

Islamic Finance *news*

2008

GUIDE

January 2008

Marking the Next Phase: Innovation

By Paul Wouters

The sector keeps growing steadily. And this is not only in nominal figures, but also vis-à-vis the conventional counterpart. Dating from the crisis in 2001, the market share has consistently increased for the last six years now, so in deposits taken and loans given.

This has happened without any particular incentive or preferential treatment from the government and with a rather limited range of products.

Turkish participation banks compared to Turkish banking (September 2007)			
	Deposits (%)	Loans (%)	Assets (%)
2005	3.33	4.89	2.54
2006	3.65	4.93	2.83
2007/3Q	3.87	5.66	3.32

Source: Participation Banks Association Turkey

At the same time, participation banks have grown stronger in equity and financial means. Bank Asya had a successful initial public offering in 2006, followed by Albaraka Türk (Albaraka Banking Group ABG – Bahrain) in 2007, and Kuveyt Türk (Kuwait Finance House KFH – Kuwait) will round this off during the first quarter of 2008.

Türkiye Finans gained a solid partner in National Commercial Bank NCB (KSA) that took a 60% shareholding and will give access to substantial additional financial resources. After Türkiye Finans broke the ceiling of 100 branches in 2006, Bank Asya followed suit a year later. Albaraka Türk and Kuveyt Türk might be assumed to open their 100th branches in 2008 or at the latest, early 2009.

All this is not so much a luxury as it is a necessity in order to stay ahead in (or at least keep abreast with) the growing banking market, as the present economical boom spreads welfare throughout the country.

The participation banks now all have a more solid basis that allows renewed expansion. Currently, all of them have an adequate strategy of branching out and Bank Asya and Kuveyt Türk are reported to be looking “beyond the borders”.

As in the past, direct contribution by the participation banks to the real estate sector surpasses that of their conventional counterparts.

Turkish participation banks Total shareholders' equity 2007/3Q			
	Shareholders' equity (thousands YTL)	Shareholders' equity (thousand US\$)	Total change (%)
2001	203,000	141,000	
2002	400,000	245,000	74
2003	670,000	478,000	95
2004	891,851	664,222	39
2005	951,089	705,398	6
2006	1,559,717	1,104,303	57
2007/3Q	2,197,241	1,815,002	64

Source: Participation Banks Association of Turkey

Some of the conventional banks have reportedly begun exploring the possibility of offering compliant products, or maybe even opening up “participation windows”. However, the current status of the legislation does not allow easy entry.

Turkish banking system Ratio used funds – Deposits/Loans 2007/3Q		
	% Deposit banks	% Participation banks
2002	40	66
2003	42	75
2004	47	82
2005	59	88
2006	68	93
2007/3Q	74	110

Source: Participation Banks Association of Turkey

Innovation

After the initial transaction in December 2006 by Kuveyt Türk (US\$200 million), both Türkiye Finans (US\$100 million) and Bank Asya (US\$175 million) issued their first well received Murabahah facilities in 2007.

In July 2007, Kuveyt Türk announced a fixed currency exchange rate service to help companies with forward currency transactions.

Both Bank Asya and Türkiye Finans entered into individual protocol agreements (for a framework of YTL 200 million [US\$172 million] each) with the Istanbul Chamber of Commerce ITO, giving the members thereof access to individual financing up to YTL 250,000.

continued...

Marking the Next Phase: Innovation (continued...)

goal would be to become one of Turkey's seven-largest banks in terms of asset value by 2010.

► Türkiye Finans

In July 2007, National Commercial Bank NCB, the biggest bank in Saudi Arabia, announced – subject to regulatory approval – the acquisition for US\$1.08 billion of a 60% share of Türkiye Finans. The price will be revised based on 2007's revenue and the total amount may increase by US\$120 million or US\$130 million.

The amount paid by NCB is said to be 5.8 times higher than the book value of the bank, marking this the highest relative price paid for a bank in Turkey to date. With upcoming revisions, the price may end up being six times book value. The existing shareholders (industrial groups Ülker and Boydak) will retain a stake of 20% each.

Last September, a two-year syndicated Murabahah of US\$100 million was confirmed in order to fund small and medium-sized enterprises and to contribute to the real estate sector in Turkey.

	The Banker Top 500 Islamic institutions #ranking	Fitch Ratings Turkish participation banks		
		Rating	Date (2007)	Outlook
Albaraka Türk	52	BB-	8 th June	Stable
Bank Asya	33	B	13 th July	Positive
Kuveyt Türk	45	BB	14 th December	Stable
Türkiye Finans	35			
Rep Turkey		BB	13 th December	Stable
Source: The Banker - Top 500 Islamic Institutions November 2007		Source: Fitch Ratings		

Final remarks

With the market being “locked up” by the IPO and strategic partnerships, one can only hope for more rapid expansion when the government allows conventional banks to open “participation windows”.

Moreover, it is not clear whether or not new “participation bank licenses” are available. For now, the authorities seem reluctant to allow new market entries (either conventional or Islamic).

Several times, the sector has publicly announced the need for Sukuk (and inherently the availability of liquidity for

that instance), but so far there hadn't been positive follow up by the government.

On the positive side, note that the economy has picked up sufficiently to allow the “second wave” of mergers and acquisitions to get started. After the financial services industry, larger production and service providers might get their turn for foreign acquisition/input. On the downside, the Central Bank decided to relax the interest rates and the government will renegotiate new terms with the International Monetary Fund. This happens mostly under pressure from the Turkish business world that wants better access to cheaper money.

After the recent interest rate cuts (and the central bank is rumored to plan more), inflation (though still contained) already rose to 8.4%, twice the year-end target. Gas and electricity prices will go up another 20% at least. Combined with the rise in oil prices, the effect will be felt throughout the economy. The somewhat unrealistic gain upon the US dollar during the last year might come to an end and the financial markets expect a slight readjustment of at least 4% for the YTL (and other emerging market currencies). And then, of course, the last waves of the subprime mortgage crisis will ripple through Turkey.

“On the positive side, note that the economy has picked up sufficiently to allow the “second wave” of mergers and acquisitions to get started”

On the political side, the government managed to avoid loopholes. The levels of democracy, minority protection and freedom of speech are rising, but apparently, there still is too much hesitation in bringing the participation banks fully at par with the conventional banks.

In 2007, Unicorn Investment Bank (Bahrain), Kuwait Investment Authority (Kuwait), National Bank of Kuwait (Kuwait), Global Investment House (Kuwait), Dubai Financial Group (UAE) and Orion Holding Overseas (UAE) established themselves in the Turkish financial landscape, either through partnerships or acquisitions. It has been rumored that DIB is looking to take over a bank.

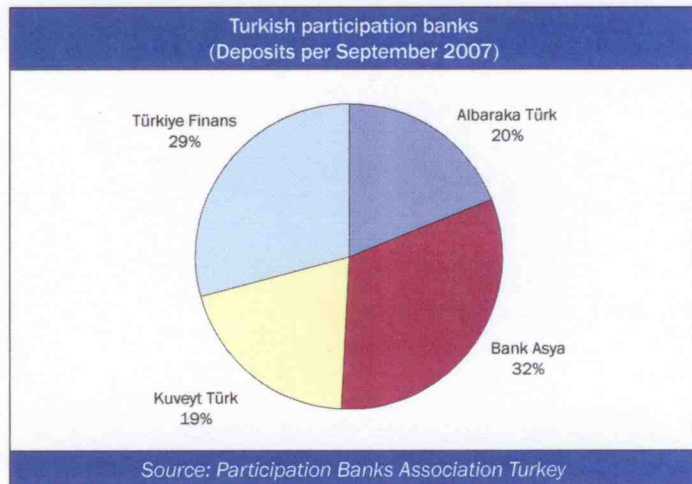
Just last December, Shamil Bank (Bahrain) launched its US\$90 million Shamil Bosphorus Mudharabah, investing in Shariah compliant real estate developments in Turkey. And

continued...

Marking the Next Phase: Innovation (continued...)

finally, at the years ending, the US\$60 million Murabahah of DRD Derindere (car leasing company) was announced. The five-year contract is the longest ever to a Turkish company and reaffirms the trust shown in the company and the future of the Turkish economy.

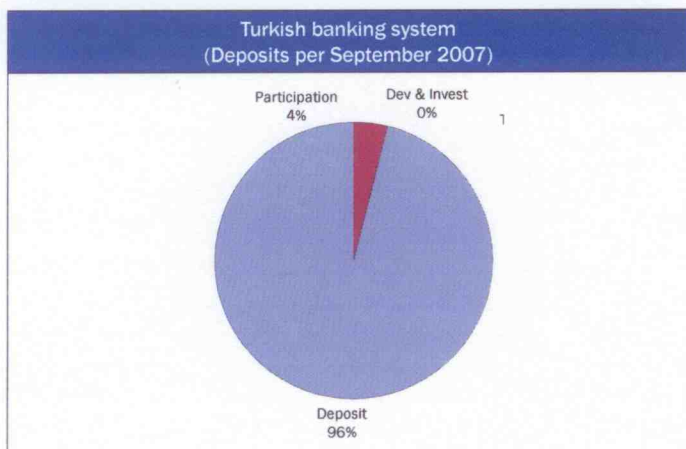
This year looks to be promising and challenging. The participation banks defined a strategy of firm growth (branch and equity), within and maybe even outside Turkey. The participants of the first "Sukuk issuance", which will bring new means to the existing financial needs, have been in the pipeline for some time. Some conventional banks were also reluctant to open "windows" to get a piece of the growing pie. The big question is what kind of legal framework will be handed to them by the government. Responsibilities have to be taken or chances might be lost. ☹



MAIN FINANCIAL FIGURES OF THE PARTICIPATION BANKS
(Thousand YTL) (September 2007)

		Total (September 2007)	% Total growth since December 2006
FUNDS	TLY	6,756,290	28
COLLECTED	FX	6,684,907	12
	TOTAL	13,441,197	20
LOANS		14,741,625	40
PROBLEM LOANS		201,937	56
TOTAL ASSETS		17,452,083	27
SHAREHOLDERS EQUITY		2,197,241	41
PROFIT NETT		367,409	37
STAFF		8,688	22
BRANCHES		401	13

Source: Participation Banks Association Turkey
January 1, 2007 - 1 US\$ is approx 1,1 YTL



BENER
Istanbul – Turkey

Paul Wouters is an adviser to Bener Law Office, in Istanbul, Turkey. He can be contacted via email at paul.wouters@bener.com.tr