FitchRatings

Fitch Affirms Halyk Bank at 'BB'; Outlook Stable

Ratings Endorsement Policy

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Fitch Ratings-Moscow/London-21 January 2015: Fitch has affirmed Halyk Bank's (HB) and its 100%-owned subsidiary JSC Halyk Finance's (HF) Long-term foreign and local-currency Issuer Default Ratings (IDRs) at 'BB' with Stable Outlook. A full list of rating actions is provided at the end of this commentary.

KEY RATING DRIVERS - HB'S IDRS, VR AND SENIOR UNSECURED DEBT RATING
The affirmation of HB's Long-term IDRs and senior debt ratings at 'BB' reflects limited recent changes to the bank's standalone credit profile. HB's Long-term IDRs are driven by its VR of 'bb', which in turn reflects the bank's established nationwide franchise, sound capitalisation, robust profitability, and adequate liquidity. The ratings factor in HB's still high levels of non-performing and restructured loans, high concentrations and significant foreign-currency loans to performing but unhedged borrowers.

The Stable Outlook reflects Fitch's view that that the bank has considerable resilience against risks stemming from a weakening of the operating environment, due to a fall in oil prices, and potential further devaluation of the tenge.

Fitch views asset quality as the main rating weakness, but does not expect it to deteriorate significantly from current levels. The NPL/gross loans ratio fell to 14% at end-9M14 from 18% at end-2013, due to loan write-offs, loan growth and some recoveries. IFRS coverage of NPLs was reasonably solid at 65% by specific reserves and at 107% by total reserves at end-2014. However, potentially high-risk restructured loans, at further 8% of gross loans, were only moderately covered by provisions. A balance sheet clean-up through sale of bad loans to the state-controlled Problem Loan Fund is currently uncertain.

Relationship-driven lending risks may stem from some of HB's long-term and lumpy acquisition financing loans secured by equities, including a large high-risk loan equal to 10% of Fitch Core Capital (FCC). Further risks stem from foreign currency loans extended to unhedged borrowers (about 70% of FCC at end-9M14), which although currently performing, may be stressed if the country devalues the tenge again. As a moderate mitigating factor most of these loans have hard collateral backing them.

Capitalisation has further strengthened as reflected by the FCC/ risk-weighted assets ratio improving to 17.7% at end-9M14 from 14.8% at end-2013. The regulatory total capital ratio also rose to 20.3% from 18.2%. The bank's pre-impairment profit is also robust (39.5% of average equity for 9M14), supporting its solid loss absorption capacity.

Liquidity risks stemming from the increased funding dollarisation (65% of deposits at end-2014, up from 43% at end-2013) are mitigated by HB's highly-liquid asset buffer accounting for KZT493bn (USD2.7bn) or 28% of customer deposits at end-2014. Refinancing risks are also moderate (outstanding eurobonds amounted to USD1bn at end-9M14, 8% of liabilities), with a negligible amount of maturities before 2017. Fitch expects the largest depositor (17% of liabilities) to remain stable.

RATING SENSITIVITIES - HB'S IDRS, VR AND SENIOR UNSECURED DEBT RATING
An upgrade of the ratings would result from a further loan book clean-up, combined with a proven resilience to the depressed oil price environment. The ratings could be downgraded if asset quality or capitalisation deteriorates sharply.

KEY RATING DRIVERS - HB'S SUPPORT RATING AND SUPPORT RATING FLOOR

HB's high systemic importance and political connections make moderate state support possible, as reflected by its 'B' Support Rating Floor and '4' Support Rating. However, large-scale capital support is unlikely to be forthcoming for any privately-owned Kazakh bank, given the recent default history at medium-sized banks.

KEY RATING DRIVERS AND RATING SENSITIVITIES - HF

HF's Long-term IDRs are aligned with the ratings of HB reflecting Fitch's view of the latter's high propensity to provide support to its subsidiary, if needed. Fitch classifies HF as a 'core subsidiary' according to 'Rating FI Subsidiaries and Holding Companies' criteria based on (i) HF's being an integral part of the group, wholly owned and supervised by the parent; (ii) significant reputational risks stemming from a potential default of the subsidiary; and (iii) limited cost of potential support.

HF's ratings would likely change in tandem with the parent bank's Long-term IDRs. The ratings could also be downgraded if support fails to be made available on a timely basis, if needed.

The rating actions were as follows:
Halyk Bank of Kazakhstan
Long-term foreign and local currency IDRs: affirmed at 'BB'; Outlook Stable
Short-term foreign and local currency IDRs: affirmed at 'B'
Viability Rating: affirmed at 'bb',
Support Rating: affirmed at '4'
Support Rating Floor: affirmed at 'B'
Senior unsecured debt: affirmed at 'BB'/'BB(EXP)'

JSC Halyk Finance
Long-term foreign and local currency IDRs: affirmed at 'BB'; Outlook Stable
Short-term foreign and local currency IDRs: affirmed at 'B'
Support Rating: affirmed at '3'

Contacts:

Primary Analyst
Roman Kornev (HB, HF)
Director
+7 495 956 7016
Fitch Ratings CIS Ltd
26 Valovaya Street
Moscow 115054

Secondary Analysts
Aslan Tavitov (HB)
Associate Director
+7 495 956 7065

Evgeny Konovalov (HF)
Associate Director
+7 495 956 9932

Committee Chairperson
Olga Ignatieva
Senior Director
+7 495 956 6906

Media Relations: Elaine Bailey, London, Tel: +44 203 530 1153, Email: elaine.bailey@fitchratings.com; Ksenia Ivanova, Moscow, Tel: +7 495 956 99 01, Email: ksenia.ivanova@fitchratings.com.

Additional information is available on www.fitchratings.com.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 31 January 2014, are available at www.fitchratings.com.

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