الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

# IIRA maintains National Scale Ratings of the Kuveyt Turk Participation Bank

**Manama, May 25, 2022** – Islamic International Rating Agency ("IIRA") has reaffirmed national scale ratings of Kuveyt Turk Participation Bank ("KTPB" or "the Bank") at 'AA (tr)/ A1+(tr)' (Double A/A One Plus). Asset quality indicators improved both on gross and net basis given the relatively contained accretion of new NPFs and sizable provisioning. Already strong liquidity indicators improved further as financing growth lagged deposit momentum, which picked up more sharply in Q4'2021. Risk profile is maintained as also reflected in continued strong capitalization indicators, given robust profitability and full retention, and even when assessed without the effects of regulatory forbearance measures. Return indicators also improved over 2020 and continued to command premium over banking sector and PB peers. Despite improvements on a relative basis, ratings on the national scale have been maintained on grounds of persistent macroeconomic risks. These risks are more comprehensively reflected in international scale ratings assigned to the Bank, having been revised to reflect IIRA's recent revision to sovereign ratings of Republic of Turkiye. Accordingly, Kuveyt Turk's foreign currency and local currency ratings on the international scale were placed at 'BB+/A3' (Double B Plus /A Three). Outlook on the ratings is now 'Stable'.

Economic profile of Turkiye was marked by robust domestic demand and recovering external demand in 2021, largely maintained buffers in the banking sector, and moderately weaker fiscal indicators, which nevertheless remained superior to peer countries. However, monetary easing in the later months of 2021, is feeding into an inflationary spiral via notable depreciation of Turkish Lira. Full year 2021 CPI realizations exceeded the CBT's estimates by a wide margin, driven by policy framework deviating from the strict inflation targeting policy. Most recent indicators point to continued price hike over the next few months. Relatively low levels of coverage of external debt by reserves is deemed to be another significant risk factor.

Despite banking sector largely holding up till now, sharp depreciation of Lira has elevated the financial stability risks posing a threat to asset quality prospects. Around 42% of the lending book in the sector is FCY denominated, and dollarization has steadily increased over time, albeit depicting a decline in the last few months, following the introduction of the FCY protected deposit scheme.

The Bank's ratings incorporate evidence of effective sponsor support with Kuwait Finance House KSC ("KFH"), controlled by Kuwait State owned entity, being the main shareholder, and having a strong financial standing. In addition, minority shareholders also comprise a Turkish government related entity and the Islamic Development Bank – a multilateral financial institution.

KTPB's gross non-performance in relation to financing portfolio retreated to 2.3% in 2021 (2020: 3.6%) and thus remains lower than the banking sector and participation banks' average. More importantly, net NPFs declined to only 0.1% of total assets (2020: 0.3%) due to accumulation of significant ECL provisions. Notable depreciation of local currency in the last quarter of 2021 increases credit risk for the near future, as does the projected slowdown in economic growth. However, overall coverage ratio standing at 279% mitigates the prospective loss to net asset values.

Funds growth was rapid with relatively higher volume growth for deposits. Hence the Bank's funding of assets via deposits improved over 2020 and points to an increasingly stable funding base. Moreover, improvement in deposit mix towards higher cost-free deposits alleviate both funding costs and asset liability mismatch risks. In 2022, deposit growth is projected to decelerate, however, the share of Turkish Lira deposits in total deposits is expected to increase owing to the FCY protected deposit scheme which should also moderately extend the average duration of deposits. The Bank's liquidity coverage ratio indicates sufficient reserves and is well above peers, while credit to deposit ratio also implies strong liquidity buffers.

Capital adequacy ratio of the Bank rose to 22.3% from 20% as did tier 1 ratio to 16.3% from 15%. On the other hand, CET1 was up by 43bps at 12.55% owing to continued healthy internal capital generation. As such, KTPB's capital buffers remain well above regulatory thresholds as well as Participation Banks' aggregate CAR and CET 1 of 18.9% and 11.6%, respectively. While in the absence of regulatory forbearance capital indicators would be well below reported levels as current level of Turkish Lira is much weaker than 252-days average, thus adjusted capital buffers are as yet strong, boosted further by prospects of improving profitability and a sizable foreign currency component of capital.

Net earnings of the Bank surged in the year 2021 to TL3.4bn with growth in margin and fee income being balanced by higher provisions and operating expenses, and profitability boosted most significantly by increase to net trading income. At 1.6% (2020: 1.3%), return on average assets stood at a sizable premium to Turkish banking sector average of 1.2%. Spreads are foreseen to widen owing to low deposit costs whereas fee & commission generation is foreseen to remain strong with new expected business generation. However, likely increase in operating expenses due to backward indexation of costs to inflation and decline in net trading income which provided a major boost to net earnings in 2021, is expected to pressure earnings generation during 2022.

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