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Siauliu Bankas, AB

Siauliu Bankas' capital metrics will strengthen with EBRD's debt-to-equity conversion

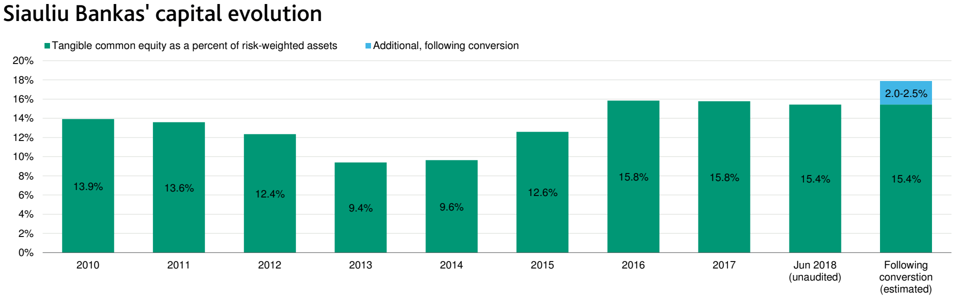
Last Monday, the European Bank for Reconstruction and Development (EBRD, Aaa stable) announced that it would convert a €20 million subordinated convertible loan to Siauliu Bankas, AB (Baa3 positive, ba2[1]), Lithuania's largest domestically owned bank, into equity shares. The conversion is credit positive because it will strengthen Siauliu Bankas' capital base by increasing its ratio of tangible common equity to risk-weighted assets by 200-250 basis points.

EBRD, Siauliu Banka's largest shareholder, will increase its ownership to around 26.0% from 18.2% as of the end of June 2018. The increased stake will strengthen the technical support that EBRD provides to Siauliu Banka and enhance the bank's corporate governance.

The 10-year loan was agreed in February 2013 and gave the EBRD the right to request conversion into equity of the loan amount and the derivative amount at the EBRD's own discretion. We estimate that the EBRD's conversion request, which is subject to Siauliu Bankas' shareholders' approval, will increase the shareholders' equity-to-total-assets ratio by around 150 basis points from the 10.3% the bank reported at the end of June 2018.

Siauliu Bankas' capitalisation in recent years has improved as a result of stronger recurring profitability. The bank's capital adequacy ratio (CAR) of 16.8% as of March 2018 already complies with Lithuania's minimum capital adequacy ratio requirements of 11.5%, which will take effect 31 December 2018 (this includes a capital conservation buffer of 2.5%, a countercyclical buffer of 0.5% and a 0.5% buffer for systemic importance, which will be implemented 31 December 2018). The debt conversion will raise the bank's CAR closer to the system average of 19.6%[2].

Exhibit 1
Siauliu Bankas' capital evolution

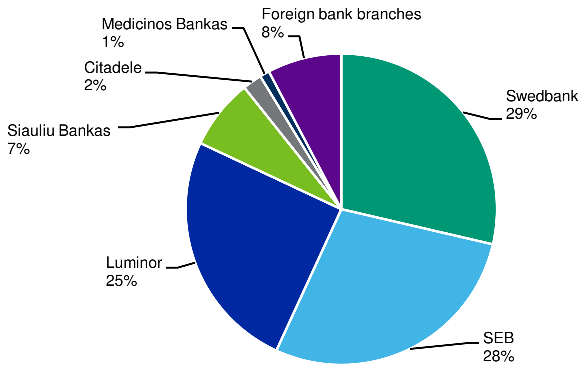


Note: the increase is estimated based on unaudited end-June 2018 and audited year-end 2017 data
Sources: Siauliu Bankas and Moody's Investors Service estimates

The strengthening of the bank's capital base will further support its growth targets as the bank seeks to increase its domestic footprint in Lithuania from a 7%-8% market share in terms of assets, loans and deposits as of year-end 2017 (see Exhibit 2). Since 2014, the bank has grown at an average rate of around 7% each year and 7% in the first six months of 2018, almost twice Lithuania's real GDP growth rate.

Exhibit 2

Lithuanian banks' market share in terms of assets as of year-end 2017



Source: Bank of Lithuania data

Our outlook on Siauliu Bankas' long-term deposit ratings is positive, reflecting our expectation that the bank will continue to effectively wind down its stock of problem loans and maintain solid capitalisation that well exceeds regulatory requirements. We further expect profitability to remain high.

Siauliu Bankas is the fourth-largest bank operating in Lithuania. Following the acquisition of AB Ukio Bankas in 2013, the bank has worked on restructuring the acquired portfolio, which was largely finalised in 2016.

Endnotes

1 The bank ratings shown in this report are the bank's domestic deposit rating and Baseline Credit Assessment.

2 The average ratio excludes data from seven foreign bank branches operating in Lithuania and was reported as of the end of March 2018.

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