MOODY'S INVESTORS SERVICE

Credit Opinion: Denizbank A.S.

Global Credit Research - 06 Mar 2015

Istanbul, Turkey

Ratings

Category	Moody's Rating
Outlook	Negative(m)
Bank Deposits	Ba2/NP
Bank Financial Strength	D-
Baseline Credit Assessment	ba3
Adjusted Baseline Credit Assessment	ba2
Parent: Sberbank	
Outlook	Negative
Bank Deposits -Fgn Curr	Ba2/NP
Bank Deposits -Dom Curr	Ba1/NP
NSR Bank Deposits -Dom Curr	Aa1.ru/--
Bank Financial Strength	D
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Senior Unsecured	Ba1
Bkd Subordinate	Ba2
Bkd Other Short Term	(P)NP

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Key Indicators

Denizbank A.S. (Consolidated Financials)[1]

	[2]9-14	[3]12-13	[3]12-12	[4]12-11	[4]12-10	Avg.
Total Assets (TRY million)	93,744.8	79,667.8	56,494.6	44,756.3	33,853.2	[5]29.0
Total Assets (USD million)	41,101.7	37,080.7	31,654.9	23,698.1	21,996.9	[5]16.9
Tangible Common Equity (TRY million)	7,109.9	6,356.6	5,101.5	4,736.8	3,632.8	[5]18.3
Tangible Common Equity (USD million)	3,117.3	2,958.6	2,858.4	2,508.1	2,360.5	[5]7.2
Net Interest Margin (%)	4.1	4.5	5.1	4.8	6.1	[6]4.9
PPI / Average RWA (%)	2.7	3.5	3.0	3.4	4.4	[7]2.7
Net Income / Average RWA (%)	1.2	1.5	1.3	2.6	2.1	[7]1.2
(Market Funds - Liquid Assets) / Total Assets (%)	14.3	15.1	7.2	9.0	10.4	[6]11.2
Core Deposits / Average Gross Loans (%)	65.6	73.1	77.4	72.3	72.7	[6]72.2
Tier 1 Ratio (%)	7.6	8.7	9.2	10.5	10.9	[7]7.6
Tangible Common Equity / RWA (%)	8.1	8.4	8.7	10.4	10.7	[7]8.1
Cost / Income Ratio (%)	51.1	47.5	47.1	49.4	45.5	[6]48.1
Problem Loans / Gross Loans (%)	3.3	2.8	3.5	2.8	4.4	[6]3.4
Problem Loans / (Equity + Loan Loss Reserves) (%)	25.0	22.3	21.5	17.1	24.6	[6]22.1

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - transitional phase-in; LOCAL GAAP [3] Basel II; LOCAL GAAP [4] Basel I; LOCAL GAAP [5] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [6] LOCAL GAAP reporting periods have been used for average calculation [7] Basel III - transitional phase-in & LOCAL GAAP reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Denizbank A.S. (Denizbank)'s Ba2/Not-Prime local-currency local currency deposit ratings are based on the bank's ba3 baseline credit assessment (BCA) and our assumptions of high parental support from majority shareholder Sberbank (FC Deposits Ba2/Debt Ba1; BFSR D/ba2), which provides one notch of uplift to deposit ratings.

We assign a standalone bank financial strength rating (BFSR) of D- to Denizbank, equivalent to a BCA of ba3. The standalone rating reflects Denizbank's (1) established market position with an emphasis on corporate and SME lending and some specialisation in agricultural and project finance and; (2) adequate recurring earnings capacity and net profits. However, the standalone rating is constrained by (1) very lean capitalisation in light of historically very rapid, albeit declining, loan growth, (2) the bank's moderate asset-quality; and (3) comparatively tighter liquidity indicators.

Due to the ownership by Russia's Sberbank the bank is covered by the EU sanctions affecting its long-term borrowing capacity in the European markets. However, it remains exempt from US sanctions.

Rating Drivers

- Leaner core capitalisation compared to peers

- Declining profitability reflecting a challenging operating environment

- Adequate liquidity profile

- Moderate asset quality expected to deteriorate further

Rating Outlook

The bank's supported ratings carry negative outlook driven by the similar rating action on the parent. Its standalone rating remains on stable outlook.

What Could Change the Rating - Up

Currently we do not envisage upward pressure on the ratings, as reflected in the negative outlook. However, in the medium term, (1) generating a stronger core capital position, (2) sustainable growth trends funded by stable funding, and (3) improvement in the domestic operating environment could positively influence Denizbank's ratings.

An upgrade of Sberbank's or Turkey's ratings could translate into higher degree of support incorporated in Denizbank's ratings, though, given the negative outlook on these ratings, Moody's views this occurrence as unlikely in the near-term rating horizon.

What Could Change the Rating - Down

Downward pressure on the standalone rating could develop in case of (1) further deterioration in core capital and/or a material increase in funding dependence on the parent (2) a material decline in profitability; (3) greater-than-expected deterioration in asset quality; or (4) significant changes in Denizbank's strategy resulting in an increase in the bank's risk appetite.

The long-term ratings could be downgraded as a result of a lowering of the standalone rating and/or the parental support assumption from Sberbank.

DETAILED RATING CONSIDERATIONS

LEANER CORE CAPITALISATION COMPARED TO PEERS

As at September-2014 Denizbank's consolidated Basel III Tier 1 and capital adequacy ratios stood at 8.1% and 12.7%, comparing poorly to its peers as well as the system averages of 13.5% and 15.9% respectively.

The bank had a declining trend in capitalisation due to the historic growth in loan book outpacing internal capital generation and increased regulatory risk weights in unsecured consumer loans. As of the latest trends the bank moderated its loan growth reversing this trend.

Nevertheless, this capital constraint places the bank at a disadvantage to most of its peers that have more leeway for future growth and market share expansion.

Denizbank has subordinated debt from Dexia Credit Local (Baa2/Prime-2, Negative; E/ca, stable) and from Sberbank equating to 4% of its September-2014 consolidated total liabilities - with maturities in 2016, 2017, 2018 and 2023&4. We believe that without periodic capital injections from Sberbank, the bank's franchise expansion plans would be challenged, In light of this the bank is planning additional Tier 1 injection in 2015.

DECLINING PROFITABILITY REFLECTING A CHALLENGING OPERATING ENVIRONMENT

As at September-2014, Denizbank's consolidated net profits (BRSA) decreased by 11% year-on-year to TRY 777 million - compared to 5% decrease reported by the banking system. Partly due to a 28% year-on-year balance sheet growth, net interest income increased by 15% to TRY 2.6 billion and net fees and commissions income increased by 39% to TRY 740 million. Although these profitability gains are mainly offset by TRY 406 million losses on trading activities. We also note that provisions for loans have decreased by 19% to TRY 667 million.

We expect Denizbank's profitability to decline further because of: (1) a material slowdown in real GDP growth, (2) higher cost of funding; and (3) rising consumer-protection pressures which could affect pricing power.

ADEQUATE LIQUIDITY PROFILE

We regard Denizbank's liquidity profile as adequate. Denizbank's consolidated gross loan to deposit ratio is 106% (2013: 110%) which compares favourably with the system average of 120%. However, the bank's gross loan to deposit ratio in local currency at 178% compares unfavourably with 142% system average.

Furthermore, Denizbank is mainly short-term funded with the bulk of deposits in the up to three months bucket, versus just 20% of loan book maturing within three months and the remainder being medium to long-term lending. The bank mitigates these risks by holding an adequate portfolio of liquid assets that account for around 30% of its total balance sheet, half of which comprises Turkish government securities. The bank has also tapped capital markets with a covered bond of EUR 300 million that contributes to maturity extension and diversification of its funding source.

MODERATE ASSET QUALITY EXPECTED TO DETERIORATE

As at September-2014, the NPL ratio stood at 3.25% (2013: 2.8%), which is weaker than the system average of 2.9%, especially when we take into account the denominator effect of high loan growth rate in previous years of 46% in 2013 (2012: 25%) versus the system average of 32% and 16% respectively. In addition, about 3.4% of bank's loans were fewer than 90 days delinquent and/or whose payment terms had been modified and were not captured by the NPL ratios, indicating the potential for further asset-quality deterioration as they season.

We expect that asset quality will decline gradually and loan loss provisioning to increase, as the very high growth rates of loan book makes it unseasoned. However, we believe that problem-loan levels should remain manageable due to the bank's long track record and NPLs should remain within bank's provisioning capacity.

Global Local Currency Deposit Rating (Joint Default Analysis)

The Ba2/NP local-currency deposit ratings are supported by Denizbank's ba3 BCA and our assessment of a high probability of parental support from Sberbank, which provides one notch of uplift to the deposit rating.

Our assessment of a high probability of parental support is based on Denizbank's importance to Sberbank, underpinned, amongst other things, by (1) Sberbank's 99.85% ownership of Denizbank; (2) Sberbank's dedicated focus to increase its cross-border expansion, whereby Denizbank provides some diversification benefits; (3) both banks having commercial consumer-oriented banking franchises; and (4) Sberbank's supportive track record towards its subsidiaries.

Foreign Currency Deposit Rating

Denizbank's foreign-currency deposit ratings are Ba2/Not-prime and are in line with bank's GLC deposit ratings.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. Bank

Financial Strength Ratings do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Moody's uses the Baseline Credit Assessment (BCA) to map BFSRs onto the 21-point Aaa-C rating scale and like the BFSR, it reflects a bank stand- alone default risk. Each point on the Aaa-C scale represents a specific probability of default and therefore allows Moody's to use the BCA as an input to Moody's Joint Default Analysis (JDA), described below. The baseline credit assessment reflects what the local currency deposit rating of the bank with the given BFSR would be without any assumed external support from a government or third party

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the Bank Financial Strength Rating as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognise the potential support from schemes that may provide assistance to banks directly. According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of any external elements of support into the bank's Baseline Credit Assessment. In assigning the local currency deposit rating to a bank, the JDA methodology also factors in the rating of the various potential support providers (parent company, cooperative group, regional or national governments), as well as the degree of dependence that may exist between each one of them and the bank. Moody's assessment of the probability of systemic support (by a national government) is derived from the analysis of the capacity of a government and its central bank to provide support on a system-wide basis. The systemic support indicator is determined for a particular country and serves as an input for all bank ratings in that country. The support indicator can be set at, above or, in rare cases, below the government's local currency bond rating for that country.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's bank financial strength scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model 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 Factors

DENIZBANK A.S.

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (70%)						**D-**	
Factor: Franchise Value						**D+**	**Neutral**
Market share and sustainability			**x**				
Geographical diversification				**x**			
Earnings stability				**x**			
Earnings Diversification [2]							
Factor: Risk Positioning						**D**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management				**x**			
- Risk Management			x				
- Controls				x			
Financial Reporting Transparency			**x**				
- Global Comparability		x					
- Frequency and Timeliness		x					
- Quality of Financial Information			x				
Credit Risk Concentration					**x**		
- Borrower Concentration					x		
- Industry Concentration		x					
Liquidity Management				**x**			
Market Risk Appetite			**x**				
Factor: Operating Environment						**D**	**Weakening**
Economic Stability					**x**		
Integrity and Corruption				**x**			
Legal System			**x**				
Financial Factors (30%)						**C**	

Factor: Profitability						**C+**	**Weakening**
PPI % Average RWA (Basel II)		3.22%					
Net Income % Average RWA (Basel II)			1.40%				
Factor: Liquidity						**D**	**Weakening**
(Market Funds - Liquid Assets) % Total Assets				10.46%			
Liquidity Management				x			
Factor: Capital Adequacy						**B+**	**Weakening**
Tier 1 Ratio (%) (Basel II)		8.95%					
Tangible Common Equity % RWA (Basel II)	8.52%						
Factor: Efficiency						**B**	**Neutral**
Cost / Income Ratio		47.99%					
Factor: Asset Quality						**C**	**Weakening**
Problem Loans % Gross Loans			3.05%				
Problem Loans % (Equity + LLR)			20.29%				
Lowest Combined Financial Factor Score (9%)						**D**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**D**	
Aggregate BCA Score						**ba2**	
Assigned BFSR						**D-**	
Assigned BCA						**ba3**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.

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