

RatingsDirect®

Albaraka Turk Katilim Bankasi AS

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Albaraka Turk Katilim Bankasi AS

SACP	bb-		+	Support	+1	+	Additional Factors	0
Anchor	bb+			GRE Support	0		Issuer Credit Rating	
Business Position	Moderate	-1		Group Support	+1		BB/Negative/B	
Capital and Earnings	Moderate	0		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.(ABG), as well as our negative view of economic risks Turkish banks face. 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 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 outlook horizon of 12 months. 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 through 2010-2013 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.
- The continuation of the decrease we observed in the proportion of lending to the construction and real estate sector within total lending as well as the current more sustainable pace of growth of lending. This could trigger an improvement of our opinion of the bank's risk position, and subsequently its SACP.

Rationale

The starting point for our issuer credit rating on Albaraka Turk is the bank's 'bb+' 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 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 risk-adjusted capital (RAC) ratio will remain close to 6% over the next 12-15 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 prior to 2014. 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: 'bb+' for banks operating in Turkey

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The BICRA scores are on scale of 1 (lowest risk) to 10 (highest risk). The anchor for a commercial bank operating only in Turkey is 'bb+'.

Our economic risk score of '6' for Turkey reflects the country's moderate per capita income compared with peers,

institutional challenges, sizable current account deficits, and external financing needs. Although banks have granular and well-diversified loan books, their credit risk is accentuated by their rapid growth in recent years and relatively high share of lending in foreign currency (about one-third of gross loans).

The industry risk score of '6' largely reflects low domestic savings and banks' resulting reliance on high amounts of short-term external debt compared with peers in other countries. This leaves the industry exposed to conditions in external debt and capital markets. Two mitigating factors are Turkey's adequate banking regulation and supervision, in our view, and banks' ability to adequately price risks, thanks to stable industry conditions.

Table 1

Albaraka Turk Katilim Bankasi AS Key Figures					
	--Year-ended Dec. 31--				
(Mil. TRY)	2014*	2013	2012	2011	2010
Adjusted assets	19,115.4	17,200.6	12,320.6	10,455.5	8,404.1
Customer loans (gross)	13,006.6	12,313.3	9,297.7	7,445.8	6,460.3
Adjusted common equity	1,573.3	1,486.1	1,210.1	1,000.4	861.5
Operating revenues	427.5	798.8	631.8	507.7	427.7
Nonprofit expenses	241.1	404.4	341.9	244.2	201.5
Core earnings	122.1	241.4	191.8	160.2	134.0

*Data as of June 30.

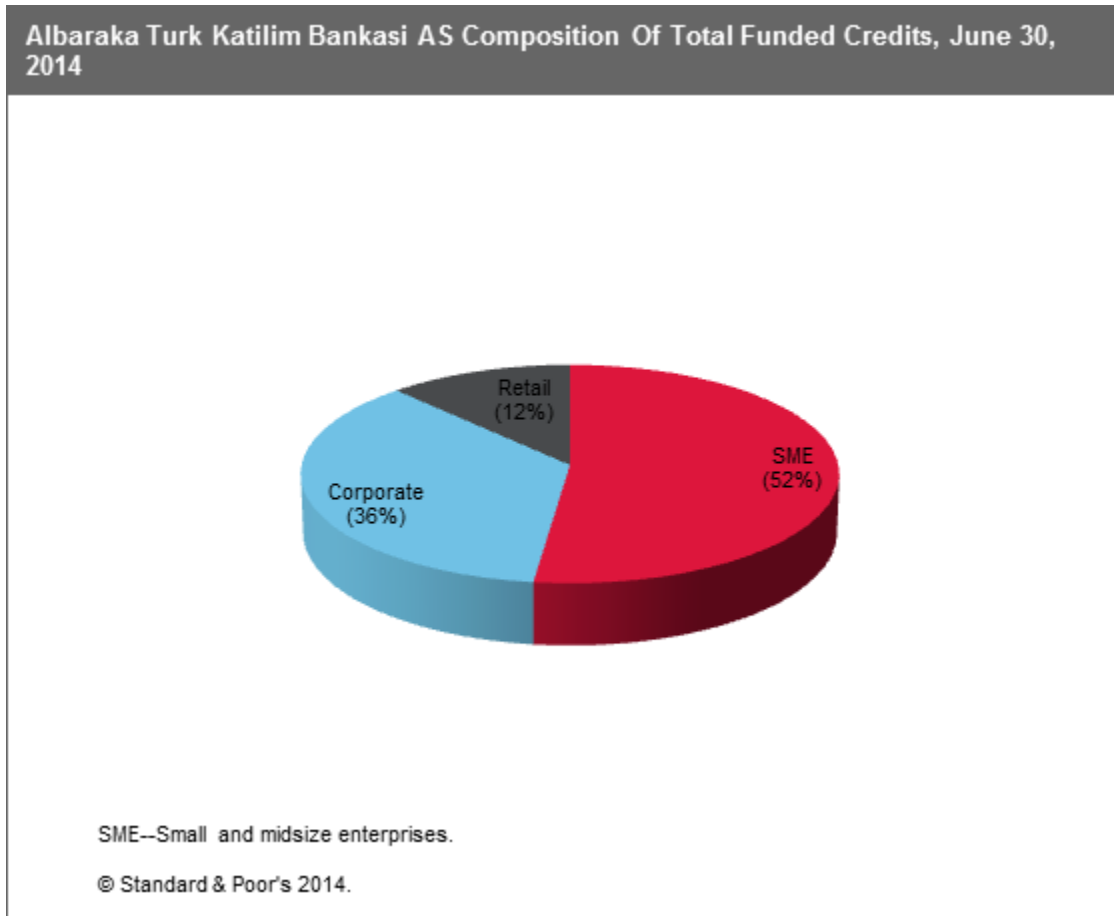
TRY--TRY-Turkish lira. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

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 1.4% in deposits and 1.1% in loans on June 30, 2014, in Turkey's highly competitive market. With total assets of Turkish lira (TRY) 19.1 billion (\$9.1 billion) on June 30, 2014, Albaraka Turk is the smallest player in Turkey's small Islamic or participation banking sector. However, it has 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 just above to 1%. Albaraka Turk's business is skewed toward small and midsize enterprises (SMEs) as the bank is a late entrant in the retail segment (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, ABG. 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. Considerable progress has been made to date: its financings increased 6% in the six months to June 2014 and the share of loans to the construction segment dropped below 20% on the same date. We view the business plan positively, as it represents a shift from the ambitious, high-risk growth strategy the bank pursued previously.

Table 2

Albaraka Turk Katilim Bankasi AS Business Position					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Loan market share in country of domicile	1.1	1.1	1.1	1.0	1.2
Deposit market share in country of domicile	1.4	1.3	1.2	1.2	1.1
Total revenues from business line (currency in millions)	427.5	894.8	705.6	552.7	472.3

Table 2

Albaraka Turk Katilim Bankasi AS Business Position (cont.)					
Commercial banking/total revenues from business line	116.9	96.3	108.7	106.7	114.3
Retail banking/total revenues from business line	(37.9)	(21.7)	(31.6)	(32.9)	(44.0)
Commercial & retail banking/total revenues from business line	79.1	74.5	77.1	73.8	70.2
Other revenues/total revenues from business line	20.9	25.5	22.9	26.2	29.8
Return on equity	15.2	17.8	17.3	17.2	17.1

*Data as of June 30.

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 is moderate and its profitability adequate. The bank's regulatory capital adequacy ratio (CAR) as per Basel III stood at 14.9% on June 30, 2014, and Dec. 30, 2013, and above the target minimum 12% required by the Turkish regulator. Reliance on Tier II capital is low and consists of only \$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 we expect to remain close to 6.0% over the next 15 months. The ratio stood at the same level on Dec. 31, 2013. The RAC ratio does not take into account the subordinated debt as we do not consider it to be loss-absorbing under our methodology. The ratio is significantly different from the bank's regulatory CAR, owing to the higher risk weights we apply to most of the asset classes, notably construction and real estate exposures. Our base-case projections assume that the bank's customer financing will continue to increase by 15%-20% per year, and that its net profit margin will remain close to 4.25% in 2014 before approaching 4.0% throughout 2015. We also expect the bank's net cost of risk to remain in the range of 0.6%-0.8%. Our projections are based on the assumption that Turkey's GDP will grow by 2.5%-3.0% annually.

In our view, Albaraka Turk's earnings quality is adequate. As with the rest of the banking sector, however, the trend is negative owing to high competition, ongoing margin squeeze, and the impact of new regulations on fees and commissions. Albaraka Turk's return on average assets is slightly below the average of other Turkish banks because a lower portion of Albaraka Turk's business comes from retail. The ratio could improve, however, if the central bank of Turkey goes ahead with further policy rate cuts through the rest of 2014.

Table 3

Albaraka Turk Katilim Bankasi AS Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Total capital ratio	14.9	14.9	13.0	12.5	14.1
S&P RAC ratio before diversification	N.M.	6.0	6.0	6.3	5.6
S&P RAC ratio after diversification	N.M.	5.3	5.3	4.9	4.7
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Double leverage	N.M.	N.M.	N.M.	N.M.	N.M.
Net profit income/operating revenues	76.9	78.3	76.9	76.0	73.9
Fee income/operating revenues	14.4	14.2	17.9	17.8	19.4
Market-sensitive income/operating revenues	6.9	4.7	3.2	4.2	3.7
Nonprofit expenses/operating revenues	56.4	50.6	54.1	48.1	47.1

Table 3

Albaraka Turk Katilim Bankasi AS Capital And Earnings (cont.)					
Preprovision operating income/average assets	2.1	2.7	2.5	2.8	3.1
Core earnings/average managed assets	1.3	1.6	1.7	1.7	1.8

*Data as of June 30.

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 4

Albaraka Turk Katilim Bankasi AS Risk-Adjusted Capital Framework Data					
(TRY 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	2,824,453	--	--	1,434,433	51
Institutions	1,547,024	--	--	734,836	48
Corporate	9,035,123	--	--	15,574,252	172
Retail	4,039,186	--	--	4,338,236	107
Of which mortgage	1,151,474	--	--	621,796	54
Securitization	0	--	--	0	0
Other assets	583,844	--	--	1,057,175	181
Total credit risk	18,029,630	--	--	23,138,932	128
Market risk					
Equity in the banking book¶	10,795	--	--	115,144	1,067
Trading book market risk	--	--	--	0	--
Total market risk	--	--	--	115,144	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	--	--	1,497,791	--
(TRY 000s)	Basel II RWA		Standard & Poor's RWA		% of Standard & Poor's RWA
Diversification adjustments					
RWA before diversification	--		24,751,867		100
Total adjustments to RWA	--		3,493,114		14
RWA after diversification	--		28,244,981		114
(TRY 000s)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)	
Capital ratio					
Capital ratio before adjustments	--	10.8	1,486,081	6.0	
Capital ratio after adjustments§	--	10.8	1,486,081	5.3	

Table 4

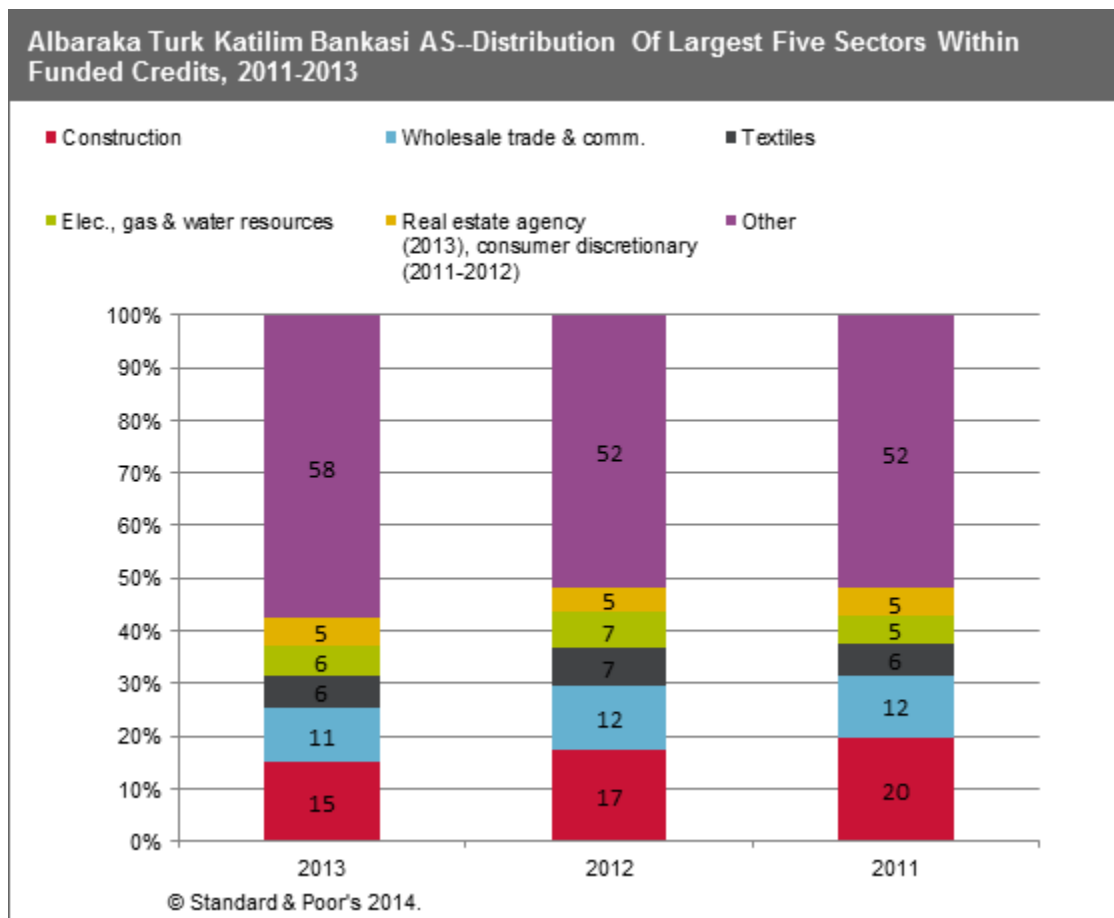
Albaraka Turk Katilim Bankasi AS Risk-Adjusted Capital Framework Data (cont.)

*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, 2013, 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 since 2012 as the share of lending to this sector has been decreasing (see chart 2). However, we note that this portfolio, as well as the entire financing book, has grown rapidly since 2009 and therefore remains vulnerable to an economic slowdown. The high share of the construction and real estate segment within restructured loans confirms our view. High levels of collateralization by tangible assets are, however, a mitigating factor.

Chart 2



Albaraka Turk's gross NPF ratio stood at 2.3% on June 30, 2014, a level that compares adequately with that of the wider Turkish banking system. Its net cost of risk compares favorably with select peers'. Problem assets are fully covered by provisions. Nevertheless, we acknowledge that the NPF ratio benefits from the denominator affect as a

result of recent rapid growth as well as restructured loans. Such loans accounted for another 2.0% of gross loans on the same date. In the next 12-18 months, we expect the NPF ratio to deteriorate only marginally on account of a more stable economic environment and a slowdown in the pace of lending.

Single name concentration does not affect our assessment. At year-end 2013, the largest 20 cash financings stood at 1.6x of total adjusted capital, which compares adequately with many peers in emerging markets.

Table 5

Albaraka Turk Katilim Bankasi AS Risk Position					
(%)	--Year-ended Dec. 31--				
	2014*	2013	2012	2011	2010
Growth in customer loans	11.3	32.4	24.9	15.3	33.6
Total diversification adjustment / S&P RWA before diversification	N.M.	14.1	N.M.	27.3	17.7
Total managed assets/adjusted common equity (x)	12.2	11.6	10.2	10.5	9.8
New loan loss provisions/average customer loans	0.5	0.9	0.6	0.9	1.1
Net charge-offs/average customer loans	N.M.	0.1	0.2	0.5	N.M.
Gross nonperforming assets/customer loans + other real estate owned	4.1	4.3	3.8	4.7	6.5
Loan loss reserves/gross nonperforming assets	50.0	47.9	56.1	45.8	39.2

*Data as of June 30.

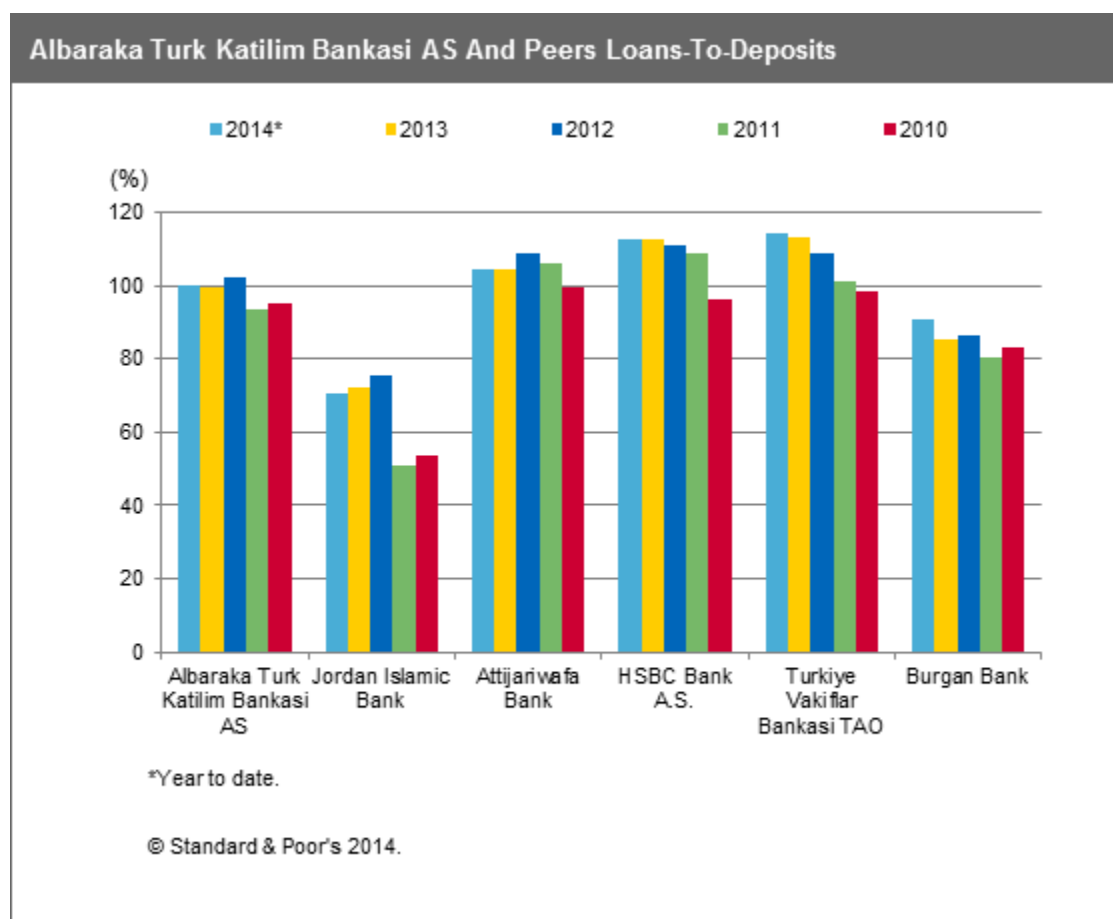
N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

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 71% of its funding base--and its adequate liquid assets (cash, central bank, and securities), which made up 31% of assets on June 30, 2014. Our view on its liquidity is also supported by the ratio of liquid assets (cash, unrestricted portion of reserves held with the central bank, and government securities) to short-term wholesale funding, which was 1.8x on March 31, 2014. Albaraka Turk enjoys good access to debt and capital markets abroad. Recent examples include a five-year sukuk for \$350 million borrowed in June 2014, and a syndicated Murabaha loan borrowed in September 2013. The latter includes one-year and two-year tranches. It also issued \$200 million of 10-year subordinated debt back in April 2013.

Albaraka Turk's loan-to-deposit ratio stood at about 100% in the past two years, below the average of 110% for the Turkish banking system and below foreign peers' (chart 3).

Chart 3



However, like 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, owing to a more granular funding base, significantly more than conventional Turkish banks. We expect the bank to maintain its current funding and liquidity metrics in the coming 15 months.

Table 6

(%)	--Year-ended Dec. 31--				
	2014*	2013	2012	2011	2010
Core deposits/funding base	77.6	80.1	83.9	85.8	91.0
Customer loans (net)/customer deposits	97.6	99.5	102.2	93.4	95.3
Long term funding ratio	89.1	87.4	85.5	87.2	92.0
Stable funding ratio	114.5	107.3	98.9	106.7	106.4
Short-term wholesale funding/funding base	11.9	13.8	16.1	14.2	9.0
Broad liquid assets/short-term wholesale funding (x)	2.6	1.9	1.4	1.9	2.5
Net broad liquid assets/short-term customer deposits	24.2	16.1	8.2	15.4	14.1
Short-term wholesale funding/total wholesale funding	53.3	69.4	100.0	100.0	100.1
Narrow liquid assets/3-month wholesale funding (x)	3.0	N/A	N/A	N/A	N.M.

Table 6**Albaraka Turk Katilim Bankasi AS Funding And Liquidity (cont.)**

*Data as of June 30.

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

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 38%, 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 into the ratings any notches of uplift for extraordinary government support.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria And Research**Related Criteria**

- Group Rating Methodology, Nov. 19, 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

Related Research

- S&P Publishes Update To Calendar Of 2014 EMEA Sovereign, Regional, And Local Government Rating Publication Dates, Oct. 3, 2014
- Presale: Bereket Varlik Kiralama A.S. Sukuk Lease Certificates, June 20, 2014
- Banking Industry Country Risk Assessment: Turkey, June 4, 2014
- Research Update: Ratings On Turkey Affirmed; Outlook Remains Negative, May 23, 2014
- Ratings On Six Turkish Banks Affirmed Despite Higher Industry Risks; Outlooks Remain Negative, March 5, 2014

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 October 21, 2014)

Albaraka Turk Katilim Bankasi AS

Counterparty Credit Rating	BB/Negative/B
<i>Turkey National Scale</i>	trAA/--/trA-1
Senior Unsecured	BB
Subordinated	B

Counterparty Credit Ratings History

30-Jun-2011	BB/Negative/B
30-Jun-2010	BB/Stable/B
22-Feb-2010	BB/Positive/B
22-Feb-2010 <i>Turkey National Scale</i>	trAA/--/trA-1
25-Sep-2009	trA+/--/trA-1

Sovereign Rating

Turkey (Republic of) (Unsolicited Ratings)	
<i>Foreign Currency</i>	BB+/Negative/B
<i>Local Currency</i>	BBB/Negative/A-2
<i>Turkey National Scale</i>	trAAA/--/trA-1

Related Entities

Al Baraka Banking Group B.S.C.

Issuer Credit Rating	BB+/Negative/B
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Jordan Islamic Bank

Issuer Credit Rating	BB-/Negative/B
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*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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