

**Credit Opinion: Eximbank Kazakhstan**

**Eximbank Kazakhstan**

*Kazakhstan*

**Ratings**

Category	Moody's Rating
Outlook	Stable
Bank Deposits	B2/NP
Bank Financial Strength	E+

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**Key Indicators**

**Eximbank Kazakhstan**

	[1]2006	2005	2004	2003	4-Year Avg.
Total Assets (US\$ million)	171.89	76.36	42.50	24.35	--
Shareholders' Equity (US\$ million)	70.39	46.42	34.34	9.88	--
Return on Average Assets	12.83	16.80	27.25	30.60	21.87
Recurring Earnings Power [2]	7.51	6.42	-1.65	-1.65	2.66
Net Interest Margin	9.40	12.07	5.37	10.65	9.37
Cost/Income Ratio (%) [3]	37.87	51.00	127.61	133.60	87.52
Problem Loans % Gross Loans	--	--	--	--	--
Equity % Assets	40.95	60.79	80.79	40.56	55.77

[1] As of December 31. [2] Preprovision income % average assets [3] Non-Interest Expense % Operating Income

**Opinion**

**SUMMARY RATING RATIONALE**

Moody's assigns a bank financial strength rating (BFSR) of E+ to Eximbank Kazakhstan (Eximbank), which translates to a Baseline Credit Assessment of B2. The rating is constrained by the bank's weak franchise and significant concentrations on both sides of the balance sheet, but is underpinned by its strong capitalisation.

Moody's assigns a long-term global local currency (GLC) deposit rating of B2 to Eximbank. Although support from the bank's shareholders cannot be ruled out, its volume and timeliness are rather uncertain. The probability of systemic support in the event of a stress situation is judged to be none, based on the bank's insignificant national market share and relative importance to the country's banking system. Consequently the bank's GLC deposit rating is at the same level as its B2 Baseline Credit Assessment.

**Credit Strengths**

- Sound capitalisation
- Improving asset quality
- Possibility to offer certain retail products to the employees and customers of the bank's parent company, JSC

Central Asian Energy Company (CAEC)

### **Credit Challenges**

- Small and underdeveloped franchise
- Large concentrations on both sides of the balance sheet
- Still-evolving corporate governance and risk management system
- Strong competition in Kazakhstan's SME and retail lending market

### **Rating Outlook**

All of Eximbank's ratings carry a stable outlook.

### **What Could Change the Rating - Up**

Significant reduction in the concentrations on both sides of the balance sheet coupled with good asset quality could exert positive pressure on the bank's ratings.

### **What Could Change the Rating - Down**

Downward rating pressure could arise from a failure to reduce balance-sheet concentrations or in the event of a material deterioration in asset quality.

### **Recent Results and Developments**

Eximbank reported total IFRS consolidated assets and net income of US\$172 million and US\$16.2 million, respectively, at year-end 2006 (US\$76 million and US\$9.9 million, respectively, a year before). Net income growth was attributable to both increased interest income and recovery of previously written-off loans, with the latter accounting for 41% of pre-tax income in 2006.

The bank does not have a licence to take private deposits but expects to get one in 3Q2007.

### **DETAILED RATING CONSIDERATIONS**

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

#### **Bank Financial Strength Rating**

Moody's assigns an E+ BFSR to Eximbank, reflecting the bank's strong capitalisation and improving asset quality, but also its weak franchise and significant concentrations on both sides of the balance sheet.

As a point of reference, the assigned BFSR is two notches lower than the D outcome of Moody's bank financial strength scorecard. Moody's believes the scorecard outcome does not appropriately reflect the risks associated with high concentrations on both sides of the balance sheet.

Qualitative Factors (70%)

Factor 1: Franchise Value

Trend: Neutral

The bank's majority shareholder CAEC (68.9% of total shares at 1Q2007) is a holding company with investments in electricity generation and distribution, chemical production, transport, etc. Eximbank's weak franchise is characterised by its immaterial market share and the geographical concentration of the bank's business in Kazakhstan. The bank has targeted SME and retail lending markets and is in the process of expanding its distribution network. Currently, Eximbank has six branches in different regions of the country and plans to have 12 branches by the YE2007.

The bank scores E for franchise value.

Factor 2: Risk Positioning

Trend: Neutral

Corporate governance and risk management systems are still evolving in the bank. Although significant work has been done by the bank to set up and maintain adequate business processes and practices, we believe that there is still some room for improvements in this area. Related party lending and borrower concentration are among the main concerns in terms of risk management.

We believe that the bank's rapid asset growth and increasing risk exposures may require more robust risk management and control systems.

Market risk exposure is also material, given the bank's notable investments in trading securities and very large open foreign currency position. The assets/liabilities maturity gap is strongly positive because of the bank's overcapitalisation. With the growth of the bank's assets, the situation is expected to change gradually. However, the bank is heavily reliant on corporate deposits, which account for approximately 40% of total funding.

Eximbank scores E for risk positioning.

### Factor 3: Regulatory Environment

Please refer to our forthcoming Banking System Outlook for Kazakhstan for a detailed discussion of the regulatory environment.

### Factor 4: Operating Environment

Trend: Neutral

This factor is also common to all Kazakh banks. Moody's assigns an E+ score for the overall operating environment.

### Quantitative Factors (30%)

#### Factor 5: Profitability

Trend: Neutral

In 2006, Eximbank reported a 55% increase in net income, which translates to ROAA of 12.83%. Net income growth was attributable to both increased interest income and recovery of previously written-off loans, the latter accounting for 41% of pre-tax income in 2006.

Eximbank scores D for profitability. However, we believe that this score does not fully capture our estimates of the bank's weaker asset quality. Consequently, we have adjusted this score to E+.

#### Factor 6: Liquidity

Trend: Neutral

The assets/liabilities maturity gap is strongly positive because of the bank's overcapitalisation. With the growth of the bank's assets, the situation is expected to change gradually. However, the bank is heavily reliant on a limited number of corporate deposits. The top 20 deposits accounted for almost 90% of total deposits, whereas total deposits' share in total funding was 40% at year-end 2006. We expect that, after securing a licence to take private deposits, Eximbank will diversify its funding profile - although not to a large extent.

The bank scores D for liquidity.

#### Factor 7: Capital Adequacy

Trend: Weakening

Currently the bank is overcapitalised, with a Tier 1 ratio of 40% at year-end 2006. However, we expect that the rapid asset growth will push the bank's capital adequacy to more moderate levels in the medium term.

Eximbank scores A for capital adequacy. After an adjustment to reflect our estimate of the bank's weaker asset quality, the score for capital adequacy remains A.

#### Factor 8: Efficiency

Trend: Neutral

For the past three years, Eximbank has been reporting notable improvements in efficiency, with the cost-to income ratio declining to 38% in 2006 from 127% in 2004. Nevertheless, we expect that the expenditure necessary for expanding the bank's branch network will constrain Eximbank's efficiency indicators in the medium term.

The bank scores D for efficiency.

Factor 9: Asset Quality

Trend: Neutral

The bank is in the process of recovering part of the loans it had previously written off. At end-1Q2007, problem loans accounted for 4.9% of total loans. However, these loans are generously covered by loan loss provisions, which stand at 9% of the loan book.

The bank scores C+ for asset quality. However, we believe this score does not fully capture the risks of very high borrower concentrations. We have therefore adjusted the score to D.

### **Global Local Currency Deposit Rating (Joint Default Analysis)**

Moody's assigns a long-term global local currency (GLC) deposit rating of B2 to Eximbank. Although support from the bank's shareholders cannot be ruled out, its volume and timeliness are rather uncertain. The probability of systemic support in the event of a stress situation is judged to be none, based on the bank's insignificant national market share and relative importance to the country's banking system. Consequently, the bank's GLC deposit rating is at the same level as its B2 Baseline Credit Assessment.

### **Foreign Currency Deposit Rating**

Moody's assigns a B2 foreign currency deposit rating to Eximbank. The rating is not constrained by the foreign currency deposit ceiling for Kazakhstan.

## **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. A Aaa 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

#### Rating Factors

#### Eximbank Kazakhstan

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
<b>Qualitative Factors (70%)</b>						<b>E+</b>	
<b>Factor 1: Franchise Value (7%)</b>						<b>E</b>	<b>Neutral</b>
<b>Market Share and Sustainability</b>					x		
<b>Geographical Diversification</b>					x		
<b>Earnings Stability</b>					x		
<b>Earnings Diversification [2]</b>							
<b>Factor 2: Risk Positioning (21%)</b>						<b>E</b>	<b>Neutral</b>
<b>Corporate Governance [2]</b>					x		
- Ownership and Organizational Complexity					x		
- Key Man Risk					x		
- Insider and Related-Party Risks				--	--		
<b>Controls and Risk Management</b>					x		
- Risk Management					x		
- Controls					x		
<b>Financial Reporting Transparency</b>			x				
- Global Comparability	x						
- Frequency and Timeliness					x		
- Quality of Financial Information				x			

<b>Credit Risk Concentration</b>	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
<b>Liquidity Management</b>					<b>x</b>		
<b>Market Risk Appetite</b>					<b>x</b>		
<b>Factor 3: Regulatory Environment (21%)</b>						<b>-</b>	<b>-</b>
<b>Factor 4: Operating Environment (21%)</b>						<b>E+</b>	<b>Neutral</b>
<b>Economic Stability</b>					<b>x</b>		
<b>Integrity and Corruption</b>					<b>x</b>		
<b>Legal System</b>				<b>x</b>			
<b>Financial Factors (30%)</b>						<b>C-</b>	
<b>Factor 5: Profitability (4.7%)</b>						<b>D</b>	<b>Neutral</b>
<b>PPP % Avg RWA</b>				1.20%			
<b>Net Income % Avg RWA</b>				0.60%			
<b>Factor 6: Liquidity (4.7%)</b>						<b>D</b>	<b>Neutral</b>
<b>(Mkt funds-Liquid Assets) % Total Assets</b>			9.38%				
<b>Liquidity Management</b>					<b>x</b>		
<b>Factor 7: Capital Adequacy (4.7%)</b>						<b>A</b>	<b>Weakening</b>
<b>Tier 1 ratio (%)</b>	61.00%						
<b>Tangible Common Equity % RWA</b>	61.00%						
<b>Factor 8: Efficiency (2.1%)</b>						<b>D</b>	<b>Neutral</b>
<b>Cost/income ratio</b>				72.16%			
<b>Factor 9: Asset Quality (4.7%)</b>						<b>C+</b>	<b>Neutral</b>
<b>Problem Loans % Gross Loans</b>			4.90%				
<b>Problem Loans % (Equity + LLR)</b>		15.00%					
<b>Lowest Combined Score (9%)</b>						<b>D</b>	
<b>Economic Insolvency Override</b>						<b>Neutral</b>	
<b>Total Scorecard Implied BFSR</b>						<b>D-</b>	
<b>Assigned BFSR</b>						<b>E+</b>	

[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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