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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	bb+			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	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, albeit declining, exposure to the construction sector, partly offset by high collateral levels. • Tight capitalization. • High asset-liability mismatches, in common with the wider Turkish banking system.

Outlook

Standard & Poor's Ratings Services' outlook on Turkey-based Albaraka Turk Katilim Bankasi (Albaraka Turk) is negative, reflecting a one-in-three chance of a downgrade over the next 12 months. The outlook reflects our negative view of economic and industry risks Turkish banks face, as well as the negative trend Albaraka Turk's capitalization exhibits. All else remaining equal, a downgrade might stem from a scenario where loan growth surpasses internal capital generation, leading our risk-adjusted capital (RAC) ratio to deteriorate below 5%, over our 12-month outlook horizon.

In our view, other rating factors that might trigger a change in the counterparty credit rating on Albaraka Turk or the bank's stand-alone credit profile (SACP)--such as its risk profile or funding and liquidity--will remain stable over the coming 12 months.

An acceleration of loan growth, which could lead to 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 2010-2014 and is therefore largely unseasoned. However, the bank's profit margins are sufficient to absorb a moderate rise in nonperforming financings (NPFs) and cost of risk.

We could revise the outlook to stable if our view on the domestic banking system trends improved. An outlook revision could also happen if the bank continues to decrease the proportion of lending to the construction and real estate sector within total lending. We would also view positively a continuation of 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.

We incorporate one notch of uplift into the rating on Albaraka Turk to reflect group support from its parent the Albaraka Banking Group B.S.C.(ABG), in accordance with our group rating methodology. Although the outlook on Albaraka Banking Group is stable, the rating on Albaraka Turk could be affected by a rating action on the parent.

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 RAC ratio will fall to close to 5.0% 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 in recent years until 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 a 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)	2015*	2014	2013	2012	2011
Adjusted assets	26,995.5	23,019.5	17,200.6	12,320.6	10,455.5
Customer loans (gross)	19,059.3	16,471.0	12,313.3	9,297.7	7,445.8
Adjusted common equity	1,836.5	1,754.0	1,486.1	1,210.1	1,000.4
Operating revenues	537.7	897.8	798.8	631.8	507.7
Noninterest expenses	311.9	492.8	404.4	341.9	244.2
Core earnings	147.7	262.2	241.4	191.8	160.2

*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 small participation banking sector

We assess Albaraka Turk's business position as "moderate," owing to its small domestic market share of about 1.5% in deposits and 1.3% in loans on Dec. 31, 2014, in Turkey's highly competitive market. With total assets of Turkish lira (TRY) 27.0 billion (\$10.0 billion at TRY2.69 to the dollar) on June 30, 2015, Albaraka Turk is the third-largest player in Turkey's small Islamic or participation banking sector. However, it has market shares of about 23% in loans and 25% of 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 about 1.5%. Albaraka Turk's business is skewed toward small and midsize enterprises (SMEs) as the bank is a late entrant in the retail segment.

In our view, Albaraka Turk's management is adequate, backed by the expertise and strategic support of its 54.1%-owner, ABG. Although small, its stable market share and good track record of operational performance since its creation support this view. Key strategic plans aim to diversify the bank's loan book by increasing the share of retail lending and limiting the share of loans to the construction industry. We also forecast that the bank will grow at slightly above the sector average, which in our view would still be high compared with the bank's projected internal capital generation. Some progress has been made to date: Its financings increased over 15% in the six months to June 2015, with lower growth expected for the rest of the year; and the share of credits (on- and off-balance-sheet) to the construction segment dropped to 18.6% (16.4% cash only) as of year-end 2014 (20.3% a year earlier). 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--				
	2015*	2014	2013	2012	2011
Loan market share in country of domicile	1.3	1.3	1.1	1.1	1.0
Deposit market share in country of domicile	1.5	1.4	1.3	1.2	1.2
Total revenues from business line (mil. TRY)	537.7	897.8	894.8	705.6	552.7
Commercial banking/total revenues from business line	95.2	120.3	96.3	108.7	106.7
Retail banking/total revenues from business line	(16.1)	(39.0)	(21.7)	(31.6)	(32.9)
Commercial & retail banking/total revenues from business line	79.1	81.3	74.5	77.1	73.8
Other revenues/total revenues from business line	20.9	18.7	25.5	22.9	26.2
Return on equity	15.2	15.4	17.8	17.3	17.2

*Data as of June 30.

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

Capital and earnings: Capitalization remains tight

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 12.17% on June 30, 2015 (down from 14.15% on Dec. 31, 2014), and just above the target minimum 12% required by the Turkish regulator. Our assessment of Albaraka Turk's capitalization reflects the bank's pre-diversification RAC ratio, which we expect to decline to close to 5.0% over the next 15 months. The ratio stood at 5.2% on Dec. 31, 2014. The RAC ratio does not take into account subordinated debt, as we do not consider it to be loss-absorbing under our methodology. Furthermore, 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 about 20% per year, and that its net interest margin will remain close to 4.0% in 2015 and throughout 2016. We also expect the bank's net cost of risk to remain in the range of 0.4%-0.8% and its dividend payout ratio to be 15%. Our projections are based on the assumption that Turkey's GDP will grow by 2.5%-3.0% annually.

Reliance on Tier II capital is above peers': Albaraka Turk has \$200 million in subordinated debt (equivalent to one-third of its common equity) issued in the second quarter of 2013; this is considered as regulatory capital under Turkish regulations. The bank has recently been using such hybrid issuance to boost its regulatory capital, which puts pressure on our RAC ratio, given the growth in risk assets.

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.

Table 3

Albaraka Turk Katilim Bankasi AS Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Tier 1 capital ratio	9.7	10.9	10.8	12.3	11.9
S&P RAC ratio before diversification	N.M.	5.2	6.0	N.M.	6.3
S&P RAC ratio after diversification	N.M.	4.4	5.3	N.M.	4.9
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 interest income/operating revenues	76.2	77.9	78.3	76.9	76.0
Fee income/operating revenues	13.4	14.3	14.2	17.9	17.8
Market-sensitive income/operating revenues	7.7	5.9	4.7	3.2	4.2
Noninterest expenses/operating revenues	58.0	54.9	50.6	54.1	48.1
Preprovision operating income/average assets	1.8	2.0	2.7	2.5	2.8
Core earnings/average managed assets	1.2	1.3	1.6	1.7	1.7

*Data as of June 30.

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

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. 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.

Albaraka Turk's gross NPF ratio stood at 3.2% on June 30, 2015, 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 were 53.3% covered by specific provisions at the same date. Nevertheless, we acknowledge that the NPF ratio benefits from the denominator effect as a result of recent rapid growth as well as restructured loans. Loan growth has exceeded 30% in the past three years and is now above the sector average. The NPF ratio includes restructured loans under close monitoring which accounted for about 1.0% of gross loans on the same date. A further 1% of loans were restructured loans classified as standard. In the next 12-18 months, we expect the NPF ratio to deteriorate marginally on account of a more stagnant economic environment and a slowdown in the pace of lending. The portion of Albaraka Turk's foreign currency denominated lending is high, at 32% as of year-end 2014, similar to domestic peers; it is principally in U.S. dollars. This remains a concern, particularly in view of the Turkish lira volatility in recent years.

Single name concentration does not affect our assessment. At year-end 2014, the largest 20 cash financings stood at 1.6x of total adjusted capital, which compares adequately with many peers in emerging markets.

Table 4

Albaraka Turk Katilim Bankasi AS Risk Position					
(%)	--Year-ended Dec. 31--				
	2015*	2014	2013	2012	2011
Growth in customer loans	31.4	33.8	32.4	24.9	15.3
Total diversification adjustment / S&P RWA before diversification	N.M.	17.6	14.1	N.M.	27.3
Total managed assets/adjusted common equity (x)	14.7	13.1	11.6	10.2	10.5
New loan loss provisions/average customer loans	0.5	0.5	0.9	0.6	0.9
Net charge-offs/average customer loans	N.M.	0.1	0.1	0.2	0.5
Gross nonperforming assets/customer loans + other real estate owned	3.2	3.9	4.3	3.8	4.7
Loan loss reserves/gross nonperforming assets	53.3	44.4	47.9	56.1	45.8

*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 core customer deposits in the bank's funding mix--about 75% of its funding base--and its adequate liquid assets (cash, central bank, and securities), which made up 28% of assets on June 30, 2015. 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 June 30, 2015. 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 (dual-currency one-year tenure) of \$150 million borrowed in September 2014. Both were oversubscribed. 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 four years and was 105% as of June 30, 2015. This is slightly below the average of 110% for the Turkish banking system and below foreign peers'.

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 Albaraka Turk's more granular funding base, this is significantly more than conventional Turkish banks. We expect the bank to maintain its current funding and liquidity metrics in the coming 15 months.

Table 5

Albaraka Turk Katilim Bankasi AS Funding And Liquidity					
(%)	--Year-ended Dec. 31--				
	2015*	2014	2013	2012	2011
Core deposits/funding base	74.6	78.6	80.1	83.9	85.8
Customer loans (net)/customer deposits	104.8	100.7	99.5	102.2	93.4
Long term funding ratio	86.2	86.8	87.4	85.5	87.2
Stable funding ratio	105.9	106.5	107.3	98.9	106.7
Short-term wholesale funding/funding base	14.8	14.4	13.8	16.1	14.2
Broad liquid assets/short-term wholesale funding (x)	1.8	1.8	1.9	1.4	1.9
Net broad liquid assets/short-term customer deposits	17.9	16.2	16.1	8.2	15.4

Table 5

Albaraka Turk Katilim Bankasi AS Funding And Liquidity (cont.)					
Short-term wholesale funding/total wholesale funding	58.5	67.2	69.4	100.0	100.0
Narrow liquid assets/3-month wholesale funding (x)	1.6	4.0	N/A	N/A	N/A

*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 B.S.C. (BB+/Stable/B). 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, over 40%, 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 September 11, 2015)

Albaraka Turk Katilim Bankasi AS

Counterparty Credit Rating

BB/Negative/B

Turkey National Scale

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

Turkey National Scale

trAA/--/trA-1

25-Sep-2009

trA+/--/trA-1

Sovereign Rating

Turkey (Republic of)

Foreign Currency

BB+/Negative/B

Local Currency

BBB-/Negative/A-3

Turkey National Scale

trAAA/--/trA-1

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

Issuer Credit Rating

BB+/Stable/B

Jordan Islamic Bank

Issuer Credit Rating

BB-/Stable/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. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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