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New Issue

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Nurol Investment Bank

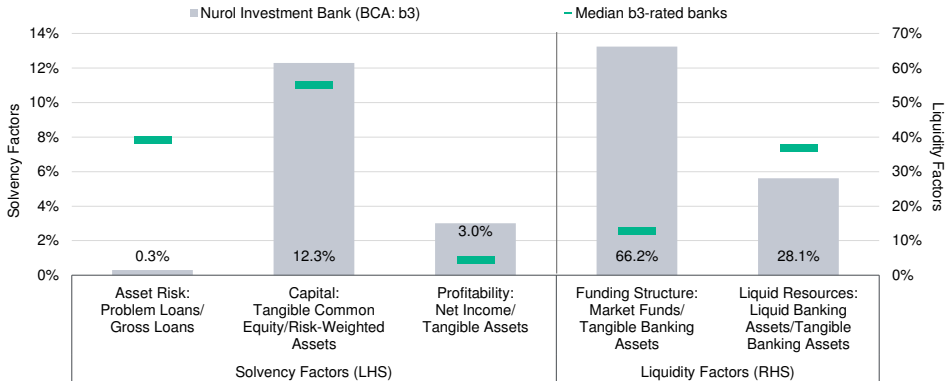
Update following rating assignment

Summary

Nurol Investment Bank's (Nurolbank's) B3 global long-term issuer ratings reflect the bank's b3 baseline credit assessment (BCA) and an assumption of a low probability of government support, which does not result in any uplift. The bank has been assigned Counterparty Risk Assessments (CR Assessments) of B2(cr)/ NP(cr) and Counterparty Risk Ratings (CRR) of B2/ NP. On the national scale ratings (NSR), the issuer ratings was assigned at Ba2.tr/TR-4 and CRR at Baa3tr/TR-3. The national scale issuer and CRRs ratings are placed under review for upgrade.

The b3 BCA is driven by the bank's solid capitalisation, supported by strong profitability. These are counterbalanced by the following: 1) young franchise with an aggressive growth strategy 2) lack of business diversification 3) significant concentration risks (borrower and sector); and 4) significant dependence on wholesale funding.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit strengths

» Good capitalisation,

» High profitability, although likely to come under pressure due to higher funding costs

» Relatively good asset quality

Credit challenges

» Young franchise with an aggressive growth strategy

» Lack of business diversification

» Significant reliance on wholesale funding with relatively modest liquid coverage metrics

» High sector and borrower concentration

Rating outlook

The outlook on the long term global scale issuer ratings is stable, driven by their resiliency at this rating level to the challenging operating environment in Turkey.

However, the outlook on Nurolbank's ratings is under review for upgrade. This reflects the bank's NSR ratings, which have been placed under review for upgrade. This review for upgrade is solely driven by the potential re-mapping of Turkish NSR as a result of the review for downgrade on the ratings of Government of Turkey.

Factors that could lead to an upgrade

The global scale issuer ratings could be upgraded if the bank (1) significantly reduces borrower and sector concentration; (2) diversifies its business and reduces its reliance on corporate banking business; and (3) significantly increases capital and liquidity buffers.

The national scale ratings could be upgraded if the bank's global scale issuer ratings (1) are upgraded while the sovereign ratings remains stable; (2) are stable while the sovereign ratings are downgraded.

Factors that could lead to a downgrade

A downward pressure on Nurolbank's global scale issuer ratings could develop as a result of (1) weakening of asset risk; (2) deterioration of profitability; (3) a material reduction in the bank's capitalisation; or 4) further deterioration of Turkey's operating environment.

A downward pressure on Nurolbank's national scale ratings could develop if the bank's global scale issuer ratings (1) are downgraded while the sovereign ratings remain stable; (2) are stable while the sovereign ratings are upgraded.

Key indicators

Exhibit 2

Nurol Investment Bank (Consolidated Financials) [1]

	12-17[2]	12-16[2]	12-15[2]	12-14[2]	2013	CAGR/Avg.[3]
Total Assets (TRY million)	1,694	1,170	716	639	-	38.4[4]
Total Assets (USD million)	447	332	245	273	-	17.8[4]
Tangible Common Equity (TRY million)	197	142	101	83	-	33.1[4]
Tangible Common Equity (USD million)	52	40	35	36	-	13.3[4]
Problem Loans / Gross Loans (%)	0.3	0.0	0.1	4.0	-	1.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	12.3	11.1	16.7	13.9	-	13.5[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	1.6	0.0	0.5	16.8	-	4.7[5]
Net Interest Margin (%)	7.4	9.4	6.9	5.2	-	7.2[5]
PPI / Average RWA (%)	4.9	5.5	4.7	3.7	-	4.7[6]
Net Income / Tangible Assets (%)	3.2	3.5	2.3	2.5	-	2.9[5]
Cost / Income Ratio (%)	31.8	32.0	41.4	43.1	-	37.1[5]
Market Funds / Tangible Banking Assets (%)	66.2	61.2	76.1	51.2	-	63.7[5]

Liquid Banking Assets / Tangible Banking Assets (%)	28.1	22.8	35.0	42.5	-	32.1[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented
Source: Moody's Financial Metrics

Profile

Headquartered in Istanbul and having started its activities in 1999, Nurolbank is a non-deposit taking institution offering a range of banking services to corporate clients. As of end-2017, Nurolbank had consolidated assets of TL1.7 billion, gross loans to corporates of 1,060 million TL, accounting for almost 100% of gross loans and 63% of total assets. Nurolbank's total cash and non-cash loan portfolio stood at 1,668 million TL as of end-2017, constituting 98% of total assets.

Detailed credit considerations

Young franchise, aggressive growth strategy combined with lack of business diversification weigh on the standalone profile

While the bank was established in 1999, it only started developing its franchise over the last four years with the appointment of the current management team. Following their appointment, the bank has grown significantly with a 46% average per annum loan growth during the last 3 years. Despite this significant growth Nurolbank still represents less than 1% of the Turkish banking system which is highly competitive and fragmented. As such, our assessment of Nurolbank also captures the short track record and the aggressive growth strategy weighing on the standalone profile of the bank.

Additionally, the bank has a corporate focused loan book. During 2017, Nurolbank reported consolidated net income of TL54.3 million, a 32% increase compared to 2016. Of this net income, 80% is generated through the corporate banking business line and the remaining 20% from other business lines. This high reliance (more than one-third) on a single business line for its revenues indicate lack of business diversification which can impact its potential to absorb unexpected shocks, creating volatility in earnings. As such, we also make a downward adjustment in our assessment of the bank's standalone profile to capture this lack of business diversification.

Stronger than peer asset quality moderated by high sector concentrations

At December 2017, Nurolbank's gross non-performing loan (NPL) ratio stood at around 0.3% much lower than the banking system average of 3%. The modest rise in the NPL ratio in 2017 from very low NPLs in 2016 is due to an exposure to a single corporate loan. The relatively strong NPL ratio can be explained by significant loan growth (46% on an average per annum during the last 3 years) which reduces the NPL ratio (has a denominator effect) but at the same time creates a large stock of unseasoned loans which can add to future asset quality challenges, particularly in a downward cycle.

Furthermore, at December 2017 loans under close monitoring accounted for 0.8% of gross loans, increasing from 0.1% at December 2016, indicating potential for deterioration in the bank's asset quality. We expect NPLs to increase over the next 12-18 months. Nurolbank's specific NPL coverage ratio of 99% at December 2017 is very strong, much higher than the 80% average for the system.

However our assessment of this strong performance is moderated by the bank's high sector concentration to financial institutions and construction sector loans which represent around 34% and 21% of its loan book respectively, as of December 2017, up from 17% and 13%, as of December 2016.

At the same time, Nurolbank has high borrower concentration. We assess this based on the Top 20 borrowers of the bank which represent more than 500% of the bank's Tier 1 capital. Additionally, amongst the top borrowers we understand there are material equity financing transactions which are relatively risky and weigh on the bank's standalone risk profile.

Good capitalisation, supported by strong internal capital generation

The bank exhibits solid capitalisation with an adjusted tangible common equity as a percentage of risk-weighted assets (RWAs) at 12.3% at December 2017 up from 11.1% as of December 2016. The improvement in capitalisation was supported by strong internal capital creation, with return on tangible assets of 3.2% for the year 2017 combined with no dividend payment for the last three years.

The BRSA requires Nurolbank to maintain a minimum total capital ratio of 8%, in line with other banks in the Turkish banking system. At December 2017, Nurolbank's reported consolidated Basel III capital adequacy ratio (CAR) stood at 18.1% (2016: 17.3%), higher the sector's 17% average, and its Tier 1 ratio at 11.7% (2016: 11.8%).

Nurolbank's CAR improvement was supported by Basel III compliant Tier 2 subordinated debt issuance of USD10million Eurobond and USD5million subordinated debt from World Business Capital. We expect Nurolbank capital buffers to remain adequate despite the bank's rapid expansion owing to strong internal capital generation. However, because of the expanding nature of the Turkish banking market coupled with Turkish lira volatility, Nurolbank will likely face longer-term challenges due to higher foreign currency (primarily US dollar) funding costs reducing internal capital creation and the need to preserve or grow its market share.

High profitability likely to come under pressure due to higher funding costs

The bank's return on assets was strong at 3.2% for 2017 when compared to 1.7% average for Turkish banking system. Such high profitability is supported by the bank's cost-to-income ratio of 31.8%, which is lower than domestic peers. Profitability in 2017 was also supported by an increase in net interest income and a reduction of loan loss provisions counterbalanced by an increase in funding costs.

We expect Nurolbank's profitability to decline over the coming 12 to 18 months given 1) pressure on the bank's net interest margin due to the likely increase in funding costs given the combination of significant reliance on short-term wholesale funding and rising interest rate environment; and 2) our expectation that provisioning costs will increase due to expectation of increasing problem loans.

We expect challenges from the difficult operating environment in Turkey to be greater for small banks such as Nurolbank, which lack diversification of funding and scale. The bank's future profitability in a volatile environment will depend upon its ability to source modest-cost funding, control operating expenses and improve net interest margins whilst preserving risk discipline.

Significant reliance on short-term wholesale funding with relatively modest liquid coverage

As at December 2017, Nurolbank's reliance on market funds represented 66.2% of its tangible banking assets. This is not covered by liquid banking assets which represent just 28.1% of tangible banking assets. Nurolbank's high market funds ratio can be explained by its investment banking license, whereby it cannot collect deposits. We consider wholesale funding by definition as potentially more volatile and as such has higher refinancing risks. Although the headline refinancing risk is higher which can be explained by the 66% market funding to tangible assets ratio, the bank's significant shorter tenor loans provides some cushion over and above the liquid assets and partially mitigates the headline refinancing risk.

Nurolbank's wholesale funding is split into debt securities issued, funds borrowed and subordinated debts, representing 44%, 32% and 4%, respectively, of total liabilities as of December 2017. Debt securities issued are all denominated in Turkish Liras and mature within 1 year with interest rates ranging from 13.95-15.00%. Around 85% of borrowed funds and the subordinated debt are denominated in foreign currencies. The short-term nature of Nurolbank's wholesale funding makes it susceptible to shifts in investor sentiment, and sensitive to the rising interest rate environment.

Support and structural considerations

Government Support

We expect a low likelihood of government support for Nurolbank, reflecting the bank's marginal market share in the Turkish banking system, resulting in no uplift in the bank's issuer ratings.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails, and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

Nurol's CR Assessment is placed at B2(cr) / Not Prime(cr)

We consider Turkey a jurisdiction with a non-operational resolution (non-ORR) regime. For non-ORR countries, the starting point for the CR Assessments is one notch above the bank's Adjusted BCA, to which we then typically add the same notches of government support uplift as applied to deposit and senior unsecured debt ratings.

Counterparty Risk Ratings (CRR)

Moody's Counterparty Risk Ratings are opinions of the ability of entities to honour the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

Nurol's CRR is placed at B2 / Not Prime

We consider Turkey a jurisdiction with a non-operational resolution (non-ORR) regime. For non-ORR countries, the starting point for the CRR is one notch above the bank's Adjusted BCA, to which we then typically add the same notches of government support uplift as applied to deposit and senior unsecured debt ratings.

Rating methodology and scorecard factors

Exhibit 3

Nurol Investment Bank

Macro Factors		
Weighted Macro Profile	**Weak**	**100%**

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.3%	baa2	← →	b1	Single name concentration	Sector concentration
Capital						
TCE / RWA	12.3%	ba3	← →	b1	Expected trend	
Profitability						
Net Income / Tangible Assets	3.0%	baa2	← →	baa2	Expected trend	
Combined Solvency Score		ba1		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	66.2%	caa2	← →	b3	Term structure	Market funding quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	28.1%	ba3	← →	ba3	Stock of liquid assets	
Combined Liquidity Score		b3		b2		
Financial Profile				b1		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				-1		
Total Qualitative Adjustments				-2		
Sovereign or Affiliate constraint:				Ba2		
Scorecard Calculated BCA range				b2-caa1		
Assigned BCA				b3		
Affiliate Support notching				0		
Adjusted BCA				b3		

Instrument class	**Loss Given Failure notching**	**Additional Notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Rating	1	0	b2	0	B2	B2

Counterparty Risk Assessment	1	0	b2	0	--	--
Senior unsecured bank debt	0	0	b3	0	B3	B3

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
NUROL INVESTMENT BANK	
Outlook	Rating(s) Under Review
Counterparty Risk Rating	B2/NP
Baseline Credit Assessment	b3
Adjusted Baseline Credit Assessment	b3
Counterparty Risk Assessment	B2(cr)/NP(cr)
Issuer Rating	B3
NSR Issuer Rating	Ba2.tr[1]
ST Issuer Rating	NP

[1] Placed under review for possible upgrade on June 28 2018

Source: Moody's Investors Service

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