003 after his party, AKP, won the 2002 general election on a reformist agenda following the 2001 Turkish economic crisis. His government's policies of fiscal prudence, privatisation and anchoring inflation expectations[(2)] helped the economy achieve real GDP growth of 5.9% per year over the period 2002-2015,[(3)] which put Türkiye among the fastest growing economies in the world. However, its heavy reliance on foreign direct investment and a chronic twin deficit makes its economy and currency particularly vulnerable to external shocks.

The civil war in Syria and the subsequent influx of over three million refugees during the period 2012-2018 provided an economic boost, as well as being a contributing factor to inflation and higher rates of unemployment. Then in 2016 the failed coup d'état against the government became a catalyst for profound changes in the system of government. In 2017, a national referendum narrowly approved the country's switch from a parliamentary democracy to a presidential one. In June 2018, President Erdogan was re-elected, and he issued a series of presidential decrees that further centralised presidential rule, leading to increased opposition and increased tensions with the EU. The government's unorthodox economic policies and interventionist approach has continued to exacerbate Türkiye's macroeconomic imbalances and has become a central issue for the 2023 elections and for foreign investors.



Source: IMF, Real GDP growth 1980-2022E(4)

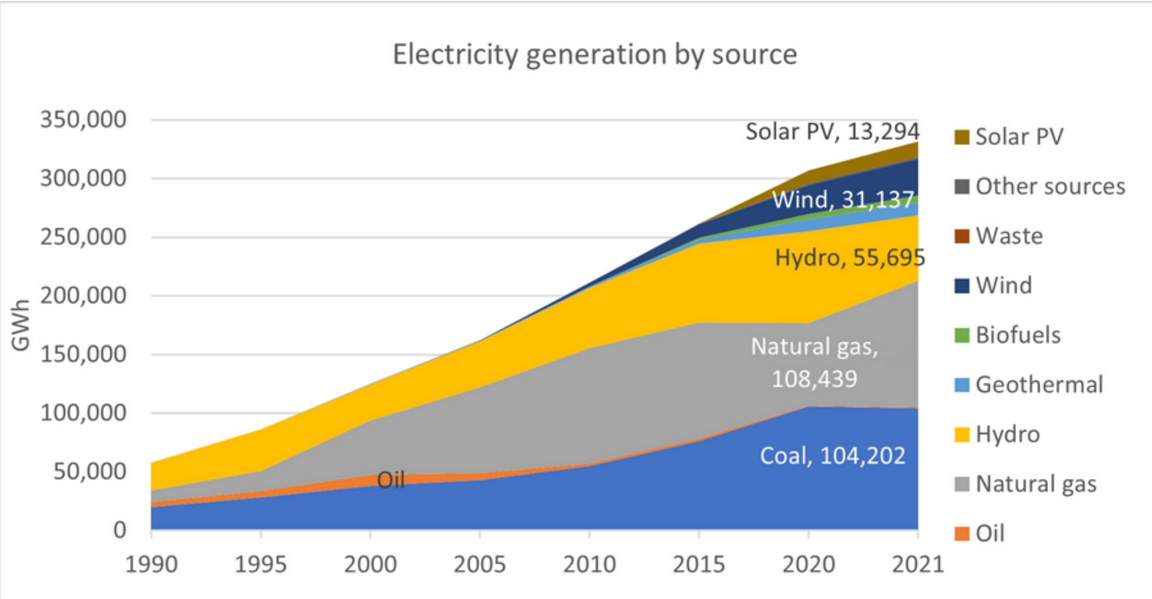


Source: IMF, Budget and current account deficit of Turkey 2001-2022E(5)

Growing energy needs and a budding renewables sector

The country's power demand has grown at 5.8% CAGR since 1990[6] – one of the highest among OECD members - and continues to be driven by the expansion of the economy, a growing export-led manufacturing sector and continuous population growth. This is a trend we expect to continue in the near term thanks to these structural growth drivers and should act as a tailwind for power generation and distribution companies. There are 23 power generation companies listed on the Borsa Istanbul (BIST) and 3 distribution companies.

In addition, Türkiye's renewables sector, excluding its conventional hydroelectric plants, remains small at 19% of the energy matrix[7] – behind most of its EU-based Mediterranean peers. Both solar and wind remain relatively unexploited despite the country's comparative advantage in solar irradiation and wind resources. A number of policy changes are still needed to enable faster development of this sector, but capacity is already growing at astonishing rates. This will help Türkiye meet its UN commitments on climate change and reduce its high dependency on imported coal and gas. Besides benefitting quality renewables operators, this will also lead to increases in transmission capacity. We expect the government to privatise TEAIS – the national electricity transmission company – in 2023 or 2024.

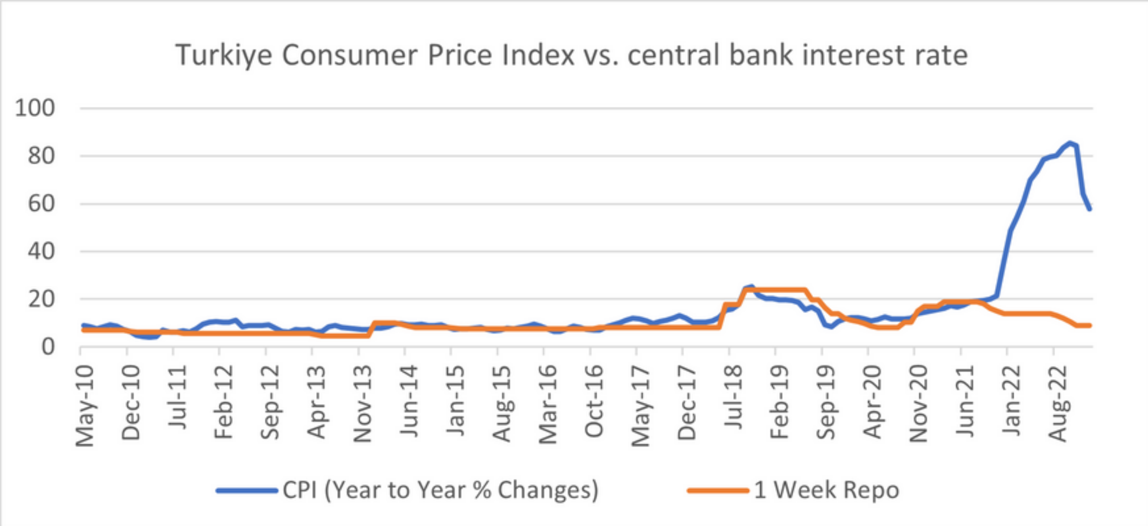


Source: IEA - Electricity generation by source (2023)

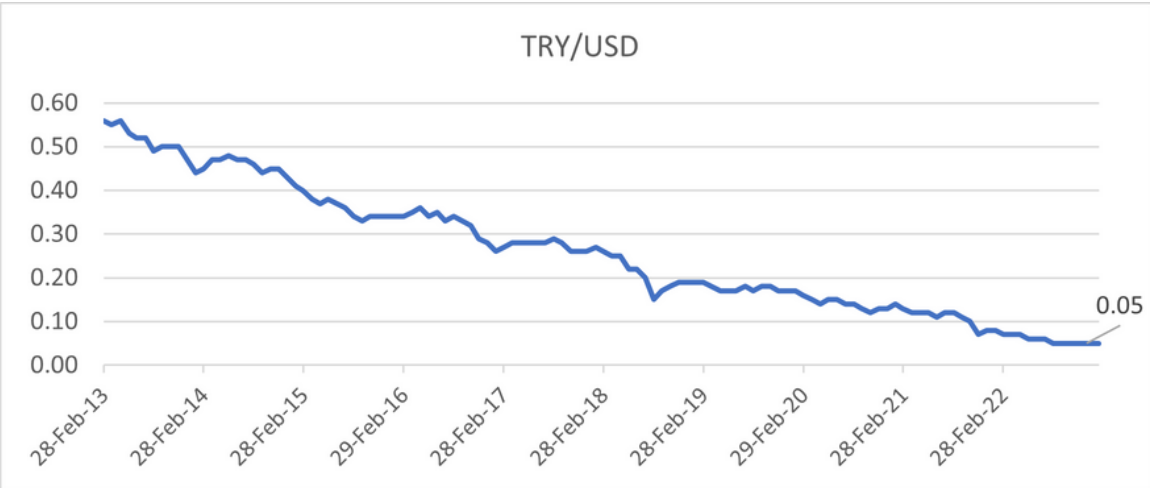
The inflation genie is out of the bottle, impacting all sectors

By 2018 the economy was showing signs of overheating and the need for monetary intervention increased. Initial steps by the central bank to contain inflation via interest rate hikes was successful, but they quickly contradicted the government's expansionary economic policy and were eventually overturned. As a result, in the last four years the Turkish central bank had four different governors who have failed to contain inflation and the rapid devaluation of the lira. Under pressure from the government[8], the central bank has maintained a course of low interest rates, despite rising inflation, which has resulted in persistently large negative real rates.

The situation was further exacerbated by the spike in energy prices following the war in Ukraine and the supply-side shocks from the post-pandemic global reopening. The lack of central bank independence and the government's prioritisation of employment over inflation was a significant contributor to the further devaluation of the currency and inflation peaking at 84% in November 2022[9].



Source: Consumer price index and 1 week repo 2010-2022 (Turkiye Cumhuriyet Merkez Bankasi)[10]

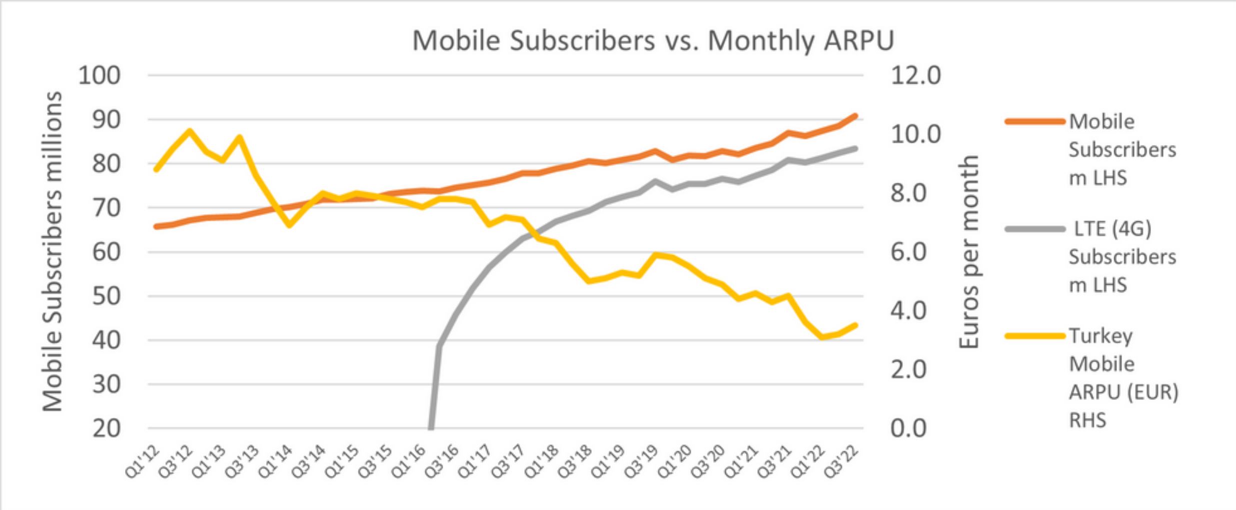


Source: TRY/USD exchange rate (Factset, 2023)

Telecoms fail to maintain pricing

After years of rapid development, the Turkish telecoms market is now relatively mature with 107% mobile penetration and 90.8m subscribers[11]. It is also highly competitive with three major telecom players (two listed) and the lowest average revenues per user (ARPU) in Europe at just €3.5 per month. Despite large network capex and big improvements in quality, due to the inflationary environment none of the major telecom players have managed to maintain their pricing in hard currency terms, which has impacted their margins in recent years. A normalisation of the inflationary environment will therefore act as a catalyst for the recovery of mobile tariffs and will significantly boost profitability.

Separately, the fixed broadband sector is far less developed with just 22.2% penetration and 11.3m subscribers[12]. The major players have now shifted away from copper and into fibre rollouts and fibre subscribers are now 5.5 million, growing at 19.5% YoY in 3Q22[13]. This segment will continue to be a source of organic growth for the telecom players in the foreseeable future.

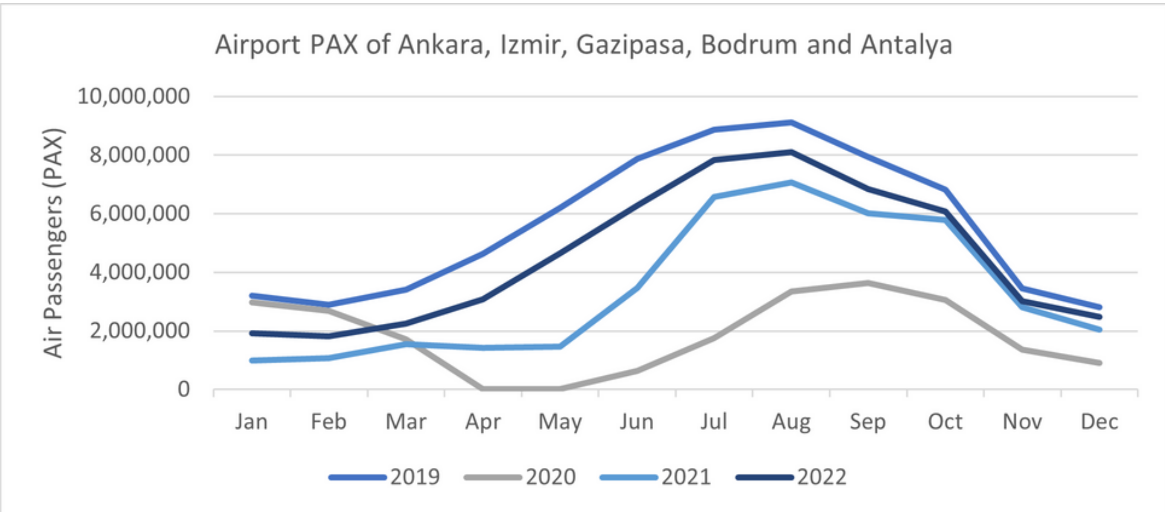


Source: Mobile subscribers and ARPU (ICTA, 2023)

Tourism has recovered to pre-pandemic levels

Türkiye is a major global tourist destination and the 4th most visited country in the world. As such tourism is an important component of the economy, contributing 11% of GDP[14] and acts as a major source of foreign currency.

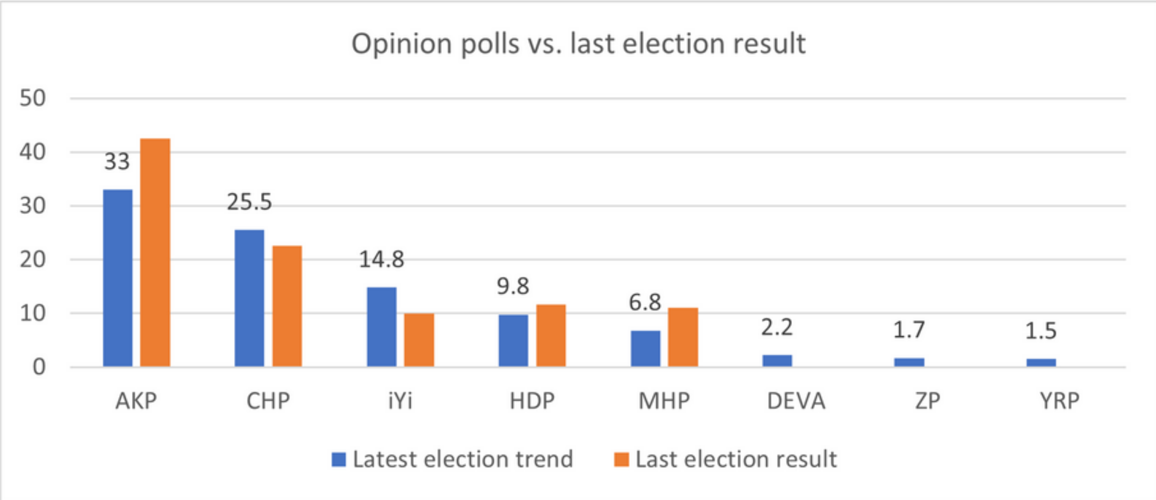
The COVID pandemic in 2020 hit air travel across the globe and recovery has been gradual since then. By the end of December 2022, airport passenger numbers (PAX) in Türkiye had almost fully recovered to 2019 levels. We expect this trend to continue in the near-term, notwithstanding the effects of the earthquake which has impacted the southern part of the country.



Source: Passenger numbers for TAV Airport's Turkish airports under operation

The stakes at the elections

Opinion polls on the Turkish presidential and general elections suggest a very tight race between President Erdogan's AKP and the opposition parties. The centre-right coalition of 6 opposition parties, led by the Kemalist CHP (Republican People's Party), advocate for a return of the parliamentary system, a complete turnaround on monetary policy to reduce inflation and increased personal freedoms[15]. Such measures are likely to be perceived well by market participants and can provide some support to the Turkish lira and the local stock market. However, the most challenging task for the opposition is to propose a joint presidential candidate, which has not happened yet due to inter-party disagreements. In addition, due to the humanitarian crisis there is also a slim probability that the elections may be postponed for later in the year.

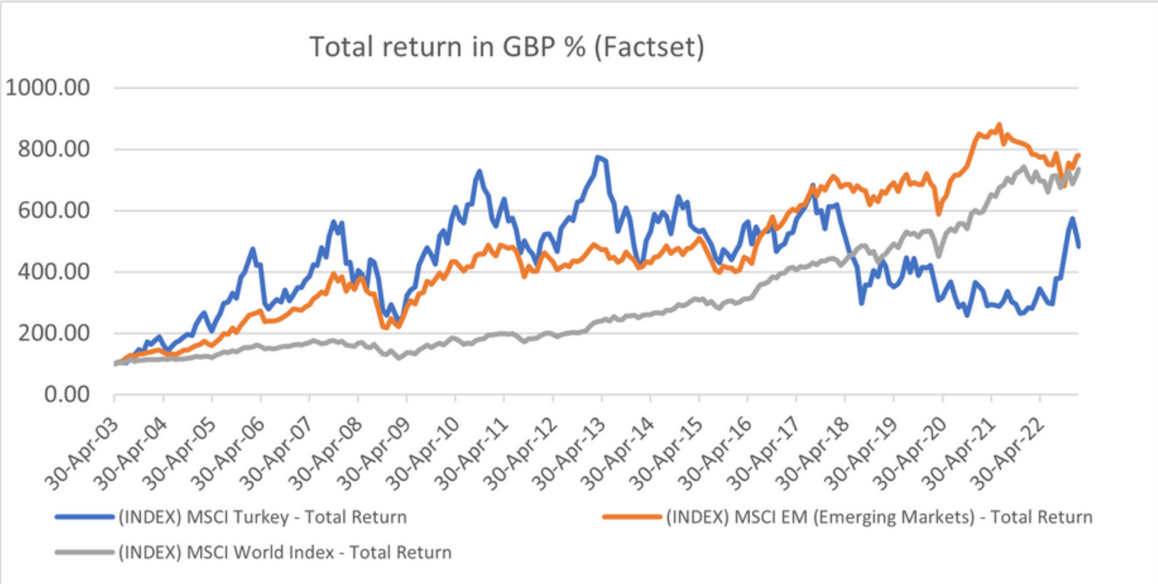


Source: Opinion polls on Türkiye's parliamentary elections in 2023[16]

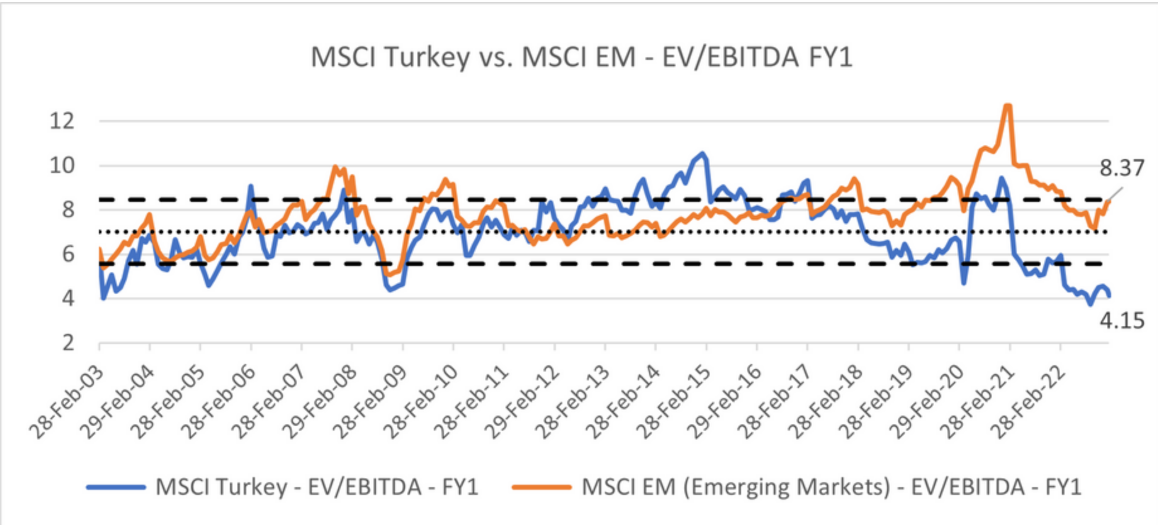
The markets will be watching closely

Over the last four years the Turkish equities market suffered low interest from investors and foreign investment outflows that reached $-0.60bn in 2022[17]. The local stock market underperformed both the global markets and the MSCI Emerging Markets index since 2017 and its relative discount has continued to grow. After a brief retail investor-led rally in H2 of 2022, which more than doubled the value of the local index (BIST Istanbul), the Turkish market resumed its decline to record-low valuations and today it trades at over 50% discount to the wider MSCI Emerging Markets index on forward EV/EBITDA multiples. This contrasts with the generally stable free cash flows and healthy balance sheets of Turkish corporates within our investment universe. A potential change in government policy or the composition of the parliament can therefore lead to a dramatic recovery of investor sentiment towards Türkiye and a substantial re-rating of the market.

UEM's sole investment in Türkiye today is TAV Airports, the country's biggest airport operator with a presence in multiple countries. Despite the lira's depreciation, the company has enjoyed a strong performance due to its foreign currency-based revenues and the gradual resumption of air travel. As one of the world's biggest holiday destinations, Türkiye's economy is highly linked to the recovery of global tourism and TAV Airports will be a prime benefiter of this trend. Meanwhile, UEM will continue to monitor the political developments in Türkiye and maintains its strategy of identifying potential value opportunities among Türkiye's infrastructure, utilities and telecoms sectors.



Source Total return of MSCI Turkey, MSCI EM and MSCI World (Factset)



Source EV/EBITDA FY1 of MSCI Turkey and MSCI EM (Factset)

George Velikov
7 March, 2023

Source Data: ICM, Factset, Bloomberg, IMF, World Bank as of 28 February 2023.

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[17] ING. (2023). Turkey: 12M rolling current account deficit highest since 2018. Retrieved from https://think.ing.com/snaps/turkey-12m-rolling-current-account-deficit-highest-since-2018/

*Total return is calculated based on undiluted Net Asset Value, plus dividends reinvested and adjusted for the exercise of warrants and subscription shares