July 2024

ABB

Offer Price:
AZN0.27
Price Target:
AZN0.45

SUMMARY

ABB is currently offering its shares on the market, with the bank valued at AZN 1.3 billion. We assess this offering as a compelling opportunity, anticipating potential capital appreciation of approximately 70% over the next 12 - 24 months. This optimism is based on a combination of factors: robust financial performance, a dividend yield that surpasses those of its regional peers, an attractively low valuation, and a limited supply of shares available.

Key Indicators	2018	2019	2020	2021	2022	2023	2024F	2025E
EPS	0.06	0.06	0.04	0.03	0.05	0.08	0.09	0.09
EPS Growth		-3.7%	-36.5%	-18.6%	66.1%	61.1%	10.3%	1.7%
EPS Adjusted	0.06	0.05	0.04	0.03	0.06	0.08	0.09	0.09
DPS	0.00	0.03	0.03	0.03	0.03	0.03	0.03	0.04
DPS Growth			0.0%	-15.3%	-8.7%	25.3%	10.7%	1.7%
Dvd payout ratio	0.00	0.70	0.84	0.91	0.43	0.41	0.41	0.41
AROE	18.2%	13.0%	10.6%	8.2%	16.4%	19.7%	18.9%	17.0%
AROA	3.6%	2.4%	1.9%	1.3%	2.2%	2.7%	3.1%	3.1%
ARORWA	6.9%	5.1%	4.0%	3.0%	6.0%	6.8%	6.1%	5.3%
NIM	10.7%	6.2%	5.1%	6.3%	7.7%	6.8%	6.6%	6.5%

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Deal Details

ABB is issuing 322 million new shares. Following this transaction, the total number of outstanding shares will increase to approximately 4.9 billion, with the paid-in capital reaching AZN 1.3 billion, matching the bank's market capitalization. As a result, the total free float will comprise 6.6% of all shares. The shares are scheduled to be listed on the Baku Stock Exchange in September. The bank is offering its shares at a discount to regional peers, such as the Bank of Georgia and TBC Bank, while providing a superior dividend yield.

Growth and Dividends

We anticipate that the earnings per share (EPS) will grow by at least 10% this year. Maintaining profitability consistent with the previous year, and adhering to the historical dividend payout ratio, the bank has distributed approximately 40% of its net income as dividends. This approach resulted in an 11% dividend yield for 2022-2023 and is expected to generate around 13-14% in 2024E.

Valuation

Valuation	2022	2023	2024F	2025E		
Price Per Share, AZN	0.27					
Market Capitalization, AZN'000	1 241 287					
P/E x	4.3	3.3	3.0	2.9		
P/B x	0.7	0.6	0.5	0.5		
Div. Yield %	10.1%	12.6%	13.7%	13.9%		
				TP	**Upside**	**Weight**
Target P/B'24			0.96	0.45	67%	40%
Target Div.Yield			8.7%	0.41	52%	40%
Target P/E'24 (Kaspi Bank)			12.28	1.06	293%	10%
		TP12M		**0.45**	**67%**	

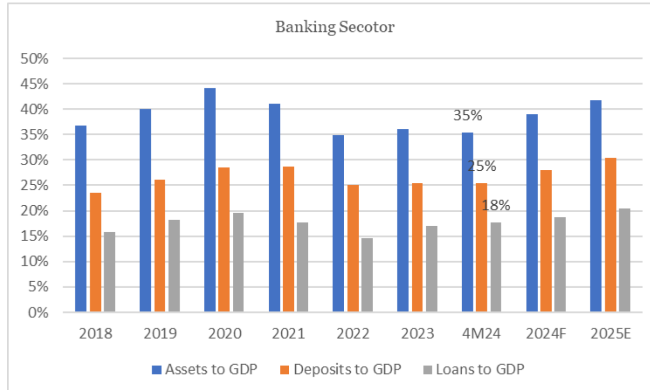
Our price target for ABB shares is set at AZN 0.45 per share, offering a potential upside of 67%. This target is derived using three methods: the target price-to-book (P/B) ratio and the dividend yield for 2024. Additionally, our blue-sky scenario, which we assign a 10% probability, values the shares at AZN 1.06, based on Kaspi Bank's projected P/E multiple for 2024.

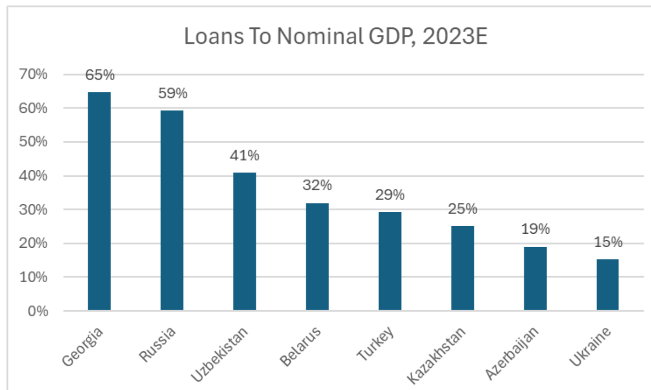
Peer Group

Name	Country	Market Cap $BN	P/E'24	P/B'24	Dividend Yield
Bank of Georgia	Georgia	2.4	4.06	1.13	6.3%
TBC Bank	Georgia	1.9	3.99	0.93	8.2%
Center Credit	Kazakhstan	0.7	2.28	0.74	0.0%
Forte Bank	Kazakhstan	1.1	3.90	1.06	11.62%
Average			**3.56**	**0.96**	**8.7%**
Kaspi Bank	*Kazakhstan*	*25*	*12.28*	*9.36*	
ABB	**Azerbaijan**	**0.7**	**3.11**	**0.53**	**13.2%**

Banking Sector

The loan portfolio of Azerbaijan banks has been growing by 13% CAGR between 2018 and 2023. The growth of the banking sector is funded by deposits, with a Loans to Deposits ratio of 67%. The banking system is very concentrated, with the top 5 banks controlling about 45% of assets and deposits as of the end of 2023. Despite the relatively low loans-to-deposits ratio, deposits are concentrated at the top 5-6 players, which in turn have limited capabilities in terms of capital to deploy those deposits into loans to the economy. Large banks are coming to the market with subordinated debts to increase their capital position and be able to increase loans to the economy and single-party exposure, which is also limited by the capital levels. Notable placements include Kapital Bank's recent US$ 35 million 7-year subordinated debt, callable after 2 years.





At the same time, the Central Bank is regulating retail loans. For example, certain limits are in place that restrict the total loan level each individual can take (through the loan-to-income ratio). It is also impossible to finance the purchase of a second car through bank loans. Given these limitations and the advantages in terms of the cost and capital of large banks, smaller banks may struggle to survive in the long run, leading to further consolidation of the banking system. Unless foreign players with superior balance sheets and lower costs of funding enter the local market, the current local incumbent banks are likely to dominate.

Previous crisis

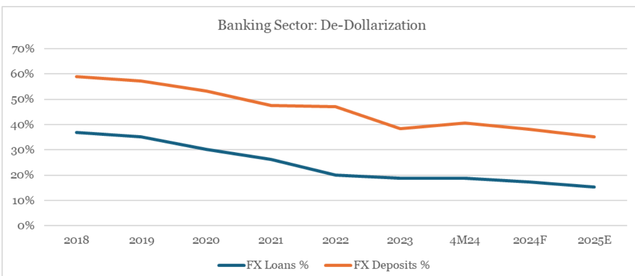
The most devastating financial crisis burdened the local financial system due to the significant drop in oil prices from peaks above $100 per barrel in 2014 to below $50, where it stayed low for almost 2 years. Given the high level of dollarization of the economy, loans, and deposits, the devaluation was unavoidable after the Central Bank exhausted almost all of its currency reserves, leading to a recession and wiping out the capital of local banks.

To gain an understanding of the situation at the time, Access Bank and Unibank provide a good representation of the system's condition during the period. Due to the crisis, both had to undergo recapitalization. Access Bank, the purest example of an SME financing institution, and Unibank, the purest example of a retail financing institution, illustrate the broader financial landscape.

Access Bank	2014	2015	2016	2017	2018	2019
COR SME	0.4%	-7.0%	-16.0%	-2.4%	3.0%	-0.2%
NPL	1.5%	40.2%	54.0%	96.0%	26.9%	69.1%
Provisions to Loans	1.1%	4.7%	18.5%	22.4%	26.0%	17.7%

Unibank	2014	2015	2016	2017	2018	2019
COR Retail		-9.6%	-19.8%	6.5%	6.6%	12.4%
NPL		26.8%	49.4%	56.4%	29.7%	29.9%
Provisions to Loans		23.0%	44.1%	41.4%	15.0%	11.2%

ABB was also part of this process. The bank was recapitalized, and the majority of toxic assets were transferred to state funds. Since then, the dollarization of loans and deposits has significantly decreased. Should there be a prolonged recession due to falling oil prices, the potential impact on the banking system should be limited, as the main players are better equipped and capitalized to handle adverse situations.



ABB

Market Share

ABB Bank, as the second-largest bank following combined Kapital and Pasha Bank—which together hold 35% of the entire banking system's assets and 38% of all banking deposits—had a market share of 18% in banking assets and 20% in banking deposits as of the end of 2023. ABB's balance sheet is robust and clean, with toxic assets having been transferred to Aqrar Kredit in 2015-2017.

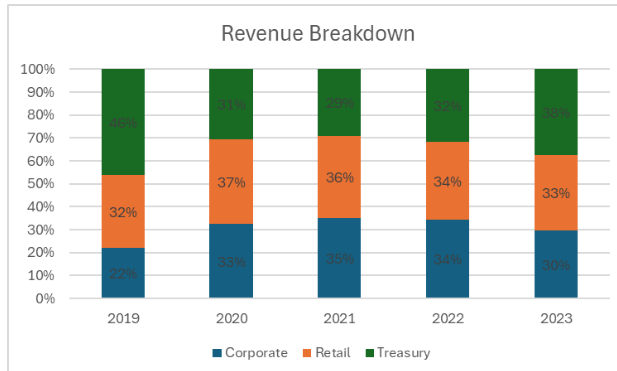
Capital Adequacy and Profitability

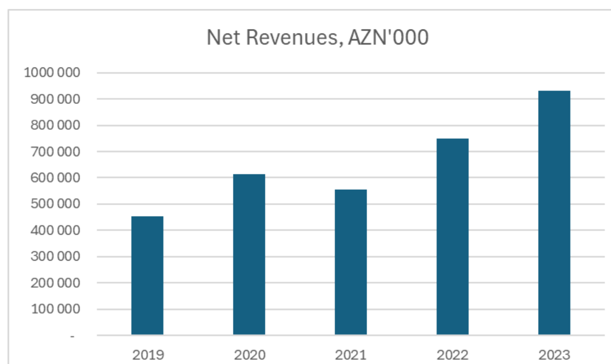
As of the end of 2023, the bank's total Capital Adequacy Ratio stood at 35%, significantly above the regulatory minimum of 12%. Despite this overcapitalization, the bank remains highly profitable, with a Return on Equity (AROE) of 19.7% in 2023.

Loan to Deposit Ratio

The Loan to Deposit ratio was 50% as of 2023, indicating an underutilized balance sheet.

Revenue Breakdown





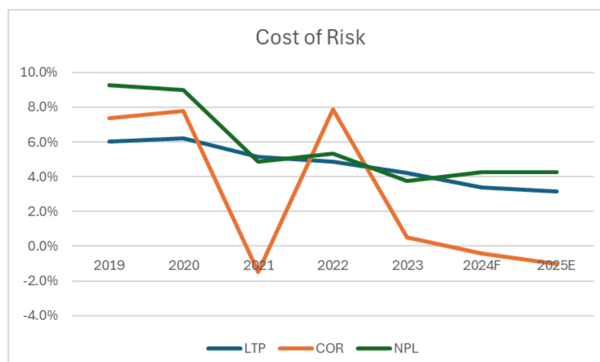
Loan portfolio

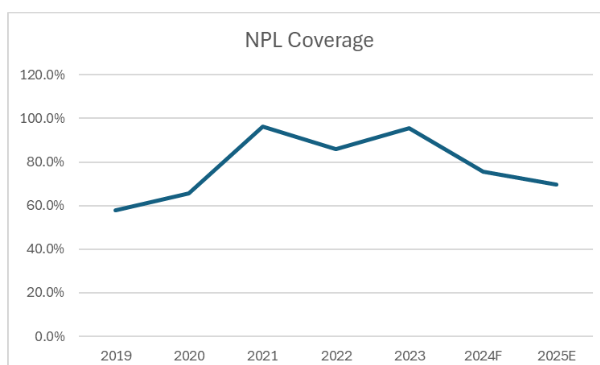
The loan portfolio of ABB Bank is almost evenly divided between loans to individuals and corporations. About 45% of consumer loans are comprised of mortgage loans, indicating a significant focus on secured lending within the individual segment. As of December 31, 2023, the Group's loan portfolio exhibited significant concentration risk, with the ten largest borrowers accounting for AZN 1,088,915 thousand, or 21% of the gross loan portfolio. This figure remained consistent with the previous year, December 31, 2022, when the ten borrowers accounted for AZN 761,815 thousand, also making up 21% of the total gross loan portfolio.

We estimate that the total Non-Performing Loan (NPL) ratio was 3.7% of gross loans as of 2023, with a strong coverage ratio—NPL to provisions was 96%. The low level of NPLs can be attributed to the bank having almost entirely rebuilt its loan portfolio from scratch following the economic downturn in 2016.

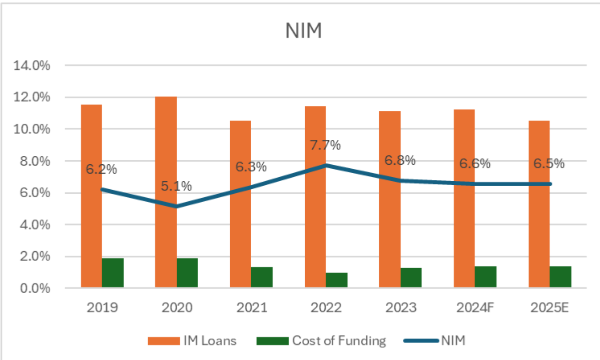
Cost of Risk

We believe that the bank is well-provisioned and the portfolio is relatively healthy. In the next two years, the net basis cost of risk should be negative, bringing the overall provisions to loan level to normal levels.





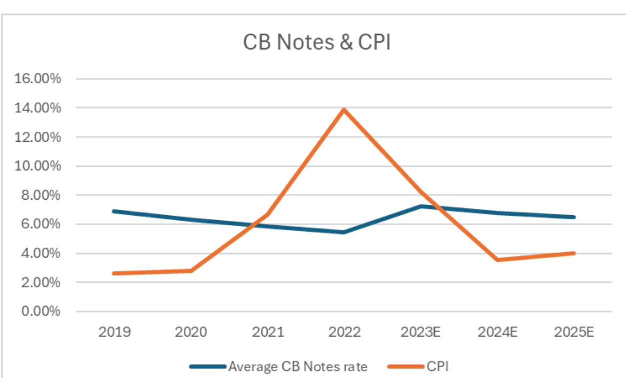
P&L Breakdown

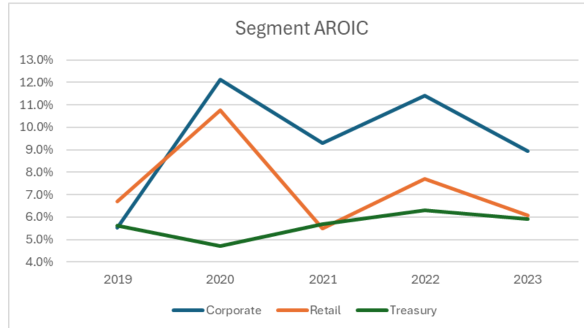


In 2023, the average gross Net Interest Margin for bank declined to 6.8%, primarily due to an increase in funding costs. Looking ahead, we expect NIM to moderate slightly, albeit with some delay, pressured by falling inflation and market rates.

Typically, banks adjust loan pricing with a lag, whereas deposit costs are adjusted more immediately. We anticipate that inflation will continue to moderate in 2024-2025.

Regarding segment Average Return on Invested Capital (AROIC), retail remains the most significant potential profit driver. Although retail has a similar exposure size to corporate, higher interest rates, and comparable gross fee income, it lags behind corporate in AROIC. Transitioning retail clients to mobile service channels will reduce operating expenses





(OPEX) and enhance the segment's profitability.

Source of further growth

Given its size, we believe that the growth of the bank is completely dependent on the growth of the overall economy. ABB, as the most well-capitalized bank, can further increase market share in corporate segment if they wish to do so. However, growth in retail will be somewhat limited given regulatory limitations.

The next round of growth for the banking system, as well as ABB in particular, might come from the intensification of investments into projects in the liberated lands in the Karabakh region, as well as the realization of international logistic corridors that might go through Azerbaijan.

Bull Case Upsides:

- Stronger-than-expected EPS Growth for 2024YE: Higher earnings per share than initially forecast could provide a significant boost to investor confidence and share price.
- Increased Dividend Payout Ratio: Given the excessive capital, there is potential for a higher dividend payout, making the stock more attractive to dividend-seeking investors.
- Improvement in Retail Costs: Effective cost management in the retail segment could lead to improved profitability and operational efficiency.
- Oversubscription of Shares: Potential oversubscription during the IPO could lead to an increase in the share price.
- Potential Placement of Shares in London: Listing shares on the London Stock Exchange could broaden the investor base, increase trading volume, and enhance visibility on a global scale.

Bear Case Risks:

- Slower Growth: Weaker economic conditions or operational challenges could lead to slower growth than anticipated, impacting earnings and investor sentiment.
- Revision of Dividends: A downward adjustment in the dividend policy, possibly due to unexpected financial needs or strategic shifts, could disappoint investors and negatively impact share prices.
- Issues with NPLs Due to Portfolio Concentration: Given the concentration of the loan portfolio, a default by a major client could lead to a significant increase in Non-Performing Loans (NPLs) and necessary provisions. This would adversely affect the bank's profitability and could lead to a sharp decline in the share price.

Case Study: Kaspi Bank - A Story of Exceptional Profitability and High Valuation

Kaspi Bank, headquartered in Kazakhstan, has become one of the most profitable banks in the region. Its high valuation compared to other regional banks can be attributed to several key factors: a diversified business model, technological innovation, strong customer focus, and effective management strategies.

Key Factors Contributing to Profitability and High Valuation: Diversified Business Model

Retail Banking: Kaspi Bank has a significant focus on retail banking, catering to individual customers with a range of products including loans, savings accounts, and payment services.

Payments and Fintech Solutions: The bank has developed a robust fintech platform, Kaspi.kz, which integrates e-commerce, payments, and financial services. This platform has driven significant customer engagement and transaction volumes.

Marketplace Services: Through Kaspi.kz, the bank operates an online marketplace, allowing customers to purchase goods and services directly, further increasing the bank's revenue streams.

Technological Innovation

Mobile App: Kaspi Bank's mobile app is one of the most popular in Kazakhstan, offering seamless banking, payments, and shopping experiences. The app's user-friendly interface and comprehensive features have attracted a large customer base.

Digital Ecosystem: The bank has invested heavily in building a digital ecosystem that connects customers with various services, from banking to shopping and payments, all within a single platform. This ecosystem has created a loyal customer base and high engagement rates.

Strong Customer Focus

Customer-Centric Approach: Kaspi Bank prioritizes customer satisfaction, continuously improving its services based on customer feedback. This approach has led to high customer retention and acquisition.

Wide Reach: The bank has an extensive network of branches and digital touchpoints, ensuring accessibility for customers across Kazakhstan.

Effective Management Strategies

Operational Efficiency: The bank has implemented efficient operational practices, reducing costs and improving profitability. This includes the use of data analytics to optimize processes and customer interactions.

Risk Management: Kaspi Bank has a strong risk management framework, ensuring a healthy loan portfolio with low non-performing loans (NPLs). This prudent approach has contributed to the bank's financial stability.

Financial Performance

Revenue Growth: Kaspi Bank has shown consistent revenue growth driven by its diversified income streams. The combination of interest income from loans and non-interest income from payments and marketplace services has strengthened its financial performance.

Profit Margins: The bank's net interest margin (NIM) and return on equity (ROE) are among the highest in the region. Efficient cost management and high revenue per customer have contributed to these strong profit margins.

Market Perception and Valuation

Investor Confidence: The bank's strong financial performance, innovative business model, and growth potential have garnered significant investor confidence. This has led to a high price-to-earnings (P/E) ratio compared to other regional banks (see valuation table).

Strategic Vision: Kaspi Bank's forward-looking strategies and ability to adapt to market changes have positioned it as a leader in the financial sector. Investors value the bank's strategic vision and execution capabilities, further boosting its valuation.

Summary

If ABB decides to replicate Kaspi Bank's success, they possess all the essential ingredients to do so. With a large footprint, ABB can leverage its existing infrastructure to create a comprehensive digital ecosystem, by developing or acquiring existing e-commerce platforms (Tap.az for example). By integrating banking, payments, and shopping services, ABB can enhance customer engagement and satisfaction.

The development of a user-friendly digital platform, similar to Kaspi.kz, would offer ABB customers seamless access to a wide range of services beyond banking. This strategy could transform ABB into a one-stop shop for both financial and non-financial needs, driving significant revenue growth and enhancing customer loyalty.

By focusing on technological innovation, customer-centric strategies, and operational efficiency, ABB has the potential to unlock the true value of the bank. The successful implementation of these strategies could position ABB as a leading player in the region, significantly enhancing its profitability and market valuation.

ABB Model Snapshot

Balance Sheet	2018	2019	2020	2021	2022	2023	2024F	2025E
Cash & Equiv	1 810 173	2 789 673	2 504 501	6 837 554	5 375 211	2 816 799	3 272 126	2 780 891
Interbank & Investments	3 395 320	3 447335	3 442 462	1 190 528	4 685 988	5 447515	4 220 577	4 162 821
Net Loans	**1 561 128**	**2 165 804**	**2 397 018**	**2 958 768**	**3 401 058**	**4 910 003**	**5 568 674**	**6 297 302**
Other Loans	1 507622	938 933	860 801	766 409	715 362	755 012	32 120	90 796
Total Assets	**8 274 243**	**9 341 745**	**9 204 782**	**11 753 259**	**14 177 619**	**13 929 329**	**13 093 498**	**13 331 811**
Deposit	4 364 649	5 606 673	5 460 956	8 696 591	11 252 021	10 261 807	9 278 642	9 269 636
Other Liabilities	2 266 405	2 051 344	2 046 933	1 353 977	1 105 235	1 620 631	1 465 361	1 463 939
Total Liabilities	6 631 054	7658 017	7507889	10 050 568	12 357256	11 882 438	10 744 003	10 733 575
Equity	**1 643 189**	**1 683 728**	**1 696 893**	**1 702 691**	**1 820 363**	**2 046 891**	**2 349 495**	**2 598 236**
P&L	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024F**	**2025E**
Interest Income	436 741	474 408	442 866	441 975	595 769	787709	826 266	820 337
Interest Expense	160 754	135 888	141328	116 231	111 105	151875	153 647	145 845
Net Interest Income	**275 987**	**338 520**	**301 538**	**325 744**	**484 664**	**635 834**	**672 619**	**674 491**
Cost of Risk	71 672	(37765)	(20 186)	8 238	(36 192)	(7848)	(2 645)	(7360)
Net Fee & Comission Income	71 027	65 591	60 874	58 152	69 449	68 439	77047	85 893
Other Income	104 844	61590	77933	8 936	100 197	101 858	100 000	100 000
OPEX	(127994)	(143 619)	(177259)	(217996)	(250 452)	(314 121)	(322 356)	(319 362)
PBT	395 536	284 317	242 900	183 074	367666	484 162	524 664	533 663
PAT	**298 676**	**215 708**	**178 956**	**139 592**	**288 782**	**380 888**	**414 485**	**421 594**
Dividends	-	150 000	150 000	127000	125 000	156 600	169 939	172 854
# Shares	4 597359	4 597359	4 597359	4 597359	4 957357	4 957357	4 861 437	4 861437
Key Indicators	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024F**	**2025E**
EPS	0.06	0.06	0.04	0.03	0.05	0.08	0.09	0.09
EPS Growth		-3.7%	-36.5%	-18.6%	66.1%	61.1%	10.3%	1.7%
EPS Adjusted	0.06	0.05	0.04	0.03	0.06	0.08	0.09	0.09
DPS	0.00	0.03	0.03	0.03	0.03	0.03	0.03	0.04
DPS Growth			0.0%	-15.3%	-8.7%	25.3%	10.7%	1.7%
Dvd payout ratio	0.00	0.70	0.84	0.91	0.43	0.41	0.41	0.41
AROE	18.2%	13.0%	10.6%	8.2%	16.4%	19.7%	18.9%	17.0%
AROA	3.6%	2.4%	1.9%	1.3%	2.2%	2.7%	3.1%	3.1%
ARORWA	6.9%	5.1%	4.0%	3.0%	6.0%	6.8%	6.1%	5.3%
NIM	10.7%	6.2%	5.1%	6.3%	7.7%	6.8%	6.6%	6.5%
IM Loans		11.6%	12.0%	10.5%	11.4%	11.1%	11.3%	10.5%
Cost of Funding		1.9%	1.9%	1.3%	1.0%	1.3%	1.4%	1.4%
Cost to Income	37%	36%	49%	57%	45%	45%	43%	42%
Revenue growth		-0.7%	-3.7%	-11.4%	52.2%	29.1%	6.6%	1.4%
Balance Sheet		**2019**	**2020**	**2021**	**2022**	**2023**	**2024F**	**2025E**
LTA		24%	28%	26%	25%	37%	44%	47%
LTD		41%	47%	36%	32%	50%	62%	70%
Efficiency ratio		37%	45%	57%	45%	46%	45%	46%
Asset Growth		13%	-1%	28%	21%	-2%	-5%	5%
Loans Growth		29%	11%	22%	15%	43%	13%	13%
Deposit Growth		28%	-3%	59%	29%	-9%	-10%	0%
Leverage Ratio	x	4.5	x 4.4	x 5.9	x 6.8	x 5.8	x 4.6	x 4.1
Asset Quility		**2019**	**2020**	**2021**	**2022**	**2023**	**2024F**	**2025E**
LTP		6.0%	6.2%	5.1%	4.9%	4.2%	3.4%	3.1%
COR		7.4%	7.8%	-1.5%	7.9%	0.5%	-0.4%	-1.0%
NPL		9.3%	9.0%	4.9%	5.3%	3.7%	4.2%	4.2%
NPL Coverage		58%	66%	96%	86%	96%	75%	70%
Business Segments		**2019**	**2020**	**2021**	**2022**	**2023**	**2024F**	**2025E**
Asset Breawkdown								
Corporate Loans		13%	14%	14%	12%	18%	22%	24%
Retail Loans		12%	14%	13%	13%	18%	22%	23%
Treasury (interbank+investments)		37%	37%	10%	33%	39%	32%	31%
Corporate		22%	33%	35%	34%	30%		
Retail		32%	37%	36%	34%	33%		
Treasury		46%	31%	29%	32%	38%		
Segment AROIC								
Corporate		5.5%	12.1%	9.3%	11.4%	8.9%		
Retail		6.7%	10.7%	5.5%	7.7%	6.1%		
Treasury		5.6%	4.7%	5.7%	6.3%	5.9%		
Valuation				**Valuation**	**2022**	**2023**	**2024F**	**2025E**