

Research Update:

Cypriot S.L. Capital Services Group Status Now Core; Raised To 'B-' On Stronger Chance Of Group Support; Outlook Stable

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Overview

- We believe that Cyprus-based S.L. Capital Services Ltd. has become an increasingly important element of and is now highly integrated within the operations of its ultimate parent, Aljba Alliance.
- We now therefore consider S.L. Capital to be "core" to Aljba; rather than "nonstrategically important".
- We are consequently equalizing the long-term ratings on S.L. Capital at 'B-' in line with the parent, one notch above S.L. Capital's stand-alone credit profile, reflecting the stronger probability of extraordinary parental support.
- The stable outlook mirrors that on the parent and balances stabilizing but still unfavorable economic conditions against continued parental support.

Rating Action

On July 5, 2010, Standard & Poor's Ratings Services raised its long-term counterparty credit rating on Cyprus-based S.L. Capital Services Ltd. to 'B-' from 'CCC+'. At the same time, we affirmed the 'C' short-term rating. The outlook is stable.

Rationale

The upgrade reflects our revision of the group status of S.L. Capital Services Ltd. to "core" from "nonstrategically important". We believe that S.L. Capital has increasingly become important to the business profile and is highly integrated within the operations of its ultimate parent, Russian Aljba Alliance (Aljba; B-/Stable/C).

The long-term counterparty credit rating on S.L. Capital is one notch higher than its stand-alone credit profile, which we have raised to 'CCC+' from 'CCC'. The notching reflects our expectation of the likelihood of an almost certain probability of extraordinary parental support. In our view, S.L. Capital has increasingly become an important part of the Aljba group, given the company's high operational and business integration, the local operation's alignment with the group's strategy, and the company's increasingly important role in the group's financial results. S.L. Capital contributed almost one-half of the group's after-tax profit in 2009.

The ratings also reflect S.L. Capital's very high dependence on Aljba for business, operational support, funding, and financial continuity. The ratings are constrained by S.L. Capital's very limited business and client base, and the inherently high volatility of its financial results due to market shifts. These factors are partly mitigated by parental financial and operating support, an adequate level of capitalization and liquid assets, and the company's relationship-driven niche customer and funding profile, which shelters the company from adverse market developments.

S.L. Capital is Aljba group's vehicle and booking center for proprietary securities investments and client-driven brokerage and underwriting operations. The company had capital of \$10.2 million on April 30, 2010.

The company mainly invests in Russian equities. Single-name proprietary issuer concentrations are high, and the four largest issuer investments represented 40% of the portfolio on April 30, 2010. On the same date, the company had investments in securities of \$2.2 million (20% of adjusted total equity [ATE]), with signs of impairment.

S.L. Capital depends highly on funding and liquidity support from Aljba, representing 36% of its liabilities on April 30, 2010, down significantly from 95% on April 30, 2009. This fairly confidence-resilient funding facilitates the company's liquidity and asset-liability management. Cash placements with Aljba comprised 32% of the company's total assets as of April 30, 2010, about the same as a year earlier.

S.L. Capital's profitability hinges on the performance of the Russian stock market, which remains volatile. Revenues are highly concentrated, owing to a limited customer base and narrow diversification of instruments, and fully dependent on market conditions and client sentiment. Due to a high negative securities revaluation and a sharp drop in brokerage commissions, S.L. Capital reported a significant loss of \$4.7 million for 2008. However the market rose in 2009, driving profits up to \$4.2 million for 2009 and \$0.2 million for the first four months 2010 (including securities revaluations). However, the near-term market outlook is uncertain and the company expects profitability will remain volatile.

With ATE to assets exceeding 50% on April 30, 2010, and risk-adjusted capital of 5.7% on Dec. 31, 2009 (according to our "Methodology And Assumptions: Risk-Adjusted Capital Framework For Financial Institutions," published April 21, 2009), we think the company has a relatively comfortable ability to absorb further potential market losses. Securities investments represented 130% of ATE on April 30, 2010, however.

Outlook

The stable outlook on S.L. Capital mirrors that on Aljba and balances market volatility against continued group support. Moreover, we consider the current absolute amount of equity to be adequate to protect the company from potential

market imbalances in the medium term.

Given the company's "core" status, strong link with, and high dependence on the parent, future changes to the ratings on S.L. Capital will largely follow changes in Aljba's credit standing and support for S.L. Capital. A downgrade of Aljba would likely result in a downgrade of S.L. Capital; likewise an upgrade of Aljba, a scenario that we currently consider unlikely in the near term, would likely result in an upgrade of S.L. Capital.

If the company strengthened, specifically through a sustained good capital position, reduced volatility in earnings, and lower concentrations, we might raise our assessment of its stand-alone credit profile, but not to higher than one notch below the long-term credit rating on Aljba.

We could lower the ratings on S.L. Capital if the Aljba group evolves in a way that weakens the company's "core" status within the group.

Related Criteria And Research

- Group Methodology, April 22, 2009
- Methodology And Assumptions: Risk-Adjusted Capital Framework For Financial Institutions, April 21, 2009
- S.L. Capital Services Ltd., Oct. 14, 2009
- Research Update: Cyprus-Based S.L. Capital Services Assigned 'CCC+/C' Ratings; Outlook Stable, July 22, 2009
- Summary: Aljba Alliance, April 9, 2010
- Research Update: Outlooks On 14 Russian Financial Institutions Are Revised To Stable As Tough Operating Conditions Ease, April 1, 2010

Ratings List

Upgraded; Ratings Affirmed

	To	From
S.L. Capital Services Ltd.		
Counterparty credit rating	B-/Stable/C	CCC+/Stable/C
Certificate of deposit	B-/C	CCC+/C

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