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**Summary:**

# Albaraka Turk Katilim Bankasi AS

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## Summary:

# Albaraka Turk Katilim Bankasi AS

**Credit Rating:** BB-/Stable/B

## Rationale

The ratings on Albaraka Turk Katilim Bankasi AS reflect its good track record in Turkey's participation (Islamic) banking market, adequate capitalization and funding, and limited market risk. The ratings are constrained by the high-risk operating environment in the Republic of Turkey (foreign currency ratings BB-/Stable/B, local currency ratings BB/Stable/B), the bank's small size and market share, high loan leverage, above-average credit risk due to its large exposure to small and midsize enterprises (SMEs), and short-term and relatively undiversified funding.

Albaraka Turk is 56.6% owned and controlled by Bahrain-based Albaraka Banking Group (B.S.C.) (ABG, BBB-/Stable/A-3). Albaraka Turk is ABG's largest subsidiary, and Standard & Poor's Ratings Services classifies the bank as strategically important to its parent. Albaraka Turk represented 28% and more than 40% of total group assets and profits in 2008. ABG has shown a strong commitment to its subsidiaries, notably through ongoing capital support and risk management discipline. However, we believe that in a downside scenario, ABG's capacity to provide extraordinary support to Albaraka Turk is somewhat limited, because the subsidiary represents a sizable portion of the group. Therefore, the ratings on Albaraka Turk reflect its stand-alone credit profile and do not factor in uplift for extraordinary support. At the same time, we believe that the ownership structure and resulting ongoing support are positive factors that we incorporate into the bank's stand-alone credit profile.

Albaraka Turk is a small, Turkish participation bank. With total assets of Turkish lira (TRY) 5.4 billion and about 100 branches on March 31, 2009, the bank has a very limited share (0.65%) of the Turkish banking market. It focuses mainly on the corporate sector. The risk profile features high credit risk, but adequate funding and liquidity, and limited market risk. Balance sheet composition is skewed toward corporate loans, including a large exposure to the local SME market--roughly 35% of gross loans. This is attributable to a less aggressive foray into the household segment and the lack of interest-free instruments in Turkish capital markets, which leaves customer lending as the main way the bank can generate assets. The bank is trying to increase its household market share by opening new branches. Its asset quality, like that of domestic peers, is sensitive to economic cycles. The ratio of nonperforming loans (NPLs) to gross loans stood at 4.3% on March 31, 2009, when restructured loans are excluded, on a par with the average for Turkish banks. Like those of Turkish banks in general, Albaraka Turk's NPLs are rising, along with the sharp contraction of the economy. We expect asset quality to continue deteriorating in the coming quarters.

Funding has historically been through "participation accounts" (the equivalent of retail and corporate deposits in conventional banking), which comprised a high 92% of total liabilities on March 31, 2009. 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.

Financial performance is satisfactory and stable. The bank's average return on assets was 3.0% over the past three years, on a par with that of domestic peers. Efficiency is satisfactory despite substantial investments in branch network expansion. Albaraka Turk's ratio of adjusted total equity (ATE) to assets stood at 13.1% on March 31,

2009. Taking into account the bank's risky operating environment and balance sheet mix, we consider that capitalization is adequate.

## Outlook

The stable outlook mirrors that on Turkey. It also balances the bank's resilience to the economic downturn with our expectations of increased pressure on asset quality, owing to the difficulties that corporate and household borrowers face. We expect the ratings on the bank to remain tightly linked with the sovereign's creditworthiness. If the economic contraction in Turkey proves to be longer than we currently expect, Albaraka Turk, along with other Turkish banks, will have to operate in a more difficult and volatile financial environment. This could exert pressure on profitability, asset quality, and capitalization. Under this scenario, the ratings could come under pressure. A positive rating action would require both an improvement in the sovereign creditworthiness and the bank's stand-alone credit profile.

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