

Credit Opinion: Halyk Savings Bank of Kazakhstan

Global Credit Research - 17 May 2013

Almaty, Kazakhstan

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Ba2/NP
Bank Financial Strength	D-
Baseline Credit Assessment	(ba3)
Adjusted Baseline Credit Assessment	(ba3)
Senior Unsecured	Ba3

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Key Indicators

Halyk Savings Bank of Kazakhstan (Consolidated Financials)[1]

	[2]12-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (KZT billion)	2,408.0	2,273.9	2,097.9	2,023.0	1,651.3	[3]9.9
Total Assets (USD billion)	16.0	15.3	14.2	13.6	13.7	[3]4.0
Tangible Common Equity (KZT billion)	245.5	220.9	226.8	192.7	144.8	[3]14.1
Tangible Common Equity (USD billion)	1.6	1.5	1.5	1.3	1.2	[3]8.0
Net Interest Margin (%)	3.5	3.6	4.1	4.5	5.4	[4]4.2
PPI / Average RWA (%)	5.7	5.1	5.7	6.7	4.9	[5]5.6
Net Income / Average RWA (%)	3.8	2.3	2.2	1.0	0.9	[5]2.1
(Market Funds - Liquid Assets) / Total Assets (%)	-26.9	-27.3	-27.3	-16.8	12.4	[4]-17.2
Core Deposits / Average Gross Loans (%)	113.8	112.7	106.1	93.6	71.4	[4]99.5
Tier 1 Ratio (%)	16.2	16.7	17.3	16.9	9.9	[5]15.4
Tangible Common Equity / RWA (%)	12.8	12.9	13.4	12.5	8.6	[5]12.0
Cost / Income Ratio (%)	38.5	41.7	36.2	28.5	41.2	[4]37.2
Problem Loans / Gross Loans (%)	21.6	22.1	22.2	18.1	8.7	[4]18.5
Problem Loans / (Equity + Loan Loss Reserves) (%)	54.6	54.2	52.1	49.7	37.0	[4]49.5

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel I & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Halyk Savings Bank of Kazakhstan's (Halyk Bank) standalone bank financial strength rating (BFSR) is D- , mapping to ba3 on our long-term scale. The rating is underpinned by the bank's leading market position in Kazakhstan, its good profitability and adequate capitalisation. However, the rating also takes into account the

concentration on both sides of the balance sheet and weak asset quality that could require a number of years to work out.

We assign a global local currency deposit rating of Ba2 to Halyk Bank. The rating is based on Moody's assessment of a moderate probability that systemic support would be extended to the bank's depositors in case of need. Consequently, there is a one-notch uplift for the deposit ratings from Halyk Bank's ba3 standalone credit assessment.

Halyk Bank reported total assets and net income of \$16 billion and \$469 million, respectively, as at year-end 2012, according to the bank's audited IFRS financial statements.

Rating Drivers

- Well-developed franchise is a major credit positive
- High borrower and funding concentration
- Good profitability with relatively well-diversified earnings
- Weak but stabilising asset quality
- Adequate capitalisation

Rating Outlook

All of the bank's ratings carry a stable outlook.

What Could Change the Rating - Up

A significant reduction in the bank's funding concentration and improvement in asset quality, coupled with good liquidity and capitalisation may have positive rating implications.

What Could Change the Rating - Down

Further significant deterioration of the bank's asset quality and material weakening of its capital adequacy might result in a downgrade of Halyk Bank's BFSR.

A downgrade of Halyk Bank's BFSR is likely to result in a downgrade of its deposit and debt ratings. Reduced systemic support probability stemming from a downgrade of Kazakhstan's sovereign ratings or an evidence of lowered willingness of the government to support the bank may also result in a downgrade of the bank's deposit ratings.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Halyk Bank's currently assigned ratings are as follows:

WELL-DEVELOPED FRANCHISE IS A MAJOR CREDIT POSITIVE

Halyk Bank is the second-largest bank in Kazakhstan in terms of assets, which stood at KZT2,408 billion (\$16 billion) at year-end 2012, according to its consolidated IFRS report. The bank is the market leader in terms of retail and corporate deposits with a 19.4% share as of year-end 2012, according to the National Bank of Kazakhstan's data. Halyk Bank has the largest regional network in Kazakhstan among the local banks. At YE2012, Halyk Bank had 22 regional branches, 122 sub-regional offices and 410 cash settlement units.

The group also has insurance, pension fund, leasing and brokerage businesses, as well as three subsidiary banks in Russia, Kyrgyzstan and Georgia. Halyk Bank's business is focused in Kazakhstan, where almost all of its assets are allocated.

79% of the bank's loan book is attributable to corporate and SME loans, the rest are consumer loans and mortgages. Thanks to the bank's relatively conservative risk appetite, stable financial position and close connection with the Kazakh authorities, Halyk Bank has been perceived as a safe haven among the Kazakh banks. This allows the bank to maintain its strong deposit taking franchise that secures quite low funding costs. Increasing competition from relatively smaller players, especially in the retail and SME segments, will likely restrain the bank's margins and push it towards products that can generate more fee income. In the near-term the bank's franchise

strength could also be challenged by the modest credit demand, especially for corporate loans. For 2013 we expect lending growth to be around 10%.

Pension Business - In early 2013 Kazakh authorities decided to consolidate all privately managed pension funds into a single state-controlled fund. This consolidation, which will probably be completed by YE2013, will adversely affect Halyk's revenues as its pension management business, the largest in Kazakhstan, accounted for nearly 10% of the bank's consolidated operating income. From the announcements of the government officials we understand that the current owners of the pension management companies will receive a compensation based on valuation of these businesses. Consequently, the net impact of this disposal on Halyk Bank's credit profile will be clearer when the amount of compensation is determined.

Possible acquisition of BTA Bank (rated E/caa3; Caa1) - Kazakh government has decided to privatise 3 nationalised banks in 2013, including BTA Bank that experienced serious financial problems and defaulted twice in the past several years (2009 and 2012). Following the second debt restructuring BTA Bank's indebtedness was halved and it reported positive capital. One of the options that the Kazakh authorities consider is to swap their share in BTA Bank with Halyk Bank's pension business. We understand that Halyk Bank is considering this option and would make a decision based on the economic rationale of such an acquisition. We believe that the likelihood of BTA Bank's acquisition by Halyk Bank is significant and expect that the transaction will be based on market conditions. We will assess the implications of this possible transaction on Halyk Bank's credit profile if it is to materialize and when its details are announced.

BALANCE-SHEET CONCENTRATIONS REMAIN HIGH

Almex Group is Halyk Bank's controlling shareholder with a 69.4% stake in the outstanding common shares of the bank. The bank is ultimately controlled by Mr. Timur Kulibayev and his spouse Ms. Dinara Kulibayeva, the son-in-law and daughter, respectively, of Kazakhstan's President Nazarbaev.

The bank's credit risk concentration is significant, as the aggregate exposure to the top-20 borrowers accounted for around 150% of the bank's equity at YE2012 (147% at YE2011). Halyk Bank's exposure to the construction and real estate sectors is relatively low (construction - 10%, real estate 7% of the loan portfolio) compared to its main competitors. However, we believe it is still substantial and could continue to hamper the bank's performance, albeit to a less extent than in the past several years as the bank has set up significant loan reserves against these exposures.

High funding concentration at Halyk Bank remains a key challenge. The bank's 20 largest customers accounted for about 46% of the total at YE2012. The lion's share of the largest deposits/current accounts are from the government and government-related entities. The refinancing risks stemming from such a concentration is partly mitigated by a high cushion of liquid assets held by the bank - liquid assets amounted to \$6.9 billion or about 40% of its total assets at YE2012.

GOOD PROFITABILITY WITH RELATIVELY WELL-DIVERSIFIED EARNINGS

Halyk Bank reported a net income of KZT69.96 billion for 2012, 77% higher than in 2011. This led to an annualised RoAA of 2.89%, significantly higher than the 1.78% reported for 2011. The increase was mainly due to lower loan loss charges, but also higher fee income from banking and insurance businesses. Net interest income growth was modest and driven by reduced cost of funding. In the near-term the bank's profitability may come under pressure from lower fee income (due to the disposal of the pension management business). However, a likely rise in net interest income from moderate credit growth, as well as revenues from insurance business will ease this negative pressure.

ASSET QUALITY IS STABILISING

According to the National Bank of Kazakhstan's data, at YE2012, the share of non-performing loans (NPLs 90+ days) in the loan portfolio made up 17% (18.6% at YE2011) whereas the loan loss reserves were 21.8% of the gross loans. We understand that part of the corporate loans have been restructured and are not classified as NPLs. We estimate the bank's problem loans at about 25% of its loan book. We note that underwriting standards, especially for retail loans, have been better at Halyk Bank than they have at many of its competitors. We expect problem loans to remain relatively stable in the near-term, albeit there could be some modest decline in their volumes if the bank transfers some of the problem loans to distressed assets funds. We believe that the bank's loan loss reserves mostly cover expected losses in the current loan book, assuming no drastic deterioration in the economic conditions in Kazakhstan.

ADEQUATE CAPITALISATION

The bank's Tier 1 ratio declined modestly to 16.2% at YE 2012 from 16.7% at YE2011 as it increased its risk-weighted assets and bought back KZT34.2 billion worth of own preferred shares from Samruk-Kazyna - Kazakhstan's sovereign Wealth Fund. In the near-term we believe the bank will have adequate level of capital as its retained earnings should be sufficient to support a moderate loan growth.

Global Local Currency Deposit Rating (Joint Default Analysis)

Halyk Bank's long-term global local currency (GLC) deposit rating is at the Ba2 level, based on Moody's assessment of a moderate probability that systemic support would be extended to the bank in case of need. Consequently, there is a one-notch uplift for the GLC deposit rating from the bank's ba3 standalone credit assessment.

Foreign Currency Debt Rating

Moody's assigns a Ba3 global foreign currency debt rating for Halyk Bank's senior unsecured obligations. No external support is implied in the debt rating of Halyk Bank, therefore it is in line with the bank's ba3 standalone credit assessment.

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. BFSRs 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 BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs 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.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR 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, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which 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 recognize 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 external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

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. AAaa 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

Halyk Savings Bank of Kazakhstan

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (70%)						D	
Factor: Franchise Value						C-	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	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management				x			
Market Risk Appetite			x				
Factor: Operating Environment						E+	Neutral
Economic Stability					x		

Integrity and Corruption							
Legal System				x	x		
Financial Factors (30%)						C	
Factor: Profitability						A	Neutral
PPI % Average RWA (Basel I)	5.49%						
Net Income % Average RWA (Basel I)	2.80%						
Factor: Liquidity						C+	Neutral
(Market Funds - Liquid Assets) % Total Assets	-27.15%						
Liquidity Management				x			
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio (%) (Basel I)	16.73%						
Tangible Common Equity % RWA (Basel I)	12.99%						
Factor: Efficiency						A	Neutral
Cost / Income Ratio	38.77%						
Factor: Asset Quality						E	Neutral
Problem Loans % Gross Loans					21.97%		
Problem Loans % (Equity + LLR)					50.13%		
Lowest Combined Financial Factor Score (9%)						E	
<i>Economic Insolvency Override</i>						Neutral	
Aggregate BFSR Score						D+	
Aggregate BCA Score						baa3/ba1	
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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