

Announcement: Moody's changes outlook on Bank of Baku's B2 ratings to positive

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London, 25 September 2012 -- Moody's Investors Service has today changed the outlook on the Azerbaijan-based Bank of Baku's B2 long-term local and foreign currency deposit ratings to positive from stable. The standalone E+ bank financial strength rating (BFSR) and Not Prime short-term bank deposit ratings were affirmed.

Moody's rating action is largely based on Bank of Baku's audited financial statements for 2011 prepared under IFRS.

RATINGS RATIONALE

According to Moody's, the positive outlook reflects: (i) improvements in Bank of Baku's franchise value in 2010-2012 and its strong market position as the second-largest provider of consumer loans in Azerbaijan, (ii) robust profitability, (iii) adequate asset quality and (iv) sufficient capitalisation to absorb expected credit losses under Moody's scenario analysis.

At the same time, Bank of Baku's ratings are constrained by its high appetite for credit risk, reflecting the bank's aggressive growth strategy and its emphasis on the riskiest and immature segment of the retail loan market -- unsecured consumer lending. We also believe that such lending growth may result in looser underwriting policies, thereby leading to a material higher cost of risk going forward.

Since 2010, Bank of Baku has substantially grown its balance sheet and improved its market position. As a result of its rapid expansion, Bank of Baku's loan portfolio increased by 42% in 2011, and by another 23% in H1 2012 to AZN329million (US\$419 million). We note that this high growth makes the loan book mostly unseasoned.

In 2011, Bank of Baku reported record profits as its net income increased by 126% to AZN26.2 million (\$33.3 million) from AZN11.6 million in 2010 (according to the bank's audited IFRS report), translating into a strong return on average assets of 9.6% and return on equity of 56.0% (2010: 5.5% and 33.5%, respectively). The rating agency notes that the bank's high profitability is driven by its focus on high-margin consumer-lending business.

In light of Bank of Baku's highly profitable lending business, Moody's views the bank's asset quality as adequate (loans 90+ days overdue accounted for 3.3% of gross loans in 2011). However, the very rapid loan book growth in the context of Azerbaijan's immature consumer credit market could adversely impact asset quality if the operating environment deteriorates.

Moody's notes that Bank of Baku's rapid loan book growth puts pressure on its liquidity. Liquid assets have decreased to around 12% of total assets during 2011 from 22% and remained at around 12.5% in H12012, which signals an aggressive liquidity management.

Moody's also notes that Bank of Baku's capitalisation benefits from the bank's strong internal capital generation. With a Tier 1 ratio of 18.5% and a Total Capital Adequacy ratio of 21 % at YE2011 the bank's capital buffer will likely be sufficient to absorb expected credit losses under Moody's scenario analysis.

WHAT COULD MOVE THE RATINGS UP/DOWN

Moody's says that any possible upgrade of Bank of Baku's ratings over the next 12-18 months will be contingent on its ability to manage its rapid growth, maintaining satisfactory financial fundamentals commensurate with those of higher-rated banks.

At the same time negative pressure could be exerted on the bank's ratings by any material adverse changes in the bank's risk profile, particularly any further weakening of the bank's liquidity position or deterioration of its asset quality.

The principal methodology used in this rating was Moody's Consolidated Global Bank Rating Methodology published in June 2012. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

Headquartered in Baku, Azerbaijan, Bank of Baku reported total assets of AZN307.3 million (US\$390.7 million), shareholders equity of AZN57.2million (US\$72.7 million) and net income of AZN26.2million (US\$33.3) million at YE2011, according to its (audited) IFRS financial statements

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Lev Dorf
Analyst
Financial Institutions Group

Moody's Investors Service Limited, Russian Branch
7th floor, Four Winds Plaza
21 1st Tverskaya-Yamskaya St.
Moscow 125047
Russia

Yves J Lemay
MD - Banking
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454



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