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Credit Opinion: DBK Leasing

Global Credit Research - 30 Jun 2014

Astana, Kazakhstan

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	Ba3
Issuer Rating	Ba3
Senior Unsecured -Dom Curr	Ba3
ST Issuer Rating	NP

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Key Indicators

DBK Leasing (Unconsolidated Financials)[1]

	[2]12-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total Assets (KZT billion)	43.2	43.9	34.8	40.0	35.6	[3]5.0
Total Assets (USD billion)	0.3	0.3	0.2	0.3	0.2	[3]4.0
Tangible Common Equity (KZT billion)	14.6	8.0	5.2	8.9	8.7	[3]14.0
Tangible Common Equity (USD billion)	0.1	0.1	0.0	0.1	0.1	[3]12.9
Net Interest Margin (%)	4.1	2.7	1.3	2.1	3.5	[4]2.7
(Market Funds - Liquid Assets) / Total Assets (%)	14.7	50.9	53.3	41.7	45.2	[4]41.2
Cost / Income Ratio (%)	118.3	61.9	-69.1	46.9	26.1	[4]36.8
Problem Loans / Gross Loans (%)	45.8	38.3	40.4	32.3	8.8	[4]33.1
Problem Loans / (Equity + Loan Loss Reserves) (%)	49.7	92.1	127.0	82.8	18.5	[4]74.0

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

Opinion

SUMMARY RATING RATIONALE

The Ba3 corporate family rating (CFR) and issuer rating assigned to DBK Leasing (DBKL) reflect a combination of the company's intrinsic credit qualities and our assessment of a high probability of support for DBKL from its parent, the Development Bank of Kazakhstan (DBK).

The Ba3 CFR and issuer rating incorporate a three-notch uplift from the company's standalone credit assessment of b3, which is based on our assessment of the very high probability of extraordinary support from the parent. The very high probability of parental support reflects: (1) DBKL's 100% ownership and around 54% non-equity funding by DBK as of year-end 2013 - which has a baseline credit assessment of ba3 and an issuer rating of Baa3 in accordance with Moody's government-related issuers (GRI) methodology; (2) DBKL's relatively small size, which enables the parent to extend the necessary level of support to DBKL in the event of need; and (3) DBKL's good fit with DBK's strategy. DBKL is highly dependent on the parent, which currently provides most of its funding, capital and the bulk of the leasing projects.

According to the company's audited financial statements under International Financial Reporting Standards (IFRS) as at YE2013, DBKL reported total assets of KZT43.2billion ($281.2million), shareholders equity of KZT14.3 billion ($93.1 million), and net loss of KZT4.8 billion ($31.2 million).

Rating Drivers

- Enhanced capital position provides acceptable loss absorption capacity against weak asset quality and profitability

- Track record of regular parental support, and participation in state-led programmes and joint projects with DBK, which increases the probability of further support

- Satisfactory liquidity position

Rating Outlook

The outlook on DBKL's ratings is stable.

What Could Change the Rating - Up

Upward pressure could be exerted on the ratings as a result of improving asset quality and profitability.

What Could Change the Rating - Down

A further material deterioration of DBKL's leasing book quality affecting the company's capital cushion could have negative rating implications, as well as any downgrade of the parent's ratings. Signs of a diminished willingness on the part of DBK to further develop DBKL, or the parent's decision to privatise the company could also exert negative pressure on the company's ratings.

DETAILED RATING CONSIDERATIONS

DBKL is an indirectly government-owned leasing company that was established by DBK for offering small-ticket leasing products to the market. DBKL initially focused on leasing to newly established textile manufacturers, but later diversified into other industries, such as transportation and logistics, manufacturing, infrastructure building, and machinery manufacturing. DBKL's niche is in providing leasing services for companies from the non-extractive industry sectors, in line with the government's policy of diversifying the national economy.

Following the global financial crisis, DBKL remained one of the most active players in the Kazakhstani leasing market along with another government owned company.

ENHANCED CAPITAL POSITION PROVIDES ACCEPTABLE LOSS ABSORPTION CAPACITY AGAINST WEAK ASSET QUALITY AND PROFITABILITY

In 2013 DBKL received KZT11.44 billion (about $75 million) of equity injection from its parent. This injection more than doubled the company's shareholders' equity, which reported a very strong Equity-to-Assets ratio of 33.1%% at -YE2013, according to the company's audited IFRS financial statements. We believe that the company's enhanced capital will be sufficient to absorb losses stemming from its weak asset quality and earnings generations in the next 12-18 months.

The company's key areas of risk are (1) weak asset quality eroding earnings, stemming from the company's underdeveloped underwriting practices, seasoning leasing portfolio and the overall economic environment in Kazakhstan which poses challenges to small and medium-sized private sector players; and (2) the high concentration in the leasing book, as exposure to its 20 largest projects accounted for over 86% of the total lease portfolio as at YE2013. The FX risk is notable (a short US dollar position), as reflected in FX borrowings from the parent. This FX risk is transferred into credit risk by having the leasing agreement stipulate that payments are linked to the US dollar, rendering the lessees' credit quality sensitive to currency movements. We note that tenge devaluated by 19% against US dollar in Q1 2014, which might put further pressure on asset quality constraining some borrowers' further creditworthiness.

According to the IFRS, 45.8% of its leasing book was overdue over 90 days as of YE2013. Against these problem leases the company held reserves of 31.3% of the leasing book. Although the loan loss reserve coverage improved within 2013, we believe it is still not sufficient to cover all expected credit losses and will likely increase over the next 12-18 months.

Higher provisioning burden will continue to put pressure on the company's already weak operating profitability. DBKL reported a loss of KZT223 million on a pre-provision basis in 2013 compared to a marginal pre-provision profit of KZT450 million in 2012. Final profitability results in 2013 were largely undermined by 19% credit costs (new loan loss provisions/gross loan book), which caused a net loss of KZT 4.8 billion.

SATISFACTORY LIQUIDITY POSITION

DBKL maintains an ample liquidity cushion amounting to 33.4%of total assets as of -YE2013. We believe that possible liquidity problems arising from the recent contraction of cash flow generated by DBKL's leasing portfolio are mitigated by the company's high reliance on parental funding (54% of liabilities as of YE2013 , down from 67% at YE2012 as most of the equity injection proceeds were used to repay part of the parental funding). We note that, although the company does not have to comply with Kazakhstani banking regulations, it reports its risk positions to DBK, which supervises DBKL's activity.

Unless noted otherwise, data in this report is sourced from company reports and Moody's Banking Financial Metrics.

Global Local Currency Issuer and Corporate Family Ratings

DBKL's Ba3 global local currency (GLC) issuer and corporate family ratings benefit from (i) our assessment of a very high probability of parental support in the event of need (given the company's 100% ownership by DBK); (ii) the company's relatively moderate size (i.e., greater chance DBK will provide support); and (iii) good fit with its parent's strategy.

Foreign Currency Issuer and Corporate Family Ratings

The company has Ba3 long-term issuer and corporate family ratings.

Local Currency Debt Rating

The Ba3 local currency debt rating is derived from DBKL's corporate family rating and seniority of issued debt.

Rating Factors

DBK Leasing

Rating Factors	**Aa/A**	**Baa**	**Ba**	**B**	**Caa**	**Historical View**	**Forward View**
Non-Financial Factors						**B**	**B**
Factor: Franchise Value						**B**	**B**
- Market Position and Sustainability				x			
- Operational Diversification				x			
Factor: Risk Positioning						**B**	**B**
- Potential Volatility of Assets/Cashflows				x			
- Governance and Management Quality				x			
- Risk Management [1]				x			
- Key Relationship Concentrations				x			
- Liquidity Management				x			
Factor: Operating Environment [2]						**B**	**B**
- Economic Strength			x				
- Institutional Strength				x			
- Susceptibility to Event Risk			x				
Financial Factors						**B**	**B**

Factor: Profitability						Caa		Caa
- PPI / AMA					-0.38%			
- Net Income / AMA					-3.00%			
- Pre-tax Income Coefficient of Variation					73.23%			
Factor: Liquidity						Aa/A		Aa/A
- 24 Month Coverage Ratio	100.00%							
- Secured Debt / Gross Tangible Assets	0.00%							
Factor: Capital Adequacy						Ba		Caa
Capital Bucket: Equipment Lessor								
- TCE / TMA			18.30%					
Factor: Asset Quality						Caa		Caa
- Problem Loans / Gross Loans					31.70%			
- Problem Loans / (Shareholders Equity + LLR)					87.80%			
- Lease Residual Value Exposure to TCE			155.57%					
Scorecard estimated stand-alone credit assessment:						B2		B3
Assigned stand-alone credit assessment:							B3	

[1] Capped at B; the risk management sub factor score will not exceed the weighted average of scores assigned to a firm's other risk positioning sub factor scores. [2] The operating environment score will not exceed the weighted average of scores assigned to a firm's other non-financial factors.

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