

CREDIT OPINION

24 May 2019

Update

✓ Rate this Research

RATINGS

Siauliu 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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Siauliu Bankas, AB

Update following upgrade

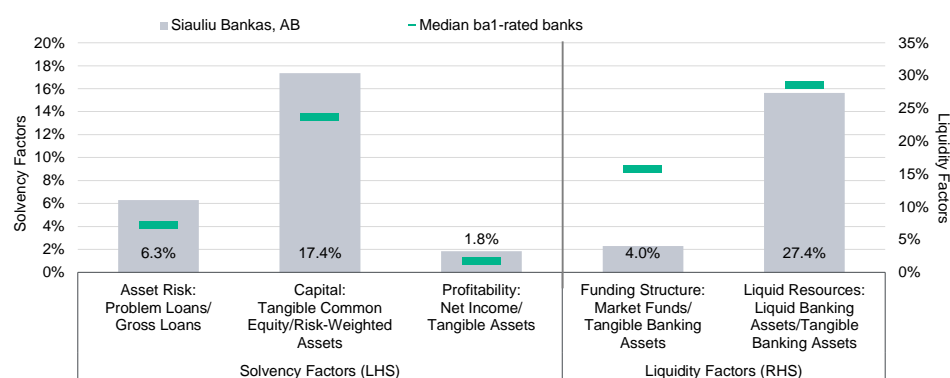
Summary

[Siauliu Bankas, AB's](#) (Siauliu Bankas) ba1 Baseline Credit Assessment (BCA) and adjusted BCA capture the improving operating environment in Lithuania and the increased capitalisation, evidenced by a tangible common equity (TCE)-to-risk-weighted assets (RWAs) ratio of 17.4% as of the end of December 2018, and strong recurring profitability. Furthermore, the risks associated with the acquisition of AB Ukio Bankas' (Ukio Bankas) portfolio in 2013 have largely been dissipated, and we view the asset risk of the acquired portfolio as largely in line with the rest of the book. This is balanced against the bank's high loan growth and sector concentration in small- and medium-sized enterprises (SMEs) and consumer finance in Lithuania.

The bank's Baa2/Prime-2 deposit ratings incorporate a two-notch uplift from the bank's ba1 Adjusted BCA, resulting from our Advanced Loss Given Failure (LGF) analysis. We view the probability of support from the [Government of Lithuania](#) (A3 stable) to Siauliu 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 Financial Metrics

Credit strengths

- » Robust capital, with important headroom above the regulatory requirements
- » Strong profitability, which supports internal capital generation capacity
- » The bank's sound funding and liquidity positions are 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 the bank's portfolio

Outlook

The stable outlook on Siauliu Bankas' long-term deposit ratings reflects our expectations that the favorable operating conditions will continue to support the bank's fundamentals. The rating agency projects that the bank will maintain solid capitalization, with a significant headroom above regulatory CET1 requirements, along with robust profitability.

Factors that could lead to an upgrade

Siauliu Bankas' ratings could be upgraded if the bank were able to demonstrate resilience in terms of broadly maintaining its problem loan ratios, profitability and capitalization, particularly in the event of an 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 of the bank's asset quality, profitability or capital.

Key indicators

Exhibit 2

Siauliu Bankas, AB (Consolidated Financials) [1]

| | 12-18 ² | 12-17 ² | 12-16 ² | 12-15 ² | 12-14 ² | CAGR/Avg. ³ |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|------------------------|
| Total Assets (USD Million) | 2,585.5 | 2,438.5 | 1,963.2 | 1,841.3 | 1,984.5 | 6.8 ⁴ |
| Tangible Common Equity (USD Million) | 310.8 | 246.1 | 184.6 | 143.8 | 124.4 | 25.7 ⁴ |
| Problem Loans / Gross Loans (%) | 6.2 | 5.5 | 7.2 | 9.9 | 12.4 | 8.3 ⁵ |
| Tangible Common Equity / Risk Weighted Assets (%) | 17.4 | 15.8 | 15.8 | 12.6 | 9.6 | 14.2 ⁶ |
| Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%) | 28.0 | 28.4 | 36.1 | 54.2 | 68.0 | 42.9 ⁵ |
| Net Interest Margin (%) | 3.0 | 3.0 | 3.1 | 3.0 | 2.8 | 3.0 ⁵ |
| PPI / Average RWA (%) | 4.5 | 2.9 | 4.2 | 3.2 | 2.9 | 3.5 ⁶ |
| Net Income / Tangible Assets (%) | 2.3 | 1.5 | 1.8 | 1.2 | 0.3 | 1.4 ⁵ |
| Cost / Income Ratio (%) | 35.1 | 51.0 | 45.5 | 51.7 | 52.5 | 47.1 ⁵ |
| Market Funds / Tangible Banking Assets (%) | 4.0 | 3.8 | 4.8 | 3.0 | 3.4 | 3.8 ⁵ |
| Liquid Banking Assets / Tangible Banking Assets (%) | 27.4 | 29.4 | 34.4 | 33.6 | 36.6 | 32.3 ⁵ |
| Gross Loans / Due to Customers (%) | 78.1 | 74.8 | 71.5 | 67.0 | 58.8 | 70.1 ⁵ |

[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 due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel III periods presented.

Source: Moody's Investors Service; Company Filings

Profile

Siauliu Bankas, AB (Siauliu Bankas) was established in 1992 in Siauliai, Lithuania, and is publicly traded on Nasdaq Vilnius. The bank had eleven subsidiaries at end March 2019. The bank is focused on finance leasing and consumer credits, life insurance, investment management activities, real estate management activities and development of residential areas in Lithuania, while the

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.com for the most updated credit rating action information and rating history.

bank commenced offering deposit services in Germany in April 2019. The bank is 26% directly owned by the [European Bank for Reconstruction & Development](#) (EBRD; Aaa stable) at end December 2018, following the conversion of a subordinate convertible loan into equity in late 2018 which increased EBRD's share by 8 percentage points.

Siauliu Bankas held €2.3 billion assets as of the end of March 2019 and with a market share of 8.2% in terms of deposits and 7.1% in terms of loans as of year-end 2018, it is the fourth largest bank in Lithuania. The bank operates in all major cities and financially active regional centres of Lithuania. As of end March 2019, the bank had 62 regional customer service points across the country and 810 employees.

Detailed credit considerations

Large domestic presence gained through the significant acquisition

In 2013, the bank almost doubled its balance sheet when it acquired at no cost around LTL1.9 billion (EUR549 million) of assets and LTL2.7 billion (EUR780 million) of liabilities from Ukio Bankas, with a contribution from the state deposit and investment insurance fund covering the balance. This followed the regulatory concerns that led to the suspension and subsequent withdrawal of Ukio Bankas' banking license. This transaction was important for Siauliu Bankas because the bank strengthened its presence in the domestic market, but because of Ukio Bankas' very weak fundamentals the deal also had a negative impact on the bank's credit profile. Since then, Siauliu Bankas has actively been restructuring the acquired portfolio, and this work was largely finalised by year-end 2016.

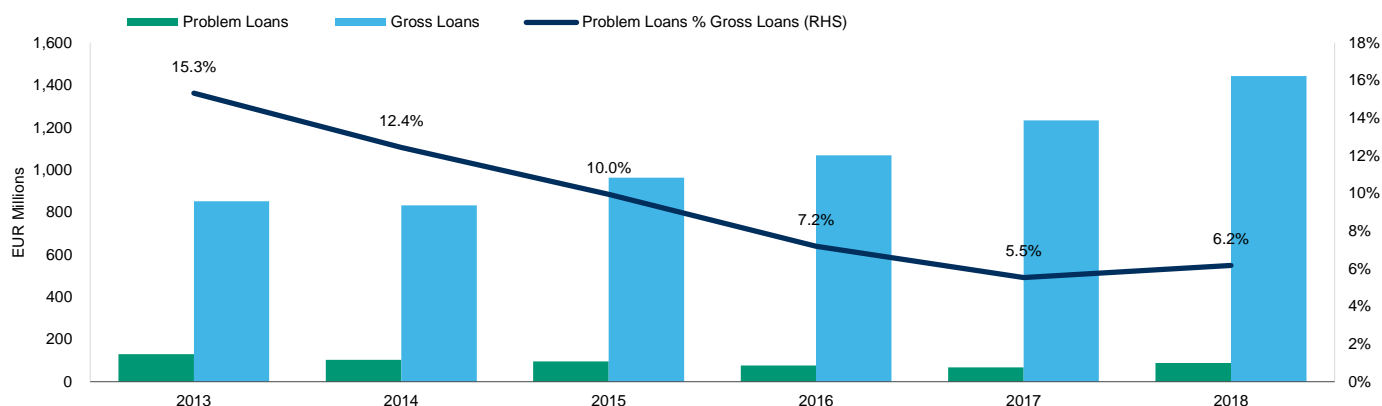
In July 2015, Siauliu Bankas acquired 100% of the shares of Bank Finasta AB and the brokerage firm Finasta AB. In settlement for the shares, the bank presented 21.35 million new shares with a total nominal value of €6.19 million to AB Invalda INVL for subscription. These acquisitions, although modest in size, will allow Siauliu Bankas to gradually improve its market share and to expand the range of services provided within investment banking.

The bank operates in Lithuania, and therefore, its macro profile is aligned with the moderate (+) macro profile of Lithuania¹, which reflects a flexible and diversified economy benefiting from a resilient and balanced post-crisis recovery and a strong medium-term growth outlook. We expect Siauliu Bankas, like other Lithuanian banks, to continue to benefit from the strong and stable economic fundamentals in the country underpinned by robust private consumption, a pickup in investment and a recovery in exports supported by improving external conditions.

Problem loans remain high despite the gradual improvement over recent years

In the improving operating environment with a pickup in exports, declining unemployment and an accommodative monetary policy, the bank's asset risk has improved markedly. 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. This improvement is reflected in the decline in the non-performing loan (NPL) ratio to 6.2% as of end-December 2018 from 15.3% as of the end of December 2013 (see Exhibit 3).

Exhibit 3

Problem loans decline due to the benign operating environment, and a disciplined review of the legacy portfolio from Ukio Bankas

Note: The increase in the problem loans ratio in 2018 is due to a change in definition (stage 3, gross loans) following the introduction of IFRS9.

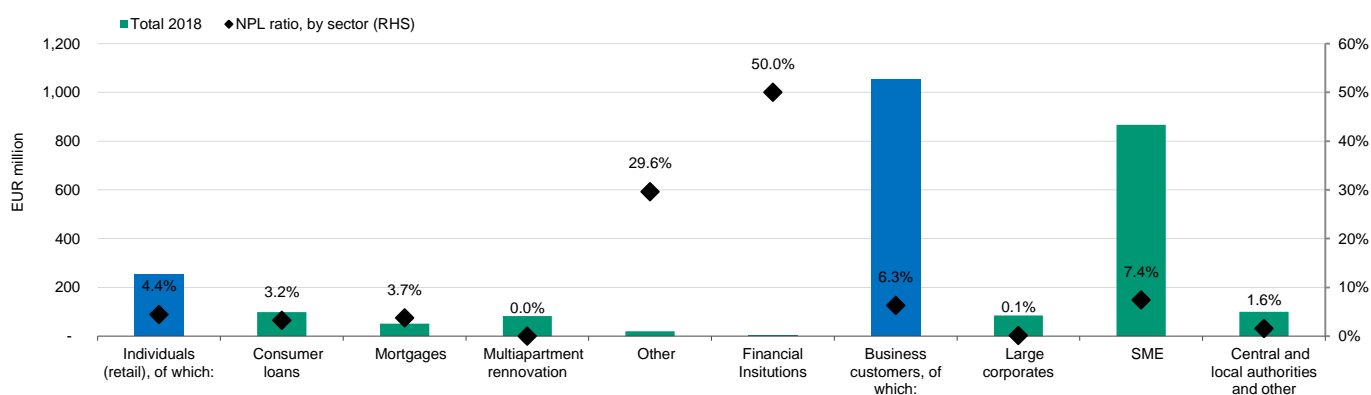
Source: Siauliu Bankas' financial reports, Moody's Investors Service

Siauliu Bankas' loan portfolio has continued to increase, and grew by 17% in 2018. The growth was primarily attributed to a 19% and 26% increase in loans extended to small- and medium- sized enterprises (SME) and individuals, which comprised 66% and 19% of the loan book, respectively, at year-end 2018.

Problem loans to gross loans stood at 6.2% at year-end 2018, above the global median of the ba1 rated peers. The coverage ratio (loan-loss reserves as a proportion of problem loans) stood at 51.1% at year-end 2018, broadly stable from the previous year. We expect the problem loans ratio to continue to improve, aided by the positive operating environment in Lithuania and continued growth in the denominator.

Nevertheless, we continue to incorporate downside risks due to the rapid loan growth and concentration towards the more vulnerable SME segment and therefore assign an asset risk score of b3 (see Exhibit 4).

Exhibit 4

Exposures are concentrated in the SME segment, which is a more vulnerable sector

Source: Siauliu Bankas' financial statements, Moody's Investors Service

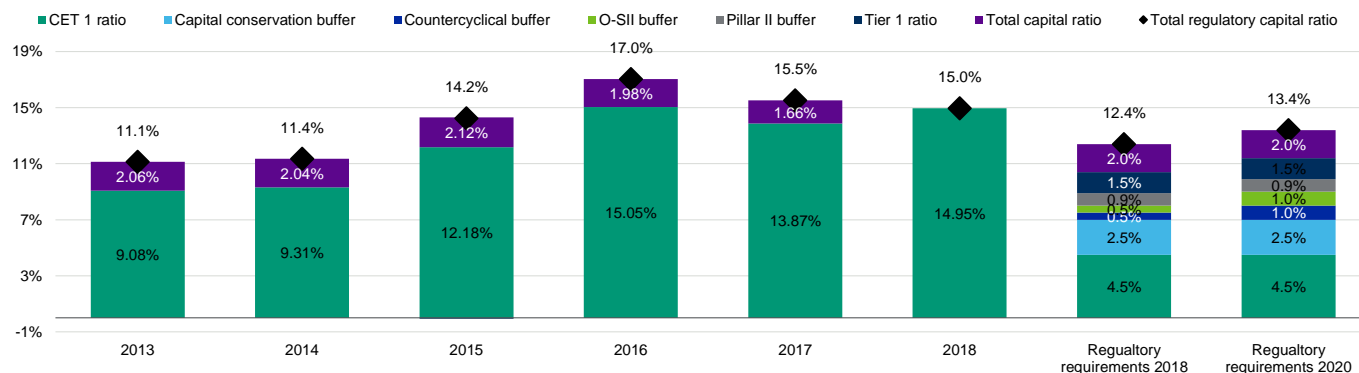
Robust capital with an important headroom above the regulatory requirements

As of year-end 2018, the bank's TCE-to-RWAs ratio stood at 17.4%, up from 15.8% a year earlier. The increase was supported by the conversion of a EUR20 million subordinated convertible loan extended by the EBRD into equity². Siauliu has a strong internal capital generation capacity, despite its more generous dividend policy approved in 2018, i.e. to pay out at least 25% of the group's annual earnings as dividends.

In terms of regulatory capital ratios, Siauliu Bankas reported a phased-in Common Equity Tier 1 (CET1) capital ratio of 14.95% as of year-end 2018, which corresponds to a headroom of 6.05 percentage points above the CET1 regulatory requirement of 8.9%. At the same time, the leverage ratio (equity to total assets) was 12.2%, up from 10.3% one year earlier.

Siauliu Bankas is required to comply with a 0.5% countercyclical capital buffer (set to increase to 1.0% by June 2019), a 0.5% Other Systemically Important Institution (O-SII) buffer (set to increase to 1.0% by year-end 2020)³, a capital conservation buffer of 2.5% and a Pillar II buffer of 0.9% (see Exhibit 5). The bank is already compliant with the future capital requirements.

Exhibit 5

Capital ratios and minimum capital requirement

Source: Siauliu Bankas' financial reports, Moody's Investors Service

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

Strong profitability, with less volatility going forward

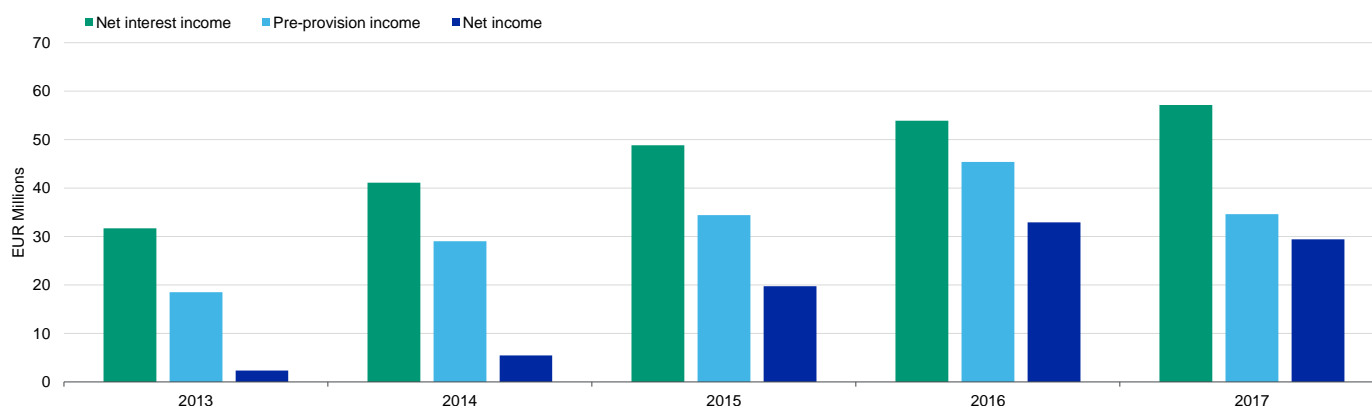
Siauliu Bankas has profitability significantly in recent years, and we expect the bank's recurring revenue generation capacity to remain strong. Our profitability score of baa1 captures the bank's sound profitability metrics, which have followed an improving trajectory over the last few years, balanced against certain volatility in earnings, the low interest rate environment and increasing competition at some point in the future.

In 2018, Siauliu Bankas reported a net profit of EUR52.6 million compared with EUR32.1 million in 2017. The bank's net income-to-tangible assets stood at 2.3% in 2018, compared to 1.5% in 2017. The 2018 performance was driven by a 10% year-on-year increase in net interest income, and EUR9.0 million fair value gain related to the subordinated loan (compared to a €12.1 million fair value loss in 2017). Excluding the fair value fluctuations, the bank's pre-tax income was very stable over these two years - at EUR48.4 million in 2018 and EUR48.7 million in 2017.

Net fees and commissions increased by 30% mainly on the back of higher contribution of fees related to the housing renovation programme and money transfer operations. The refurbishment programmes are likely to continue for a few more years, but bank will start to take the loans directly on its own balance sheet within short.

In 2019, we expect Siauliu Bankas' profitability (as measured by the net income to total assets ratio) to return to more normalised levels, which we expect to be between 1.4% and 1.6%.

Exhibit 6

Profitability evolution has been strong in recent years

Source: Siauliu Bankas' financial reports, Moody's Investors Service

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

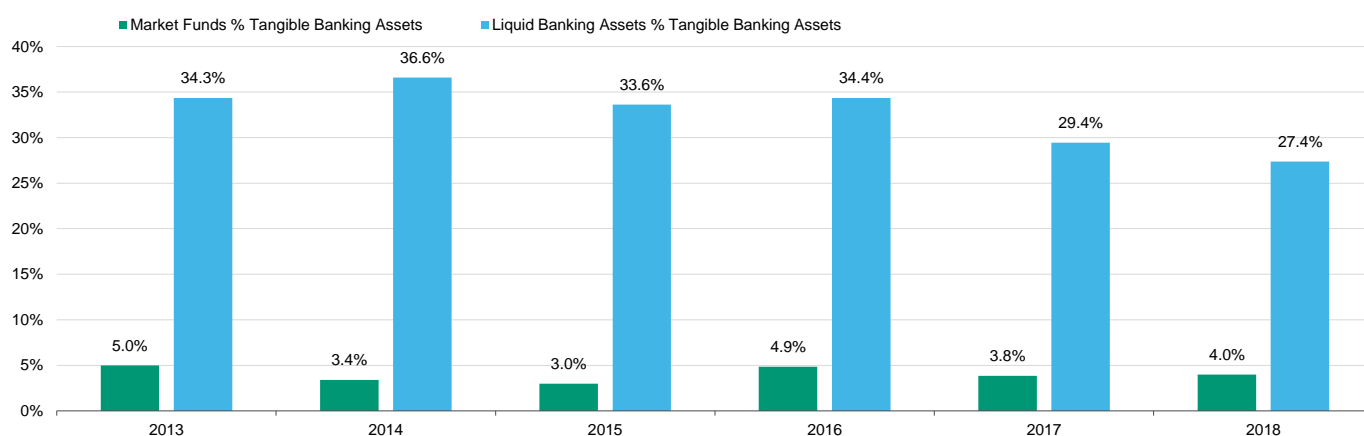
We assess Siauliu Bankas' funding and liquidity position based on its funding structure and stock of liquid assets. We assign a funding score of baa1, adjusted two notches below the macro-adjusted score. The adjustment highlights the relatively high share of corporate deposits over total deposits, which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

Most of the deposits are from Lithuanian residents. This contrasts with many domestic banks in neighbouring Latvia, where some banks hold high shares of non-resident deposits, which we consider less stable.

Siauliu Bankas' liquidity benefits from its deposit-oriented business model, with deposits funding 82% of total assets. As of year-end 2018, the bank reported a loan-to-deposit ratio of 78% up from 75% a year earlier, owing to a more rapid growth of loans (at 17%) than deposits (at 12%) during 2018.

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

Exhibit 7

Funding and liquidity profiles of Siauliu Bankas constrained by more volatile junior deposits

Source: Siauliu Bankas' financial reports, Moody's Investors Service

Concerns regarding the rapid loan growth, SME concentration along with potential risk of money laundering in the Lithuanian environment holds 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 Siauliu's rapidly expanding loan portfolio, with an annual average increase of about 15% between 2015-2018, and primarily towards 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 hasn't been any allegations regarding Siauliu 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 Siauliu in 2013 at no cost following regulatory concerns which led to the withdrawal of Ukio's banking license), although the risk is now broadly in line with the bank's own portfolio.

Support and structural considerations

Loss Given Failure analysis

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

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

Counterparty Risk Ratings

CRRs are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRRs are distinct from ratings assigned to senior unsecured debt instruments and different from 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 uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements.

Siauliu Bankas' CRRs is positioned at Baa1/P-2

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.

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

The CR Assessment, prior to 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 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.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment 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.

Rating methodology and scorecard factors

Exhibit 8

Siaulių Bankas, AB

Macro Factors

| Weighted Macro Profile | | Moderate | 100% | | | | |
|---|--|----------------|----------------------|--------------|----------------|---------------------------|---------------|
| | | + | | | | | |
| Factor | | Historic Ratio | Macro Adjusted Score | Credit Trend | Assigned Score | Key driver #1 | Key driver #2 |
| Solvency | | | | | | | |
| Asset Risk | | | | | | | |
| Problem Loans / Gross Loans | | 6.3% | ba3 | ←→ | b3 | Sector concentration | Loan growth |
| Capital | | | | | | | |
| Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in) | | 17.4% | a2 | ←→ | a3 | Stress capital resilience | |
| Profitability | | | | | | | |
| Net Income / Tangible Assets | | 1.8% | a3 | ↓ | baa1 | Expected trend | |
| Combined Solvency Score | | | baa2 | | ba1 | | |
| Liquidity | | | | | | | |
| Funding Structure | | | | | | | |
| Market Funds / Tangible Banking Assets | | 4.0% | a2 | ←→ | baa1 | Deposit quality | |
| Liquid Resources | | | | | | | |
| Liquid Banking Assets / Tangible Banking Assets | | 27.4% | baa2 | ←→ | baa2 | | |
| Combined Liquidity Score | | | a3 | | baa1 | | |
| Financial Profile | | | | | baa3 | | |
| Qualitative Adjustments | | | | | Adjustment | | |
| Business Diversification | | | | | 0 | | |
| Opacity and Complexity | | | | | 0 | | |
| Corporate Behavior | | | | | 0 | | |
| Total Qualitative Adjustments | | | | | 0 | | |
| Sovereign or Affiliate constraint | | | | | A3 | | |
| Scorecard Calculated BCA range | | | | | baa2 - ba1 | | |
| Assigned BCA | | | | | ba1 | | |
| Affiliate Support notching | | | | | 0 | | |
| Adjusted BCA | | | | | ba1 | | |

| Balance Sheet | In-scope (EUR Million) | % In-scope | At failure (EUR Million) | % At failure |
|--|------------------------|------------|--------------------------|--------------|
| Other liabilities | 324 | 14.4% | 513 | 22.7% |
| Deposits | 1,846 | 81.8% | 1,658 | 73.4% |
| Preferred deposits | 1,366 | 60.5% | 1,298 | 57.5% |
| Junior Deposits | 480 | 21.3% | 360 | 15.9% |
| Senior senior unsecured bank debt | 0 | 0.0% | 0 | 0.0% |
| Senior unsecured bank debt | 20 | 0.9% | 20 | 0.9% |
| Junior senior unsecured bank debt | 0 | 0.0% | 0 | 0.0% |
| Dated subordinated bank debt | 0 | 0.0% | 0 | 0.0% |
| Junior subordinated bank debt | 0 | 0.0% | 0 | 0.0% |
| Preference shares (bank) | 0 | 0.0% | 0 | 0.0% |
| Senior unsecured holding company debt | 0 | 0.0% | 0 | 0.0% |
| Dated subordinated holding company debt | 0 | 0.0% | 0 | 0.0% |
| Junior subordinated holding company debt | 0 | 0.0% | 0 | 0.0% |
| Preference shares(holding company) | 0 | 0.0% | 0 | 0.0% |
| Equity | 68 | 3.0% | 68 | 3.0% |
| Total Tangible Banking Assets | 2,258 | 100.0% | 2,258 | 100.0% |

| Debt Class | De jure waterfall | | De facto waterfall | | Notching | | LGF notching guidance versus BCA | Assigned LGF notching | Additional notching | Preliminary Rating Assessment |
|------------------------------|-----------------------------------|----------------|-----------------------------------|----------------|----------|----------|----------------------------------|-----------------------|---------------------|-------------------------------|
| | Instrument volume + subordination | Sub-ordination | Instrument volume + subordination | Sub-ordination | De jure | De facto | | | | |
| Counterparty Risk Rating | 20% | 20% | 20% | 20% | 3 | 3 | 3 | 3 | 0 | baa1 |
| Counterparty Risk Assessment | 20% | 20% | 20% | 20% | 3 | 3 | 3 | 3 | 0 | baa1(cr) |
| Deposits | 20% | 3% | 20% | 4% | 2 | 2 | 2 | 2 | 0 | baa2 |

| Instrument Class | Loss Given Failure notching | Additional notching | Preliminary Rating Assessment | Government Support notching | Local Currency rating | Foreign Currency rating |
|------------------------------|-----------------------------|---------------------|-------------------------------|-----------------------------|-----------------------|-------------------------|
| | | | | | | |
| 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 9

Category [Moody's Rating](#)

SIAULIU BANKAS, AB

| | |
|-------------------------------------|------------------|
| 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 Please refer to [Macro Profile – Lithuania: Moderate +](#), 11 March 2019
- 2 Please refer to [Siauliu Banks' capital metrics will strengthen with EBRD's debt-to-equity conversion](#), 13 August 2018
- 3 Please refer to [Lithuania raises Siauliu Bankas' capital requirements, a credit positive](#), 3 December 2018

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