FitchRatings

Fitch Affirms 4 State-Owned Uzbek Banks at 'B+'; Outlooks Stable

Fitch Ratings-Moscow-11 July 2017: Fitch Ratings has affirmed the Long-Term Foreign Currency Issuer Default Ratings (IDRs) of Uzbek Industrial and Construction Bank Joint-Stock Commercial Bank (Uzpromstroybank; UPSB), Asaka Bank (Asaka), OJSC Agrobank and Microcreditbank's (MCB) at 'B+'. The Outlooks are Stable. A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

IDRS, SUPPORT RATINGS, SUPPORT RATING FLOORS

The affirmation of the Long-Term Foreign Currency IDRs and Support Rating Floors (SRFs) of all four banks at 'B+' reflects Fitch's view of a high propensity of the Uzbek authorities to support the banks, in case of need. This view of support is based on (i) the state's majority ownership; (ii) the banks' policy roles (to a lesser extent for MCB) and (iii) the track record of capital support, including from Fund for Reconstruction and Development and Ministry of Finance, which administered recapitalisation programmes of USD500 million and UZS1.2 trillion, respectively, for state banks (including the reviewed ones) in 2017. These injections are made in steps, with some amounts already disbursed and the rest by end-2017.

In Fitch's view, the state's ability to provide support is currently solid, considering the moderate size of the banking sector relative to the Uzbek economy (loans/GDP ratio of around 37% at end-2016) and reasonably large foreign-currency reserves. However, it should also be viewed in the context of the banking sector being concentrated and support-dependent and the economy's structural weaknesses, as Uzbek exports are commodities-driven and concentrated on a few countries, and external finances are heavily supported by remittances.

The previous government's plan to attract new foreign investors to all four banks through minority stake sale was abandoned in late 2016. Fitch therefore believes that the state is likely to retain majority stakes and operational control in the banks, and its propensity to support them should therefore remain strong.

Viability Ratings (VRs)

The affirmation of UPSB's and Asaka's VRs at 'b' reflect the banks' reasonable performance and asset quality metrics to date, mostly due to exposure to higher-quality borrowers that is partly covered by state guarantees. Agrobank's and MCB's VRs at 'b-' reflects the banks' weaker asset quality and profitability metrics, as the result of the banks' focus on higher-risk segments.

At the same time, all four banks' VRs continue to reflect Uzbekistan's difficult operating environment, the banks' limited commercial franchises, high concentrations in their balance sheets, and potential deficiencies in underwriting policies leading to high credit and operational risks.

UPSB and Asaka reported low non-performing loans (NPLs) at end-2016 (below 1% and 2% respectively, fully covered by reserves). This is due to their focus on the export-oriented commodity and auto industries and a high share of state-owned borrowers (UPSB - 85% of loans, Asaka - 60%), with a significant share of larger exposures also being guaranteed by the state (54% of loans at UPSB and 36% at Asaka).

Agrobank also has low NPLs (2.5% at end-2016), but its asset quality remains weakened by unreserved problem receivables (UZS261 billion or 7% of total assets), which resulted from a 2010 fraud. MCB's NPL ratio was a high 13% at end-2016, due to financial difficulties in a number of agricultural companies. The unreserved portion of these loans was a significant 35% of end-2016 Fitch Core Capital (FCC), as MCB expects to recover a significant part of them. Positively, the bank has sufficient capital to reserve these loans and remain compliant with regulatory capital ratios.

Loan books are more concentrated and dollarised in UPSB (78%) and Asaka (57%), although the risks are mitigated by most borrowers, who have taken foreign-currency loans, being either state-owned/guaranteed or have foreign-currency revenues. Agrobank's and MCB's loans are mostly in local currency and more granular by borrower, albeit concentrated on the agricultural industry and therefore prone to risk of commodity (eg cotton) price fall.

Profitability was moderate at UPSB and Asaka in 2016 (return on average equity (ROAE) of around 11% at both banks), and weak at Agrobank (2%) and MCB (negative 11%), reflecting the mostly state-directed nature of banks' operations (at UPSB and Asaka) and rather weak operating efficiency (at Agrobank and MCB).

Capitalisation was moderate at UPSB (FCC/risk-weighted assets (RWA) of 15% at end-2016), MCB (FCC/total assets of 13%), modest at Asaka (FCC/RWA of 11%) and weak at Agrobank (FCC/RWA of 6%, adjusted for unreserved problem receivables). Asaka and Agro were also in breach of the minimum regulatory capital requirements at end-5M17 (total capital ratios of 11.6% and 7.8%, respectively, compared with prudential minimum of 12.5%) due to lending expansion, but this should be rectified soon, as all state banks will be recapitalised by end-2017. Fitch expects capital contributions from the state to equal around 6% of end-5M17 RWAs in UPSB, 7% in Asaka, 8% in Agro and 18% in MCB.

However, the increased capital buffers are likely to be consumed, as internal capital generation is lagging behind growth at all four banks, and also due to potential further som depreciation after the already high 23% in 1H17 (non-annualised).

The banks' funding is mainly sourced from customer deposits and government and quasi-government entities. Depositor concentrations were high at UPSB, Asaka and MCB, with 20 largest depositors accounting for 45%, 70% and 46% of total customer funding, respectively. Agrobank's deposits were more granular (15%). UPSB is the only bank with meaningful borrowings from foreign financial institutions (21% of liabilities). However, UPSB's foreign debt repayments are small (below 5% of total liabilities in 2H17-2018) and linked to loan repayments.

Liquidity is comfortable at UPSB and Asaka due to solid buffers (liquid assets net of near-term repayments were about half of customer deposits at end-4M17 at UPSB and 35% at end-5M17 at Asaka), and somewhat tighter at Agrobank and MCB, as these two banks have high reliance on short-term inter-bank placements. All four banks hold large enough foreign currency liquidity buffers to withstand a substantial reduction in foreign-currency-denominated customer funding.

RATING SENSITIVITIES
IDRS, SUPPORT RATINGS, SUPPORT RATING FLOORS
A change in UPSB's, Asaka's, Agrobank's and MCB's support-driven IDRs could result from a strengthening/weakening of the sovereign's credit profile. A weakening of the state's propensity to support the banks may result in a downgrade of the ratings.

VRS
All four banks' VRs could be downgraded as a result of deterioration in the banks' asset quality if this is not fully offset by fresh equity injections. Upgrades of the VRs could result from improvements in Uzbekistan's operating environment and strengthening of the banks' commercial franchises, although upgrades of Agrobank's and MCB's VRs would also require improvements in the banks' asset quality and performance.

The rating actions are as follows:

UPSB
Long-Term Foreign-Currency and Local-Currency IDRs affirmed at 'B+'; Outlooks Stable
Short-Term Foreign-Currency and Local-Currency IDRs affirmed at 'B'
Viability Rating affirmed at 'b'
Support Rating affirmed at '4'
Support Rating Floor affirmed at 'B+'

Asaka
Long-Term Foreign-Currency and Local-Currency IDRs affirmed at 'B+'; Outlooks Stable
Short-Term Foreign-Currency and Local-Currency IDRs affirmed at 'B'
Viability Rating affirmed at 'b'
Support Rating affirmed at '4'
Support Rating Floor affirmed at 'B+'

Agrobank
Long-Term Foreign-Currency and Local-Currency IDRs affirmed at 'B+'; Outlooks Stable
Short-Term Foreign-Currency and Local-Currency IDRs affirmed at 'B'
Viability Rating affirmed at 'b-'
Support Rating affirmed at '4'
Support Rating Floor affirmed at 'B+'

MCB
Long-Term Foreign-Currency and Local-Currency IDRs affirmed at 'B+'; Outlooks Stable
Short-Term Foreign-Currency and Local-Currency IDRs affirmed at 'B'
Viability Rating affirmed at 'b-'
Support Rating affirmed at '4'
Support Rating Floor affirmed at 'B+'

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Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016) (https://www.fitchratings.com/site/re/891051)

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