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Al Janoob Islamic Bank – Ratings Reinstated

Capital Intelligence Ratings (CI Ratings or CI) today announced that it has reinstated and affirmed all ratings assigned to Al Janoob Islamic Bank (JIB) at their pre-suspension level. This follows the provision of more up-to-date financial data. The Bank's Long-Term Foreign Currency Rating (LT FCR) and Short-Term Foreign Currency Rating (ST FCR) have been reinstated at 'B-' and 'B', respectively, the Bank Standalone Rating (BSR) at 'b-', and the Core Financial Strength (CFS) rating at 'b+'. The Outlook for both the LT FCR and BSR is Stable. The ESL is Uncertain.

In addition, JIB's Long- and Short-Term Ratings on the Iraq National Scale have been reinstated and affirmed at 'iqBBB' and 'iqA3', respectively, with a Stable Outlook. These ratings are supported and constrained by the same factors as the CFS, as outlined below.

The Bank's BSR is derived from a CFS rating of 'b+' and an Operating Environment Risk Anchor (OPERA) of 'c+'. The latter is at a level indicative of a high degree of risk and is a key rating constraint for JIB, as well as for all other Iraqi banks. The CFS is supported by the Bank's significant IQD260bn rights issue in 2023, high liquidity, good profitability at both operating and net levels, and capable management. The main constraints on the CFS are the Bank's high credit risk profile (due to a difficult operating environment despite favourable oil prices), concentrations in assets and customer deposits, and a relatively small balance sheet and market share due to a relatively short track record. Iraq's weak regulatory and supervisory framework also remains a credit challenge. Although JIB (along with many other Iraqi banks) is currently excluded from Central Bank of Iraq's (CBI) USD auction (based on CBI instructions), management inform that they are able to access other hard currencies to fulfil their commitments.

We consider the likelihood of sufficient and timely official extraordinary support being made available to JIB (or any other private sector bank) in the event of financial distress to be uncertain and, consequently, do not incorporate such support into the Bank's LT FCR. Moreover, even if the government may be willing to provide extraordinary support in case of need, its financial capacity to do so is limited as indicated by our internal assessment of Iraqi sovereign credit risk.

Since establishment eight years ago, JIB has made moderate progress building the business franchise as a Shari'a-compliant bank in Iraq's still underdeveloped banking system. Management's current focus is to develop the retail banking operation in part to diversify assets and revenue streams and, in turn, reduce existing concentration risks. Concurrently, the Bank has temporarily retreated from trade finance activities in response to the USD ban. Notwithstanding competitive market pressures – in part due to the dominance of state-owned banks − we consider the adopted business growth strategy appropriate given current business conditions in Iraq.

Although the balance sheet contracted in H1 24, this was mainly due to settlements of LCs and, in turn, a consequent decline in margin accounts. Contingent accounts were equivalent to a significant proportion of total assets in prior years. Meanwhile, the Bank's financing portfolio – though a comparatively small component of the balance sheet – remains concentrated in terms of both borrowers and economic sector. This reflects the scarcity of sound credit opportunities in the economy. Having peaked a few years earlier amid difficult economic conditions, compounded by the impact of Covid, NPFs (Stage 3) subsequently declined in money terms in 2022-23 mainly due to settlements. NPFs resumed growth in H1 24 primarily due to an exposure to a single corporate customer (since settled in Q3). There persists limited stress in the financing portfolio as evidenced by the level of Stage 2 financings – equivalent to 3.8% of gross financings. Although this could translate into new NPFs in the short term given elevated credit risk in the system, we expect the magnitude of any increase to be manageable given the portfolio's size and JIB's prudent lending policy and strong collection processes.

Financing-loss reserve coverage temporarily dropped to 54% in H1 24 as a result of an increase in NPFs. Crucially, however, the extended NPF coverage ratio remained high at 12,065% in first half 2024, reflecting the strong Tier 1 capital base. CI considers the Bank to have good overall credit-loss absorption capacity. This is an important credit strength.

As is the case with peer banks, JIB has significant Iraq sovereign risk exposure in the form of balances at the CBI. These assets represent a high multiple of total equity, and a significant share of total assets. Under CI's rating criteria, central bank balances come firmly under the sovereign risk category. This raises concentration risk issues, particularly in the context of Iraq's high sovereign credit risk. In our view, a significant sovereign credit event could potentially transmit sovereign stress to the Bank's balance sheet particularly capital. This is an important risk factor for the ratings.

Although growing, the small and concentrated customer deposit base is currently a potential source of vulnerability, particularly in the context of limited public confidence in private sector banks. There is also a high possibility of event risk in Iraq. These risk factors are partially mitigated by JIB's large stock of liquid assets, principally CBI balances and to a lesser extent bank placements. The preservation of liquidity is vital in a banking system where there is no official lender of last resort, and where there is no real interbank market either. Looking ahead, the focus on building granular retail deposits is expected to bring some degree of diversity to customer deposits.

Capitalisation strengthened significantly in 2023, and is currently better than almost all other private sector banks in Iraq. Following the IQD260bn rights issue in 2023 – which exceeded the amount needed to comply with CBI's revised IQD400bn paid-up capital requirement − JIB's total capital more than doubled in money terms. As is the case with other Iraqi banks, the Bank's risk weighted asset (RWA) based capital ratios are flattered to some degree by the zero-weighted CBI balances. Nevertheless, the conservative balance sheet leverage ratio of 47% in H1 24 underscores a strong buffer and capacity to withstand unforeseen setbacks. The quality of capital is high and capital flexibility has improved due to full retention of good earnings. As was the case in the previous three years, the Bank does not plan to pay a cash dividend to shareholders in respect of 2024 net profit.

The good profitability at all levels over the last few years and in H1 24 supports the rating. However, in common with almost all other Iraqi banks, JIB's operating income remains heavily skewed toward non-financing income (non-FI). This is in large part due to the lack of avenues in which to profitably invest surplus liquidity in the Iraqi banking system. This in turn depresses the net financing margin. Due to financing contraction, coupled with the negligible size of the financing portfolio, net financing income (NFI) fell into negative territory in 2023. The resumption of lending in H1 24 saw the Bank generate marginal NFI. Nevertheless, the underlying stability and quality of non-FI streams are satisfactory, with the bulk derived from fees and commissions. Although customer concentrations introduce some degree of income volatility, the expansion into retail banking is likely to positively impact income generation. Retail banking is also expected to broaden the product mix and improve cross-selling capability. Operating profitability provides good risk absorption capacity, and cost efficiency remains competitive.

Iraq's OPERA is at a level indicative of a high degree of risk. The OPERA takes into account the volatility of the economy and underlying structural and fiscal weaknesses, as well as significant socio-economic imbalances and deficiencies in the country's political and institutional frameworks. Although the Iraqi economy continued to recover moderately in 2023 from the economic fallout of the pandemic – buoyed by favourable oil prices − credit risk remains elevated. OPERA also reflects the challenges inherent in a banking sector that is small, underdeveloped, and dominated by financially weak state-owned banks. The latter elevate banking systemic risks. Legal and corporate governance standards are weak.

Rating Outlook

The Outlook for JIB's ratings is Stable, indicating that they are unlikely to change over the next 12 months. This reflects our view that the Bank will maintain its current risk profile, including the concentrations in the balance sheet.

Rating Dynamics: Upside Scenario

We do not expect an upward change in the ratings and/or outlook unless OPERA improves. This is currently seen as being unlikely to change within a 12-month timeframe.

Rating Dynamics: Downside Scenario

While not our current expectation, JIB's ratings could be reduced by one notch over the next 12 months in the event key credit metrics worsened significantly and should OPERA be revised downwards.

Ratings

Foreign Currency		Outlook	BSR	Outlook	CFS	ESL	OPERA
LT	ST	LT FC		BSR			
B-	B	Stable	b-	Stable	b+	Uncertain	c+

National Scale Ratings*		
LT	ST	Outlook
iqBBB	iqA3	Stable

**A National Rating summarises the repayment risk of an entity relative to other entities within the same economy. It is not an absolute measurement of risk. National Ratings are not directly comparable across borders.*

Contact

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About the Ratings

The credit ratings have been issued by Capital Intelligence Ratings Ltd, P.O. Box 53585, Limassol 3303, Cyprus.

The following information sources were used to prepare the credit ratings: public information and information provided by the rated entity. Financial data and metrics have been derived by CI from the rated entity's financial statements for FY2020-2 and H1 2024. CI may also have relied upon non-public financial information provided by the rated entity and may also have used financial information from credible, independent third-party data providers. CI considers the quality of information available on the rated entity to be satisfactory for the purposes of assigning and maintaining credit ratings. CI does not audit or independently verify information received during the rating process.

The principal methodologies used to determine the ratings are the Bank Rating Methodology, dated 3 April 2019 (see www.ciratings.com/page/rating-methodologies/bank-ratings), and the National Scale Ratings Criteria for Iraq, dated 15 March 2020 (see http://www.ciratings.com/page/rating-methodologies/national-ratings). Information on rating scales and definitions, the time horizon of rating outlooks, and the definition of default can be found at www.ciratings.com/page/our-policies-procedures. Historical performance data, including default rates, are available from a central repository established by ESMA (CEREP) at http://cerep.esma.europa.eu

This rating action follows a scheduled periodic (annual) review of the rated entity. International and National ratings on the entity were first released in December 2019 and suspended in April 2024 due to a lack of sufficient information. The ratings have now been reinstated due to the receipt of more up to date financial data. The ratings were first released in August 2020 and last updated in April 2022. The ratings and rating outlook were disclosed to the rated entity prior to publication and were not amended following that disclosure. The ratings have been assigned or maintained at the request of the rated entity or a related third party.

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