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Summary:

Turkiye Vakiflar Bankasi TAO

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Summary:

Turkiye Vakiflar Bankasi TAO

Credit Rating: BB/Positive/B

Outlook: Positive

The positive outlook on Turkiye Vakiflar Bankasi TAO (Vakifbank) reflects that on Turkey. Bank-specific factors leading to a revision of the ratings appear limited. The bank ratings will therefore be largely driven by future rating actions on Turkey, if any.

A positive rating action on the foreign currency rating on the sovereign would trigger a positive rating action on the bank ratings. Any negative rating action on the sovereign would trigger the same rating action on Vakifbank. For instance, we would revise the outlook on Vakifbank to stable if we were to revise the outlook on the sovereign to stable.

Rationale

The ratings on Vakifbank reflect its 'bbb-' anchor, as well as its "adequate" business position, "adequate" capital and earnings, "adequate" risk position, and "average" funding and "adequate" liquidity, as our criteria define these terms. The stand-alone credit profile (SACP) is 'bbb-'.

Under our bank criteria, we use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating (ICR). Our anchor for a commercial bank operating in Turkey is 'bbb-'.

The BICRA score is informed by our evaluation of economic risk, which in our view is shaped by Turkey's economic volatility and structural imbalances, in particular its high current account deficit and net external debt. In our view, these factors expose the financial system and export-oriented industries to external shocks. With regard to industry risk, we view Turkey's overall institutional framework as positive, as demonstrated by the authorities' increasingly proactive and prudent stance toward the industry. We also believe that the industry has largely stabilized and benefits from adequate pricing power without any market distortions. Nevertheless, the banks' moderate risk appetite adds to their funding risks that stem from a granular but short-term customer deposit base, in our view. The anchor is two notches above our foreign currency rating on Turkey because our BICRA methodology excludes a sovereign default scenario, which is incorporated into the ICR.

Our assessment of Vakifbank's business position as "adequate" balances its strong commercial position as the sixth largest commercial bank in Turkey against its lack of geographic diversification. Vakifbank is a quasi-state-owned entity as it is indirectly majority owned by the state through the General Directorate of Foundations (GDF), and 25% of its shares have been publicly listed since 2005. The past decade resulted in a significant improvement in the bank's management and strategy, bringing them more in line with privately owned banks. We understand that Vakifbank's medium-term strategy is to rank among the top three Turkish banks by capitalizing on the growth opportunities resulting from the country's economy and underserved population vis-à-vis financial services. Although in the last two years the bank successfully increased its market share both in deposits and loans, the

continued fast growth in lending is ambitious in our view and could result in higher credit losses for the bank in the medium term. Vakıfbank holds about 8% of Turkey's deposits and loans market. It enjoys privileged status with government-related entities which translates into a high proportion of payroll accounts and the consequent benefits of lower cost funding and lower-risk lending opportunities owing to salary assignments.

Our assessment of capital and earnings as "adequate" reflects our expectation that the bank's risk adjusted capital (RAC) ratio before adjustments will remain in the 7%-8% range over the next 12-18 months. Its Tier 1 ratio was 14% on June 30, 2011, well above the regulatory minimum. The gap between the Tier I ratio and our RAC ratio primarily reflects our higher risk-weight for most asset classes. The margin contraction driven by regulatory measures to slow down systemic credit growth has come to an end, in our opinion. Vakıfbank's net interest margin stood at 3.7% for the first half of 2011. Vakıfbank's return on average assets averaged 1.9% in the years 2007-2010, providing an adequate buffer against its expected losses. As with other large Turkish banks, bottom-line earnings benefited from a strong nonperforming loan (NPL) collection in 2011 and resulted in a negative cost of risk. We expect this trend to reverse in 2012. With respect to earnings mix, Vakıfbank lags behind rated private Turkish banks as the contribution of fee income is relatively lower than these. Yet, its operational efficiency is in line with peers' despite having outperformed them in terms of branch openings in 2010 and 2011. We expect Vakıfbank's adequate internal capital generation and conservative dividend payout policy to remain supportive of its capitalization.

We assess Vakıfbank's risk position assessment as "adequate", mainly reflecting our view that the majority of risks the bank could face are captured by our RAC ratio. A positive feature of the bank's risk profile is its strong loss experience, as evidenced by its cost of risk in the recent downturn. New loan loss provisions as a share of customer loans averaged 0.9% between the years 2007-2010, a level below domestic peers'. Vakıfbank's asset quality continued to improve in 2011 when recoveries exceeded new NPL formation. Therefore, NPL decreased in both absolute and relative terms. Yet, Vakıfbank's asset quality indicators also benefit from a buoyant loan growth, which we view negatively as it accentuates the bank's credit risks should the Turkish economy face an economic downturn. On June 30, 2011, Vakıfbank's gross NPL ratio stood at 3.9%, 1.21% lower than the year-end 2010 ratio. The ratio is slightly above the sector average as Vakıfbank--unlike domestic peers--did not sell or write-off its legacy NPLs. Coverage by provisions stood at 100% at mid-year 2011, a level we expect to be maintained by the bank.

Vakıfbank has a non-complex business model that does not add to its risk profile. One of the bank's weaknesses is the single party concentration of its loan book compared with peers, but the fact that the majority of large loans are lent to several companies operating under large diversified industrial groups is a mitigating factor. Going forward, interest rate risks stemming from duration gaps between assets and liabilities remain a major risk factor that is not captured by our RAC ratio, as is the case for its domestic competitors.

Our assessment of Vakıfbank's funding as "average" and liquidity as "adequate" reflects the high proportion of customer deposits in its funding mix and its high amount of readily available assets (cash, interbank, and available for sale assets), which accounted for 34% of liabilities on June 30, 2011. At 102% on the same date, its loan-to-deposit ratio was above the system average of 94% but we do not expect it to increase further. Like its peers, Vakıfbank has a short-term funding base leading to high asset-liability mismatches. Despite this, Vakıfbank's customer deposits have remained stable in times of stress, and we expect the bank to diversify the maturity profile of its funding by issuing longer term domestic bonds. Turkey changed its capital market regulations in 2010, making it easier for Turkish banks to expand their domestic debt issuances. With respect to the heightened rollover risks in

2012 and owing to the difficulties in the European Economic and Monetary Union (EMU or eurozone), we believe that the impact on Vakifbank will be manageable. The bank has two term borrowings due in March and September 2012, and these sums are insignificant compared with its liquid assets. On June 30, 2012, Vakifbank's broad liquid assets (cash and reserves at the central bank net of restricted reserves plus securities and due from banks) covered 2x its short-term wholesale funding (due to banks plus funds borrowed under repurchase agreements). Our base-case scenario does assume a moderate drop in the rollover ratios for Turkish banks in 2012, as experienced in 2009, but does not exclude a hike in the overall cost of such funds.

The bank's long-term rating is two notches below the SACP and the same as Turkey's foreign currency ratings. This reflects our view that Vakifbank would be unlikely to withstand a scenario where Turkey defaulted on its obligations. We view Vakifbank as having "high" systemic importance and classify the Turkish government as "supportive" toward its banking sector. But this does not result in any uplift above the SACP due to the level of the foreign currency ratings on the sovereign.

Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

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