

Rating Action: Moody's upgrades Bank of Baku to B1; outlook stable

Global Credit Research - 12 Dec 2013

London, 12 December 2013 -- Moody's Investors Service has today upgraded OJSC Bank of Baku's long-term local and foreign-currency deposit ratings to B1 from B2. Concurrently, Moody's has affirmed the bank's standalone E+ bank financial strength rating (BFSR), and raised the equivalent baseline credit assessment (BCA) to b1 from b2. Moody's also affirmed the bank's Not Prime short-term local and foreign-currency deposit ratings. All the aforementioned long-term ratings carry a stable outlook.

The rating upgrade reflects Bank of Baku's track record of strong financial performance and Moody's expectation that the bank's standalone credit worthiness will remain robust for the foreseeable future.

Moody's rating action is primarily based on Bank of Baku's audited financial statements for 2012 prepared under consolidated IFRS, as well as the bank's unaudited financial statements for 30 November 2013, prepared in accordance with the non-consolidated local GAAP

RATINGS RATIONALE

According to Moody's, the rating action reflects the bank's (1) good asset quality, leading to lower credit costs compared with those of similarly rated peers; and (2) healthy capital buffer, which, together with a robust pre-provision profitability, provide the bank with good loss-absorption capacity. However, at the same time, Moody's says that Bank of Baku's relatively high appetite for credit risk -- demonstrated by the rapidly growing retail loan book in recent years -- will be a key constraining factor for the ratings.

SOLID ASSET QUALITY

Despite rapid lending growth in recent years, Bank of Baku's asset quality has remained solid and Moody's expects the bank's asset quality to remain stable over the next 12-18 months given that the favourable operating environment in Azerbaijan (Baa3 stable) supports credit quality.

Moody's notes that Bank of Baku's overall asset quality remains superior to that of similarly rated peers, with the level of loans overdue for more than 90 days at around 3.2% of the gross loan portfolio, as of 30 June 2013. In addition, the bank provides sufficient coverage of problem loans, by maintaining loss loan reserves at around 4.0% of gross loans and its cost of risk is expected to remain below 2% in 2013 (year-end 2012: 1.5% and year-end 2011: 0.6%)

STRONG PROFITABILITY LEADS TO AMPLE INTERNAL CAPITAL GENERATION CAPACITY

The rating action also considers that the bank's focus on high-margin consumer-lending business has provided it with robust core profitability.

For end-November 2013, the bank reported net income of AZN48 million (AZN32.3 million for the whole year of 2012), in accordance with local GAAP, translating into annualised return on average assets of 9.2% and return on equity of 41.6% .

Moody's expects that Bank of Baku's core profitability will remain robust over the next 12-18 months, supported by (1) the recent growth of the loan portfolio (35% expected in 2013) ; (2) strong margins (around 16% in 2012) and good cost efficiency (the cost-to-income ratio was around 37% in 2012).

Bank of Baku's capital position benefits from its strong internal capital generation and Moody's expects that the bank's capital buffer will be sufficient to absorb expected credit losses under Moody's central and adverse scenario, with a Tier 1 ratio of 12.63% and a Total Capital Adequacy ratio of 19 % reported by the bank at H1 2013. (11.77% and 21.3 % respectively in 2012)

WHAT COULD MOVE THE RATING UP/DOWN

Considering that today's rating action reflects Moody's forward-looking view of Bank of Baku's performance over the next several years, any positive rating actions are unlikely over the next 12-18 months. In the longer term,

material improvements in the bank's market franchise as well as maintenance of sound asset quality, profitability and capitalisation may have positive rating implications for the bank's ratings.

Downward pressure could be exerted on Bank of Baku's ratings as a result of any material adverse changes in the bank's risk profile, particularly any significant impairment in the bank's asset-quality.

PRINCIPAL METHODOLOGIES

The principal methodology used in this rating was Global Banks published in May 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Headquartered in Baku, Azerbaijan, Bank of Baku reported total assets (under non-audited Local GAAP) of AZN649.4 million, total equity of AZN125.6 million, and net income of AZN48 million as of 30 November 2013.

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