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Albaraka Turk Katilim Bankasi AS

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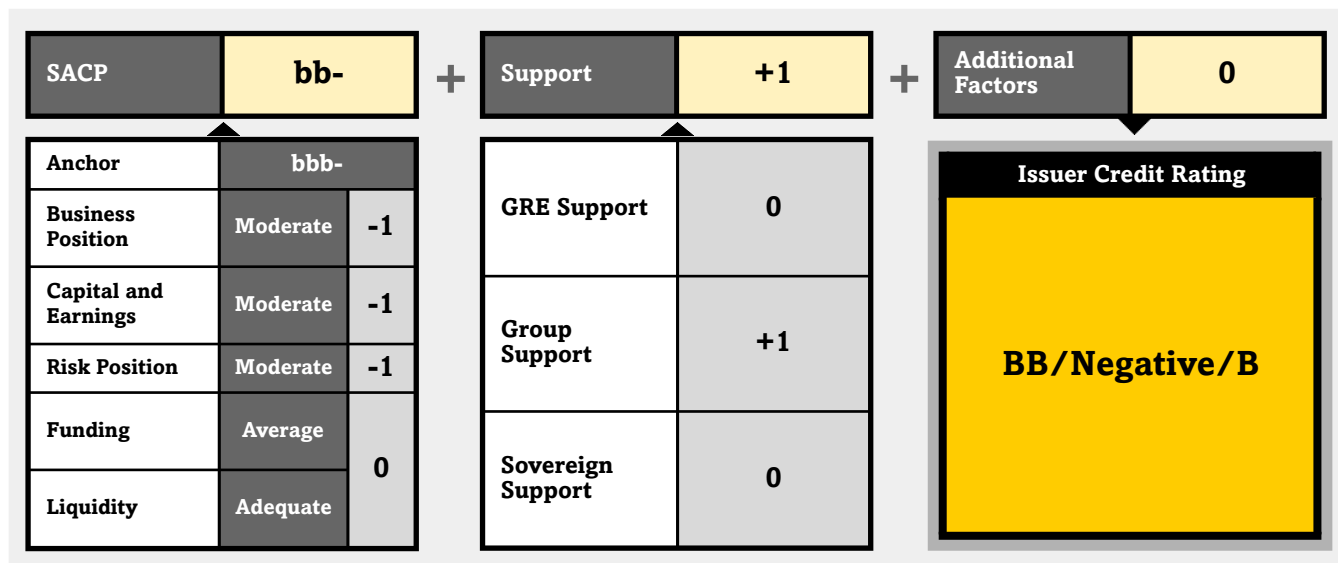
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Albaraka Turk Katilim Bankasi AS



Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Good operational track record and growth potential in Turkey's interest-free banking segment. • Good core operating performance. • Majority ownership by Al Baraka Banking Group. 	<ul style="list-style-type: none"> • Limited diversification opportunities. • Above-average credit risk due to large exposure to small and midsize enterprises and construction sector. • Limited financial flexibility and internal capital generation.

Outlook: Negative

Standard & Poor's Ratings Services' outlook on Turkish bank Albaraka Turk Katilim Bankasi (Albaraka Turk) is negative, based on the one-in-three possibility of a downgrade in the next 12 months if the bank continues its high-risk lending strategy and fails to reverse the negative trend in its capitalization.

Although the fast pace of growth in lending slowed down and the bank is aiming to limit its exposure to the construction segment, we believe its current composition of assets and high share of unseasoned new lending will drive future asset quality. We forecast the bank's risk-adjusted capital (RAC) ratio, before diversification adjustments, to remain close to 6% in the next 12-18 months based on financing growth close to 20%, a marginal increase in the cost of risk, and strong margins.

A revision of the outlook to stable would hinge on an improvement in capitalization and balance sheet growth more diversified by industry and commensurate with its capital build up.

Rationale

The starting point for our rating on Albaraka Turk is a 'bbb-' anchor, which is based on our view of the banking system and the operating environment in Turkey. In our view, Albaraka Turk's business position is "moderate," reflecting mainly its limited customer franchise and market position, as well as its limited geographic and business diversification. Our "moderate" assessment of its capital and earnings reflects 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. Albaraka Turk's aggressive lending strategy in the recent past drives our "moderate" assessment of its risk position. We base our view of the bank's "average" funding and "adequate" liquidity on its satisfactory deposit franchise and liquidity position. The combination of these bank specific factors with its anchor translates into a stand-alone credit profile (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 is shaped by Turkey's economic volatility and structural imbalances, in particular its high current account deficit and net external debt. In our view, these factors expose the financial system and export-oriented industries to external shocks.

With regard to industry risk, we view Turkey's overall institutional framework as positive, as evidenced by the authorities' increasingly proactive and prudent stance toward the industry. We also believe that the industry has largely stabilized and benefits from adequate pricing power without any market distortions. Nevertheless, banks' moderate risk appetite adds to their funding risks that stem from a granular but short-term customer deposit base.

The anchor is two notches above our foreign currency rating on Turkey because our BICRA methodology excludes a sovereign default scenario, which is incorporated into the issuer credit ratings on individual banks.

Table 1

Albaraka Turk Katilim Bankasi AS Key Figures					
--Year-ended Dec. 31--					
(Mil. TRY)	2012*	2011	2010	2009	2008
Adjusted assets	10,301.4	10,455.5	8,404.1	6,413.3	4,749.7
Customer loans (gross)	7,877.9	7,445.8	6,460.3	4,837.1	3,690.3
Adjusted common equity	1,001.7	963.5	832.8	706.9	635.4
Operating revenues	157.7	552.7	472.3	440.9	323.3
Noninterest expenses	77.4	244.2	201.5	177.3	138.1
Core earnings	39.2	160.2	134.0	105.3	136.9

*Data as of March 31.

TRY--Turkish lira.

Business position: Strong growth potential in Turkey's nascent participation banking segment

We assess Albaraka Turk's business position as "moderate," owing to its small domestic market share of approximately 1.0% in deposits and loans in Turkey's increasingly competitive market. With total assets of Turkish lira (TRY) 10.3 billion (\$5.8 billion) on March 31, 2012, Albaraka Turk is the smallest player in Turkey's small participation banking segment. The underdeveloped status of this segment in Turkey—namely the lack of eligible sharia-compliant assets other than customer financings (equivalent to customer loans in conventional banking)—prevents Albaraka Turk from diversifying its asset mix, which is more skewed toward lending than conventional banks.

Owing to the strong competition from larger conventional players and its relatively weak retail franchise compared with the other three participation banks, Al Baraka Turk's customer base is concentrated on small and midsize enterprises (SMEs).

Although the bank benefits from strong margins and a competitive advantage owing to its expertise and long track record with its clientele, this increases loan leverage and leads to lower capitalization.

Table 2

Albaraka Turk Katilim Bankasi AS Business Position					
	--Year-ended Dec. 31--				
(Mil. TRY)	2012*	2011	2010	2009	2008
Loan market share in country of domicile (%)	1.1	1.0	1.15	1.1	0.9
Deposit market share in country of domicile (%)	1.1	1.2	1.11	1.1	0.9
Total revenues from business line (currency in millions)	157.7	552.7	472.3	440.9	323.3
Return on equity	15.3	17.2	17.1	15.6	23.4

*Data as of June 30.

TRY--Turkish lira. N/A--Not applicable.

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. (ABG, BBB-/Negative/A—3). Albeit small, its stable market share and good track record of operational performance since its creation support our view. However, from 2007 the bank adopted a more aggressive growth strategy at the expense of its capitalization. Although we recognize the competitive pressure coming from Turkey's fast growing banking sector, the continuation of this strategy could lead us to have a more negative opinion of Albaraka Turk's business position if we were to conclude that it increases risks. Positively, management has 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 strengthening its capitalization through new capital injections.

Capital and earnings: On a weakening trend since 2010**Table 3**

Albaraka Turk Katilim Bankasi AS Capital And Earnings					
	--Year-ended Dec. 31--				
(Mil. TRY)	2012*	2011	2010	2009	2008
Tier 1 capital ratio	N/A	N/A	N/A	N/A	17.7
S&P RAC ratio before diversification	N.M.	6.0	5.4	6.5	N.M.

Table 3

Albaraka Turk Katilim Bankasi AS Capital And Earnings (cont.)					
S&P RAC ratio after diversification	N.M.	4.7	4.6	5.3	N.M.
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	67.1	69.8	66.9	69.7	64.5
Fee income/operating revenues	17.5	16.3	17.6	18.3	28.2
Market-sensitive income/operating revenues	2.0	3.8	3.4	5.7	5.2
Noninterest expenses/operating revenues	49.1	44.2	42.7	40.2	42.7
Provision operating income/average assets	3.1	3.3	3.7	4.7	4.4
Core earnings/average managed assets	1.5	1.7	1.8	1.9	3.3

*Data as of March 31.

TRY--Turkish lira. N/A--Not applicable. N.M.--Not meaningful.

Our assessment of Albaraka Turk's capital and earnings as "moderate" is based on our view of its moderate capitalization and adequate profitability. The bank had a regulatory capital adequacy ratio (CAR) of 12.3% on Dec. 31, 2011, while we project that our RAC ratio before adjustments will stand close to 6.0% over the next 12 to 18 months. Although its CAR is above the local minimum requirement of 8%, it is very close to the 12% targeted by the Turkish regulator, a threshold below which a bank is prohibited from opening new branches. Our projected RAC ratio assumes that the bank's customer financing will continue to increase by 20% per year, and that its net interest margin and cost-to-income ratio will stabilize at around 4.5% and 45%, respectively. We also expect the bank's cost of risk to remain in the range of 1% to 1.5%.

Our assumption on growth of customer financing factors in a low-single-digit GDP growth in Turkey, the bank's limited financial flexibility owing to its modest internal capital generation, and limited liquidity across the banking system caused by slow-paced savings growth. System-wide liquidity is also constrained by regulatory measures aimed at preventing banks from continuing their ambitious lending strategies.

In our view, Albaraka Turk's earnings quality is adequate. Its provision operating income to average assets averaged 3.5% over the past four years, while its average cost of risk over the same period was 1.5%, as measured with the ratio of new loan loss provisions to average customer financings.

Risk position: Ambitious lending strategy

Table 4

(Mil. TRY)	--Year-ended Dec. 31--				
	2012*	2011	2010	2009	2008
Growth in customer loans	23.2	15.3	33.6	31.1	32.7
Total diversification adjustment / S&P RWA before diversification	N.M.	26.7	17.4	22.9	N.M.
Total managed assets/adjusted common equity (x)	10.3	10.9	10.1	9.1	7.5
New loan loss provisions/average customer loans	1.6	1.5	1.9	3.1	0.4
Gross nonperforming assets/customer loans + other real estate owned	2.3	2.3	3.0	3.5	2.9
Loan loss reserves/gross nonperforming assets	92.5	92.4	85.7	88.8	96.3

*Data as of March 31.

TRY--Turkish lira. N.M.--Not meaningful.

We assess Albaraka Turk's risk position as "moderate," mainly because of the bank's aggressive growth strategy in 2007-2010, which has doubled its customer financing in nominal terms. The bank's off-balance sheet loans increased by 4.9x over that period, which mainly caused its capitalization to deteriorate. The new financing went mostly to the construction sector, including to residential project developers, a segment we consider to be high risk. At the end of 2011, the construction sector accounted for about 20% of funded customer financings, and a high 33% of off-balance-sheet.

The bank's asset quality metrics are good as evidenced by its 2.3% gross nonperforming loan (NPL) ratio at Dec. 31, 2011. In addition, its problem loans are fully covered by provisions, a level that compares adequately with its peer group. In the next 12 months, we expect the NPL ratio to gradually deteriorate on the account of a system-wide decrease in problem loan recovery coupled with a gradual increase in new NPL inflows. The increase in the amount of "loans overdue but not impaired" in the first quarter of 2012 supports our assumption.

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

Table 5

(Mil. TRY)	--Year-ended Dec. 31--				
	2012*	2011	2010	2009	2008
Core deposits/funding base	86.5	85.8	91.0	98.5	98.2
Customer loans (net)/customer deposits	100.5	93.4	95.3	87.1	91.7
Long term funding ratio	90.7	89.6	95.4	100.0	98.4
Broad liquid assets/short-term wholesale funding (x)	1.3	2.1	2.8	18.4	13.6
Net broad liquid assets/short-term customer deposits	5.2	18.1	N.M.	N.M.	29.2
Narrow liquid assets/3-month wholesale funding (x)	7.2	8.4	51.8	N.M.	N/A
Net short-term interbank funding/total wholesale funding	(9.6)	(19.6)	(54.7)	(734.2)	(785.1)
Short-term wholesale funding/total wholesale funding	100.0	100.0	100.0	100.0	100.0

*Data as of March 31.

TRY--Turkish lira. N/A--Not applicable. N.M.--Not meaningful.

Our view of Albaraka Turk's "average" funding and "adequate" liquidity draws on the high proportion of customer deposits in its funding mix and its adequate amount of liquid assets (cash, central bank, and securities), which made up 20% of assets on March 31, 2012. Its loan-to-deposit ratio stood at about 100% on the same date, in line with the domestic average. As is the case for conventional peers, the bank's funding is short term, leading to high 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. The bank has a \$350 million syndicated term-borrowing (murabaha) due in September 2012.

External support: 1 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 Albaraka Group. We base our view 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 our ratings on Albaraka Turk.

Additional rating factors: None

No additional factors affect this rating

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Banking Industry Country Risk Assessment: Turkey, May, 2012.

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 27, 2012)

Albaraka Turk Katilim Bankasi AS

Counterparty Credit Rating

BB/Negative/B

Turkish National Scale

trAA-/--/trA-1

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

Turkish National Scale

trAA-/--/trA-1

25-Sep-2009

trA+/-/--/trA-1

Ratings Detail (As Of August 27, 2012) (cont.)

Sovereign Rating

Turkey (Republic of)

Foreign Currency

BB/Stable/B

Local Currency

BBB-/Stable/A-3

Turkish National Scale

trAA+/-/trA-1

Related Entities**Al Baraka Banking Group B.S.C.**

Issuer Credit Rating

BBB-/Negative/A-3

Certificate Of Deposit

BBB-/A-3

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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