



IIRA Maintains Ratings of Al Baraka Turk and Improves the Fiduciary Score

Manama, July 13, 2021 – Islamic International Rating Agency (“IIRA”) has reaffirmed the foreign currency ratings of Albaraka Türk Katılım Bankası A.Ş. (“Albaraka Turk” or “the Bank”) at ‘BB+/A3’ (Double B Plus / A Three) and local currency ratings at ‘BBB-/A3’ (Triple B Minus / A Three), respectively on the international scale. Outlook on the assigned ratings remains ‘Negative’ reflecting the outlook on Republic of Turkey Sovereign rating, last revised on June 11, 2021. Meanwhile, IIRA assigned national scale credit ratings of ‘A+(tr)/A1(tr)’ (A Plus / A One) to the Bank with a ‘Stable’ outlook.

Despite posting positive growth in 2020, the Turkish economy witnessed exacerbation of imbalances with sizable current account deficit and erosion of reserves, triggering sharp depreciation of the currency. The economic activity is expected to post above-trend GDP growth in the year 2021 owing to base effects, expected recovery in tourism and better external balances. Inflationary pressures have persisted despite the tighter monetary stance, given global food price and energy price increase and lagged impact of TL depreciation. In view of the economic and business pressures, Banking Regulation and Supervision Agency (BRSA) enacted forbearance measures for relaxed capital calculations and extended NPL recognition to 180 days from 90 days which shall be valid until end of September 2021. Partly on account of these measures, asset quality indicators of the banking sector did not post any material deterioration, and capital buffers remained within regulatory requirements, despite rapid loan growth, boosted by the loose monetary stance of the Central Bank of Turkey (CBT) as well as the asset ratio regulation which terminated in December 2020.

Albaraka Turk is one of the six participation banks in Turkey and has held a stable market share within the domestic banking sector at 1.1% over the last three years, even as its share in participation banking segment fell to 15.9% of segment assets (2019: 18.1%) by end -2020. Assigned ratings derive support from its controlling shareholder’s, Al Baraka Banking Group (“ABG”), maintained oversight.

Gross NPF ratio and net non-performance of the Bank has retreated markedly in 2020, with strong collections and partly due to forbearance measures in effect. More importantly, we have noted the decoupling of trends from the sector, which posted lesser decline in non-performance and the resulting convergence of the Bank’s non-performance indicators to sector aggregates positively. In view of the lifting of forbearance measures in 2021, the Bank may recognize higher NPFs stemming from Covid-19 crisis in line with sectorwide trends. On the other hand, projected improvement in economic activity may give impetus to revival of businesses. Overall, NPF ratio for the Bank should head up in 2021, but cost of credit risk should decline as provisions have been booked proactively in 2020.

Growth in funding base during 2020 was also boosted by TL depreciation. Even though there was modest shift in funding mix away from deposits to funds borrowed and money market borrowings, assets are still predominantly funded by deposits. Liquidity coverage to funds has improved modestly. Total Capital

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Adequacy Ratio of the Bank retreated to 13.5% depicting 144bps decline over the previous year. Concurrently, tier 1 and CET1 ratios fell to 9.4% and 7.5% respectively from 10.4% and 8.4% at prior year-end. Al Baraka Turk's capitalization indicators stood somewhat above the regulatory thresholds of 12% and 8.5% for CAR and tier 1 ratio, however, going forward, the lifting of the forbearance measures would pose a risk to capital as would the expected risk asset growth for 2021 in the absence of capital strengthening measures. On the upside, normalization of the bank's earnings could also support internal capital generation which could suffice for relatively modest risk weighed asset growth expectations of 8% to 10% in 2021. Nevertheless, capital reinforcement is required to support expected growth in subsequent years.

The Bank's earnings rose in 2020, from a significantly low base. Main contributors were the notable growth in net profit share income, despite the negative pull from lower net fee income and trading gains as well as increasing provision charges and inflationary push on operating costs. Despite the notable improvement, the Bank's return indicators lagged peers. Following a relatively better year of earnings; the profitability outlook for 2021 is marked by weaker profit share margins and an increasing cost base. However, continued growth along with expectations of improvement in net fees and cost of credit risk, will support the bottom line.

The Bank's fiduciary score improved to '76-80' which reflects strong fiduciary standards wherein rights of various stakeholders are protected. The improvement in the overall fiduciary score was mainly driven by increase in corporate governance score to 81-85 band as the independent representation on the Board improved both as per local regulations and best practices; further efforts on the sustainability front are viewed positively.

On the Participation Banking Governance front, the year 2020 has witnessed the Bank's efforts to fully adopt BRSA's September 2019 regulations pertaining to Participation Banking Governance. We note that Al Baraka Turk was the only Bank in Turkey to have established a direct reporting line for PB Compliance Unit to Consultancy Committee. Even though the Turkish regulatory framework deviates from best practices in some aspects, we note that Al Baraka Turk complies with all local regulations as well as global best practices, where not in conflict with local regulations or legal requirements. ABG oversight further strengthens the overall Governance framework.

For further information on this rating announcement, please contact us at iira@iirating.com