CASE 5

Probil IPO: Maximising the Value of an Exit Strategy

DESCRIPTION

The case presents the initial public offering of shares by a rapidly growing IT firm in Turkey. Students are asked to evaluate the attractiveness of investing in the company's shares from the investors' perspective. The case introduces the application of Monte Carlo simulation in investment and financing decisions of a firm.

LEARNING OBJECTIVE

To understand issues in going public in a volatile market and advanced valuation concepts.

SUBJECTS COVERED

Financial Management, IPOs, Valuation

☞ This case was written by Fabian Barros, Marcelo Bermudez, Chris Rowell, Mari Subburathinam, Alexandre Wolynec, and Campbell Harvey under the supervision of Prof Campbell Harvey, Fuqua School of Business, Duke University, USA, as the basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation.

INTRODUCTION

Kagan Ceran pushed back his chair and stared out the window of his Istanbul office. It was early February 2001 and the ever-growing skyline silhouetted against darkening clouds seemed annoyingly metaphoric given the business environment he currently found himself in. The supposedly high-flying young venture capitalist felt anything but self-satisfied at the moment. In fact, he was positively weighed down by the possibility of a major investment falling short of expectations.

A year earlier, Kagan had left the security of a large international asset-management firm in London to start his own emerging markets investment vehicle, EMEA Technology Investments or ETI,[1] initially focusing on investments in Turkey and the surrounding region. He felt his approach was unique and well suited to his chosen markets. Rather than raise money based on track record, he had incubated a number of promising companies to the point of initial funding and launched his fund based on investors' preference for concrete projects rather than investment concepts. His style was very proactive and hands-on. He used his cross-border knowledge to spot business opportunities. He then developed business plans, identified suitable existing companies in which he could implement them, recruited any management talent that might be missing, and played an active role in operations.

He viewed Probil his most successful investment to date. Probil was now the largest independent multi-vendor systems integrator in Turkey. With $12 million in the bank and the need to maximise investor returns over the next three years, Probil was currently making key business and financing decisions. As Kagan saw it, to accelerate growth, he could acquire a local distributor or an Internet professional services firm in the US or the EU. In either case, he would need more cash to grow the current business, make strategic investments and still retain a significant buffer against potential fluctuations in the Turkish market. He had originally planned an IPO of shares (on the Istanbul Stock Exchange) for Probil to raise the needed cash. He still thought this was the best alternative although market volatility meant he would have to time the IPO just right. In addition, a private equity investor had recently indicated interest in investing in Probil providing a new option.

The company's board meeting was less than a month away and Kagan needed to convince the management of the right strategy for raising cash to grow the company and maximise his investors' return.

ABOUT TURKEY[2]

In 1923, General Mustafa Kemal (later known as "Ataturk") founded modern Turkey, establishing a secular government and trying to orient business and politics towards the western European way of thinking. With a population of 63 million and a GDP of US$200 billion in 1999, Turkey had been a democratic country since multiparty democracy was instituted in 1945, interrupted only

[1]EMEA Technology Investment, a venture capital fund co-managed by EFG Hermes—the leading Middle Eastern Investment Bank with over $2 billion (USD) in private equity investments throughout the region.

[2] Information for this section was drawn from "EIU Country Profile: Turkey, 04 August 2000" and "EIU County Finance: Turkey, 31 January 2000".

by three brief periods of military rule (1960–61, 1971–73 and 1980–83). The multiparty system made it difficult for any single party to win a majority during elections, resulting in weak coalition governments unable or unwilling to implement necessary but painful structural reforms. In 1980, after serious political violence that claimed 5000 lives, the military took over and restored law and order by curtailing civil rights and instituting economic reforms that reduced inflation and the trade deficit, and fuelled economic growth. In 1983, the military regime returned control of Turkey to a democratic government. Political stability eluded the governments that followed, which applied loose fiscal policies resulting in a boom-and-bust pattern of economic growth.

A decade later, Turkey reached an agreement with the European Union (EU) on the terms of a customs union that went into effect from January 1, 1996. Relations with the EU and Greece improved further as a result of the help provided by them to Turkey after a disastrous earthquake on August 17, 1999. This was a crucial turning point and the EU declared Turkey an accession candidate.

Economic Structure and Policy

Throughout the 1980s and 1990s, the Turkish economy was notorious for persistently high levels of inflation. This made business planning and accounting difficult, discouraged long-term saving and lending, leading to high real interest rates and tended to weaken the currency. One of the primary causes of the high rate of consumer price inflation was Turkey's persistently high public sector borrowing requirement (PSBR), which increased the cost of servicing the public debt and crowded out lending to productive sectors of the real economy.

Between 1982 and 1987, a comparatively low rate of depreciation against major currencies led to an increasing overvaluation of the Turkish lira. The lira stabilised during the period 1988–92, but a heavy inflow of speculative funds in 1993 attracted by high real interest rates and a booming stock market (the index rose by over 200% in US dollar terms in the year) contributed to a further real appreciation of the lira. This, combined with strong growth in domestic demand for imports, drove the current account from being approximately in balance in 1991 to a deficit of US$6.4 billion, or 3.5% of GDP, in 1993.

The crisis came to a head in the beginning of 1994, as the investor confidence in Turkey weakened sharply. In January 1994, two US-based rating agencies reduced Turkey's credit rating of sovereign debt to sub-investment grade, triggering a rapid depreciation in the value of the lira, which fell by almost 35% against the dollar in the first quarter of the year. In response, the government announced a package of emergency stabilisation measures and passed a comprehensive privatisation law. The government followed up its emergency package with a US$742 m borrowing from the IMF to reduce the inflation rate, then around 107%, to balance the current account in 1994 and 1995, and to reduce PSBR. But the framework of that April 1994 austerity program gradually disintegrated during the months following the September 1995 government crisis. The government started spending its way into the December 1995 election, causing the IMF to suspend the last tranche of its July 1994 standby agreement. The economy remained rudderless due to unstable governments during 1996–99.

In 1999, Turkey again reached an agreement with the IMF for US$4 billion of standby facility to tackle the high double-digit inflation. In December 2000, the IMF increased its support for the Turkish stabilisation programme by extending a US$7.5 billion supplemental reserve facility (SRF) in addition to the three-year US$4 billion standby facility agreed in December 1999. The extra facility became necessary when US$6 billion–7 billion worth of foreign currency fled Turkey amid financial market turmoil in late November–early December 2000. The SRF provided the Central Bank of Turkey with a cushion of reserves with which to defend the preordained rate of depreciation of the Turkish lira—a vital ingredient of the anti-inflation strategy. Also, on December 21, 2000, the World Bank approved a US$5 billion three-year Country Assistance Strategy for Turkey.

Through fiscal tightening and modifications to the exchange rate, Turkey began to reduce inflation from the annual average of 80 per cent during the second half of the 1990s. The Government had set an inflation target of 25% for 2000 and 12–15% for 2001. Preliminary estimates in January 2001 indicated the actual inflation to be around 39% for 2000. By the end of 2000, Turkey's sovereign debt rating as rated by S&P and Moody's was B and B1, respectively, and 46.8 as rated by the International Investor. Exhibit 4 presents Turkey's credit rating provided by International Country Risk Guide.

COMPANY DESCRIPTION

Founded in 1989, the Probil Group was the largest and best-known independent multi-vendor provider of information and communication technology (ICT) solutions in Turkey. The Probil Group consisted of three companies—Probil provided computer hardware and implementation services; ProNetwork provided networking hardware, implementation and design services; and ProServis provided maintenance and support services. The Probil Group companies were tightly integrated with headquarters co-located in Istanbul, Turkey. By June of 2000, Probil employed approximately 280 people in six cities around the country.

Probil had always been regarded by the Turkish business community as an innovator and technology leader. Probil's claims to fame stemmed from its following achievements:

- 1991: First LAN to HOST connectivity
- 1992: First fully integrated PC automation system (PCs replaced "dumb terminals") in the financial sector
- 1994: First Windows NT project
- 1995: First Windows NT WAN application with 1500 users (first in Europe)
- 1999: First private WAN with 155 Mbps connection and first wide area multi-point video conferencing implementation

Probil had also established a strong reputation for quality through the success of its many projects and had won several vendor awards such as "Digital, Reseller of the Year Award" (1996 and 1997), "Microsoft BackOffice Reseller of the Year Award" (1995 through 1999), "Cisco, Customer Satisfaction Award" (1998), and "Cisco, EMEA Reseller of the Year Award" (1999).

Partners

Probil had long established re-seller relationships with companies like Cisco, Nortel, Lucent, HP, Compaq, IBM and Microsoft. In contrast to most other companies in the market, Probil had been able to use its independence and size to establish re-seller relationships with multiple competing vendors (e.g. Cisco and Nortel Networks). This was particularly significant because typically re-sellers were able to contract with only one vendor in Turkey. For example, they would sell IBM but not HP or they would sell Lucent but not Nortel. Probil's position as a multi-vendor provider was relatively unique and complemented by the fact that Probil was privately owned and not owned by one of the holding groups that dominated Turkish business.

In addition to its relationships with hardware and networking vendors, Probil had recently formed a partnership with Siebel to sell and implement Siebel's CRM and other software. Probil planned to establish more such partnerships in the near future.

Customers

Probil was an expert in providing and implementing core information technology (IT) infrastructure for customers and had strong relationships with industry-leading companies, particularly in the banking and telecommunications industries. All the top banks, GSM operators and ISPs were Probil's customers. Exhibit 3 presents a sample of Probil's customer base.

Probil was creating new business by convincing these major companies to move to Web-based systems and then selling new IT infrastructures capable of handling high volumes of Internet traffic. These customers then had the infrastructure to support Web-based business and needed direction on how to most effectively move to the new Internet environment and generate revenues. They were asking Probil for help there too. Probil saw that the IT sector growth was accelerating and wanted to position itself to take advantage of that growth.

Exhibits 1 and 2 present Probil's financial statements.

IT MARKET[3]

The Turkish IT sector grew 28.4% from 1995 to 1999, which was 9 times the corresponding GDP growth during the same period. Since 1987—with the exception of 1994, when the Turkish economy went through a major currency crisis and a GDP contraction of 5.0%—the IT sector had registered double-digit growth rates.

The total size of the IT market was US$ 1.8 billion in 1999, or 1.0% of GDP, according to the International Data Corporation (IDC). In 1997, the hardware arm of Turkey's IT sector accounted for 0.45% of GDP (compared to 2.49% in EU and 2.78% in the OECD), while services and software accounted for only 0.29% of GDP (compared to 0.98% in the EU and 1.30% in the OECD). Turkey's IT hardware sector was relatively less underdeveloped than services and software. The distribution of IT revenues at the end of 1999 was: hardware 68%, services 17%, software 12% and supplies 3%. This was consistent with the higher growth in the software and services segments of the Turkish IT sector. This pattern of high development rates reflected that the sector was also highly sensitive to

[3] This section is based on Finansinvest's research report on Arena, a Turkish IT distributor, by Serhan Gok dated 22 January 2001.

prices and the underlying economic growth. A regression analysis suggested that the combined effect of per cent changes in GDP and real exchange rates explained together on average 72% of the per centage growth in the overall sector.

IT BUSINESS ENVIRONMENT AND COMPETITION

One feature of the Turkish economy was the preponderance of holding companies. These companies typically owned a wide variety of businesses and were the large players in Turkey. For example, a holding company might own businesses in textiles, manufacturing, transportation, export/import, banking, leasing, real estate, retail and information technology services to name a few. Each of the subsidiary companies had an advantage in that essentially it had the right of first refusal with its siblings. For example, KoçSistem, a Probil competitor, was a subsidiary of one of the largest holding groups in Turkey and had an automatic advantage in bidding for IT projects for other Koç group companies such as banks. However, KoçSistem was also at a disadvantage when trying to do business with a different group when compared to that group's IT subsidiary (if any) or an independent company. Probil, as an independent company, could do business in the entire market.

Another significant feature of the IT business landscape was that typically hardware re-sellers did not sell competing products. For example, if they sold Cisco equipment, they would not sell equipment from Nortel Networks. Finally, the manufacturers themselves had significant presence in Turkey. IBM, HP, Compaq and Siemens were strong contenders although IBM was very open to sharing opportunities as long as IBM equipment was used.

EMEA'S INVESTMENT IN PROBIL

In 1998, Kagan had approached Turgut Gursoy, co-founder and co-owner of the Probil Group, to discuss investment opportunities. Turgut had co-founded the Probil Group over a decade earlier and had created a company that was well respected in the business and workforce community. From Kagan's point of view, what was unique at Probil was Turgut's vision and willingness to adopt new ideas/methods/technologies. For example, Probil had been the first to formalise the maintenance and repair offering, winning customers' loyalty and gratitude.

From his previous experience covering the Turkish, Greek and Israeli IT markets for one of the largest securities companies in the world, Kagan knew that the Turkish IT market was following a path similar to the other two. Greece had an economy that was 2/3rd the size of Turkey, yet there were a large number of listed IT companies valued at high valuation multiples on the Athens Stock Exchange. Israel was in a unique situation due to the highly skilled human resources it had been able to attract from the US, Europe, and the former Soviet Union. In comparison, Turkey had a large economy and an excellent human resources pool due to the emphasis placed on the educational system by Ataturk during the formation of the republic. Yet, in looking at the IT market, Kagan discovered that other than several medium-sized companies belonging to big groups and multinationals, the sector was extremely fragmented, composed of over 3,000 small enterprises. By providing growth capital, an investor could easily help a company, or group of companies, achieve significant gains in market share.

Kagan saw the explosive growth coming to Turkey and an opportunity to merge Probil with a competitor to create the largest independent, multi-vendor IT solutions company in Turkey. The only issue was to find management that was progressive enough to share such a vision.

In order to take advantage of the opportunities now available and expand much more rapidly, Turgut and the directors of Probil felt Kagan's proposed equity investment represented a good opportunity to accelerate growth and take the company to the forefront of Turkey and beyond. Debt in the Turkish market had been extremely expensive. As with other countries experiencing persistent high rates of inflation, companies could typically only secure debt for short tenors at high cost. As a result, Probil had funded its growth by reinvesting retained earnings. The company had no debt outstanding (although it did use letters of credit for financing hardware resale) and had no outside investors.

An agreement was reached in which the Probil Group companies and Bordata (an IBM equipment distributor and service provider) would merge. Kagan's fund would invest US$ 21 million in the merged entity with $11 m of that going towards acquisition of shares from existing owners and the remaining $10 m going towards acquisition of new shares to infuse cash into the business. By August 2000, the investment and merger were complete, and the fund now owned 51% of the company although the directors of the company held four seats on the Board while the fund held three. The company's new Board of Directors consisted of Turgut Gursoy, founder and CEO, Ozgen Gulmen, founder, Hilmi Gungen, partner, Murat Eroglu, CFO, Kagan Ceran, founder and manager of EMEA Technology Investments, Ken Sawyer, Saints Ventures (a US-based venture capital firm).

DRIVING GROWTH

The challenge was how best to accelerate the company's growth to take advantage of the growing IT sector. Since the Internet-based software market, especially business-to-business, was sure to grow dramatically, they considered reselling business applications (such as Siebel) and offer implementation and support services. This would require building a staff skilled in this technology. Although Probil wanted to go into the IT professional services business (i.e. selling expertise and billing people out by the day as a consulting firm), it did not want to give up the hardware business because there was still a lot of infrastructure to be built in Turkey and the hardware business would open doors to the client. The problem with selling hardware was that they would be selling sophisticated clustered systems at one end and printer cartridges on the other end. As they used the same expensive resources for both the tasks up to 30% of sales had low margin. This had to be rectified and done more efficiently because abandoning it would have resulted in a loss of power with vendors and customers as well as revenues.

The $12 m in the bank would provide some investment opportunity, but money also had to be kept in reserves because of the volatile Turkish market. The original investment had anticipated that an IPO would be necessary to fund the growth plan. In fact, the original investment was intended to allow Probil to position itself in such a way that it achieved maximum valuation during an IPO. In addition, the investors wanted to exit this venture in 5 years (possibly by selling out to a multinational company). So accelerating growth was crucial.

Probil needed to explore its financing options (IPO or private equity) in the context of the current capital markets while simultaneously pursuing growth. They were already in discussion to acquire a US-based Internet-consulting company that could provide needed skill set and position it better for the IPO.

TURKEY'S CAPITAL MARKET[4]

The Istanbul Stock Exchange (ISE) was revamped in 1986 after a comparatively moribund existence over the preceding 60 years. The ISE became very attractive to foreign investors, who had held almost half of its shares over the previous 10 years. Most of these investors were institutions that invested for the medium to long term. Although the stock market was still relatively small, it had grown considerably over the past decade and a half. Average daily trading volumes on the equity markets rose from $3 million in 1989 to around $231 million in 1997, before falling back to $152 million in 1998. However, average daily trading volumes grew steadily through the first 10 months of 1999 to reach $219 million in October, before soaring during an extended bull run to $523 million in November and $959 million in December. During the year 2000, the ISE-National 100 index lost 51% of its value in dollar terms coupled with a steep decrease in average volumes traded. The historical daily volumes and performance of the ISE-National 100 are shown in Exhibit 6.

Capital market reforms passed in 1992 extended the supervisory powers of the regulatory agency (SPK), making its functions comparable to those of the Securities and Exchange Commission in the US. At 2000 year-end, the main market, named "National Market", comprised 312 companies. One hundred of these stocks, representing approximately 85% of the total value of the National Market, made up the ISE National 100 Index. For the year 2000, the National Market reached a total market capitalisation of $50 billion compared to $34 billion at year-end 1998.

During the mid-1990s, the high cost of bank loans, tax incentives and a boom in share prices fueled a rapid increase in the number of companies going public. The number of companies whose shares were traded on the ISE's domestic markets rose from 160 at year-end 1993 to 312 by year-end 2000. However, demand had slackened since 1999 with only 8 entrants that year and 35 in the year 2000. At the end of 2000, the price-earnings ratio at ISE was 6.8, one-quarter of that commanded by companies on the Athens stock exchange and lower than most of the emerging markets exchanges. However, Osman Birsen, the Chairman and CEO of the ISE, had a positive outlook for the market in the coming years:

> "…when we look into the future we see a very positive outlook because our environment is getting better on the domestic side and new listings on the ISE will serve to stabilise the market's volatility. There is also a very strong trust building with foreign investors…they fill the main gap in our market. Unfortunately we don't have enough institutional investors in the domestic market."[5]

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[4] Information for this section was drawn primarily from the Istanbul Stock Exchange website at http://www.ise.org/.

[5] "The Istanbul Stock Exchange: Profitable and Growing", *The Washington Times*, December 5, 2000.

In terms of investors' profile, domestic funds and foreign institutional investors oriented to long-term investments accounted for half the daily volume traded at the ISE while the remaining 50% was made of day traders that provided liquidity to the market.

THE IPO MARKET

After a hot IPO market during 1995–99, evident in an average annual volume of $30 billion in the US alone, demand for IPOs plummeted in the middle of the year 2000 mainly due to the crash of Internet-related stocks. In spite of the poor market conditions worldwide, Turkey maintained an active market during this crisis, helped by a higher concentration in traditional industries. Specifically, the Turkish market had shown an increasing trend in the number and volume of IPOs during the previous four years; the number of companies going public increased from 27 in 1997 to 35 in 2000, with volumes increasing from $65.1 million to $157.5 million in this period. However, the market was extremely sensitive as shown by the volatility of the average daily volumes. In good periods, the market could trade $1.5 billion daily and a typical $40–$50 million IPO would represent a minor share of that period's activity. However, in bad periods, the market might trade only $150 million daily, and an average size IPO would struggle to capture demand. This lack of depth in the Turkish market had forced Turkcell, a leading telecommunications company in the country, to do its $1.8 billion IPO in August 2000 through a local offer jointly with an ADR issue. However, Arena, an IT distributor, went public in November 2000 with a $10 million issue in the local market. Exhibits 7 and 8 show statistics of the Turkish IPO market. Given the high volatility of the market, normally investment banks operated on a best effort basis or under a stand-by underwriting agreement.

There was empirical evidence that Turkish IPOs were, on average, underpriced by 13.1% on the listing day and by an average of 4.7% after 4 weeks.

PROBIL'S COMPARABLES

Despite the low appetite for IPOs, Probil was considering going public to fund expected future growth, acquisitions and market diversification, and to gain visibility within the industry. Probil's management was focused on assessing the real appetite for a potential issue and trying to determine an adequate price for the issue in order to minimise the money "left on the table" but at the same time avoid over-pricing. Kagan believed that in addition to the discounted cash-flow method of valuation, investors assessed the attractiveness of an equity offer using comparable companies. After some research, he put together a short list of comparables from the US and from other similar emerging markets (Exhibits 8 and 9). The analysis of the peer group companies showed a decreasing trend in the average Enterprise Value/EBITDA ratio, and it was expected to drop from 9.78 in 2000 to 7.92 in 2001 with a growth of 15% in the US market compared to 25% in Turkey. Following the same pattern, the average peer group P/E ratio also showed a downward trend and was expected to drop from 17.9 in 2000 to 15.4 in 2001.

Financial Projections

The company had performed well in the past and was expected to post strong growth in future. Probil had revenues of $75 million (75%–80% for equipment resale, the remainder for services) in 2000 and had targeted revenues of $95 million–$110 million for 2001. In the process of assessing how much they could get from an IPO and how much the company was worth, Murat Eroglu, the CFO, had prepared some projections of the company's cash flows for the next 10 years. These are shown in Exhibit 10. The expected growth rate was 40% for the next year and 25% during the rest of the 10-year period. Looking at these projections, Kagan recognised that the projections reflected a base case scenario, which did not consider the risks of the industry. The growth rate was the most important variable, and he wondered how a drop in the expected growth rate would affect the base case cash flows. He also knew that sudden exchange rate fluctuations could be a problem since they were reselling imported equipment paid for in US dollars. If the Turkish lira (TL) depreciated, their local TL-denominated fees might be insufficient to pay suppliers in US dollars. In order to reduce the exposure, Probil had recently agreed with its suppliers to share the currency risk. In addition, Probil's customers paid on a net-30 basis, whereas Probil paid vendors on a net-45 or net-60 basis.

The next step was to value Probil based on an appropriate discount rate. In valuation the company faced several issues: (1) Should the rate reflect the company's specific risks? (2) Was there any other way to take volatility into account? (3) Where should country risk be included, if at all?

Probil had no debt and was not planning to take any in the near future. This reduced the exercise to estimation of a suitable cost of equity for Probil.

Exhibit 11 presents data on risk-free rates and country premiums for Turkey.

Stock market analysts and investors valued an IPO based on the EV/EBITDA multiple although DCF was also used.

Probil was planning to offer 25% of the company in the IPO, and in order to maximise the value they would get, they would have to seek the highest possible EV/EBITDA ratio. From his conversations with investment bankers, Kagan knew he could expect an EV/EBITDA ratio of about 15, but could range from 8 to 24.

Alternative Funding

Two months earlier, Kagan had approached another Turkish venture capital fund to jointly acquire a US-based Internet consulting company. The VC had indicated an interest in investing in Probil itself, not just the US company. This offer was not contingent on the US company deal. Kagan realised that it provided an interesting alternative or a complement to the IPO. An equity investment would provide an alternative source of funds to an IPO in a bad Turkish market, but the equity investor would not pay as high an EV/EBITDA multiple as the stock market would. In fact, they were probably looking at an investment of around $7 million at an EV/EBITDA of 10. If Probil decided to accept this investment, it could still do an IPO to sell up to 25% of the company in total.[6]

[6] VC + IPO = 25% of shares

International Expansion

The negotiations for acquiring the US Internet consulting company had progressed well. It looked like a real opportunity and provided many potential benefits for Probil. First, Probil was looking at moving into e-business application implementation, and acquiring the US company could jumpstart the process of building the necessary resources. Second, a presence in the US would raise the image of the company in the Turkish market both while seeking business and at the time of the IPO. Third, the US business could be a hedge if the Turkish market was in recession.

Probil was considering investing up to $5 million in the US company. The company had recorded revenues of $13 million in 2000 and was expected to grow at 15% per year in the following years.

Kagan was confronted with several issues: Would it be a good idea to expand right now or wait for one year? What would be first, the international expansion or the IPO? Should they accept the equity investment from the VC if they were unable to do the IPO soon? If the international expansion preceded the IPO, would it enhance the chances of a successful IPO?

Exhibit 1 Income Statement of Probil for the Year 2000 ($)

A. Gross sales	75,336,542
B. Sales deductions	1,167,738
C. Net sales	74,168,804
D. Cost of sales and services	62,703,470
Gross profit	11,465,334
E. Operating expenses	7,078,959
Operating profit	4,386,375
F. Income from other operations	1,684,802
G. Expenses of other operations	1,348,504
H. Financial expenses	110,579
Ordinary income	4,612,094
I. Extraordinary income	16,925
J. Extraordinary expenses	118,576
Profit for the year	4,510,443
K- Corporation tax	251,942
Net profit for the year	4,258,501

Source: Company

Exhibit 2 Balance Sheet of Probil as on December 31, 2000 ($)

Assets		Liabilities	
I— Current assets	27,381,951	I. Short-term Liabilities	16,261,241
A. Cash and banks	11,297,401	II. Long-term Liabilities	718,822
B. Marketable securities	1,903,898		
C. Trade receivables	7,496,885	III. Shareholder's Equity	14,707, 686
D. Other receivables	203		
E. Inventories	4,599,775		
G. Prepaid expenses and income accruals	498,561		
H. Other current assets	1,585,229		
II — Fixed assets	4,305,799		
TOTAL ASSETS	31,687,750	TOTAL LIABILITIES	31,687,750

Source: Company

Exhibit 3 Sources and Uses of Cash for the Year 2000 ($)

Beginning cash	**2,434,444**
Sources	
Profit	4,258,501
Fixed asset advances received back	1,039,229
Increase in L/T liabilities	714,953
Increase in share capital	467,295
Depreciation	887,092
Share premium	9,852,842
Increase in fixed asset revaluation reserve	428,268
Increase in legal reserves	3,444
Total	**17,651,626**
Uses	
Dividends	2,160,131
Increase in pre paid expenses and income accruals–L/T	434,771
Corporation tax withheld	107,470
Fixed asset purchases	2,112,952
Increase in intangible assets	1,502,386
Participations	551,394
Total	**6,869,103**
Increase in working capital	**10,782,523**

(*Contd.*)

(**Exhibit 3** *Contd.*)

Analysis of working capital accounts	
Increase in trade receivables	4,533,946
Increase in inventory	2,679,206
Decrease in post-dated checks given	1,647,104
Increase in other current assets	672,310
Increase in prepaid expenses and income accruals–S/T	498,128
Decrease in provisions for liabilities and expenses–S/T	157,877
Decrease in deferred income	50,898
Decrease in advances received	4,358
Increase in trade payables	8,309,724
Increase in tax payables	754,386
Increase in bank borrowings	1,255,047
Increase in other payables	72,855
Decrease in other receivables	28,479
Net cash flow	**10,959,188**
Translation difference	**192,334**
Ending cash	**13,201,299**

Source: Company

Exhibit 4 Probil Customers as of June 2000

Company	Sector (Industry)	Rank in Sector	Size
Yapi ve Kredi Bank	Banking*	1	$7.9 billion in assets
Akbank	Banking	2	7.7
Garanti Bank	Banking	3	7.7
Is Bankasi	Banking	4	7.4
Pamukbank	Banking	5	5.1
Vakiflarbank	Banking	6	4.7
Demirbank	Banking	7	2.6
Toprakbank	Banking	8	2.3
Osmanli Bank	Banking	9	2.1
Korfez Bank	Banking	10	1.9
Turkcell	Telecommunications**	1	$30 billion
SuperOnline	ISP	1	250,000 subscribers
Turk.Net	ISP	2	120,000

(*Contd.*)

(**Exhibit 4** *Contd.*)

Company	Sector (Industry)	Rank in Sector	Size
VestelNet	ISP	3	80,000
Tansas	Retail	3	
Government and Military			
Aselsan	Military		
Havelsan	Military		
Central Bank of Turkey	Government		
Finance Ministry	Government		
Treasury Department	Government		
Treasury Banknote Printing House	Government		
Water Works Department	Government		
Railroad Administration	Government		
Electric Distribution Administration	Government		
TRT–Turkish Radio and Television	Government		
Sabanci University	Education		
Bosphorus University	Education		
Gazi University	Education		
Middle East Technical University	Education		
Hacetepe University	Education		
Cukurova	Holding group	1	
Sabanci	Holding group	2	
Koc	Holding group	3	
Dogus	Holding group	4	
Eczacibasi	Holding group	5	
Zorlu	Holding group	6	
Toprak	Holding group	7	
Anadolu	Holding group	8	
Alarko	Holding group	9	
EGS	Holding group	10	

(*)Private banks ranked according to Total Assets as of March 1999. Probil worked with the top 20 private banks and their subsidiaries in Turkey.

(**) Turkcell was about 6 years old and was larger than the two holding groups (Koc and Sabanci) that dominated the market. Turkcell was to go public in 2000 with an estimated market cap of $30 billion US dollars.

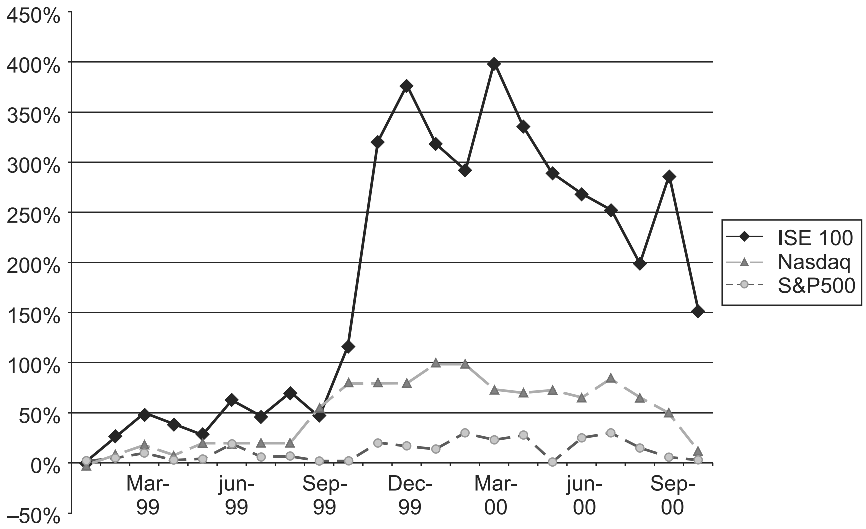
Source: Probil

Exhibit 5 Turkey's Credit Rating based on International Country Risk Guide Ratings for 9/2000 Re-scaled to Reflect Institutional Investor Credit Rating

		Maximum	Turkey
Political Risk			
Government Stability		12	9
Socioeconomic Conditions		12	2
Investment Profile		12	11
Internal Conflict		12	8
External Conflict		12	9
Corruption		6	3
Military in Politics		6	3
Religious Tensions		6	4
Law and Order		6	4
Ethnic Tensions		6	2
Democratic Accountability		6	4
Bureaucracy Quality		4	2
	50%	**100**	**61**
Financial Risks			
Total Foreign Debt as per cent of GDP		10	5
Debt Service as per cent of Exports of Goods and Services		10	6
Current Account as per cent of Exports of Goods and Services		15	13
Inter-national Liquidity as months of import cover		5	2
Exchange Rate Stability as per centage change		10	4
	25%	**50**	**29**
Economic Risks			
GDP per head of Population		5	2
Real Annual GDP Growth		10	9
Annual Inflation Rate		10	3
Budget Balance as per cent of GDP		10	3
Current Account as per cent of GDP		15	11
	25%	**50**	**26**
Composite rating		**100**	**47**

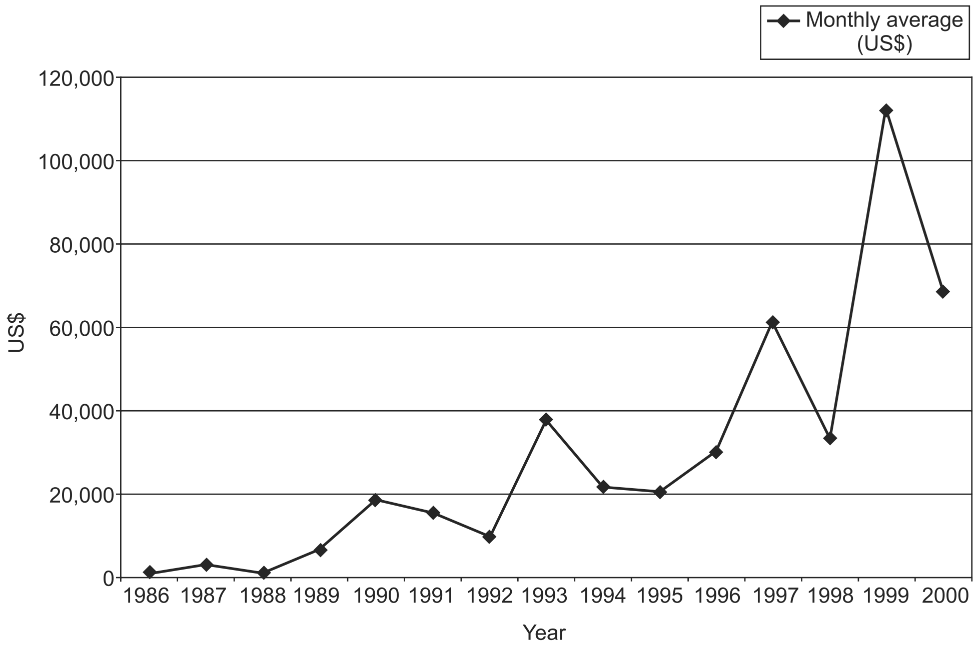
Exhibit 6 Historical Performance of Turkey Stock Market

Turkey ISE Index



Source: ISE

Turkey Stock Market—Year-end average monthly volume



Source: ISE

Exhibit 7 Turkey Stock Market

Transactions by sector during January–September of 2000

SECTOR	Number of Companies	Traded Value (US$ mil)	Value Turnover (%)
Agriculture, Forestry and Fishing	0	0	0
Mining	0	0	0
Manufacturing Industry	186	58,154.9	694.2
Electricity, GAS and Water	7	2359.5	524.4
Construction and Public Works	1	141.6	839.3
Wholesale, Retail, Hote and Restaurants	20	6992.1	379.2
Transportation, Communication and Storage	4	2,721.1	129.3
Financial Institutions	88	86031.9	564.6
Technology	5	5,404.2	918.5
Personal Services	2	524.9	2315.6
TOTAL	**312**	**163,130.1**	**540.3**

Number of IPOs

Year	Companies	Volume (US$ mil.)
1997	27	65.1
1998	20	48.6
1999	8	52.4
2000	35	157.5

Source: ISE

Exhibit 8 Financial Highlights Traded Comparables Traded in the US

	Probil	Tech Data	Primix Solutions	Datalink	European Micro Hldgs	Cumetrix Data Systems
Price (12/00)	N/A	33.2	1.25	9.1	3.5	0.25
P/E *	N/A	12.20	N/A	9.29	N/A	N/A
Price/Sales *	N/A	0.11	0.64	0.74	0.10	0.21
Beta	N/A	1.42	1.44	1.25	1.51	2.01
Business	Distrib./Services	Distribution	Services	Services	Distribution	Distribution
*= Trailing 12-months as of 2/01						
Income Statement	**FYE00**	**FYE99**	**FYE99**	**FYE99**	**FYE99**	**FYE99**
Revenue	74.1	16,991.8	12	118.9	115.5	18.6
Gross Profit Margin	15.4%	5.50%	19.20%	26.10%	9.90%	2.90%
SG&A Expense	7	661.8	9.9	22.1	14.1	4.2
Operating Income	4.3	272	–7.6	8.9	–2.7	–3.7
Operating Margin	5.8%	1.6%	–63.3%	7.5%	–2.3%	–19.9%
Total Net Income	4.2	127.5	–6.4	7.3	–3.2	–4
Net Profit Margin	5.7%	8.0%	–53.3%	6.1%	–2.8%	–21.5%
Diluted EPS ($)	N/A	2.34	–0.44	0.98	–0.64	N/A
Balance Sheet						
Total Current Assets	18	3,587.8	22.7	36.1	22.9	6.9
Total Assets	31.7	4,123.8	27.3	42.1	30.2	7.8
Total Current Liabilities	16.2	2,792.2	2.9	18.3	16.7	1.7
Long-Term Debt	2.3	316.8	0	1.4	2.4	0.1
Total Liabilities	17	3,110.1	2.9	20.3	19.2	1.8
Total Equity	14.7	1,013.7	24.5	21.7	11.1	6
Shares Outstanding (mil.)	N/A	52.2	15.3	8.8	4.9	N/A
IPO Summary Data						
Date went public	—	—	7/3/96	8/6/99	6/12/98	4/8/98
Proposed Offer Price	—	—	$13.00 – $15.00	$8.0 – $10.0	$10.00	$4.5 – $5.0
Actual offer price	—	—	$16.00	$7.50	$10.00	$5.00
First day close	—	—	$18.00	$7.69	$10.50	$6.25
Shares offered (mil.)	—	—	3.75	2.6	1.1	2.35
Offering amount (mil.)	—	—	$60.00	$19.50	$11.00	$11.80
Post-offering shares (mil.)	—	—	14.84	9.7	4.9	7.05

Source: Hoovers.com

Exhibit 9 Peer Group Comparison of Key Valuation Ratios

	Country	EV/EBITDA 1999	EV/EBITDA 2000	EV/EBITDA 2001 (E)
Domestic				
Escort	Turkey	18.5	9.4	8
Arena	Turkey	3.5	4.7	4.3
International				
Tech Data	USA	13.9	11.8	8.9
Altec	Greece	N/A	8.1	6.2
Computer Land	Poland	19.3	14.9	12.2
Average		**13.8**	**9.78**	**732**

		P/E 1999	P/E 2000	P/E 2001 (E)
Domestic				
ISE Technology Index	Turkey	25.1	17.3	16.4
Arena	Turkey	13.8	11.1	8.1
Escort	Turkey	24.8	17.3	14.8
International				
Tech Data	USA	19.8	13.7	9.9
Pouliadis	Greece	N/A	25.6	21.6
Altec	Greece	N/A	10.7	14.8
Computer Land	Poland	41.5	29.5	22.3
Average		**25.0**	**17.89**	**15.41**

Exhibit 10 Probil Financial Projections

Cash Flows Projections Million US$	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Revenues	**74.17**	**103.84**	**130.21**	**163.28**	**204.75**	**256.75**	**321.85**	**403.72**	**506.26**	**634.83**	**796.07**
Domestic	74.17	103.84	130.21	163.28	204.75	256.75	321.95	403.72	506.26	634.83	796.07
International	—	—	—	—	—	—	—	—	—	—	—
Cost of Sales	**62.70**	**87.78**	**110.08**	**138.04**	**173.10**	**217.06**	**272.18**	**341.31**	**428.00**	**536.70**	**673.01**
Cost of goods sold	58.36	81.71	102.46	128.48	161.11	202.03	253.34	317.68	398.36	499.54	626.41
Cost of services	4.34	6.08	7.62	9.56	11.99	15.03	18.85	23.63	29.64	37.16	46.60
Gross Profit	**11.47**	**16.05**	**20.13**	**25.24**	**31.65**	**39.69**	**49.77**	**62.41**	**78.26**	**98.14**	**123.06**
Operating Expenses	**7.08**	**8.91**	**10.54**	**12.58**	**15.14**	**18.35**	**22.38**	**27.42**	**33.75**	**41.69**	**51.65**
R&D	0.13	0.18	0.23	0.29	0.36	0.45	0.56	0.71	0.89	1 .11	1.39
Marketing Expenses	1.44	1 .81	2.14	2.56	3.08	3.74	4.56	5.59	6.88	8.50	10.54
SG&A	5.51	6.92	8.17	9.74	11.70	14.16	17.25	21.13	25.99	32.08	39.72
Operating profit	**4.39**	**7.14**	**9.59**	**12.66**	**16.51**	**21.34**	**27.39**	**34.98**	**44.50**	**56.44**	**71.41**
Financial Income (Expenses)	0.12	—	—	—	—	—	—	—	—	—	—
Profit Before Taxes	**4.26**	**7.14**	**9.59**	**12.66**	**16.51**	**21.34**	**27.39**	**34.98**	**44.50**	**56.44**	**71.41**
Corporate Taxes	0.25	0.42	0.57	0.75	0.98	1.26	1.62	2.07	2.63	3.34	4.22
Profit After Taxes	**4.01**	**6.72**	**9.02**	**11.91**	**15.53**	**20.08**	**25.77**	**32.92**	**41.87**	**53.11**	**67.19**
Operating Cash Flow											
Profit After Taxes	**4.01**	**6.72**	**9.02**	**11.91**	**15.53**	**20.08**	**25.77**	**32.92**	**41.87**	**53.11**	**67.19**
(+) Depreciation	0.89	1 .07	1.22	1.42	1.67	1.98	2.37	2.86	3.47	4.24	5.21
(+) Financial Income (Expenses)	(0.12)	-	-	-	-	-	-	-	-	-	-
(+) Tax Adjustments	0.01	-	-	-	-	-	-	-	-	-	-
Operating Cash Flow	**4.78**	**7.78**	**10.25**	**13.33**	**17.20**	**22.06**	**28.14**	**35.78**	**45.35**	**57.35**	**72.40**
Changes in Working Capital	(0.60)	(1 .48)	(1.32)	(1 .65)	(2.07)	(2.60)	(3.26)	(4.09)	(5.13)	(6.43)	(8.06)
Changes in Fixed Assets	(2.00)	(2.00)	(2.00)	(2.00)	(2.00)	(2.00)	(2.00)	(2.00)	(2.00)	(2.00)	(2.00)
Cost of regional expansion		—	0.00								
Free Cash Flows	**2.18**	**4.30**	**6.93**	**9.68**	**13.13**	**17.46**	**22.88**	**29.69**	**38.22**	**48.92**	**62.34**
EBITDA	**5.15**	**8.21**	**10.81**	**14.08**	**18.18**	**23.32**	**29.76**	**37.85**	**47.98**	**60.69**	**76.62**

Domestic Expansion Projects	2001	2002	2003	2004	2005
Investment needed to step up growth bv 20%	15.22	18.23	21 .60	25.32	29.35

Exhibit 11 Capital Market Data

10 Year T-Bond Rate	5.56%
US Market Risk Premium	5.0%
Turkey's Country Risk premium[7]	4.5%

[7] *Source:* Moody's