

# Albaraka Turk Katilim Bankasi AS

**Primary Credit Analyst:**

Goeksenin Karagoez, Paris (33) 1-4420-6724; goeksenin\_karagoez@standardandpoors.com

**Secondary Contact:**

Paul-Henri Pruvost, Paris (33) 1-4420-6691; paul-henri\_pruvost@standardandpoors.com

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# Albaraka Turk Katilim Bankasi AS

## Major Rating Factors

### Strengths:

- Good track record in interest-free banking.
- Adequate funding.
- Good core operating performance.

### Weaknesses:

- High-risk operating environment in Turkey.
- Small customer franchise and weak market position, albeit set to increase.
- Above-average credit risk due to large exposure to small and midsize enterprises and the construction sector.
- Rapid loan growth that puts pressure on capitalization.

Counterparty Credit Rating
BB/Negative/B
<i>Turkish National Scale</i>
trAA+/-/trA-1

## Rationale

The ratings on Albaraka Turk Katilim Bankasi AS (Albaraka Turk) reflect Standard & Poor's Ratings Services view of its good track record in Turkey's participation (Islamic) banking market, adequate funding coming from a strong but short-term deposit base, and limited market risk. Weaknesses for the ratings are the high-risk operating environment in the Republic of Turkey (foreign currency ratings BB/Positive/B, local currency ratings BBB-/Positive/B; Turkish National Scale trAA+/-/trA-1), the bank's small size and market share, and above-average credit risk due to its large exposure to small and midsize enterprises (SMEs) and the construction sector. In addition, rapid loan growth constrains the bank's capitalization.

Bahrain-based Al Baraka Banking Group B.S.C (ABG; BBB-/Negative/A-3) has 56.6% ownership and control of Albaraka Turk. It is ABG's largest subsidiary and ABG has shown a strong commitment to its subsidiaries, notably through capital support and risk management discipline. However, we believe that in a worst-case scenario, ABG's capacity to provide extraordinary support to Albaraka Turk is somewhat limited because the subsidiary represents a sizable portion of the group (32.7% of total group assets at year-end 2010). Therefore, the ratings on Albaraka Turk reflect its stand-alone credit profile (SACP) and do not factor in uplift for extraordinary support.

Albaraka Turk is a small, Turkish participation bank. With total assets of Turkish lira (TRY) 8.6 billion (unconsolidated and under local accounting standards) on June 30, 2011, the bank has a very limited share of the Turkish banking market of about 1.0%. Its key strategic objective is to focus on those sectors where it can excel, given its resources. This includes maintaining its corporate banking franchise with a focus on SMEs and expanding its retail offering. We believe that the strategy the bank has adopted is a good example of building competitive advantage through a "differentiation focus" and should sustainably support its future growth, although the high pace of growth is a negative rating factor.

The bank's financial risk profile features high credit risk, but adequate funding and liquidity, and limited market risk. Albaraka Turk's ambitious growth strategy in 2007-2010 has led its loan book to more than double in absolute terms. The new lending, especially in 2010, resulted mostly from loans in the construction sector, including to residential project developers, a segment we view to be high risk. At the end of 2010, the construction sector

accounted for more than 25% of Albaraka Turk's funded customer loans, and a high 32% of on- and off-balance-sheet credit risk. Positively, the bank reduced its lending in 2011, which increased by only 4% in the first half of the year, substantially less than the domestic system average of about 20%. Albaraka Turk's current asset quality metrics compare well with peers--based on its ratio of nonperforming loans (NPL) to gross loans of 2.9%--we believe that the bank's rapid growth could lead to an increase in the number of problematic loans as new loans season, especially if the Turkish economy's current brisk growth slackens. Fast growth has also led to weaker regulatory capital ratios and Standard & Poor's risk-adjusted capital (RAC) ratio, our key measure of banks' capitalization. At year-end 2010, Albaraka Turk's regulatory capital ratio stood at 14.1%, compared with 21.7% at year-end 2007, below the average for Turkish banks. At 5.5% before diversification adjustments, our estimated RAC ratio at year-end 2010 versus 6.2% at year end-2009 also illustrates the bank's deteriorating capital, which continues to lag behind levels at domestic peers.

Funding has historically been through "participation accounts," the equivalent of retail and corporate deposits in conventional banking. Like its peers, Albaraka Turk has large maturity mismatches and increasing liquidity and repricing risks in times of stress due to the short-term nature of those funds. The stickiness of these deposits and the bank's negligible reliance on interbank borrowing are positive factors, however.

In our view, Albaraka Turk's core operating performance is a relative positive factor for the ratings and provides an adequate buffer against expected losses. At 4.6% in the first half of 2011, the bank's profit margins (equivalent of net interest margin) were strong and stood above the system-wide average. We believe that the bank's relatively lower proportion of retail loans and government securities makes it less vulnerable to the recent system-wide margin squeeze.

## Outlook

The negative outlook reflects the possibility that we could lower Albaraka Turk's rating in the next 12 months, because of our negative view of its aggressive lending strategy and the subsequent pressure on its capitalization and future asset quality. Although we understand that the bank aims to keep loan growth in 2011 below 15%, we are concerned about the current composition of its loan book and the high share of unseasoned loans that will drive future asset quality. We expect the bank's core financial performance to continue to provide support for its ratings over the medium term. We could lower the ratings on Albaraka Turk if it continues what we view as a high-risk lending strategy and fails to shore up its balance sheet and capitalization. A revision of the outlook back to stable would hinge on the bank's capitalization increasing significantly, higher diversification of its loan book by industry, accompanied by decreasing exposure to riskier segments, and less ambitious balance sheet growth.

**Table 1**

<b>Albaraka Turk Katilim Bankasi AS Asset Quality, Funding, And Liquidity Ratios</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2011*</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Gross nonperforming assets/customer loans + other real estate owned	2.9	3.0	3.5	2.9	1.5
Net nonperforming assets/customer loans plus other real estate owned	0.3	0.4	0.4	0.1	(0.5)
Loan loss reserves/gross nonperforming assets	88.7	85.7	88.8	96.3	131.3
Loan loss reserves/customer loans	2.6	2.5	3.1	2.8	2.0

**Table 1**

<b>Albaraka Turk Katilim Bankasi AS Asset Quality, Funding, And Liquidity Ratios (cont.)</b>					
New loan loss provisions/average customer loans	1.5	1.9	3.1	0.4	0.5
Customer deposits/funding base	93.1	94.8	98.6	98.5	98.9
Total loans/customer deposits	96.9	93.9	88.5	92.6	92.7
Total loans/customer deposits + long-term funds	85.7	83.5	78.3	79.9	78.8
Customer loans (net)/adjusted assets	75.2	74.9	73.1	75.5	74.3

\*Data as of June 30.

**Table 2**

<b>Albaraka Turk Katilim Bankasi AS Profitability Ratios</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2011*</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Net interest income/average earning assets	4.6	4.7	6.1	5.4	5.3
Net interest income/operating revenues	70.0	66.9	69.7	64.5	64.8
Fee income/operating revenues	16.9	17.6	18.3	28.2	25.3
Market-sensitive income/operating revenues	3.3	3.4	5.7	5.2	6.3
Personnel expenses/operating revenues	27.5	25.5	24.5	25.7	26.0
Noninterest expenses/operating revenues	46.2	42.7	40.2	42.7	48.5
New loan loss provisions/operating revenues	18.9	22.3	29.9	4.1	5.0
Preprovision operating income/loan loss provisions	285.4	257.6	200.0	1,386.4	1,035.1
Operating income after loss provisions/operating revenues	35.0	35.1	29.9	53.1	46.5
Pretax profit/operating revenues	35.0	35.1	29.9	53.0	46.5
Tax/pretax profit	20.2	19.1	20.1	20.3	20.6
Core earnings/operating revenues	27.9	28.4	23.9	42.4	36.9
Core earnings/average adjusted assets	1.7	1.8	1.9	3.3	2.7
Noninterest expenses/average adjusted assets	2.7	2.7	3.2	3.3	3.6
Core earnings/average regulatory risk-weighted assets	2.6	2.8	2.9	4.4	3.2
Core earnings/average adjusted common equity	16.6	17.4	15.7	23.5	21.5
Pretax profit/average common equity	20.2	21.2	19.6	29.4	27.1

\*Data as of June 30.

**Table 3**

<b>Albaraka Turk Katilim Bankasi AS RACF (Risk-Adjusted Capital Framework) Data</b>				
<b>(Mil. TRY)</b>	<b>Exposure*</b>	<b>Standard &amp; Poor's RWA</b>	<b>Average Standard &amp; Poor's RW (%)</b>	
<b>Credit risk</b>				
Government and central banks	956	759	79	
Institutions	729	448	61	
Corporate	8,013	12,405	155	
Retail	530	398	75	
Of which mortgage	424	268	63	
Securitization	0	0	0	
Other assets	236	497	211	
Total credit risk	10,464	14,507	139	

Table 3

Albaraka Turk Katilim Bankasi AS RACF (Risk-Adjusted Capital Framework) Data (cont.)				
<b>Market risk</b>				
Equity in the banking book¶	0		0	0
Trading book market risk	--		73	--
Total market risk	--		73	--
<b>Insurance risk</b>				
Total insurance risk	--		0	--
<b>Operational risk</b>				
Total operational risk	--		801	--
<b>(Mil. TRY)</b>			<b>Standard &amp; Poor's RWA</b>	<b>% of Standard &amp; Poor's RWA</b>
<b>Diversification adjustments</b>				
RWA before diversification			15,381	100
Total adjustments to RWA			2,373	15
RWA after diversification			17,755	115
<b>(Mil. TRY)</b>	<b>Tier 1 capital</b>	<b>Tier 1 ratio (%)</b>	<b>Total adjusted capital</b>	<b>Standard &amp; Poor's RAC ratio (%)</b>
<b>Capital ratio</b>				
Capital ratio before adjustments	868	14.0	845	5.5
Capital ratio after adjustments§	868	14.0	845	4.8

\*Exposure at default. €Securitisation Exposure includes the securitisation 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, 2010, Standard & Poor's.

Table 4

Albaraka Turk Katilim Bankasi AS Capital Ratios					
	--Year-ended Dec. 31--				
(%)	2011*	2010	2009	2008	2007
Adjusted common equity/risk assets	15.5	15.7	17.1	20.6	17.2
Tier 1 capital ratio	N/A	N/A	N/A	17.7	21.4
Adjusted total equity/adjusted assets	10.1	9.9	10.9	13.4	14.5
Adjusted total equity/managed assets	10.1	9.9	10.9	13.4	14.5
Adjusted total equity plus loan loss reserves (specific)/customer loans (gross)	15.6	15.4	17.6	20.0	21.1
Common dividend payout ratio	0.0	0.0	0.0	0.0	38.6

\*Data as of June 30. N/A--Not applicable.

Table 5

Albaraka Turk Katilim Bankasi AS Summary Balance Sheet					
	--Year-ended Dec. 31--				
(Mil. TRY)	2011*	2010	2009	2008	2007
<b>Assets</b>					
Cash and money market instruments	1,413.8	1,431.9	1,225.1	1,058.8	878.6
Securities	486.9	435.3	327.6	14.1	6.1
Trading securities (marked to market)	5.9	4.6	3.0	10.1	2.1

**Table 5**

<b>Albaraka Turk Katilim Bankasi AS Summary Balance Sheet (cont.)</b>					
Nontrading securities	481.0	430.8	324.6	4.0	4.0
Customer loans (gross)	6,706.6	6,460.3	4,837.1	3,690.3	2,780.1
Loan loss reserves	174.1	163.5	151.1	101.9	56.3
Customer loans (net)	6,532.5	6,296.8	4,686.0	3,588.4	2,723.8
Earning assets	7,754.6	7,626.6	5,772.6	4,379.6	3,332.4
Investments in unconsolidated subsidiaries (financial companies)	2.0	2.0	6.0	0.0	0.0
Intangibles (nonservicing)	3.0	2.2	1.6	0.0	0.0
Fixed assets	199.7	192.3	140.1	49.4	43.1
All other assets	47.3	45.7	28.5	39.1	12.8
Total assets	8,685.2	8,406.3	6,414.9	4,749.7	3,664.4
Intangibles (nonservicing)	3.0	2.2	1.6	0.0	0.0
Adjusted assets	8,682.2	8,404.1	6,413.3	4,749.7	3,664.4
<b>Liabilities</b>					
Total deposits	7,427.7	7,256.4	5,539.6	4,047.1	3,030.1
Noncore deposits	509.9	374.8	75.0	62.0	32.0
Core/customer deposits	6,917.9	6,881.6	5,464.6	3,985.1	2,998.1
Other credit reserves	59.9	59.6	47.7	0.0	0.0
Other liabilities	289.1	237.7	191.9	129.2	135.0
Total liabilities	7,776.7	7,553.7	5,779.2	4,176.3	3,165.1
Total equity	908.5	852.6	710.7	635.4	531.3
Common shareholders' equity	908.5	852.6	710.7	635.4	531.3
Share capital and surplus	539.0	539.0	539.0	536.6	536.6
Revaluation reserve	29.2	31.1	12.7	0.0	0.0
Retained profits	71.3	134.4	105.6	31.4	(20.1)
Total liabilities and equity	8,685.2	8,406.3	6,489.9	4,811.7	3,696.4

\*Data as of June 30. TRY--TRY-Turkish lira.

**Table 6**

<b>Albaraka Turk Katilim Bankasi AS Equity Reconciliation Table</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(Mil. TRY)</b>	<b>2011*</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Common shareholders' equity	908.5	852.6	710.7	635.4	531.3
Minus dividends (not yet distributed)	0.0	13.4	10.6	0.0	0.0
Minus revaluation reserves	(29.2)	(31.1)	(12.7)	0.0	0.0
Minus nonservicing intangibles	(3.0)	(2.2)	(1.6)	0.0	0.0
Adjusted common equity	876.3	832.8	706.9	635.4	531.3
Total Adjusted Capital	876.3	832.8	706.9	635.4	531.3
Minus equity in unconsolidated subsidiaries	(2.0)	(2.0)	(6.0)	0.0	0.0
Adjusted total equity	874.3	830.8	700.9	635.4	531.3

\*Data as of June 30. TRY--TRY-Turkish lira.

Table 7

<b>Albaraka Turk Katilim Bankasi AS Profit And Loss</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(Mil. TRY)</b>	<b>2011*</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Net interest income	177.9	316.2	307.5	208.4	146.7
Interest income	356.8	666.5	656.0	541.6	375.0
Interest expense	179.0	350.3	348.5	333.2	228.3
Operating noninterest income	76.3	156.1	133.4	114.9	79.8
Fees and commissions	42.8	82.9	80.7	91.2	57.4
Trading gains	8.4	16.0	25.0	16.7	14.3
Other noninterest income	25.1	57.2	27.6	7.0	8.1
Operating revenues	254.2	472.3	440.9	323.3	226.5
Noninterest expenses	117.4	201.5	177.3	138.1	110.0
Personnel expenses	69.9	120.5	108.2	83.2	58.9
Other general and administrative expense	40.3	70.5	59.3	45.9	42.7
Preprovision operating income	136.8	270.8	263.5	185.2	116.6
Credit loss provisions (net new)	47.9	105.1	131.8	13.4	11.3
Operating income after loss provisions	88.9	165.7	131.8	171.8	105.3
Nonrecurring/special expense	N/A	N/A	N/A	0.6	0.0
Pretax profit	88.9	165.7	131.8	171.2	105.3
Tax expense/credit	18.0	31.6	26.5	34.8	21.7
Net income (before minority interest)	70.9	134.0	105.3	136.5	83.6
Net income before extraordinary	70.9	134.0	105.3	136.5	83.6
Net income after extraordinary	70.9	134.0	105.3	136.5	83.6

\*Data as of June 30. TRY--TRY-Turkish lira. N/A--Not applicable.

Table 8

<b>Albaraka Turk Katilim Bankasi AS Core Earnings Reconciliation Table</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(Mil. TRY)</b>	<b>2011*</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Net income (before minority interest)	70.9	134.0	105.3	136.5	83.6
Plus nonrecurring/special expense	N/A	N/A	N/A	0.6	0.0
Plus or minus tax impact of adjustments	N/A	N/A	N/A	(0.1)	0.0
Core earnings	70.9	134.0	105.3	136.9	83.6

\*Data as of June 30. TRY--TRY-Turkish lira. N/A--Not applicable.

## Related Criteria And Research

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

- FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004
- Albaraka Turk Outlook To Negative On Ambitious Growth Strategy And Weakening Capital; 'BB/B' Ratings Affirmed, June 30, 2011

<b>Ratings Detail</b> (As Of October 26, 2011)	
<b>Albaraka Turk Katilim Bankasi AS</b>	
Counterparty Credit Rating	BB/Negative/B
<i>Turkish National Scale</i>	trAA-/--/trA-1
Certificate Of Deposit	BB/B
<b>Counterparty Credit Ratings History</b>	
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>Turkish National Scale</i>	trAA-/--/trA-1
25-Sep-2009	trA+/--/trA-1
<b>Sovereign Rating</b>	
Turkey (Republic of)	
<i>Foreign Currency</i>	BB/Positive/B
<i>Local Currency</i>	BBB-/Positive/A-3
<i>Turkish National Scale</i>	trAA+/--/trA-1
<b>Related Entities</b>	
<b>Al Baraka Banking Group B.S.C.</b>	
Issuer Credit Rating	BBB-/Negative/A-3
Certificate Of Deposit	BBB-/A-3
<b>Jordan Islamic Bank</b>	
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.

**Additional Contact:**

Financial Institutions Ratings Europe; FIG\_Europe@standardandpoors.com

**Additional Contact:**

Financial Institutions Ratings Europe; FIG\_Europe@standardandpoors.com



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