

## CREDIT OPINION

22 May 2020

### Update

 Rate this Research

#### RATINGS

##### Siaulių Bankas, AB

Domicile	Siauliai, Lithuania
Long Term CRR	Baa1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Baa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Siaulių Bankas, AB

### Update to credit analysis

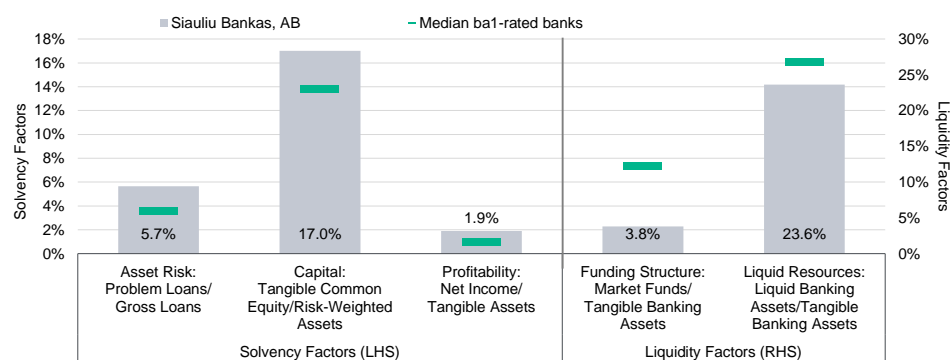
#### Summary

[Siaulių Bankas, AB's](#) (Siaulių Bankas) ba1 Baseline Credit Assessment (BCA) and Adjusted BCA capture the operating environment in Lithuania, the bank's increased capitalisation, illustrated by its tangible common equity (TCE) to risk-weighted assets (RWAs) ratio of 17.0% as of the end of December 2019, and strong recurring profitability. This is balanced against the bank's high loan growth and sector concentration in small- and medium-sized enterprise (SME) and consumer finance in Lithuania.

The bank's Baa2/Prime-2 deposit ratings incorporate a two-notch uplift from its ba1 Adjusted BCA, resulting from our Advanced Loss Given Failure (LGF) analysis. We view the probability of support from the [Government of Lithuania](#) (A3 positive) to Siaulių Bankas as low, resulting in no further uplift for the deposit rating.

Exhibit 1

#### Rating Scorecard - Key financial ratios



The problem loan and profitability ratios are the weaker of the average of the latest three year-end ratios and the latest reported ratio. The capital ratio is the latest reported figure. The funding structure and liquid asset ratios are the latest year-end figures.

Source: Moody's Investors Service

## Credit strengths

- » Robust capital, with important headroom above regulatory requirements
- » Strong profitability, which supports internal capital generation capacity
- » Sound funding and liquidity, underpinned by its stable deposit base

## Credit challenges

- » Sector concentration towards the more vulnerable SME segment along with high loan growth
- » A limited risk linked to the legacy portfolio of Ukio Bankas, although the risk is now broadly in line with that of the bank's portfolio

## Outlook

The stable outlook on Siauliu Bankas' long-term deposit ratings reflects our expectations that the bank will maintain solid capitalisation, with significant headroom above regulatory Common Equity Tier 1 (CET1) capital requirements, along with robust profitability, albeit dented by the ongoing coronavirus crisis, for the next 12-18 months.

## Factors that could lead to an upgrade

Siauliu Bankas' ratings could be upgraded if the bank could demonstrate strong resilience in terms of maintaining its problem loan ratios, profitability and capitalization, particularly during a severe economic downturn.

## Factors that could lead to a downgrade

Conversely, downward pressure on Siauliu Bankas could develop if the operating environment deteriorated significantly, resulting in a significant deterioration in the bank's asset quality, profitability or capital.

## Key indicators

Exhibit 2

### Siauliu Bankas, AB (Consolidated Financials) [1]

	12-19 <sup>2</sup>	12-18 <sup>2</sup>	12-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (EUR Million)	2,508.2	2,261.7	2,030.8	1,861.3	1,695.0	10.3 <sup>4</sup>
Total Assets (USD Million)	2,815.4	2,585.5	2,438.5	1,963.2	1,841.3	11.2 <sup>4</sup>
Tangible Common Equity (EUR Million)	295.0	271.9	204.9	175.0	132.4	22.2 <sup>4</sup>
Tangible Common Equity (USD Million)	331.1	310.8	246.1	184.6	143.8	23.2 <sup>4</sup>
Problem Loans / Gross Loans (%)	5.3	6.2	5.5	7.2	9.9	6.8 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	17.0	17.4	15.8	15.8	12.6	15.7 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	27.0	28.0	28.4	36.1	54.2	34.7 <sup>5</sup>
Net Interest Margin (%)	3.1	3.0	3.0	3.1	3.0	3.0 <sup>5</sup>
PPI / Average RWA (%)	4.0	4.5	2.9	4.2	3.2	3.8 <sup>6</sup>
Net Income / Tangible Assets (%)	2.0	2.3	1.5	1.8	1.2	1.7 <sup>5</sup>
Cost / Income Ratio (%)	38.8	35.1	51.0	45.5	51.7	44.4 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	3.8	4.0	3.8	4.8	3.0	3.9 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	23.6	27.4	29.4	34.4	33.6	29.7 <sup>5</sup>
Gross Loans / Due to Customers (%)	84.9	78.1	74.8	71.5	67.0	75.3 <sup>5</sup>

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel III - fully loaded or transitional phase-in; IFRS. [3]May include rounding differences because of the scale of reported amounts. [4]Compound annual growth rate (%) based on the periods for the latest accounting regime. [5]Simple average of periods for the latest accounting regime. [6]Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Profile

Siauliu Bankas, AB (Siauliu Bankas) was established in 1992 in Siauliai, Lithuania, and is publicly traded on Nasdaq Vilnius. The bank had 10 subsidiaries as of the end of December 2019. Siauliu Bankas is focused on finance leasing and consumer credits, life insurance, investment management activities, real estate management activities and the development of residential areas in Lithuania, and it commenced offering deposit services in Germany in April 2019. The bank was 26% directly owned by the [European Bank for Reconstruction & Development](#) (EBRD, Aaa stable) as of the end of March 2020, following the conversion of a subordinate convertible loan into equity in late 2018, which increased the EBRD's share by 8 percentage points.

Siauliu Bankas held €2.6 billion in assets as of the end of March 2020, and with a market share of 8.1% in terms of deposits and 8.2% in terms of loans as of year-end 2019, it is the fourth-largest bank in Lithuania. The bank operates in all major cities and financially active regional centres of Lithuania. As of 31 March 2020, the bank had 60 regional customer service points across the country and 852 employees.

## Recent developments

We have [revised our 2020-21 growth forecasts](#) downward as the coronavirus outbreak will cause an unprecedented shock to the global economy. Business activity will likely fall sharply across advanced economies in the first half of 2020 and we project cumulative contractions over Q1 and Q2 of 2020 for a substantial number of countries. We now expect real GDP in the global economy to contract in 2020, followed by a recovery in 2021. The direct negative credit impact on the European banking sector would be limited. A prolonged outbreak, however, would have a more severe outcome, weighing on banks' loan quality and profitability. We expect fiscal policy measures, as already announced by a variety of euro-area nations to mitigate the economic contraction caused by the outbreak.

On 12 March, the European Central Bank (ECB) announced a series of measures to help EU economies weather the widening effects of the coronavirus pandemic, temporarily increasing banks' liquidity provision and lowering regulatory capital and liquidity requirements. As part of these temporary measures, the ECB increased its targeted long-term refinancing operations (TLTRO III) under more favourable terms and its financial asset purchase programme, while refraining from lowering the ultralow interest rates further.

The temporary suspension of buffer requirements for regulatory capital and the liquidity coverage ratio (LCR) gives banks greater flexibility and additional leeway to absorb the economic impact, such as, for example, asset quality declines. Overall, the package aims to help the banks continue to finance corporates and SMEs suffering from the effects of the coronavirus outbreak. We believe that the ECB's measures will provide a limited relief for banks and their borrowers and it will require meaningful fiscal policy measures by the European Union and its member states to avert higher default rates in banks' lending books.

Siauliu Bankas has completed the acquisition of [Danske Bank AS](#)' (A3 stable/A2 negative, baa2)<sup>1</sup> Lithuania branch private customers credit portfolio. The major part of the portfolio consists of housing loans, increasing Siauliu Bankas' market share to 3.2%.

## Detailed credit considerations

### The ratings reflect the bank's Lithuanian operations, incorporating a Moderate + Macro Profile

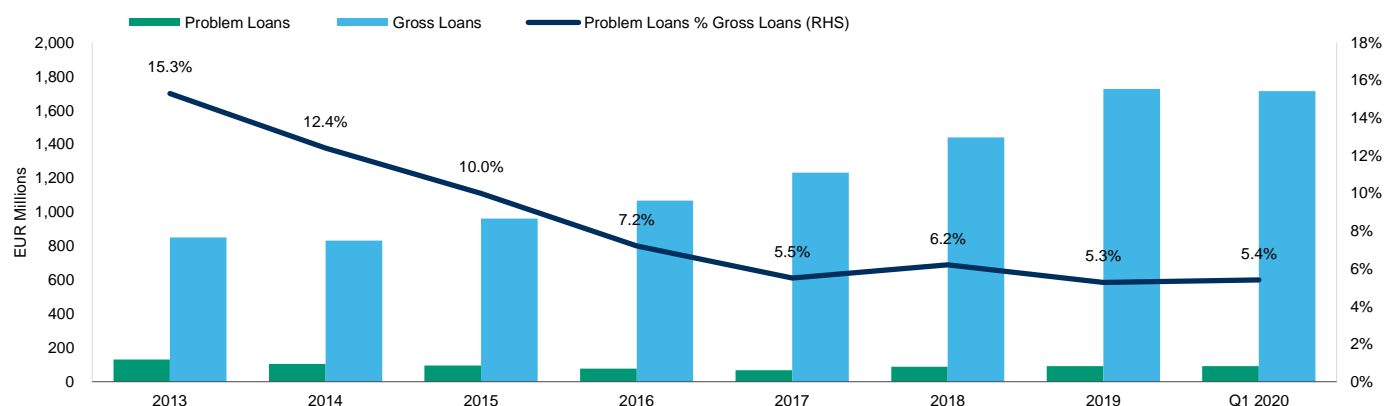
The operating environment in the Baltics is rapidly changing and the shocks to supply and demand because of the coronavirus outbreak will likely be significant, even if the recovery were to be rapid. The Baltic countries are small open economies and are sensitive to external shocks. Siauliu Bankas operates in Lithuania, and therefore, its Macro Profile is aligned with the Moderate (+) Macro Profile of Lithuania<sup>2</sup>.

### High loan growth in recent years

We expect the coronavirus outbreak to have a direct negative impact on banks' asset quality. The size of the impact will depend on the length and severity of the shock.

The bank's asset risk improved in 2019 because of the favourable operating environment at the time. Following the acquisition of Ukio Bankas in 2013, which had a higher credit risk profile, Siauliu Bankas has focused on reducing the stock of problem loans through recoveries and write-offs. The bank's nonperforming loan (NPL) ratio stood at 5.4% as of the end of March 2020, down from 15.3% as of the end of December 2013 (see Exhibit 3). Nevertheless, the improvement in the NPL ratio also reflects rapid lending growth in recent years.

Exhibit 3

**Problem loans decline because of a disciplined review of the legacy portfolio from Ukio Bankas along with strong lending growth**

The increase in the problem loan ratio in 2018 is because of a change in definition (stage 3, gross loans) following the introduction of IFRS9.

Sources: Siauliu Bankas' financial reports

Siauliu Bankas' loan portfolio grew very rapidly in 2019, up 19.8%, and the growth was primarily attributable to a 10% increase in SME lending and a 46% increase retail lending, which comprised 55% and 21% of the total loan book, respectively, as of the end of December 2019.

Problem loans to gross loans was 5.4% as of the end of March 2020, above the global 3.4% median of its Ba1 BCA peers. The coverage ratio (loan-loss reserves/problem loans) was 51.4% as of the end of March 2020, slightly higher than the 46.6% as of year-end 2019.

Nevertheless, we continue to incorporate downside risks because of the rapid loan growth and concentration towards the more vulnerable SME segment and therefore assign an Asset Risk score of b3.

### Robust capital with important headroom above the regulatory requirements

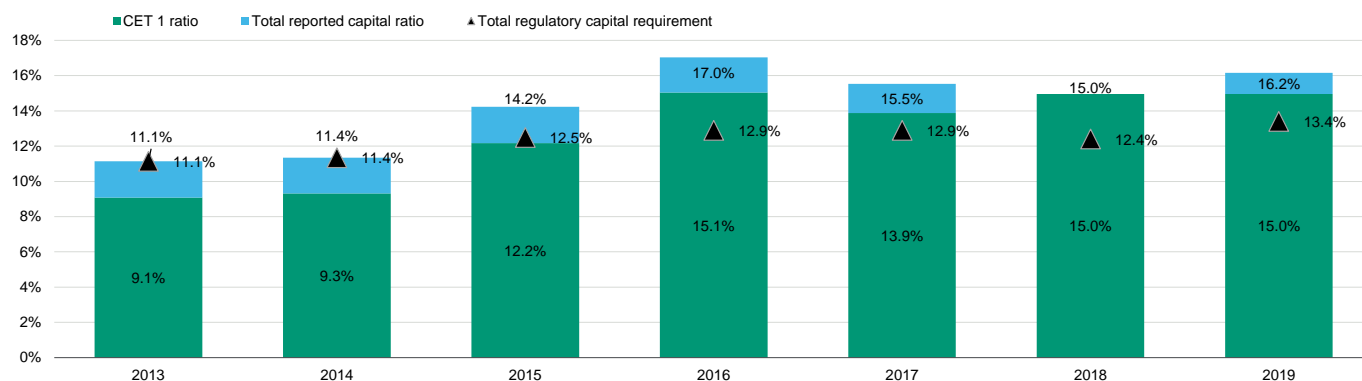
As of year-end 2019, the bank's Tangible Common Equity (TCE) to RWA ratio was 17.1%, slightly down from 17.4% a year earlier. In 2018, the bank's capital increase was supported by the conversion of a €20 million subordinated convertible loan extended by the EBRD into equity<sup>3</sup>. At the same time, the leverage ratio (TCE to total assets) was 11.8% as of year-end 2019.

Siauliu Bankas has strong internal capital generation capacity. In 2018, the bank updated its dividend policy to pay out at least 25% of the group's annual earnings as dividends. The bank will not pay dividends for 2019 because of the coronavirus outbreak, however.

Siauliu Bankas reported a phased-in CET1 capital ratio of 14.95% as of year-end 2019, which corresponds to a headroom of 5.05 percentage points above the CET1 regulatory requirement of 9.9%.

As of year-end 2019, Siauliu Bankas is required to comply with a 1.0% countercyclical capital buffer, a 0.5% Other Systemically Important Institution (O-SII) buffer (set to increase to 1.0% by year-end 2021)<sup>4</sup>, a capital conservation buffer of 2.5% and a Pillar II buffer of 1.4% (see Exhibit 5). Because of the coronavirus-induced disruptions, the Bank of Lithuania has decided to decrease the countercyclical capital buffer to 0% from 1%; the changes apply from 1 April 2020. The bank is already compliant with the future capital requirements.

Exhibit 4

**Siauliu Bankas capital ratio development**

Source: Siauliu Bankas' financial reports

Our assessment of Siauliu Bankas' robust capital is reflected in the assigned a3 Capital score.

**Strong profitability will be challenged**

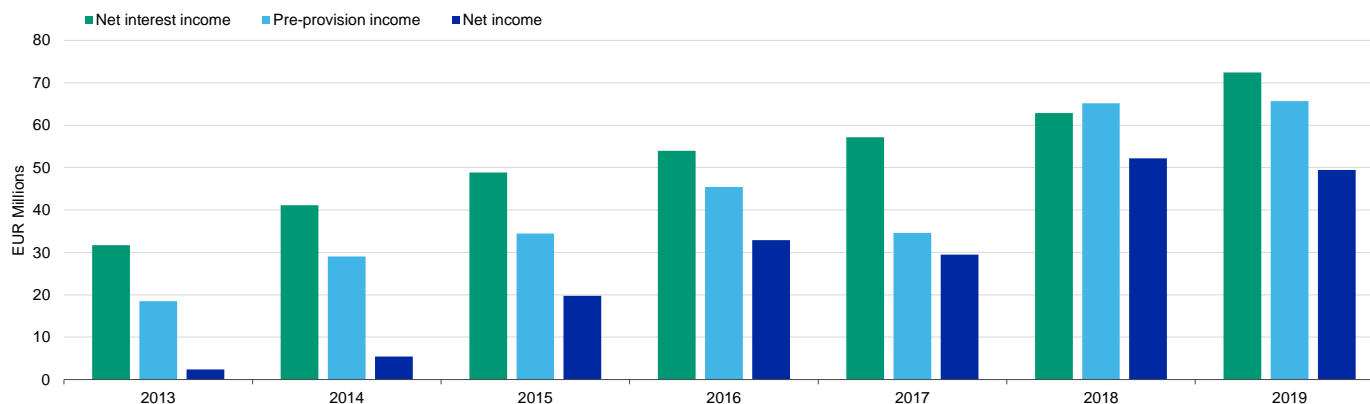
Siauliu Bankas' profitability has increased significantly in recent years, and we expect the bank's recurring revenue generation capacity to remain strong. Our Profitability score of baa1 captures the bank's sound profitability metrics, which have improved over the last few years, balanced against some volatility in earnings, the low interest rate environment and increasing competition at some point in the future. The bank will also likely face further profitability friction in 2020 and 2021 from coronavirus-induced disruptions.

In Q1 2020, the bank reported a lower net profit of €8.4 million compared with €14.7 million in Q1 2019. The bank's net income to tangible assets ratio was 1.97% for 2019, compared with 2.31% for 2018. In the first three months of 2020, the bank made higher provisions for credit losses. The new number of credit agreements decreased by 23% compared with Q4 2019, while the decline in new business and consumer financing was partly offset by strong growth in mortgage lending due to the acquisition of the private customers' credit portfolio from Danske Bank A/S Lithuania branch.

Net fees and commissions increased by 5% mainly on the back of higher contribution from fees related to the housing renovation programme and money transfer operations. The refurbishment programmes are likely to continue for a few more years, but the bank will start taking the loans directly on its own balance sheet.

In 2020, we expect Siauliu Bankas' profitability to return to be pressured by effects stemming from coronavirus disruptions.

Exhibit 5

**Profitability evolution has been strong in recent years**

Sources: Siauliu Bankas' financial reports

### Sound funding and liquidity, underpinned by a deposit-based funding model

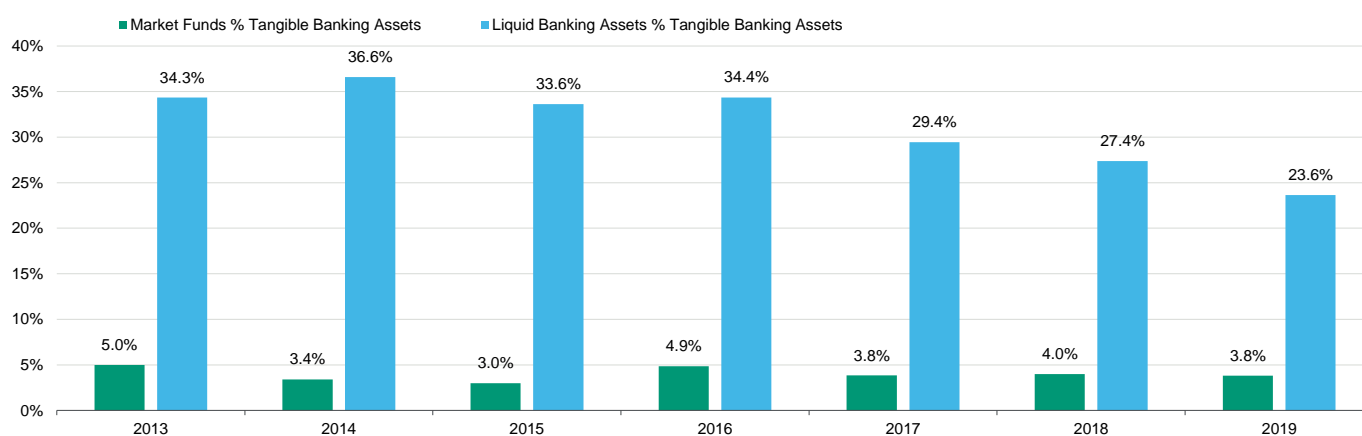
We assess Siaulių Bankas' funding and liquidity based on its funding structure and stock of liquid assets. We assign a Funding score of baa1, adjusted two notches below the Macro-Adjusted score. The adjustment highlights the relatively high share of corporate deposits over total deposits, which tend to be more volatile than retail deposits.

Siaulių Bankas' liquidity benefits from its deposit-oriented business model, with deposits funding 82% of total assets as of the end of March 2020, and primarily coming from domestic residents. As of year-end 2019, the bank reported a loan-to-deposit ratio of 85%, up from 78% a year earlier, because of a more rapid growth in loans (at 20%) than in deposits (at 10%) during 2019.

Most of the securities in the bank's liquidity portfolio are debt securities, mainly Lithuanian government bonds. Siaulių Bankas mainly invests in investment-grade assets.

Exhibit 6

#### Siaulių Bankas' funding and liquidity constrained by more volatile junior deposits



Sources: Siaulių Bankas' financial reports and Moody's Investors Service

### Concerns regarding rapid loan growth, SME concentration and a potential risk of money laundering in the Lithuanian environment hold the overall BCA back

We position the BCA at ba1, at the bottom of the BCA range in the bank's scorecard, primarily to reflect the risk that Siaulių Bankas' rapidly expanding loan portfolio, with an annual average increase of about 16% between 2015 and 2019, and issued primarily to the SME segment, will be particularly hit if there is a significant downturn in the Lithuanian economy. It also reflects the potential risk of money laundering issues (although there has not been any allegations regarding Siaulių Bankas in this respect), given the environment where the bank operates, and a limited risk linked to the legacy portfolio of Ukio Bankas (which was acquired by Siaulių Bankas in 2013 at no cost following regulatory concerns, which led to the withdrawal of Ukio Bankas' banking licence), although the risk is now broadly in line with that of the bank's own portfolio.

### Sources of facts and figures cited in this report

Unless noted otherwise, the bank specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to the document [Financial Statement Adjustments in the Analysis of Financial Institutions](#), published on 9 August 2018.

### ESG considerations

In line with our general view for the banking sector, Siaulių Bankas has a low exposure to environmental risks, see our [Environmental risks heat map](#) for further information.

The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are further social risks. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital

banking services increasing information technology cost, ageing population concerns in several countries affecting the demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base. We also regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. Overall, we believe banks, including Siaulių Bankas, face moderate social risks. For more details see our [Social](#) risks heat map.

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The securities sector has been one of the sectors affected by the shock given the profound economic and financial market upheavals it has caused. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

Governance is highly relevant for Siaulių Bankas, as it is to all entities in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for Siaulių Bankas, we do not have material governance concerns. Nonetheless corporate governance remains a key credit consideration and requires ongoing monitoring.

## Support and structural considerations

### Loss Given Failure analysis

We apply our advanced LGF analysis to Siaulių Bankas because the bank is subject to the European Union Bank Resolution and Recovery Directive, which we consider an operational resolution regime. For this analysis, we assume that equity and losses are at 3% and 8%, respectively, of tangible banking assets in a failure scenario. We also assume a 25% run-off of junior wholesale deposits, a 5% run-off in preferred deposits and a 26% proportion of junior deposits. These are in line with our standard assumptions.

Siaulių Bankas' deposits are likely to face very low loss given failure because of the loss absorption provided by the large volume of junior deposits. Siaulių Bankas' deposits are rated two notches above the ba1 Adjusted BCA because of a significant buffer of liabilities eligible for bail-in.

### Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and issuer ratings because they reflect the fact that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

#### Siaulių Bankas' CRRs are positioned at Baa1/P-2

Siaulių Bankas' CRRs are positioned at Baa1/P-2, incorporating three notches of uplift from the LGF analysis.

There is a considerable volume of loss-absorbing liabilities junior to the CRR obligations. In this case, we assume a nominal volume at failure, because we are not able to accurately assess the volume of CRR liabilities at failure or the inherently more volatile nature of such liabilities as the bank approaches failure. The ratings incorporate three notches of uplift for the CRRs from the bank's Adjusted BCA of ba1.

### Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

#### Siaulių Bankas' CR Assessment is positioned at Baa1(cr)/P-2(cr)

The CR Assessment, before government support, is positioned three notches above the Adjusted BCA of ba1. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default

on certain senior obligations, rather than the expected loss; therefore, we focus purely on subordination and take no account of the volume of the instrument class.

### Government support considerations

We assign a low probability of government support for deposits, which does not translate into any uplift. Likewise, the CR Assessment does not benefit from government support.

## Methodology and scorecard

### About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.



## Exhibit 7

**Siauliu Bankas, AB**

Balance Sheet		in-scope (EUR Million)		% in-scope		at-failure (EUR Million)		% at-failure		
Other liabilities		374		14.9%		581		23.2%		
Deposits		2,034		81.3%		1,826		73.0%		
Preferred deposits		1,505		60.1%		1,430		57.1%		
Junior deposits		529		21.1%		397		15.8%		
Senior unsecured bank debt		20		0.8%		20		0.8%		
Equity		75		3.0%		75		3.0%		
Total Tangible Banking Assets		2,503		100.0%		2,503		100.0%		
Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
	Instrument subordination	Sub- ordination	Instrument subordination	Sub- ordination	De Jure	De Facto	Notching Guidance vs. Adjusted BCA	LGF notching		
Counterparty Risk Rating	19.6%	19.6%	19.6%	19.6%	3	3	3	3	0	baa1
Counterparty Risk Assessment	19.6%	19.6%	19.6%	19.6%	3	3	3	3	0	baa1 (cr)
Deposits	19.6%	3.0%	19.6%	3.8%	2	2	2	2	0	baa2

Counterparty Risk Rating	3	0	baa1	0	Baa1	Baa1
Counterparty Risk Assessment	3	0	baa1 (cr)	0	Baa1(cr)	
Deposits	2	0	baa2	0	Baa2	Baa2

[1]Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

## Ratings

Exhibit 8

Category	Moody's Rating
<b>SIAULIU BANKAS, AB</b>	
Outlook	Stable
Counterparty Risk Rating	Baa1/P-2
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa1(cr)/P-2(cr)

Source: Moody's Investors Service

## Endnotes

- 1 The ratings shown in this report are the long-term senior unsecured and long-term deposit ratings, and the Baseline Credit Assessment.
- 2 Please refer to [Macro Profile – Lithuania: Moderate +](#), 9 January 2020.
- 3 Please refer to [Siauliu Bankas' capital metrics will strengthen with EBRD's debt-to-equity conversion](#), 13 August 2018.
- 4 Please refer to [Lithuania raises Siauliu Bankas' capital requirements, a credit positive](#), 3 December 2018.

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