

Rating-Agentur Expert RA GmbH assigned 'B' credit rating to Bank Saderat Tashkent according to the international scale. The rating outlook is stable.

Rating-Agentur Expert RA GmbH assigned 'B' (Moderately low level of creditworthiness) credit rating according to the international scale to Bank Saderat Tashkent. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

BANKING SYSTEM RISK ASSESSMENT:

The bank's operations are concentrated 100% in Uzbekistan, and the bank's funding base is concentrated 100% in Iran. The banking system risk (BSR) of Uzbekistan and Iran is high. Therefore, the overall systemic risk of Bank Saderat Tashkent was assessed as high.

MAJOR FACTORS THAT INFLUENCED THE RATING:

Positive factors:

- Sufficient capital coverage as evidenced by the capital adequacy ratios. Since the major part of the bank's capital is mainly formed by equity, the TIER I capital adequacy ratio stood at 87% as of May 2017 and has remained significantly stable over time. Additionally, the total capital adequacy ratio stood well above the Central Bank of Uzbekistan (CBU) requirement (14,5%) at 87,4%. Given the low amount of loans to customers, we consider that the exposure of the capital to credit risks is negligible;
- Strong liquidity of the bank as shown by the short-term liquidity ratios up to 1 day and up to 30 days, which stood at around 385% and 63484% as of May 2017;
- Positive profitability indicators, as the ROE averaged 2,2% between 2013-2016. ROA was reported at 1,5% in 2016, which is comparable to ROA of the other peer foreign banks operating in Uzbekistan;
- Despite being highly concentrated, the funding base of the bank is considerably stable as the bank is funded entirely by the BSI. Moreover, there is a high probability that BSI will post additional liquidity to Bank Saderat Tashkent in case of a financial distress of the latter;
- Low exposure to market risks as the bank conducts few operations in Uzbekistan and has almost no interest rate risk. Additionally, 100% of the bank's equity as well as the term deposits at BSI are denominated in FX, which hedges the bank for any possible devaluation of the UZS and hence reduces the currency risk;
- Reduced risk on the term and structure of assets. As of June 2017, 96% of the bank's assets were deposits in the BSI in the form of interbank deposits. These deposits are mainly FX denominated and short-term (with a maturity of one year or less);
- High level of transparency of the ownership structure. There are no intermediate companies between the Bank Saderat Tashkent and the BSI and information about the largest beneficial owners has been disclosed.

Restricting factors:

- Low diversification level of the funding base with equity being the largest source of financing accounting for 92% of the entire balance sheet of the bank as of May 2017. Additionally, the deposits from the bank's major depositor account for 97% of all deposits

and around 8% of the entire balance sheet of the bank. This risk is however mitigated by the fact that the largest depositor is unlikely to withdraw its funds in the near future given the long-lasting relationship, as well as the depositor's need for Saderat Bank for its regular operations;

- The strategic plan of the bank is consistent with the past business development, however it comprises very general short-term plans.

Negative factors:

- Negative macro profile as the bank operates in Uzbekistan and has strong links with Iran, two countries with a reduced transparency and underdevelopment of the financial system. Additionally, Uzbekistan is characterized by capital controls and a parallel FX market, which combined with underdeveloped financial institutions and rather unfavorable business environment had a negative effect on the ratings;
- Strong signs of captivity as evidenced by the high share of related parties on the banks operations. As of May 2017, around 96% of total assets were linked to related parties, mainly through loans and interbank deposits with Bank Saderat Iran (BSI). This figure has increased by around 18p.p. from 78,3% in 2013. Additionally, 94% of the income from interest and commissions was attributed to operations with related parties in 2016, and this metric has also increased by around 6,5p.p. from 87,5% in 2013;
- Diminished geographic reach and competitive position, as the bank operates in Uzbekistan with a single office in Tashkent and the share of loans to customers accounted for as low as 0,3% of total assets as of May 2017. In contrast to other foreign banks in Uzbekistan, the main business of the bank consists of interbank lending to BSI and represents 97% of total assets, which reduces the potential of the bank to penetrate the Uzbek market.

External support factors:

- Support from the owners. The bank has received financial support from the BSI in the form of additional capital during periods of non-financial distress and based on recommendation of the CBU (decision to increase capital by USD 2 m during 2017). This demonstrates the shareholder's ability and willingness to support the bank if required.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Significant improvement of the economic and financial conditions of Uzbekistan and Iran according to our internal BSR assessment;
- Reduction in the amount of operations with related parties, mainly through loans and interbank deposits;
- Increase of the bank's competitive position as a result of a stronger penetration in the Uzbek market and lower dependence on funding from the Iranian branch.

The following developments could lead to a downgrade:

- Significant deterioration of the bank's capital and liquidity coverage indicators;
- Deterioration of the financial conditions of Bank Saderat Iran, the bank's main source of funding.

JUSTIFICATION OF THE RATING:

The Agency assigned a rating of 'B' with a stable outlook to Bank Saderat Tashkent mainly based on low competitive position, high concentration of the funding base, low geographical reach and strong signs of captivity, which were evidenced by the concentration of interbank deposits on a single counterparty and operations with related parties. However, the rating was influenced positively by the bank's outstanding capital and liquidity coverage combined with acceptable profitability metrics and low exposure to market risks. Given the exposure of the bank to the Iranian and Uzbek financial markets, the BSRs of both countries influenced the assessment of the rating.

Evidenced by the high involvement of related parties in the regular operations of the bank, there are noticeable signs of captivity. As of May 2017, 96% of assets were linked to operations with related parties mainly through loans and interbank deposits while 13% of total loans outstanding was granted to three related parties. In the same period, around 94% of total fee and commission income was generated through operations with related parties. The BSI received almost the entire amount of the Bank Saderat Tashkent's interbank deposits, and consequently was the main source of interest income for the bank. We also noticed that the level of involvement of related parties in the operations of the bank has increased in recent years.

BSI owns 100% of the bank and at the same time is the main source of funding for the bank, whose equity represented 92% of the entire balance sheet as of May 2017. This, combined with the low geographical reach of the bank and the reduced amount of loans to customers (accounting for 0,3% of total assets) is a significant obstacle which, in our view, reduced the potential of the bank to penetrate the local market. Furthermore, while the rating was negatively influenced by the high concentration of deposits at 97% on a single depositor, we believe that the stability of these deposit balances combined with low probability of withdrawal in the near future mitigate the concentration risks aforementioned.

As a result of the high concentration of the bank's operations on interbank lending coupled with continuous stability of the TIER I capital, the bank showed strong liquidity and capital coverage metrics which were well above the CBU's requirements. Additionally, the bank's profitability was adequate with ROA being close to the average reported by other peers in the Uzbek banking sector. This, combined with the low exposure of the bank to market and FX risks as well as reduced balance-sheet mismatch risks contributed to the positive assessment of the bank. In our view, the support from BSI to the bank in case of financial distress also played a positive role in the rating assessment.

The stable outlook was mainly driven by bank's stable structure and operations. In our view, the link of the bank to the Bank Saderat Iran serves a regular and certain source of income and funding which contributes to the stability of the bank.

COMPANY PROFILE:

Bank Saderat Tashkent was established in 1999 and is a subdivision and a fully-owned subsidiary of the Bank Saderat Iran which is located in Tehran (Iran). The bank carries out its main activities on the basis of the banking license for banking operations issued by the Central Bank of the Republic of Uzbekistan No. 2 – D dated from 25 September 2004. The principal activity of the Bank is commercial and retail bank operations on the territory of the Republic of Uzbekistan and beyond. These operations include operations with securities, foreign currency, attracting deposits and issuance of commercial loans in UZS, and in freely convertible currencies, rendering services to customers in realization of export and import operations. The Bank operates its principal activities in Tashkent city and does not have any branches in the Republic of Uzbekistan.

Responsible expert: Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH

Reviewer: Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH

Related research:

- ◆ Research report on Uzbekistan– 24.03.2017 :
https://raexpert.eu/reports/Research_report_Uzbekistan_24.03.2017.pdf

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Minute's summary:

The rating committee for Bank Saderat Tashkent was held on 28 July 2017. The quorum for the rating committee was present. After the responsible expert presented the factors which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Banks methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the rating class voting.

The rating was disclosed to the rated entity prior to the publication and was not changed during the process of coordination.

The following methodology was used for the rating assessment: Methodology for Assigning Credit Ratings to Banks – Short Public Version (from December 2016) can be found under the following link: http://www.raexpert.eu/files/methodology/Methodology_Short_Credit_Ratings_BanksV3.pdf. Descriptions and definitions of all rating categories can be found under the following link: <http://www.raexpert.eu/banks/> under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

This rating is solicited. The rated entity participated in the rating assignment process.

No other third party participated in the preparation of the rating.

Main sources of information:

- Annual IFRS report from the bank
- Monthly reports of the bank to the CBU
- Questionnaire from the bank
- Saderat Bank Iran website

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information as well as non-public information (obtained from the rated entity and/or other third parties) which was considered to be reliable, complete and non-biased. The responsible expert performed rating assessment of the bank with information considered as the most reliable and up to date in accordance to the overall position of the bank and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. The experts involved in the rating assessment and revision of the rated entity showed no conflict of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies from RAEX group.

Risk warning

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This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.