FitchRatings

Fitch Affirms Four Mid-Sized Turkish Banks

Fitch Ratings-London-07 March 2018: Fitch Ratings has affirmed the Long-Term Foreign Currency Issuer Default Ratings (IDRs) of Turk Ekonomi Bankasi A.S. (TEB), QNB Finansbank A.S. and ING Bank A.S. (INGBT) at 'BBB-' and of Denizbank A.S. at 'BB+'. The Outlooks on the banks' Long-Term IDRs are Stable, except for Denizbank, which is Positive.

At the same time, the agency has downgraded QNB Finansbank's Viability Rating (VR) to 'bb' from 'bb+', reflecting the gradual reduction in the bank's core capitalisation relative to peers. The VRs of TEB, INGBT and Denizbank have been affirmed.

The support-driven IDRs of subsidiaries Deniz Finansal Kiralama A.S. (Deniz Leasing), Joint-Stock Company Denizbank Moscow (Denizbank Moscow) and Finans Finansal Kiralama A.S. (QNB Finansleasing), which are equalised with those of their parents, have also been affirmed.

A full list of rating actions is at the end of this commentary.

KEY RATING DRIVERS

IDRS, NATIONAL RATINGS, SENIOR DEBT RATINGS, SUPPORT RATINGS

The banks' IDRs, National Ratings and senior debt ratings are driven by parental support. INGBT is fully owned by ING Bank N.V. (A+/Stable). TEB is 55%-owned, but fully controlled, by TEB Holding, a holding company in which BNP Paribas (A+/Stable) holds a 50% stake. BNP Paribas directly owns an additional 44.7% stake in TEB. QNB Finansbank and Denizbank are both 99.9% owned by their respective shareholders, Qatar National Bank S.A.Q. (QNB, A+/Negative) and Sberbank of Russia (Sberbank, BBB-/Positive).

Recent statements by Sberbank have confirmed that Emirates NBD (A+/Stable) has expressed an interest in acquiring Denizbank. However, no further announcements have been made as to the scope, likelihood or timing of any sale.

The Long-Term Foreign-Currency IDRs of INGBT, TEB and QNB Finansbank are capped by Turkey's 'BBB-' Country Ceiling, while their 'BBB-' Long-Term Local-Currency IDRs continue to take into account Turkish country risks. Denizbank's IDRs are notched once from its parent.

Deniz Leasing's, Denizbank Moscow's and QNB Finansleasing's support-driven IDRs and National Ratings are equalised with those of their respective parents reflecting their close integration, including the sharing of risk assessment systems, customers, branding and management resources.

The Positive Outlooks on the Long-term Ratings of Denizbank, Deniz Leasing and Denizbank Moscow mirror those on their parents and indicate the potential for Sberbank's ability to provide support to increase.

VRs

The downgrade of QNB Finansbank's VR to 'bb' is driven primarily by Fitch's reassessment of the bank's core capitalisation. This reassessment is based on a Fitch Core Capital (FCC)/risk-weighted assets ratio (end-2017: 12.1%) that is now broadly comparable with most peers. As a result, Fitch no longer believes that capitalisation is a relative rating strength for the bank. QNB Finansbank was the only bank of the peer group to report a slight fall in its FCC ratio in 2017 despite uplift from lower risk weightings on loans issued under the Credit Guarantee Fund. TEB, INGBT and Denizbank all saw an increase of over 100bp in their FCC ratios year-on-year.

The VRs of all four banks reflect their moderate market shares (ranging from 2% to 4% of sector assets), limited franchises and ensuing limited competitive advantages in the volatile Turkish market. The banks provide a mix of services to corporate and commercial customers, small and medium-sized companies (SMEs, which are most sensitive to swings in the economy) and retail customers. QNB Finansbank's operations, which were previously focused primarily on the retail and SME segments, are shifting more towards the corporate segment under its revised strategy. Denizbank has something of a niche in servicing agro customers.

All four banks have exposure, to varying degrees, to foreign currency (FC) lending (which inflates risk-weighted assets as the Turkish lira depreciates) and to potentially risky sectors. TEB has typically grown below the sector average, reflecting its historically fairly conservative risk appetite. Growth at INGBT has slowed as it has adopted a more conservative approach to growth in FC lending. QNB Finansbank's fairly aggressive growth appetite since 2016 has reflected its quest for market share and strategic shift into corporate lending. Its loan book grew significantly above sector and peer averages in 2017, while it also has some appetite for

FC loan growth, including long-term project finance. Loan growth at Denizbank has remained more consistent, but quite rapid.

The four banks all made use of the Credit Guarantee Fund (CGF) stimulus in 2017. This facility primarily consists of short-term working capital loans to SME customers, which benefit from a treasury guarantee up to the 7% non-performing loan threshold.

Performance has generally remained reasonable at the four banks, although they have lower economies of scale and more limited franchises than their large Turkish banks peers. They have typically reported fairly high, albeit still manageable, loan impairment charges relative to pre-impairment profit, reflecting their focus on more risky customer segments.

However, the banks' net interest margins have generally remained reasonable, supported by a focus on high-yielding loan segments and hedging, although if adjusting for foreign currency swap costs, margins are tighter. Furthermore, the banks' funding costs have come under pressure, as for the sector, and further increases could weigh on earnings. Access to group funding provides some relief in terms of funding costs and the banks are endeavouring, to varying degrees, to offset margin pressure through the disbursement of floating-rate loans and funding diversification.

Asset quality metrics remained reasonable in 2017, despite the challenging operating environment, with all four banks reporting declines in Non-performing loan (NPL) origination ratios. NPL ratios fell to a moderate 2.9% at TEB at end-2017 (end-2016: 3.0%), 4.7% at QNB Finansbank (2016: 5.6%) and 3.4% at Denizbank (2016: 3.7%), albeit in part due to NPL sales in all cases. NPLs remained reasonable at INGBT, despite rising (end-2017: 3.5%; end-2016: 3.2%).

Immediate risks to the banks' asset quality metrics have moderated, in our view, given the supportive economic backdrop (estimated GDP growth: 6.8% for 2017). Nevertheless, significant watchlist loans, which amounted to 4.3% of gross loans at TEB, 4.7% at QNB Finansbank, 3.1% at INGBT and 8.4% at Denizbank, could result in new NPL growth. Furthermore, the share of restructured loans within the watchlist category was also fairly high (with the exception of INGBT).

FC lending (including FC-indexed loans) is material at all four banks. It amounted to 24% (TEB), 28% (QNB Finansbank), 49% (Denizbank) and 38% (INGBT) of the respective banks' performing loans at end-2017. However, INGBT has been actively reducing its FC loan exposure (down from 47% at end-2016) as a result of a reduction in risk appetite. QNB Finansbank, on the other hand, increased FC lending in 2017 (up from 26% at end-2016) as it expanded corporate lending.

Fitch believes FC loans could bring credit losses as the loans season, particularly given the depreciation of the Turkish lira in recent years and borrowers not all being fully hedged. This risk is mitigated by some FC borrowers being large Turkish corporates with diversified operations. In addition, FC loans are typically long-term, albeit amortising, meaning any asset-quality problems should feed through gradually.

The banks' Fitch Core Capital (FCC)/risk-weighted assets ratios stood at around a moderate 12% (TEB, QNB Finansbank, INGBT) and a fairly weak 10.5% (Denizbank) at end-2017. We consider capitalisation to be only adequate given the banks' heightened risk profiles, generally moderate internal capital generation, modest NPL reserve coverage and fairly rapid growth (QNB Finansbank, Denizbank). In 2017, the banks' capital ratios were also flattered by loan growth under the CGF, as for the sector.

Pre-impairment profit provides an additional buffer to absorb unexpected losses, ranging from 2.9% (TEB) to 4.3% (QNB Finansbank) of average loans of the four banks in 2017. In addition, the banks have FC subordinated debt in issuance, largely qualifying as Tier 2 capital (with the exception of QNB Finansbank, where the majority of the subordinated debt is amortising), providing a partial hedge against FC risk-weighted assets.

The banks' funding and liquidity profiles are also reasonable, as reflected in high shares of stable, granular deposit funding, moderate FC wholesale funding and stable group funding, to varying degrees. Denizbank has a more significant deposit franchise as reflected in its loans/deposits ratio - the strongest of the four banks - which outperforms peer and sector averages. TEB, INGBT and QNB Finansbank all report high loans/deposits ratios (significantly above the sector average in the case of INGBT and QNB Finansbank) but refinancing risks are mitigated by available funding and liquidity support from the banks' shareholders.

At end-2017, FC wholesale funding accounted for 16% of non-equity funding at Denizbank, 20% at TEB, 28% at QNB Finansbank and 46% at INGBT. Net of parent funding the share of FC wholesale funding was below sector average at both TEB and INGBT. Denizbank is subject to European Union sanctions due to its parent. Its wholesale funding primarily comprises self-liquidating trade finance facilities and short-term loans due in under 28 days, both of which are exempt from the sanctions.

The four banks' exposure to external FC wholesale funding exposes them to potential changes in investor sentiment but market access has remained good to date, while their available FC liquidity should mean they can cope with a short-lived market closure.

RATING SENSITIVITIES
IDRS, NATIONAL RATINGS, SENIOR DEBT RATINGS AND SUPPORT RATINGS

The IDRs, National Ratings and debt ratings of all four banks are sensitive to any change in the ability or propensity of their parent institutions to provide support.

We believe that Sberbank will continue to have a high propensity to support Denizbank, while it remains part of the Sberbank group.

Given the Country Ceiling constraint, the IDRs of TEB, QNB Finansbank and INGBT are sensitive to a downgrade of the sovereign rating and lowering of the Country Ceiling. Conversely, an upgrade of the sovereign and an upward revision of the Country Ceiling would likely lead to an upgrade of the three banks' ratings.

The Positive Outlooks on the Long-Term ratings of Denizbank and its subsidiaries indicate that the ratings could be upgraded by a notch if Sberbank's ratings (also on Positive Outlook) are upgraded.

VRs
The VRs of all four banks remain primarily sensitive to a material weakening in the operating environment or in their asset quality metrics and capital buffers.

Upside potential for the banks' VRs is limited in the near term, given the volatile operating environment and the fact that they are already at, or close to, the level of the sovereign foreign currency rating.

A significant improvement in QNB Finansbank's franchise and core capitalisation could result in upside potential for the bank's VR in the medium term, while a marked improvement in core capitalisation could also contribute to an upgrade of Denizbank's VR.

INGBT's VR could be upgraded in the medium term in case of an expansion of its franchise, strengthening of its deposit base and an extended track record of sound performance, without a sharp increase in its risk profile.

BANK SUBSIDIARIES - Finans Finansal Kiralama, Deniz Finansal Kiralama and Joint-Stock Company Denizbank Moscow
The IDRs of the banks' subsidiaries are equalised with those of their respective parents, reflecting their strategic importance to and integration with their shareholders. Consequently, the subsidiaries' IDRs are sensitive to a change in their parents' ratings or a change in the ability or propensity of parent banks to provide support.

The rating actions are as follows:

Denizbank, Deniz Finansal Kiralama and Joint-Stock Company Denizbank Moscow:
Long-Term Foreign- and Local-Currency IDRs: affirmed at 'BB+'; Positive Outlook
Short-Term Foreign- and Local-Currency IDRs: affirmed at 'B'
Viability Rating (Denizbank only): affirmed at 'bb'
Support Ratings: affirmed at '3'
National Ratings (Denizbank and Deniz Finansal Kiralama only): affirmed at 'AA(tur)'; Positive Outlook

QNB Finansbank and Finans Finansal Kiralama A.S.:
Long-Term Foreign- and Local-Currency IDRs: affirmed at 'BBB-'; Stable Outlook
Short-Term Foreign- and Local-Currency IDRs: affirmed at 'F3'
Viability Rating (QNB Finansbank only): downgraded to 'bb' from 'bb+'
Support Ratings: affirmed at '2'
National Rating: affirmed at 'AAA(tur)'; Stable Outlook
Senior unsecured long-term debt (QNB Finansbank only): affirmed at 'BBB-'
Senior unsecured short-term debt (QNB Finansbank only): affirmed at 'F3'

ING Bank A.S.:
Long-Term Foreign- and Local-Currency IDRs: affirmed at 'BBB-'; Stable Outlook
Short-Term Foreign- and Local-Currency IDRs: affirmed at 'F3'
Viability Rating: affirmed at 'bb'
Support Rating: affirmed at '2'
National Rating: affirmed at 'AAA(tur)'; Stable Outlook

Turk Ekonomi Bankasi:
Long-Term Foreign- and Local-Currency IDRs: affirmed at 'BBB-'; Stable Outlook
Short-Term Foreign- and Local-Currency IDRs: affirmed at 'F3'
Viability Rating: affirmed at 'bb+'
Support Rating: affirmed at '2'

National Rating: affirmed at 'AAA(tur)'; Stable Outlook
Senior unsecured long-term debt: affirmed at 'BBB-'
Senior unsecured short-term debt: affirmed at 'F3'

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Applicable Criteria
Country Ceilings Criteria (pub. 21 Jul 2017) (https://www.fitchratings.com/site/re/901393)
Global Bank Rating Criteria (pub. 25 Nov 2016) (https://www.fitchratings.com/site/re/891051)
Global Non-Bank Financial Institutions Rating Criteria (pub. 10 Mar 2017) (https://www.fitchratings.com/site/re/895236)
National Scale Ratings Criteria (pub. 07 Mar 2017) (https://www.fitchratings.com/site/re/895106)

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