MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Société Tunisienne de Banque's long-term rating; outlook changed to stable from negative

Global Credit Research - 19 Nov 2015

Limassol, November 19, 2015 -- Moody's Investors Service has today affirmed Société Tunisienne de Banque's (STB) B1 long-term deposit ratings and its caa3 baseline credit assessment (BCA). At the same time, the rating agency changed to stable from negative the outlook on the bank's B1 deposit ratings. A full list of affected ratings is provided at the end of this press release.

Today's affirmation of the ratings reflects STB's: (1) high level of problem loans, driven by historically weak underwriting standards and concentrated exposure to the tourism sector; (2) low profitability and loss-absorption capacity; (3) a challenged deposit base and low liquidity buffers; (4) weak internal audit and reporting systems; but also (5) the very high probability of government support in case of need.

The outlook change to stable from negative reflects STB's successful recapitalisation in September 2015, primarily stemming from government capital injection, which restored the bank's solvency above minimum regulatory capital ratios and reduces the probability of regulatory intervention.

RATINGS RATIONALE

- The outlook change

The outlook change to stable from negative reflects STB's stabilising solvency profile. The successful recapitalisation of the bank on 19th of September, which amounted to TND 652.5 million, brings capital metrics back in line with regulatory minimum, with a reported Tier 1 ratio of 8.14% and a Capital Adequacy Ratio at 12.4%, as of June 2015. Although we view the new capitalisation still too low to allow material asset growth, it stabilizes the credit profile of the bank by reducing the probability of regulatory intervention and any associated restriction to its activities.

- The rating affirmation

The rating affirmation is primarily driven by the weakness of STB's asset quality, a key factor that underscores its caa3 BCA. According to reports from the bank, non-performing loans (NPLs) as of June 2015 represented 29.1% of total loans. The primary cause of STB's poor asset quality is the high level of legacy NPLs, reflecting: (1) historically weak underwriting standards; and (2) high concentration to the tourism sector, which now represents around 20% of the loan portfolio and more than 50% of the bank's problem loans. Recovery in the tourism sector, an important sector for Tunisian economy (around 7% of GDP and employment) has also been made more challenging by recent terrorist acts. In this context, Moody's does not expect any significant reduction in NPLs for STB in the next 12 to 18 months, unless the government's intention to create an asset management company (AMC) - in order to remove NPLs related to the tourism sector from the banking sector - materializes.

The rating affirmation also reflects low profitability and loss-absorption capacity. Despite the bank's recapitalisation, which brought Tier 1 and capital adequacy ratios above regulatory minima (to 8.1% and 12.4% respectively from -4.8% at June-end 2015), loss absorption buffers remain weak in light of the very high proportion of NPLs, high loan concentration and a limited ability to generate capital internally through profits. We estimate that NPLs still represented 118% of shareholders' equity and loan loss reserves based on June 2015 accounts, inclusive of additional capital.

Similarly, the bank reported modest profitability metrics (Net income to tangible banking assets of 0.6% as of June 2015), mainly due to high provisioning costs. We expect that the planned restructuring of the bank post recapitalisation will benefit its profitability in the medium term, but restructuring costs will weigh in the short term on the ability of the bank to generate capital internally. Capital buffers could also be eroded by the ambitious growth targets of 8.1% annually until 2019, aiming at regaining market share lost in recent years.

According to Moody's, the bank's ratings are also constrained by STB's contracting client deposit base, stemming from a tightening liquidity environment in recent years. As a result STB's net loans-to-deposits ratio remains elevated at 103% as of June 2015, one of the highest among rated Tunisian peers. In this Tunisian context of challenging funding conditions, we expect that STB's loan growth strategy will lead the bank to increase its recourse to Central Bank funding (9% of total assets as of June 2015), although this could be constrained by the relatively low level of liquid assets (12.8% liquid assets to tangible banking assets as of June 2015) that can be available as a collateral against Central Bank funding.

The bank's ratings remain also constrained by sub-standard quality of financial reporting, weak internal control and unsophisticated risk management systems. These issues are being addressed under a broad governance and organisational restructuring plan, in line with the recommendations from the audit requested by the government in 2014, but full implementation will take time.

Finally, the affirmation of the deposit rating of B1, which carries five notches of uplift from the BCA of caa3, is based on our assessment of a very high probability of government support in the event of need. By contributing to the majority of the recent capital injection and increasing its direct and indirect ownership to 82% from 51%, the Tunisian government confirmed its commitment to support the bank in case of need.

WHAT COULD CHANGE THE RATING -- UP

Upward pressure on the bank's ratings could develop following: (1) sustained improvements in the operating conditions (2) a material decrease in problem loans, which could stem for instance from the transfer of impaired tourism assets to the long-awaited Asset Management Company; and/or (3) higher capital and liquidity buffers.

WHAT COULD CHANGE THE RATING - DOWN

Downward rating pressure on the bank's ratings could develop following: (1) a deterioration in the operating environment or a downgrade of the government debt rating signalling a reduction in the government's capacity to support banks in case of need; and (2) renewed pressure on the bank's capital buffers, requiring additional capital.

The principal methodology used in these ratings was Banks published in March 2015. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Full list of affected ratings

Affirmations:

.... LT Bank Deposits (Foreign Currency and Local Currency), Affirmed B1 stable

.... ST Bank Deposits (Foreign Currency and Local Currency), Affirmed NP

.... Baseline Credit Assessment, Affirmed caa3

.... Adjusted Baseline Credit Assessment, Affirmed caa3

.... Counterparty Risk Assessment, Affirmed Ba3(cr)

.... Counterparty Risk Assessment, Affirmed NP(cr)

Outlook Actions:

....Outlook, Changed To Stable From Negative

The Local Market analyst for this rating is Olivier Panis, 971.4. 237.9533.

REGULATORY DISCLOSURES

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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