MOODY'S
INVESTORS SERVICE

Credit Opinion: OJSC Bank Eskhata

Global Credit Research - 07 Jun 2013

Tajikistan

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits -Fgn Curr	Caa2/NP
Bank Deposits -Dom Curr	B3/NP
Bank Financial Strength	E+
Baseline Credit Assessment	(b3)
Adjusted Baseline Credit Assessment	(b3)

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Key Indicators

OJSC Bank Eskhata (Unconsolidated Financials)[1]

	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (TJS thousands)	517	345	295	261	354
Total Assets (USD billion)	109	78	68	75	82
Tangible Common Equity (TJS billion)	50	39	30	34	38
Tangible Common Equity (USD thousands)	11	9	7	10	9
Net Interest Margin (%)	9.7%	7.7%	9.2%	10.2%	9.2%
PPI / Avg RWA (%)	8.97%	6.00%	--	--	7.49%
Net Income / Avg RWA (%)	4.54%	2.95%	--	--	3.75%
(Market Funds - Liquid Assets) / Total Assets (%)	15.6%	22.4%	12.3%	27.2%	19.4%
Core Deposits / Average Gross Loans (%)	76.6%	65.8%	68.5%	51.8%	65.7%
Tier 1 Ratio (%)	12.6%	14.1%	--	--	13.3%
Tangible Common Equity / RWA (%)	12.3%	13.5%	--	--	12.9%
Cost / Income Ratio (%)	66.2%	67.8%	58.5%	68.1%	65.2%
Problem Loans / Gross Loans (%)	4.8%	5.5%	13.7%	2.7%	6.7%
Problem Loans / (Equity + Loan Loss Reserves) (%)	21.7%	21.1%	49.6%	10.6%	25.7%

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel I; IFRS

Opinion

SUMMARY RATING RATIONALE

We assign a standalone bank financial strength rating (BFSR) of E+ to Tajikistan-based Bank Eskhata, mapping a standalone credit strength of b3, which reflects the (i) weak and potentially volatile operating environment in Tajikistan; (ii) the bank's high credit risk appetite as demonstrated by recent rapid loan book growth, and (iii) a very high proportion of FX-denominated loans which increases uncertainty over the bank's asset quality.

At the same time, Eskhata's ratings are underpinned by: (i) the high granularity of its loan book, supported by the bank's focus on microfinance and retail business; (ii) good financial fundamentals including asset quality, liquidity and profitability; and (iii) currently sufficient capitalisation to absorb expected credit losses under Moody's central scenario.

Eskhata's Global Local Currency (GLC) deposit ratings of B3/Not Prime do not incorporate any element of systemic support and therefore, are based solely on its standalone credit strength. Eskhata's long-term ratings carry a stable outlook.

Eskhata reported total assets of TJS712 million (US$150 million) and shareholders' equity of TJS119.6 million(US$25.2 million) - under unaudited local GAAP - as at 30 March 2013.

Rating Drivers

- Weak and potentially volatile operating environment in Tajikistan

-Good market position in servicing the microfinance sector and cash remittances

- Good profitability benefits from wide margins and strong fees and commissions

-Adequate liquidity profile has been supported by ample liquidity cushion

-Adequate asset quality to date will remain challenged by very rapid lending growth

-Adequate capital buffer is supported by a strong internal capital generating capacity

Rating Outlook

All of Eskhata's long term ratings carry a stable outlook.

What Could Change the Rating - Up

An upgrade of Eskhata's ratings is unlikely in the near term, given the weak and potentially volatile operating environment in which the bank operates.

What Could Change the Rating - Down

Downward pressure could be exerted on Eskhata's ratings if economic conditions were to worsen beyond current expectations, leading to materially weaker asset-quality, impaired profitability and weaker capitalisation levels.

DETAILED RATING CONSIDERATIONS

WEAK AND POTENTIALLY VOLATILE OPERATING ENVIRONMENT IN TAJIKISTAN

Eskhata's ratings are strongly dependent upon government policy and Tajikistan's operating and economic environment. Despite the acceleration of economic growth in recent years (Tajikistan GDP grew by 7.5% in 2012, 7.4% in 2011, and 6.5% in 2010), Tajikistan's economic conditions and the operating environment remain weak and constrained by the country's limited economic development, weak institutions and high levels of dollarisation.

Given the country's heavy dependence on remittances from expatriates working in Russia (in 2012 remittances accounted for around 50% of Tajikistan GDP), the local economy and the banking sector are highly vulnerable to external shocks - particularly to a drop in international oil prices which could affect Russia and lead to a drop in money transfers. We note that such a shock was experienced in 2009, when remittances decreased by around 30%.

GOOD MARKET POSITION IN SERVISING THE MICROFINANCE SECTOR AND CASH REMITTANCES

Bank Eskhata was established in Tajikistan in 1993 by the local Nasirov family which currently controls around 63% of the bank's shares according to audited IFRS for 2012. In 2005, the bank signed an equity investment agreement with the European Bank for Reconstruction and Development (EBRD) and Shore Capital - a US-based microfinance development institution (in 2010, Shore Capital sold its stake to the Nasirov family). The EBRD is planning to gradually exit the bank in the near future, and its stake could be purchased either by the Nasirovs or a foreign investor: in 2012, EBRD reduced its stake to 18% from 21%.

Eskhata's franchise development benefits from funding, technical and risk management assistance provided by the EBRD and other Western public-sector international financial institutions (IFIs). With total assets of TJS713 million at YE2012 (US150 million), Eskhata is a medium-sized bank in Tajikistan, ranking fifth by assets among the 17 banks in the system. As at YE2012, Eskhata held 6.8% of total assets, 7.6% of loans and 8% of retail deposits. The bank has historically focused on microfinance business in Tajikistan which together with SME segment account for the largest portion (78%) of the bank's loan portfolio. The bank operates a relatively large distribution network of 18 branches, 20 outlets and 200 offices servicing money transfers. Domiciled in the city of Khudjant (north of the country)- Eskhata has historically good market positions in the northern parts of Tajikistan and is planning to increase its presence in the southern regions - which are somewhat less developed.

Eskhata has demonstrated strong lending growth over the past years. Thanks to improving credit conditions in Tajikistan and increased demand for credit, its loan portfolio grew by almost 29% in 2012, 50% in 2011 and by 40% in 2010, exceeding the banking system's growth (13% in 2012). In recent years, Eskhata has become one of the leading players on the money transfer market, servicing remittance payments and accounting for 30.5% of all cash transfers to Tajikistan in 2012.

GOOD PROFITABILITY BENEFITS FROM WIDE MARGINS AND STRONG FEES AND COMMISSIONS

Over the last three years, Eskhata reported strong profitability, which was supported by (i) growing business volumes, (ii) wide net interest margin, (iii) strong fees and commissions, and (iv) stable asset quality.

For 2012 Eskhata reported a net income of TJS45 million- a material increase from TJS15million in 2011, which translated into a strong return on average assets (RoAA) of 7.4% in 2012, according to the bank's audited IFRS report. The bank's profitability was largely driven by significant increase in income from FX operations while Eskhata's recurring profit from net interest income and fees and commissions together increased by 38% from 2011 .

Eskhata's profitability benefits from its focus on high-yielding retail and microfinance loans, and relatively cheap funding provided by IFIs the bank reported healthy net interest margin of 9.6% in 2012 (2011: 9.7%).

In addition , its profitability benefits from a strong fees-generating capacity. Its fee and commission income, mostly generated by the remittance business, remains one of the main income sources, generating around 26% of the total operating income at YE2012 (vs. 32% in 2011). FX operations are another important source of earnings for Eskhata, considering the high dollarisation of the Tajik economy and the banking system.

In our opinion, the bank's profitability will remain robust in the short term (12-18 months) considering currently stable credit conditions, and the growing volume of remittances.

GROWING DEPOSITS AND AMPLE LIQUIDITY CUSHION SUPPORT LIQUIDITY POSITION

Eskhata maintains an ample liquidity cushion which is necessary to support its money transfer operations. As at YE2012, cash and nostro accounts comprised approximately 31% of Eskhata's total assets (YE2011 : 27%). Eskhata non-equity liabilities represent a relatively stable and balanced funding mix between (i) interbank funding which accounted for 45% of total liabilities, and includes bilateral and subordinated loans from IFIs, and (ii) customer deposits which accounted for the remaining 47%. In recent years, Eskhata has been focusing on attracting retail deposits which grew by 58% in 2012 (2011: 85%), and accounted for around 79% of total customer funds. We note that retail deposits, while granular, represent a risk for the bank's liquidity position given the low depositor confidence in the banking system.

We currently regard Eskhata's exposure to refinancing risks as low, given the satisfactory short- to medium-term liquidity profile which is supported by the relatively long-term nature of its cross-border funding from foreign shareholder and other IFIs. We expect the bank to continue financing its lending growth with longer-term international borrowings and to continue focusing on the local deposit market in order to fund retail loans and maintain its liquidity buffer.

CURRENTLY ADEQUATE ASSET QUALITY WILL REMAIN CHALLENGED BY VERY RAPID LENDING GROWTH

According to the bank's data, the level of loans overdue for more than 90 days and restructured loans was relatively low: 1% and 1.5% of the gross loan portfolio, respectively, as at 31 December 2012. Provisioning coverage was maintained at 4.2% of gross loans, which provides sufficient problem loans coverage. We note, however, that the bank's true asset quality could be masked by the very rapid lending growth (30-50% over the past three years), which we regard as a risk factor.

The bank's asset quality benefits from the high granularity of the loan portfolio and the low level of indebtedness in Tajikistan. In addition, accelerating inflows of remittances in the last two years had positive implications for the overall economy, including the SME and retail sectors. Remittances are an important source of income for most of Eskhata's clients, supporting borrowers' repayment capability, and positively affecting the overall asset quality of the bank.

In light of the currently stable operating environment, we expect asset quality to remain stable; however, we note that asset quality ratios could be further diluted if the bank maintains rapid loan-book growth, which could result in a higher level of delinquencies in a maturing loan portfolio.

The proportion of FX denominated loans has historically been high (which is common for Tajikistan), and accounted for around 90% of the bank's loan portfolio, thus rendering asset-quality vulnerable to a potential local currency depreciation.

STRONG INTERNAL CAPITAL GENERATION CAPACITY SUPPORTS CAPITALISATION

In 2012, Eskhata's capital base grew by more than 80% mainly supported by the bank's strong internal capital generating capacity. In light of Eskhata's sufficient loan loss reserves and strong internal capital generating capacity, we regard its capital profile as adequate, with Total regulatory capital ratio of 19.1% reported at YE2012 (YE2011: 15.6%). This capital buffer is sufficient to absorb the bank's expected credit losses according to our central scenario.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a long-term GLC deposit rating of B3 to Eskhata.

Foreign Currency Deposit Rating

Moody's assigns Caa2/Not Prime foreign currency deposit ratings to Eskhata.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees

Rating Factors

OJSC Bank Eskhata

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (70%)						E	
Factor: Franchise Value						D+	Neutral
Market share and sustainability			x				
Geographical diversification					x		
Earnings stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						E	Neutral
Corporate Governance [2]					x		
- Ownership and Organizational Complexity					x		
- Key Man Risk					x		
- Insider and Related-Party Risks							
Controls and Risk Management					x		
- Risk Management					x		
- Controls					x		
Financial Reporting Transparency				x			
- Global Comparability		x					
- Frequency and Timeliness					x		
- Quality of Financial Information					x		
Credit Risk Concentration				x			
- Borrower Concentration				x			
- Industry Concentration			x				
Liquidity Management				x			
Market Risk Appetite					x		
Factor: Operating Environment						E	Neutral
Economic Stability					x		
Integrity and Corruption					x		
Legal System					x		
Financial Factors (30%)						C	
Factor: Profitability						A	Neutral
PPI % Average RWA (Basel I)	--	--	--	--	--		
Net Income % Average RWA (Basel I)	--	--	--	--	--		
Factor: Liquidity						D	Neutral
(Market Funds - Liquid Assets) % Total Assets				14.93%			
Liquidity Management				x			

Factor: Capital Adequacy						**A**	**Neutral**
Tier 1 Ratio (%) (Basel I)	--	--	--	--	--		
Tangible Common Equity % RWA (Basel I)	--	--	--	--	--		
Factor: Efficiency						**C**	**Neutral**
Cost / Income Ratio			62.73%				
Factor: Asset Quality						**D+**	**Neutral**
Problem Loans % Gross Loans				5.19%			
Problem Loans % (Equity + LLR)			21.45%				
Lowest Combined Financial Factor Score (9%)						**D**	
Economic Insolvency Override						**--**	
Aggregate BFSR Score						**D-**	
Aggregate BCA Score						**ba3**	
Assigned BFSR							
Assigned BCA							

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.