

Rating Action: Moody's changes rating outlook for Black Sea Trade and Development Bank to stable from negative

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Frankfurt am Main, September 30, 2016 -- Moody's Investors Service has today changed the rating outlook for Black Sea Trade and Development Bank (BSTDB) to stable from negative and affirmed its long-term and short-term A2/P-1 issuer ratings. At the same time, the bank's MTN programme has been affirmed at (P)A2 and the senior unsecured debt ratings at A2.

The key drivers underlying Moody's decision to change the outlook on BSTDB's A2 rating to stable from negative are the following:

(1) The improvement in BSTDB's asset quality in 2015 with the reduction of non-performing loans (NPLs) over total gross loans to 1.2% (from 5.5% in 2014), despite stressed macro conditions in Russia and the rest of CIS region last year; and

(2) The stabilisation of macro conditions in Russia and Ukraine this year and the expected return to positive growth in 2017 ease a source of potential asset quality pressure for BSTDB going forward.

The affirmation of BSTDB's A2 rating is based on its sound capital adequacy and liquidity position, coupled with the strength of member support which has proven resilient to the weakening of the credit profile of several of BSTDB's members over the past two years. BSTDB's key credit metrics are also broadly aligned to those of A-rated peers.

RATINGS RATIONALE

RATIONALE FOR OUTLOOK CHANGE TO STABLE

FIRST DRIVER -- MATERIAL DECLINE IN THE GROSS NPL RATIO, WHICH REDUCES THE RISK OF LOSSES AND PRESSURES ON THE BANK'S CAPITAL BUFFERS

The first driver of Moody's decision to change the outlook to stable is related to the improvement of asset quality that resulted from the marked reduction of non-performing loans (NPLs) over gross loans. By the end of 2015, the ratio of NPLs had declined to 1.2% compared with 5.5% at the end of 2014 after the bank managed to sell or write off three NPLs long-present in BSTDB's portfolio. With a fourth one written off in the first half of 2016, the NPLs currently account for 1.1% of the outstanding loan operations.

As a result of released provisions against loan disposals and write-offs, the total level of provisions declined in 2015 to EUR26.5 million against EUR47.7 million. Although total provisions over total gross loans had fallen to 2.5% at the end of 2015 from 5.4% at the end of 2014, the ratio of total provisions over the remaining two NPLs increased to more than 200% compared to 98.6% the year before.

Moody's adds however that BSTDB's capacity to keep the current level of NPLs stable and thereby reduce the negative pressure on its capital adequacy will be tested against the portfolio growth to more than EUR1.2 billion (from current EUR1 billion) envisaged in the bank's medium-term strategy for 2015-18. In this regard, Moody's believes that the bank's continued improvement in assessing credit risk should help limit the level of NPL formation in the coming years.

SECOND DRIVER - STILL CHALLENGING, BUT STABILIZING OPERATING ENVIRONMENT THANKS TO RETURN TO POSITIVE GROWHT IN RUSSIA AND UKRAINE NEXT YEAR

Since March 2015, when Moody's assigned a negative outlook to BSTDB's rating on the back of the risks stemming from the economic crisis in Russia and Ukraine, both countries have started to stabilize and are now showing signs of a gradual economic recovery for next year. This is an important factor informing BSTDB's credit profile because lending activities in those two countries represented more than 30% of the bank's loan book at the end of 2015. Russia's contraction in real terms this year will be significantly smaller than last year (-1% compared to -3.7% in 2015) and Moody's expects the economy to grow by 1.5% in 2017. In short

Moody's believes that the gradual improvement of economic conditions across the CIS region should contribute to easing the risk of BSTDB's asset quality pressure in the coming years.

Nevertheless, the economic environment in which the bank operates remains fundamentally challenging because it limits diversification opportunities and it leaves the performance of its loan book exposed to the elevated economic vulnerabilities of the countries it lends to. Although BSTDB's medium-term strategy targets a more balanced exposure by country, Russia (26% of the loan book in 2015) and Turkey (at 21.3%) will remain the biggest single country exposures as a reflection of limited demand for investment in the other countries of the bank's operating area.

RATIONALE FOR AFFIRMATION OF BSTDB'S A2 RATING

Moody's decision to affirm BSTDB's A2 rating is supported by the bank's high level of usable equity relative to its loan book, its low leverage, a significant amount of callable capital, and substantial liquid assets, all of which support BSTDB's resilience to the challenging macroeconomic operating environment it operates in. Moreover, despite the downgrades of Azerbaijan to Ba1 on 29 April 2016 (representing 5% of BSTDB's subscribed capital) and of Turkey to Ba1 on 23 September 2016 (16.6% of subscribed capital), the ability of BSTDB's shareholders to provide support remains material.

About EUR443 million (27.6% of total callable capital) could potentially be provided by investment-grade members out of EUR1.6 billion worth of nominal callable capital. Moody's also notes that the Ba1 median weighted shareholder rating is aligned to the median of A-rated MDBs. In addition, the coverage of the debt stock by callable capital from investment-grade members still compares favourably with BSTDB's peers -- even when including the \$500 million five-year bond issued by the bank in May 2016.

BSTDB's usable capital amounted to EUR721 million at year-end 2015. This includes paid-in capital, reserves and profits and can be utilized to absorb losses on assets and repay creditors. BSTDB's usable capital increased by 3.8% in 2015, thanks to a EUR15.2 million net income that year and continued paid-in capital contributions from member states. BSTDB's profits have on average been stable and positive since 2008, ranging from EUR10 million to EUR15 million, with a return on assets averaging 1.4% over 2008-15. Profitability in 2016 will likely be reduced by the impact of increased interest payments and provisions. Moody's views profitability as neutral in its assessment of capital adequacy.

BSTDB's liquidity policy sets the minimum level of liquid assets at 50% of the next 12 months' net cash requirements, and the bank has consistently held liquid assets in excess of this level. As of the end of 2015, this policy measure was 71%. In Moody's view, cash coverage provides a sizable liquidity cushion because it includes not just debt service, but also budgeted loan disbursements and administrative expenses. In an extreme liquidity stress scenario, this would allow the bank to ensure debt service by reducing loan disbursements.

WHAT COULD MOVE THE RATING UP/DOWN

Upward rating pressure could emerge if BSTDB demonstrated an extended track record of low NPL levels, a strengthening of its capital buffers and/or a material improvement of the credit profile of its major shareholders.

Conversely, a further weakening of the credit profile of BSTDB's major borrowers and a material rise in NPL formation would likely lead to downward rating pressure.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities published in December 2013. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

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