Black Sea Trade and Development Bank

William Hahn
Credit Research
+44 20 7597 8321
William.Hahn@uk.daiwacm.com

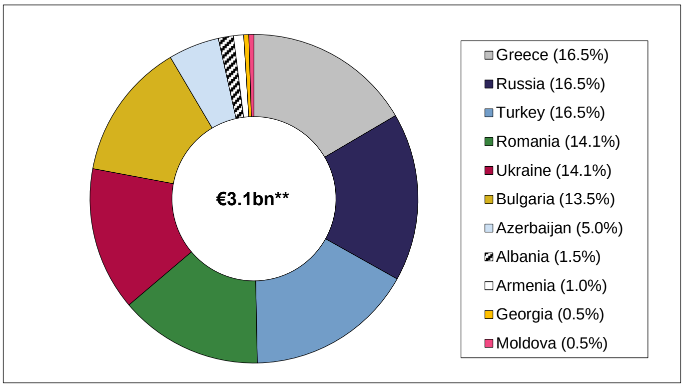
	Long-term	Short-term	Outlook
Moody's	Baa2	P-3	Stable
S&P	BBB	A-2	Stable

Source: Moody's, S&P

Background and ownership

The Black Sea Trade and Development Bank (BSTDB) was established in 1997 by its 11 member states, which either border or are located in the vicinity of the Black Sea. It was formed as the financial pillar of the Black Sea Economic Cooperation (BSEC) and countries must belong to the BSEC to become BSTDB member states, though the establishment agreement also permits multilateral development banks (MDBs) and financial institutions to become shareholders. BSTDB started operations in June 1999 and following the May-2024 capital increase, has authorised capital of EUR3.45bn and subscribed capital of EUR3.1bn (+35% post capital increase). All member states are both capital contributors and borrowers and are represented on the board of governors (BoG) in which all decision-making authority is ultimately vested.

Member state shares after 2024 capital increase*



*Source: Company reports; *capital contributions commence in 2027; **Subscribed share capital*

Preferred creditor status and capital increase

The bank's preferred creditor status means debt repayments with respect to its loans or those guaranteed by its member states are generally not rescheduled. Loans to private sector borrowers are also not rescheduled in the event of foreign exchange unavailability in the borrower's country. The dynamic between BSTDB members has been complicated by wars and conflicts in recent years. Russia's ongoing invasion of Ukraine and several short-lived assaults by Azerbaijan on Armenia have created tensions. Nevertheless, in May 2024 the bank agreed on its capital increase, showcasing shareholder support, with capital allocations due to commence in 2027. 10 of the 11 member states participated in the increase, and as a result, the shares of Romania and Ukraine will rise slightly due to their oversubscriptions, while Albania opted not to participate. All other shareholders, including Russia, will see their ownership shares remain unchanged. Steps previously taken to manage the relationship with Russia remain in place, including the removal of its appointee from BSTDB's management team, replacing its sanctioned BoG representative, suspending new lending and reducing outstanding portfolio balances.

Deepening ties with Japan

In February, BSTDB attended the 'Japan-Ukraine Conference for Promotion of Economic Growth and Reconstruction', which was held in Tokyo and attended by 130 firms from both countries, resulting in 56 agreements being signed between businesses and government officials. The Japan Bank of International Cooperation (JBIC) and BSTDB also used this opportunity to sign a memorandum of understanding (MOU), aiming to strengthen the relationship between the two parties and facilitate business activities that contribute toward the reconstruction of Ukraine. The aim is to structure and promote projects in the areas of agriculture, food, transport and logistics for exports, digital infrastructure, and medicine in Ukraine and its neighbours. Support for projects that contribute toward the mitigation of climate change in BSTDB member countries was also agreed. The MOU signed with JBIC provides the basis for discussions towards a two-step loan that would provide BSTDB up to USD150m to collaborate on the aforementioned areas.

Main activities

BSTDB supports economic development and regional cooperation in the Black Sea Region through trade and project finance via loans, guarantees, and equity participation in private enterprises and public entities. **Private sector** lending as a share of the total outstanding loan portfolio was approximately 75% as at FY23, somewhat above BSTDB's historical strategy goal of a 65-70% share. Products on offer range from loans typically denominated in US dollars or euros, trade finance, SME financing through credit lines to local financial intermediaries, equity investments (typically 5-25% stake) both direct and via investment funds, guarantees and co-financing. BSTDB has a high exposure to financial institutions because it uses banks to direct loans to SMEs and for trade finance rather than lending directly, as well as leasing and subordinated lending. BSTDB has sought to increase the share of **sovereign and public sector** operations, but so far has remained behind this target over the past five years. The bank lists the pandemic and the war between Ukraine and Russia as contributing factors for this shortcoming but also highlights the inherently low relative competitiveness vis-à-vis 'AAA' rated MDBs who offer large-sized loans to the public sector at more favourable terms.

Medium-term business plan (2023-2026)

BSTDB underwent nearly two decades of steady growth, which was disrupted in 2022 by a series of shocks and uncertainties caused by the war in Ukraine as well as challenging global financial conditions related to tighter monetary policy. The resulting economic downturn has reduced growth prospects and poses significant challenges for the bank, which it seeks to address with its 2023-2026 business plan, presented in two parts:

1. **Phase 1 (2023-2024):** Focus on stabilisation and consolidation by implementing mechanisms to safeguard member states' investments as well as the institution's credibility towards key interlocutors. Main goal is to maintain financial sustainability and achieve operational consolidation. For this, BSTDB intends to limit new operational activity and focus on portfolio monitoring to prevent further asset quality deterioration and ensure recovery of exposures at risk. The lower level of new activity shall favour shorter operations of smaller size than has been the case in the recent past, focusing on post-war reconstruction activities and countries that have been under-served to date.

2. **Phase 2 (2025-2026):** Focus is on the return to growth and value creation. A greater level of operational activity will aim to return to the steady, managed growth of previous years. BSTDB will look to expand its infrastructure and green financing offering, in line with rising regional demand while further diversifying its portfolio by sector and geography.

Financial strength indicators

Profitability – Black Sea Trade and Development Bank closed 2023 with a net profit of EUR20.4m, having recorded its first ever net loss one year prior (FY22: EUR-27.6m) due to higher than usual loan loss provisions (LLP). BSTDB managed to reduce the latter substantially (-66% yoy) as it scaled backed some of its previous over-provisioning. Earnings performance also improved to EUR67m (+5% yoy), largely helped by the partial redemption of issued bonds prior to maturity, generating a net gain of EUR14m. In FY23, the benefits of the higher interest environment started to wane, as net interest income (NII) declined to EUR56m (-42% yoy), mostly due to a jump in interest expenses. Profitability metrics have normalised for BSTDB, bringing them in line with average annual net income results (EUR14.5m) seen in the decade leading up to the conflict in Ukraine. BSTDB arguably navigated the conflict between its member states better than expected. Under its own baseline scenario in the 2023-2026 business plan the bank expected to record a net income profit of EUR9.4m for 2023, which it evidently exceeded.

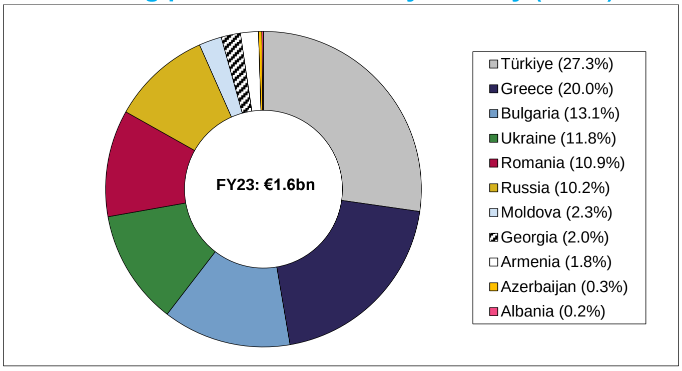
BSTDB – Key Data			
Key Ratios (%)	FY23	FY22	FY21
Capital adequacy ratio*	54.1	40.4	37.4
Stage 3 loan ratio	9.7	9.4	3.0
Stage 3 coverage ratio	41.0	35.8	54.5
Liquid assets/ borrowing	40.0	52.9	35.6
RoE	2.4	-3.3	5.0
Balance Sheet (EURm)			
Total assets	2,169	2,935	3,235
Total loans	1,565	2,041	2,329
Total liabilities	1,310	2,099	2,349
Borrowings	1,174	1,916	2,274
Total members' equity	859.1	836.3	885.7
Income Statement (EURm)			
Operating income	67.1	63.7	51.0
o/w NII	56.1	96.6	60.4
Operating expenses	23.0	23.3	21.4
Loan loss provisions	-23.2	-68.1	-38.6
Net income	20.4	-27.6	43.9

*Source: Company earnings reports; *Total equity / Outst.& disb. assets*

Asset quality – Total assets at FY23 amounted to EUR2.17bn (-26% yoy), comprised of loans (72% of total), cash and balances due from banks (17%) and securities investments (4%). The outstanding lending portfolio is generally well diversified by country and sector, in line with historical trends. Credit risk exposures to Ukraine and Russia have fallen and account for a combined 22% of total exposures (FY22: 32%). According to the most recent investor presentation, the Russia portfolio as at 1H24 decreased by 70% from 2022 to EUR141m, a positive for the bank's capital position. Sector concentration is moderate and geared towards utilities (26% of total), industrials (22%), financial institutions (12%) and materials (10%).

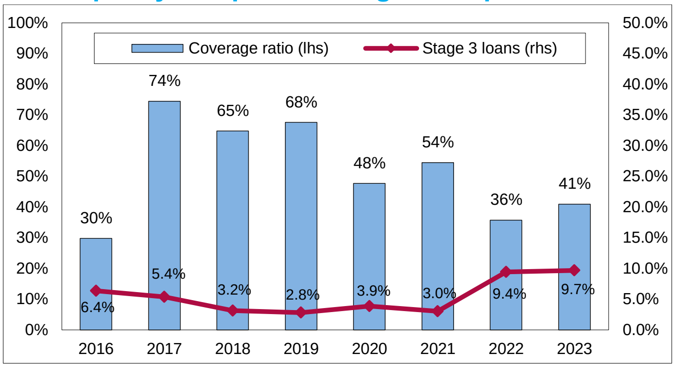
As part of its 2023-2026 strategic business plan, BSTDB made some conservative projections on continued portfolio developments under a base-case scenario. It expects the portfolio to shrink by 14.5% between end-2022 and end-2024, resulting in a balance sheet reduction of 22.3% over the same period. As of end-2023, BSTDB appears to be well on track to meet these targets as outstanding operations have already fallen by 23% and the balance sheet is down by 26%. The reduced lending activity over this period is considered positive for the capital position and liquidity preservation, but it may curtail the bank's policy importance should this situation endure beyond 'Phase 2 (2025-2026)' of the strategic plan, which specifically targets growth. In line with the bank's strategy, and due to changes to the operating environment of its member states, new lending is expected to remain constrained over the foreseeable future and in the case of Russia remains suspended.

Outstanding portfolio balance by country (FY23)



Source: Company reports

Asset quality and provisioning development



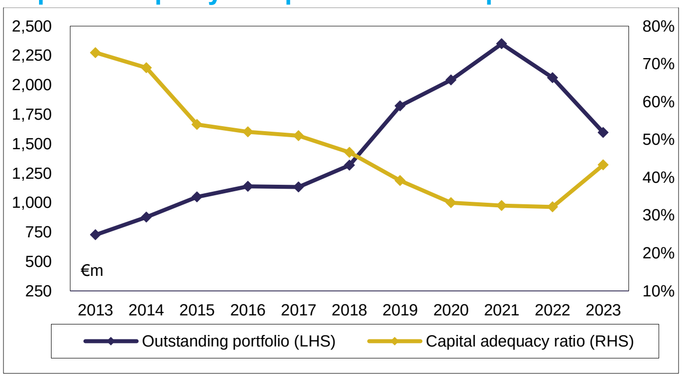
Source: Company reports

Asset quality has generally been robust, even throughout challenging periods such as the pandemic, when stage 3 loans only experienced modest upticks. In part, this is due to BSTDB using public-sector guarantees for risk-sharing and by operating through financial intermediaries when lending to SMEs, thus benefitting from their due diligence processes and generally taking the risk of the intermediary and not that of the end recipients. The upturn in stage 3 loans since 2022 is primarily due to weakening asset quality among member states locked in conflict and we expect it to remain strained for the duration of the war. The most recent coverage ratio stood at a modest 41%, despite provisioning amounts rising sharply since 2021, raising our expectation of elevated LLP levels over the near term in order to return to more adequate coverage levels.

Funding & Liquidity – Total liabilities, excluding members' equity, amounted to EUR1.3bn at FY23 (-37.6% yoy), comprising debt in issue (80% of total), amounts due to financial institutions (9%), and derivatives (8%). The bank established its first EMTN programme in 2015 for EUR1bn and launched its second in 2020 for EUR2bn. BSTDB also utilises short-term financing facilities in the form of euro-commercial paper (ECP) for cash management purposes. Credit facilities from multilateral development banks (MDB) and national development banks (NDB) provide additional diversification to the issuer's funding profile and are expected to be extended, as capital market funding costs for the issuer are considered prohibitive at present. As at FY23, EUR1.17bn in borrowing was held across a variety of currencies, including USD (38% of total), EUR (27%), CHF (14%), JPY (3%), AUD (2%) as well as other local-currencies of member countries. BSTDB has generally managed its liquidity position well, last seen in the successful redemption of the remaining USD412.5m of a euro-dollar note that was due in June. Following this, the issuer has no upcoming maturities >EUR200m until 2031. We deem BSTDB's liquidity position as at end-2023 to be adequate, with the liquid asset portfolio amounting to EUR452m, of which 60% carry a credit rating of AA- or above, and comprised of EUR375m in cash and bank balances. Liquid assets as a proportion of the total balance sheet have been fairly stable and stood at 21% as at end-2023 (2019: 18%).

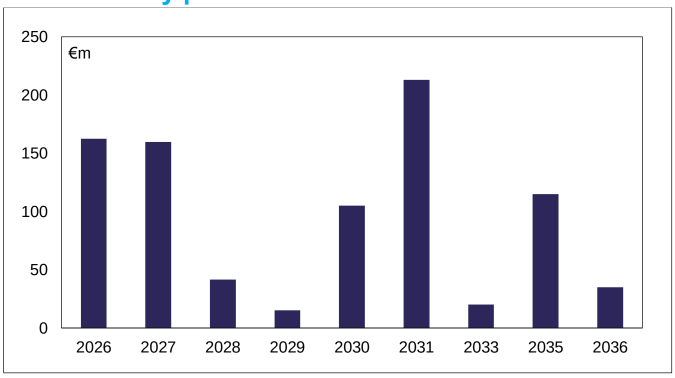
Capitalisation – The bank has paid-in share capital of EUR687m, which equates to 30% of the total subscribed share capital of EUR2.3bn as at FY23. Together with reserves and retained earnings, total members' equity stands at EUR859m. A supporting element of the bank is the EUR816.5m capital increase agreed in October 2021 and concluded in May 2024. Of the increased amount, 30% (EUR245m) is paid-in and 70% callable, bringing the total subscribed capital to EUR3.1bn. Shares will be transferred between 2027 and 2034 across eight instalments, increasing paid-in capital up to EUR932m. Shareholders' willingness to support the bank by agreeing this capital replenishment demonstrate their long-term commitment to BSTDB and its policy relevance. Based on the above and its liquid assets to borrowing ratio of 40%, we deem the bank to be in a good position to deal with near-term obligations.

Capital adequacy and portfolio development



Source: Company reports

Debt maturity profile



Source: Bloomberg

ESG activities

BSTDB aims to promote environmental and social sustainability in its member states and therefore applies sustainability principles to its business management, and also requires its clients to follow them. These environmental and social principles relate to i) pollution prevention and mitigation; ii) respect for fundamental human rights in the working environment; iii) addressing climate change; iv) promoting sustainable use of natural resources; v) protection and conservation of biodiversity; and vi) disclosure of information on environmental and social performance of its operations. While BSTDB seeks to apply its principles in accordance with internationally recognised standards and principles, to our knowledge, alignment has not been assessed or verified by a third party so far.

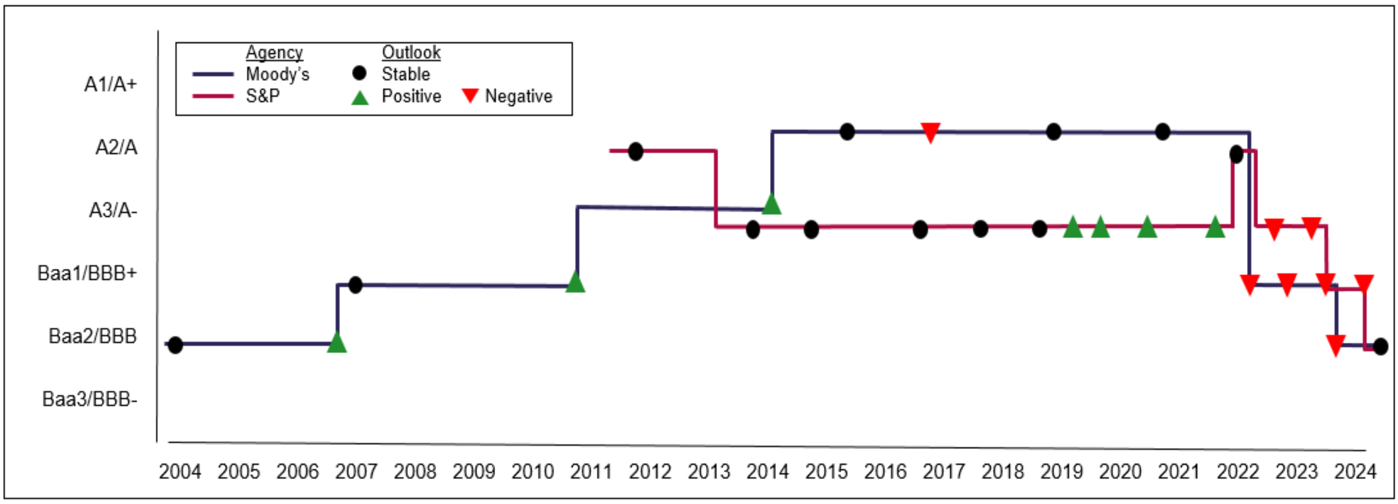
The bank categorises its operations based on potential environmental and social risks and impacts. The five categories (A, B+, B, C, FI) signal high to low risk operations with the highest categories warranting impact assessments, public consultations and disclosures of additional related information to the public. In early 2021, BSTDB signed off on its climate change strategy with the main goal of better aligning its financing with climate priorities of its member states. Specifically, the bank commits to gradually reduce net emissions of its portfolio, increase the share of funding to climate positive operations and those with climate co-benefits to at least 30%. Renewable energy and green buildings and transportation systems are among BSTDB's financing priorities, while at the same time it seeks to gradually phase out support for carbon-intensive sectors. Comprehensive reporting on financed environmental and social projects appears to be limited and an assessment of the overall size is therefore not possible.

Rating agencies' views

Moody's: The rating action from July 2024 states that Black Sea Trade and Development Bank's (BSTDB) long-term issuer rating was affirmed at 'Baa2'. The outlook was changed to stable from negative, while the short-term issuer rating was also affirmed at P-3. The affirmation of the Baa2 ratings reflects BSTDB's solid capital position, and expectation that the leverage and asset quality will remain broadly stable in the medium term amid a persistently difficult operating environment. The rating also reflects adequate liquid resources, which are sufficient to meet debt repayments due over the next 12 months even when assuming no access to external funding. While Moody's expects funding conditions to gradually improve, it also expects BSTDB to continue to generate financial resources internally and rely on new bilateral financing to service its financial obligations and finance its operations unless borrowing becomes available on more affordable terms.

S&P: In July 2024 S&P ratings lowered its long-term issuer credit rating on Black Sea Trade and Development Bank (BSTDB) to 'BBB' from 'BBB+' and affirmed the 'A-2' short-term issuer credit rating. The outlook is stable and S&P removed the ratings from CreditWatch, where it was placed with negative implications on July 26, 2023. The downgrade reflects the agency's view that BSTDB's public policy role has structurally weakened following its substantial balance-sheet reduction over the past two years. This erased the positive momentum the bank enjoyed in 2018-2021. S&P consider the unwinding of activity to have come at the expense of a diminishing policy importance, which they believe will take time to restore. Therefore, BSTDB's enterprise risk profile is assessed as weak, reflecting its reduced developmental impact and the bank's restart in 2025-2026 remains challenged by the ongoing war in its region of operations and impaired access to deep funding markets. The bank's extremely strong capitalisation, and S&P's expectation that its liquidity position will remain solid over 2024-2025, support the ratings.

BSTDB RATING HISTORY



Source: Moody's; S&P

Credit Research

Key contacts

London		
Head of Research	*Chris Scicluna*	+44 20 7597 8326
Head of Financials, Supras/Sovereigns & Agencies, ESG	*William Hahn*	+44 20 7597 8321
Head of Translation, Economic and Credit	*Maki Duffield*	+44 20 7597 8327
Tokyo		
Domestic Credit		
Chief Credit Analyst, Financials, Power, Communication, Wholesale Trade, Air Transportation	*Toshiyasu Ohashi*	+81 3 5555 8753
Local government, Government agency	*Kouji Hamada*	+81 3 5555 8791
Electronics, Non-Banks, Real Estate, REIT, Retail trade, Chemicals, Iron & Steel, Marine	*Takao Matsuzaka*	+81 3 5555 8763
Transportation, Pulp & Paper, Oil, Land Transportation	*Kazuaki Fujita*	+81 3 5555 8765
Automobiles, Foods, Heavy equipment, Construction, Machinery	*Ayumu Nomura*	+81 3 5555 8693
International Credit		
Non-Japanese/Financials	*Fumio Taki*	+81 3 5555 8787
Non-Japanese/Financials	*Hiroaki Fujioka*	+81 3 5555 8761
Non-Japanese/Corporates	*Stefan Tudor*	+81 3 5555 8754
ESG		
Chief Securitisation Strategist	*Koji Matsushita*	+81 3 5555 8778
Strategist	*Shun Otani*	+81 3 5555 8764
Strategist	*Takao Matsuzaka*	+81 3 5555 8763
Strategist	*Kaori Ichikawa*	+81 3 5555 8758

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3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.

4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of Y10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

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- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
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