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Albaraka Turk Katilim Bankasi AS

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Albaraka Turk Katilim Bankasi AS

SACP	bb-		+	Support	+1	+	Additional Factors	0
Anchor	bbb-			GRE Support	0		Issuer Credit Rating <div style="background-color: yellow; padding: 10px; text-align: center;"> BB/Negative/B </div>	
Business Position	Moderate	-1		Group Support	+1			
Capital and Earnings	Moderate	-1		Sovereign Support	0			
Risk Position	Moderate	-1						
Funding	Average	0						
Liquidity	Adequate							

Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Good operational track record and growth potential in Turkey's interest-free (participation) banking segment. • Good core operating performance. • Support provided by majority owner, Al Baraka Banking Group B.S.C. 	<ul style="list-style-type: none"> • Above-average credit risk due to large exposure to the construction sector. • Tight capitalization. • High asset liability mismatches in common with the wider Turkish banking system.

Outlook: Negative

Standard & Poor's Ratings Services' outlook on Turkey-based Albaraka Turk Katilim Bankasi (Albaraka Turk) is negative, reflecting that on the bank's parent, the Albaraka Banking Group B.S.C. We incorporate one notch of uplift into the rating on Albaraka Turk to reflect group support, in accordance with our group rating methodology. A downgrade of the parent would lead to a loss of this support and in turn a downgrade of Albaraka Turk, all else being equal.

In our view, other rating factors that might trigger a change in the issuer credit rating (ICR) on Albaraka Turk or the bank's stand-alone credit profile (SACP)—such as its capital and risk profile—will remain mostly stable over the next 12-18 months, all else being equal. A material deterioration in the bank's funding and liquidity profile could trigger a negative rating action, but this is not our base-case scenario. We believe that Albaraka Turk's asset quality is still vulnerable to an economic slowdown, as the loan book has grown rapidly over the past four years and is therefore still unseasoned. However, the bank's profit margins are sufficient to absorb a moderate rise in nonperforming financings (NPFs) and cost of risk.

A revision of the outlook to stable would hinge upon one of the following three scenarios:

- A revision of the outlook on Albaraka Banking Group to stable.
- An improvement in Albaraka Turk's capitalization through a capital injection such that its risk-adjusted capital (RAC) ratio exceeded 7%, leading to an improvement of our opinion of its capital and earnings, and subsequently its SACP.
- A sustained decrease in the proportion of lending to the construction sector within total lending accompanied by a pace of growth of total financings commensurate with the pace of the bank's internal capital generation. This could trigger an improvement of our opinion of the bank's risk position, and subsequently its SACP.

Rationale

The starting point for our ICR on Albaraka Turk is the bank's 'bbb-' anchor, which is based on our view of the banking system and operating conditions in Turkey. In our view, Albaraka Turk's business position is "moderate," mainly reflecting it's the bank's limited customer franchise and market position, as well as its geographic and business concentration. We assess the bank's capital and earnings as "moderate," reflecting our expectation that its pre-diversification RAC ratio will remain close to 6% over the next 12-18 months and that its financial performance will remain relatively stable. We assess Albaraka Turk's risk position as moderate on the basis of the bank's relatively high exposure to the construction industry and its unseasoned financing book—a product of aggressive growth pursued in the recent past. We view the bank's funding as "average" and liquidity as "adequate" on the basis of its satisfactory deposit franchise and liquidity position. The combination of these bank-specific factors with the anchor translates into an SACP of 'bb-'.

Anchor: 'bbb-' for banks operating in Turkey

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor. The anchor for a commercial bank operating in Turkey is 'bbb-', based on an economic risk score of '6' and an industry risk score of '5'.

Our evaluation of economic risk reflects Turkey's relatively low per capita income, economic volatility, and structural

imbalances, specially its high current account deficit and net external debt. In our view, these factors expose the financial system to external shocks. In terms of industry risk, we view Turkey's overall institutional framework as positive, as demonstrated by the authorities' increasingly proactive and prudent stance toward the industry. We believe that the industry is stable and benefits from adequate pricing power without any market distortions. Nevertheless, funding risk has increased owing to a granular but short-term customer deposit base and increasing reliance on external funding, in our view. The anchor is one notch above our foreign currency rating on Turkey because our BICRA methodology excludes a sovereign default scenario, which is incorporated into the ICR.

Table 1

Albaraka Turk Katilim Bankasi AS Key Figures					
--Year-ended Dec. 31--					
(Mil. TRY)	2013*	2012	2011	2010	2009
Adjusted assets	13,374.6	12,320.6	10,455.5	8,404.1	6,413.3
Customer loans (gross)	9,577.0	9,297.7	7,445.8	6,460.3	4,837.1
Adjusted common equity	1,207.2	1,210.1	1,000.4	861.5	717.4
Operating revenues	243.3	705.6	552.7	472.3	440.9
Noninterest expenses	90.2	341.9	244.2	201.5	177.3
Core earnings	53.7	191.8	160.2	134.0	105.3

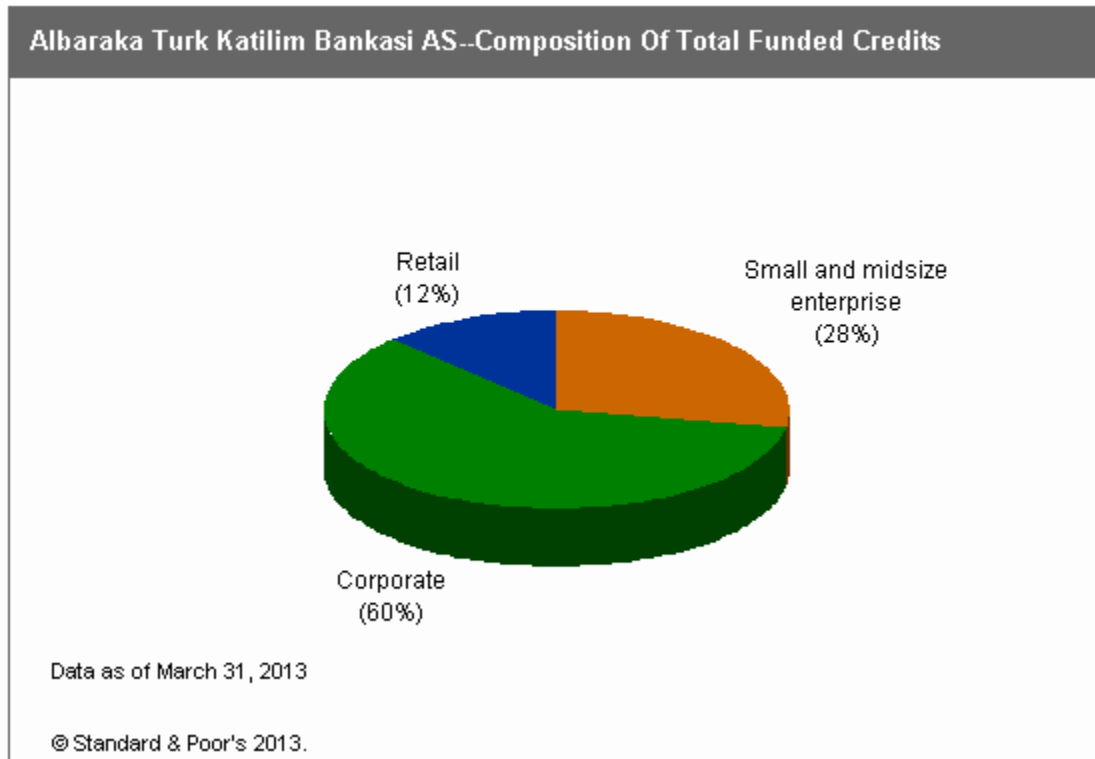
*Data as of March 31. TRY--Turkish lira.

Business position: Strong growth potential in Turkey's young participation banking sector

We assess Albaraka Turk's business position as "moderate," owing to its small domestic market share of about 1.2% in deposits and 1.1% loans in Turkey's relatively competitive market. With total assets of Turkish lira (TRY) 14.2 billion (\$7.4 billion) on June 30, 2013, Albaraka Turk is the smallest player in Turkey's small Islamic or participation banking sector. However, it has about market shares of about 20% in loans and deposits within this sector.

Despite its small size, Albaraka Turk has historically shown good resilience to strong competition from its peers as well as conventional players and has maintained its market shares at close to 1%. Albaraka Turk's business is skewed towards small and midsize enterprises as the bank has only recently started focusing on retail customers (see chart 1).

Chart 1



In our view, Albaraka Turk's management is adequate, backed by the expertise and strategic support of its 56.6%-owner, Al Baraka Banking Group B.S.C. Although small, its stable market share and good track record of operational performance since its creation support this view. In 2012, management embarked on a three-year transformation plan that aims to diversify the bank's loan book by increasing the share of retail lending to 20% of loans and limiting the share of loans to the construction industry to 15% of total financing. The bank also aims to maintain annual credit growth of close to 20%, which in our view would be in line with the bank's projected internal capital generation. We view the business plan positively, as it represents a shift from the ambitious, high-risk growth strategy the bank pursued until 2012.

Table 2

Albaraka Turk Katilim Bankasi AS Business Position					
	--Year-ended Dec. 31--				
(%)	2013*	2012	2011	2010	2009
Loan market share in country of domicile	1.1	1.1	1.0	1.2	1.0
Deposit market share in country of domicile	1.3	1.2	1.2	1.1	1.0
Total revenues from business line (Mil. TRY)	243.3	705.6	552.7	472.3	440.9
Commercial banking/total revenues from business line	86.3	108.7	106.7	114.3	128.0
Retail banking/total revenues from business line	(20.4)	(31.6)	(32.9)	(44.0)	(53.8)
Commercial & retail banking/total revenues from business line	65.9	77.1	73.8	70.2	74.1
Other revenues/total revenues from business line	34.1	22.9	26.2	29.8	25.9
Return on equity	17.3	17.3	17.2	17.1	15.6

Table 2**Albaraka Turk Katilim Bankasi AS Business Position (cont.)**

*Data as of March 31. TRY--Turkish lira.

Capital and earnings: Capitalization remains tight and a rating constraint

Our assessment of Albaraka Turk's capital and earnings as "moderate" is based on our view that its capitalization moderate and its profitability adequate. The bank's regulatory capital adequacy ratio stood at 15.6% on June 30, 2013, about 2.5 percentage points higher than at year-end 2012 and comfortably above the minimum 12% required by the Turkish regulator. The improvement is attributable to \$200 million in subordinated debt issued in the second quarter of 2013; this is considered as regulatory capital under Turkish regulations. Our assessment of Albaraka Turk's capitalization reflects the bank's pre-diversification RAC ratio, which stood at 6.0% on Dec. 31, 2012. The RAC ratio does not take into account the new subordinated debt as we do not consider it to be loss-absorbing under our methodology. We project that the RAC ratio before adjustments will remain relatively stable over the next 12-18 months. Our projections assume that the bank's customer financing will continue to increase by 20% per year, and that its net profit margin will gradually decrease to about 4.8%. We also expect the bank's cost of risk to remain close to 1.5%. Our projections are based on the assumption that Turkey's GDP will grow by 3%-4% annually.

In our view, Albaraka Turk's earnings quality is adequate. Its pre-provision operating income to average assets has averaged 3.7% over the past four years, comfortably above its average cost of risk over the same period.

Table 3**Albaraka Turk Katilim Bankasi AS Capital And Earnings**

(%)	--Year-ended Dec. 31--				
	2013*	2012	2011	2010	2009
S&P RAC ratio before diversification	N.M.	6.0	6.2	5.6	6.6
S&P RAC ratio after diversification	N.M.	5.2	4.9	4.7	5.3
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	62.0	68.9	69.8	66.9	69.7
Fee income/operating revenues	10.6	16.1	16.3	17.6	18.3
Market-sensitive income/operating revenues	3.3	2.9	3.8	3.4	5.7
Noninterest expenses/operating revenues	37.1	48.5	44.2	42.7	40.2
Preprovision operating income/average assets	4.8	3.2	3.3	3.7	4.7
Core earnings/average managed assets	1.7	1.7	1.7	1.8	1.9

*Data as of March 31. N.M.--Not meaningful.

Table 4**Albaraka Turk Katilim Bankasi AS Risk-Adjusted Capital Framework Data**

(Mil. TRY)	Exposure*	Basel II RWA	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk				
Government and central banks	1,818		994	55
Institutions	1,037		493	47
Corporate	8,516		14,913	175
Retail	1,773		1,622	91

Table 4

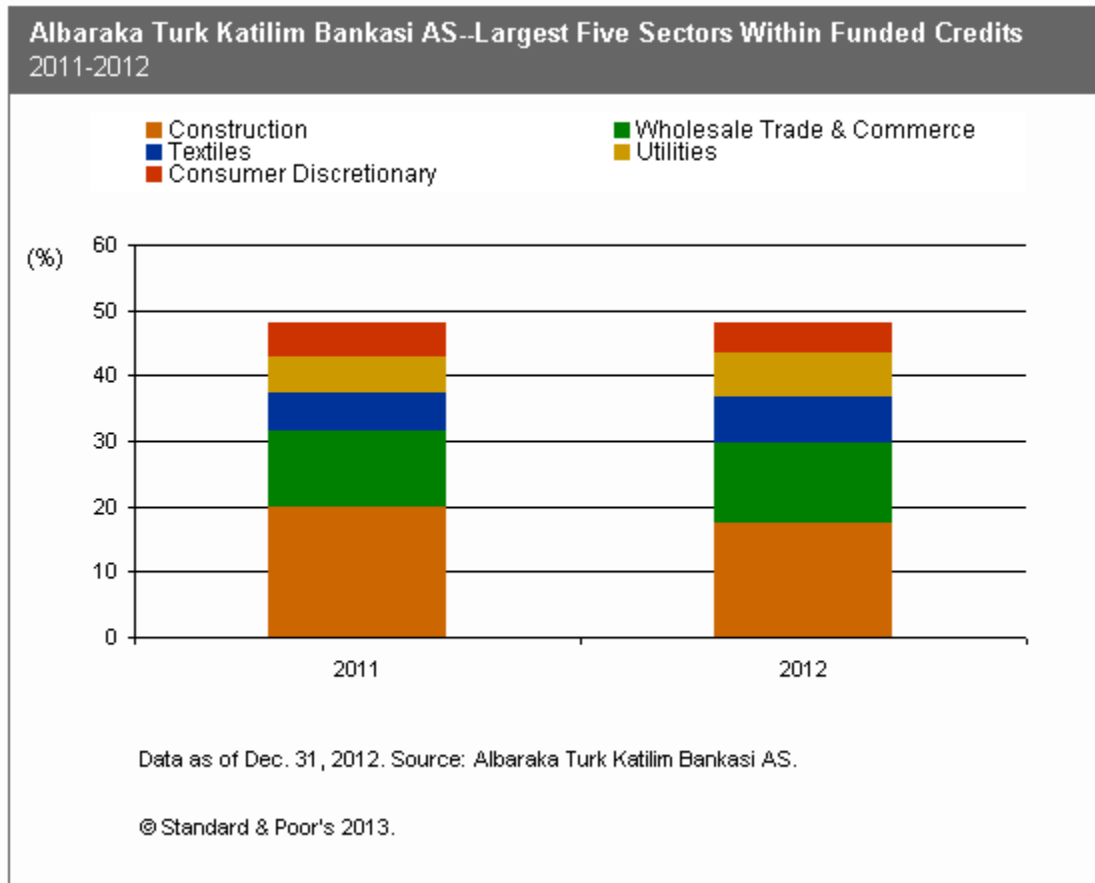
Albaraka Turk Katilim Bankasi AS Risk-Adjusted Capital Framework Data (cont.)					
Of which mortgage	876		473	54	
Securitization§	0		0	0	
Other assets	361		654	181	
Total credit risk	13,505	8,266	18,675	138	
Market risk					
Equity in the banking book†	15		151	1,028	
Trading book market risk	--		8	--	
Total market risk	--	65	159	--	
Insurance risk					
Total insurance risk	--	0	0	--	
Operational risk					
Total operational risk	--	835	1,323	--	
(Mil. TRY)		Basel II RWA	Standard & Poor's RWA	% of Standard & Poor's RWA	
Diversification adjustments					
RWA before diversification		9,166	20,157	100	
Total Diversification/Concentration Adjustments		--	2,959	15	
RWA after diversification		--	23,116	115	
(Mil. TRY)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio					
Capital ratio before adjustments		1,125	12.3	1,210	6.0
Capital ratio after adjustments‡		--	--	1,210	5.2

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. TRY--Turkish lira. Sources: Company data as of Dec. 31, 2012, Standard & Poor's.

Risk position: Adequate asset quality but vulnerable to an economic slowdown

We assess Albaraka Turk's risk position as "moderate," mainly balancing the bank's satisfactory asset quality metrics against its relatively high exposure to the construction sector, an industry we consider to be inherently high risk. We acknowledge the positive trend in the past 18 months as the share of lending to this sector has been decreasing (see chart 2). However, we acknowledge that this portfolio, as well as the entire financing book, has grown rapidly since 2009 and therefore remains vulnerable to an economic slowdown. High levels of collateralization by tangible assets are, however, a mitigating factor.

Chart 2



Albaraka Turk's gross NPF ratio stood at 2.2% on March 31, 2013, a level that compares adequately with that of the wider Turkish banking system. Problem assets are fully covered by provisions. Restructured loans accounted for 1.0% of gross loans on the same date. We acknowledge that the NPF ratio benefits from the denominator effect as a result of recent rapid growth. In the next 12-18 months, we expect the NPF ratio to deteriorate gradually on account of a system-wide decrease in problem financing recovery coupled with a slight increase in new NPF. The increase in the amount of overdue (but not impaired) financing in the first half of 2013 supports our assumption.

Single name concentration does not affect our assessment. At year-end 2012, the largest 20 cash financings stood at 1.3x of total adjusted capital, a level well below that of many peers in emerging markets.

Table 5

Albaraka Turk Katilim Bankasi AS Risk Position					
	--Year-ended Dec. 31--				
(%)	2013*	2012	2011	2010	2009
Growth in customer loans	12.0	24.9	15.3	33.6	31.1
Total diversification adjustment/S&P RWA before diversification	N.M.	20.0	26.7	17.4	22.9
Total managed assets/adjusted common equity (x)	11.1	10.2	10.5	9.8	8.9
New loan loss provisions/average customer loans	3.6	1.5	1.5	1.9	3.1

Table 5

Albaraka Turk Katilim Bankasi AS Risk Position (cont.)					
Net charge-offs/average customer loans	N.M.	0.2	0.5	N.M.	N.M.
Gross nonperforming assets/customer loans + other real estate owned	2.2	2.4	2.3	3.0	3.5
Loan loss reserves/gross nonperforming assets	83.6	88.8	92.4	85.7	88.8

*Data as of March 31. N.M.--Not meaningful.

Funding and liquidity: A stable but short-term deposit base, in line with domestic peers

Our view of Albaraka Turk's funding as "average" and liquidity as "adequate" draws on the high proportion of customer deposits in the bank's funding mix--about 84% of its funding base-- and its adequate liquid assets (cash, central bank, and securities), which made up 27% of assets on March 31, 2013. Albaraka Turk's loan-to-deposit ratio stood at about 97% on the same date, below the system-wide average. However, as the bank's conventional peers, Albaraka Turk's funding is mainly short term, leading to high levels of asset-liability mismatches. On a positive note, about half of Albaraka Turk's customer deposits are covered by Turkey's Savings Deposits Insurance Fund's guarantee scheme, significantly more than conventional Turkish banks. We expect the bank to increase its long-term cross-border borrowing over time, albeit with a marginal impact on the overall maturity profile of its liabilities.

Table 6

(%)	--Year-ended Dec. 31--				
	2013*	2012	2011	2010	2009
Core deposits/funding base	83.6	83.9	85.8	91.0	98.5
Customer loans (net)/customer deposits	96.7	102.2	93.4	95.3	87.1
Long term funding ratio	85.4	85.5	87.2	92.0	100.0
Stable funding ratio	N/A	99.0	106.7	106.4	N/A
Short-term wholesale funding/funding base	16.2	16.1	14.2	9.0	0.0
Broad liquid assets/short-term wholesale funding (x)	N/A	1.4	1.9	2.5	N/A
Net broad liquid assets/short-term customer deposits	N/A	8.2	15.5	14.1	N/A
Short-term wholesale funding/total wholesale funding	99.1	100.0	100.0	100.1	0.0

*Data as of March 31. N/A--Not applicable.

External support: One notch of uplift over the SACP for group support

The long-term rating on Albaraka Turk is one notch above its SACP, because we view the bank as having "moderate" strategic importance for its parent, Al Baraka Banking Group. We base our view on the likelihood of support, if required, on Albaraka Turk's majority ownership and control by its parent. Albaraka Turk accounts for a significant portion of the group's assets, about 25%, and is closely linked to its parent's reputation, name, and brand. We view Albaraka Turk as having "low" systemic importance within the Turkish banking system. As a result, we do not incorporate any notches of uplift for extraordinary government support into the ratings.

Additional rating factors: None

No additional factors affect this rating

Related Criteria And Research

- Banking Industry Country Risk Assessment Update: August 2013, Aug. 9, 2013
- Bahrain-Based Al Baraka Banking Group Lowered To 'BB+/B' On High MENA Sovereign And Economic Risks; Outlook Negative, Aug. 6, 2013.
- Banking Industry Country Risk Assessment: Turkey, July 10, 2013.
- Group Rating Methodology, May 7, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of August 29, 2013)	
Albaraka Turk Katilim Bankasi AS	
Counterparty Credit Rating	BB/Negative/B
<i>Turkey National Scale</i>	trAA/--/trA-1
Subordinated	B
Counterparty Credit Ratings History	
30-Jun-2011	BB/Negative/B
30-Jun-2010	BB/Stable/B
22-Feb-2010	BB/Positive/B
23-Sep-2009	BB-/Stable/B
19-Jun-2009	BB-/Negative/B
22-Feb-2010	<i>Turkey National Scale</i>
25-Sep-2009	trAA/--/trA-1
	trA+/--/trA-1
Sovereign Rating	
Turkey (Republic of) (Unsolicited Ratings)	
<i>Foreign Currency</i>	BB+/Stable/B
<i>Local Currency</i>	BBB/Stable/A-2

Ratings Detail (As Of August 29, 2013) (cont.)

<i>Turkey National Scale</i>	trAAA/--/trA-1
Related Entities	
Al Baraka Banking Group B.S.C.	
Issuer Credit Rating	BB+/Negative/B
Jordan Islamic Bank	
Issuer Credit Rating	BB-/Negative/B

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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