

# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Asaka Bank

Global Credit Research - 17 Feb 2016

Uzbekistan

#### Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits -Fgn Curr	B2/NP
Bank Deposits -Dom Curr	B1/NP
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	b2
Counterparty Risk Assessment	B1(cr)/NP(cr)

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#### Key Indicators

##### Asaka Bank (Consolidated Financials)[1]

	[2]12-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (UZS million)	5,253,633.04	5,24,756.04	2,28,058.03	4,93,595.02	6,75,805.0	[3]18.4
Total Assets (USD million)	2,168.8	2,054.7	2,131.1	1,946.3	1,631.6	[3]7.4
Tangible Common Equity (UZS million)	638,103.0	544,330.0	463,809.0	409,549.0	346,583.0	[3]16.5
Tangible Common Equity (USD million)	263.4	247.2	233.8	228.2	211.3	[3]5.7
Problem Loans / Gross Loans (%)	1.7	12.2	12.4	17.0	16.7	[4]12.0
Tangible Common Equity / Risk Weighted Assets (%)	16.2	16.2	15.7	15.2	16.9	[5]16.1
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.4	51.4	50.7	64.2	55.5	[4]45.8
Net Interest Margin (%)	4.2	3.1	3.7	4.7	6.4	[4]4.4
PPI / Average RWA (%)	4.9	3.9	4.3	4.9	7.3	[5]5.1
Net Income / Tangible Assets (%)	1.5	1.2	1.1	1.2	1.1	[4]1.2
Cost / Income Ratio (%)	50.5	54.4	52.0	48.9	49.6	[4]51.1
Market Funds / Tangible Banking Assets (%)	19.6	17.0	20.6	23.5	26.7	[4]21.5
Liquid Banking Assets / Tangible Banking Assets (%)	26.7	30.5	36.9	32.2	37.4	[4]32.7
Gross loans / Due to customers (%)	112.2	100.3	92.1	112.1	107.8	[4]104.9

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel I & IFRS reporting periods have been used for average calculation

#### Opinion

## **SUMMARY RATING RATIONALE**

We incorporate our assessment of a high probability of government support in the ratings of Asaka Bank, as reflected in the one-notch uplift of the bank's global local currency (GLC) deposit rating to B1/Not-Prime from the bank's baseline credit assessment (BCA) of b2. This uplift takes into account (1) the state ownership of the bank; and (2) its domestic market of around 10% in terms of corporate loans and deposits.

Asaka bank's ratings are supported by its (1) good financial performance, (2) adequate capital levels, and (3) sufficient liquidity cushion. Concurrently, BCA is constrained by (1) the high concentration of the bank's assets and liabilities - in terms of both single-name and industry concentration; (2) the short-term nature of its customer funding base; and (3) the rapid growth and hence untested quality of the bank's loan book and its potential deterioration in a less favorable economic environment.

### **Rating Drivers**

- High credit concentration and non-core investments undermine asset quality
- Sound financial performance bolstered by healthy net interest and commission income
- Capital cushion is modest and requires regular replenishing
- Reliance on short-term customer accounts, although the majority of depositors have been historically committed to the bank

### **Rating Outlook**

All of Asaka Bank's ratings carry a stable outlook.

### **What Could Change the Rating - Up**

Asaka Bank's B1 local currency deposit rating is unlikely to be upgraded in the next 12 months, as it already takes into account the bank's adequate financial results, as well as our assessment of the high probability of government support to the bank.

We note the possibility of a higher b1 BCA (as opposed to the current level of b2) if the bank qualitatively enhances its corporate governance and risk management practices and demonstrates a substantial decrease of related-party lending and non-core investments, while also reporting a decline in borrower concentration and demonstrating greater diversification of the funding base. However, in our view, these improvements may only materialise over the longer period of time.

### **What Could Change the Rating - Down**

In the absence of adequate capital support from shareholders, any evidence of sustained and rapid growth of the bank's risk-weighted assets could lead to a lowering of Asaka Bank's BCA to b3 (as opposed to b2 currently). A dramatic deterioration of Asaka Bank's asset quality indicators and/or weakening of its liquidity profile could also lead to the lowering of the bank's BCA.

Any downgrade of Asaka Bank's B1 GLC deposit rating may materialise if Moody's reduces its current assessment of a potential government support to the bank.

## **DETAILED RATING CONSIDERATIONS**

### **HIGH CREDIT CONCENTRATION AND NON-CORE INVESTMENTS UNDERMINE ASSET QUALITY**

We note historically material volume of loan book concentration due to Asaka Bank's business model and its close ties with the state-owned automotive industry. The bank's largest credit exposure to manufacturing, which largely comprises automotive production accounted for 57% of gross loan book or 284% of Tier 1 equity as of year-end 2015 under local GAAP. The single-name concentration is also high with top 20 loans totaling 34% of gross loans or 207% of the bank's Tier 1 capital at year-end 2014 according to the latest available audited IFRS report. We also note the sizeable level of related-party lending at 22% of gross loans or 132% of Tier 1 capital as of year-end 2014 under IFRS. We expect material loan portfolio concentrations to persist in the next 12-18 months given no changes in the bank's business model.

The level of restructured and past due by over 90 days loans increased to 4.2% at year-end 2015 from 2.1% a year before under local GAAP. Meanwhile, the loans which are not treated as standard or good quality drastically increased to 8.5% as of year-end 2015 from 2.7% at year-end 2014. We understand that automotive sector, where the bank holds the largest exposure, has remarkably suffered from the decline of exports to Russia and Kazakhstan in 2015 due to relatively stronger local currency compared to rouble and tenge.

We expect further deterioration of the asset quality in the next 12-18 months given seasoning of the loan portfolio which grew by 24% p.a. in average over few recent years and challenging economic conditions in neighboring CIS countries, the key markets for Uzbek automotive production.

On top of the above, we note the risks associated with Asaka Bank's non-core investments: shares of manufacturing entities and other acquired property on the bank's balance sheet accounted for approximately 48% of its Tier 1 capital as of year-end 2015 according to local GAAP reports (year-end 2014: 46%). Such investments render the bank's financial fundamentals vulnerable to numerous risks of a non-financial nature that are beyond the scope of its core activity, including additional market risks.

#### SOUND FINANCIAL PERFORMANCE BOLSTERED BY HEALTHY NET INTEREST AND COMMISSION INCOME

In 2015 Asaka Bank's net income increased to UZS85.2 billion from UZS78.0 billion a year before as reported under local GAAP. The bank's financial metrics remained healthy in 2015: return on average assets (ROAA) stood at 1.4% and return on average equity (ROAE) amounted to 9.9% (2014: 1.6% and 10.4%, respectively). Historically the bank benefited from high level of core earnings - in 2015 net interest income accounted for 54% of net revenue, and the share of net fee and commission income was also remarkable at 19% of total.

We have not seen any remarkable decline in net fees & commission income in 2015 (down by 4% only compared to 2014) as remittances from Russia accounted for moderate part of the revenues. We believe the bank's provisioning charges are insufficient to compensate for the rapid growth of its loan book and potential asset quality deterioration resulting from the high concentration levels. We believe expected provisioning charges will suppress the currently good bottom-line result in the next 12-18 months.

#### CAPITAL CUSHION IS MODEST AND REQUIRES REGULAR REPLENISHING

Despite rapid asset growth over the recent years Asaka Bank's capital levels have historically been maintained at a healthy level, thanks to timely capital injections and retained earnings. Over 2015 Asaka Bank's total capital increased by 14%. The statutory Tier 1 ratio and total CAR at year-end 2015 declined to 10.6% and 11.4%, respectively from 16.5% and 16.9% as of year-end 2014. This has been driven by (1) outpacing growth of assets (up by 38%) compared to capital, and (2) recent adoption of Basel III elements in calculation of regulatory capital adequacy ratios.

Taking into account high single-name concentrations in Asaka Bank's loan portfolio and the unseasoned nature of the banking book we are of the opinion that provisions at 2% of gross loan book as of year-end 2015 under local GAAP are not sufficient to fully cover expected credit losses. We also consider capital cushion currently maintained by Asaka Bank as modest relative to its credit concentration levels and risks inherent to the domestic economic environment. At the same time growth of the bank's total and risk-weighted assets necessitates the build-up of the bank's capital cushion on a regular basis, to keep it above the regulatory minimum required. We also note that the bank's "free" capital (i.e., the capital available to absorb potential losses) is negatively affected by its investments in non-core assets, as discussed above.

#### RELIANCE ON SHORT-TERM CUSTOMER ACCOUNTS, ALTHOUGH THE MAJORITY OF DEPOSITORS HAVE BEEN HISTORICALLY COMMITTED TO THE BANK

Asaka Bank's funding base is, to a large extent, dependent on customer accounts (71% of non-equity funding at year-end 2015), of which 50% are on demand deposits. Moreover, Asaka Bank's customer funding demonstrates extremely high concentration with the top 10 customer deposits accounted for 63% of total at year-end 2014 under IFRS, thus exposing the bank to sudden sizeable withdrawals by large customers. This scenario is mitigated by the fact that the bank's key depositors are automotive industry producers and suppliers that are related to Asaka Bank and have to date demonstrated their long-standing commitment.

In view of the very high concentration of customer funds, the liquidity cushion (embraces largely cash and due from banks) being maintained by Asaka Bank at 27% of total assets or 40% of customer accounts at year-end 2015 under local GAAP appears to be sufficient to address the potential sizeable withdrawals.

## Notching Considerations

### HIGH PROBABILITY OF SUPPORT FROM THE GOVERNMENT IN CASE OF NEED

Asaka Bank's B1/Not Prime ratings derive from the bank's BCA of b2 and also incorporate a one-notch uplift of the GLC deposit rating to B1, reflecting the high probability of government support expected to be rendered to the bank in case of distress. This support assessment takes into account (1) the state ownership of the bank; and (2) its domestic market of around 10% in terms of corporate loans and deposits.

## Foreign Currency Deposit Rating

We assign B2/Not Prime long-term and short-term foreign-currency deposit ratings to Asaka Bank.

### CR Assessment

Moody's has assigned a Counterparty Risk Assessment (CR Assessment) of B1(cr) / Not Prime(cr) to Asaka Bank.

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 (e.g., swaps), letters of credit, guarantees and liquidity facilities.

In most cases, the starting point for the CR Assessment -- which is an assessment of the ability to avoid defaulting on its operating obligations -- is one notch above the bank's adjusted baseline credit assessment (BCA), which represents the rating agency's view of the probability of a bank failing on its obligations without considering government support. Moody's then adds the same uplift due to the likelihood of government support as applied to deposit ratings. However, in the case of the higher-rated government-owned Uzbek banks the CR Assessments do not benefit from the additional one notch of government support that the rating agency imputes in their deposit ratings.

### NOTE ON DATA

Unless noted otherwise, all figures shown in this report are sourced from the bank's latest annual and interim financial reports and additional information from the bank. In addition, where indicated through the document we use reference to Moody's Banking Financial Metrics which are based on our own chart of account, and are adjusted for analytical purposes. Please refer to the documents entitled "Financial Statement Adjustments in the Analysis of Financial Institutions" published on 15 June 2015.

### About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating Factors

### Asaka Bank

<b>Macro Factors</b>	
<b>Weighted Macro Profile</b>	<b>Very Weak +</b>

<b>Financial Profile</b>						
<b>Factor</b>	<b>Historic Ratio</b>	<b>Macro Adjusted Score</b>	<b>Credit Trend</b>	<b>Assigned Score</b>	<b>Key driver #1</b>	<b>Key driver #2</b>

<b>Solvency</b>						
<b>Asset Risk</b>						
<i>Problem Loans / Gross Loans</i>	8.8%	caa2	↑ ↑	caa1	Expected trend	Single name concentration
<b>Capital</b>						
<i>TCE / RWA</i>	16.2%	ba3	← →	ba3	Access to capital	
<b>Profitability</b>						
<i>Net Income / Tangible Assets</i>	1.3%	b2	↑	b2	Expected trend	
<b>Combined Solvency Score</b>		b2		b2		
<b>Liquidity</b>						
<b>Funding Structure</b>						
<i>Market Funds / Tangible Banking Assets</i>	19.6%	b3	← →	b2	Market funding quality	
<b>Liquid Resources</b>						
<i>Liquid Banking Assets / Tangible Banking Assets</i>	26.7%	b3	← →	b3		
<b>Combined Liquidity Score</b>		b3		b2		

<b>Financial Profile</b>
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<b>b2</b>
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<b>Qualitative Adjustments</b>
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<b>Adjustment</b>
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Business Diversification
Opacity and Complexity
Corporate Behavior

0
0
0

<b>Total Qualitative Adjustments</b>
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<b>0</b>
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Sovereign or Affiliate constraint
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-
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Scorecard Calculated BCA range
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<b>b1 - b3</b>
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<b>Assigned BCA</b>
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<b>b2</b>
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Affiliate Support notching
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<b>0</b>
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<b>Adjusted BCA</b>
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<b>b2</b>
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Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	0	0	b2	1	B1	B2

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on <http://www.moodys.com> for the most updated credit rating action information and rating history.

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