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## IIRA Maintains the Credit Ratings of Banque Al Baraka D'Algérie while increasing the Fiduciary Scores

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**Manama, November 02, 2020**– The Islamic International Rating Agency (IIRA) has maintained the outstanding foreign currency ratings of 'BBB- / A3' (Triple B Minus / A Three), and a local currency rating of 'BBB / A2' (Triple B / A Two) on the international scale, assigned to Banque Al Baraka D'Algérie ('Al Baraka Algeria' or 'the Bank'). Meanwhile, the national scale rating has also been maintained at 'A+/A1' (Single A Plus / A One). The outlook on the assigned ratings remains 'Stable'. Al Baraka Algeria's fiduciary score has been revised up to the range of '71-75' from '66-70'.

While reaffirming the credit ratings of the Bank, IIRA is cognizant of the downward pressures on the asset quality front due to deterioration in the operating environment, with the economy being hit by the twin crisis of COVID-19 pandemic and falling oil prices. Concerns are further exacerbated by the relatively modest capital buffers of the bank, while being above regulatory requirements. These strains are to be balanced by the continued healthy profitability, albeit being negatively impacted by recent regulatory amendments to conduct foreign currency transactions as well as the fee structure of banks on the one hand, and relatively muted growth prospects, on the other.

Banque Al Baraka D'Algérie is one of the two banking institutions in Algeria operating in accordance with participation finance principles. With 31 branches, the bank holds a 2.0% market share in terms of deposits as of year-end 2019. Al Baraka Banking Group ("ABG" or the "Group") holds majority stake at 55.65%; the Group's strong franchise and multi-jurisdictional presence supports the ratings. Banque de l'Agriculture et du Développement Rural ("BADR") holds the remainder of the Bank's shares and is one of the largest state banks in Algeria with around 9.5% market share in terms of assets and a particular focus on developing the country's agricultural sector and promoting rural development.

Growth in Algeria for the year 2019 remained much below expectations as political uncertainty weighed negatively on the economic outlook for most of the year. As the COVID-19 pandemic hit the global economy and trade, plunging oil prices will inevitably take a toll on the economy, evident in year-to-date economic performance. GDP is expected to contract notably during 2020 as fiscal and current account deficits widen. Low external debt levels have provided cushion to currency value in 2017 - 2019, however, depreciation accelerated in the current year. Heightened credit risk in the economy will burden asset quality of the banking sector. Policy rate cuts by the Banque d'Algérie ("BA" / the "Central Bank"), is likely to cause banking margins to narrow; cancellation of select fees and expected rise in provisioning charges pose risks to the profitability of the banking sector.

The Bank's asset base contracted 3.5% in 2019 to DZD262bn following 9.0% growth in the previous year, as a consequence of reduction in margin deposits held, and given declining trade finance business. Weak market conditions will continue to impact growth, amidst the liquidity challenges in the banking sector despite the 4percentage points cut in the required reserve ratio by the Central Bank, as also evidenced by 2.0% contraction in H1'2020. Despite falling from previous year, liquidity buffers of the Bank are deemed strong. Funding profile of the bank also derives strength from reliance on core deposit funds, and healthy diversification of depositor base.



Impairment indicators have deteriorated notably with a 110bps increase in gross impairment, given the increase in non-performing financings and muted volume growth. While some support from lower policy rates environment is conducive for payment capacity of borrowers, much lower oil prices and headwinds from COVID 19 may result in further weakness in asset quality in the current year. Prospects of rising unemployment will strain the consumer segment as well. Indeed, worsening of asset quality indicators has accelerated in the first half of the ongoing year with gross impairment ratio rising to 8.0% as of June 2020 indicating 2.4 percentage points rise compared to the year-end. Net non-performance corresponded to 3.1% of total assets which is still indicative of moderate asset quality, albeit notably deteriorated over 1.5% at prior year-end. Most of the new impairments in recent periods stem from the real estate sector due to the delay in completion and the decline in sales due to the Covid-19 triggered crisis. We note that the collateralization of the real estate exposures remains solid. Even though asset quality prospects of the bank are partly supported by a diversified portfolio and relatively strong collateralization, further deterioration in impairment metrics may be expected.

The Bank's surplus liquidity is largely maintained in the form of non-remunerative placements with BA in the absence of a Shari'a compliant interbank market, and hence yielding lower asset margins overall. During 2019, spread income was pressured from a declining asset base as well as weaker margins. However, the bank's profitability has been supported by both FCY trading commissions and moderate operating costs. As a result, the Bank was able to uplift its return on average assets to 2.4% marking a 40bps increase over prior year. In the ongoing year, the bank will be pressured from downside risks to economic activity, which will moderate volume growth, whereas regulation on fee income and sharp cut to FCY margin rates by Bank of Algeria poses further downside risks, exacerbated by expected increase in provision expenses.

The bank's equity base grew at a healthy rate as internal capital generation improved in tandem with better profitability and lower dividend payout. Combined with a declining asset base, the bank's capitalization metrics notched up with CAR and tier-1 ratios registering at 14.0% and 12.7% comfortably above 12.0% and 9.5% minimum thresholds of the Bank of Algeria. In the current year, capitalization profile will be supported by moderate risk weighted asset growth, while reduced profitability prospects may have adverse effects. In the medium term, the Bank's buffers will be adequate, and dividend payouts could be adjusted to allow for moderate business growth, coupled with Central Bank's allowances on the capital front which effectively lowering the minimum capital adequacy threshold to 9.5% and tier-1 ratio to 7.0%.

Al Baraka Algeria's fiduciary score has been revised up to the range of '71-75' from '66-70', reflecting adequate fiduciary standards wherein rights of various stakeholders are adequately defined and protected. The main drivers of the upgrade were the improvements on the corporate and Shari'a governance fronts for each of which the score bands were uplifted by one band. Restructuring of risk management department and strengthening of the headcount of control functions were the key positive changes for corporate governance practices. Banque d'Algerie recently issued standards for participation banking and it setup a National High Shari'a Authority under its purview, reinforcing the Shari'a Governance framework in the Country. The Bank has separated Shari'a Audit and Shari'a Compliance functions, to better align with best practices and with directives of the Central Bank of Bahrain. Another positive development since our prior review has been the conduct of the external



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Shari'a Audit, which yielded a generally cautious, positive review of Shari'a practices and controls. Meanwhile, the additional layer of oversight exercised by ABG contributes to our assessment on the fiduciary scores.

For further information on this rating announcement, please contact us at [iira@iirating.com](mailto:iira@iirating.com).

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