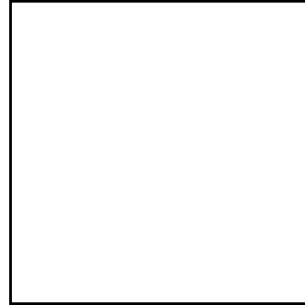


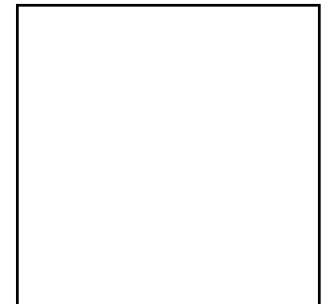
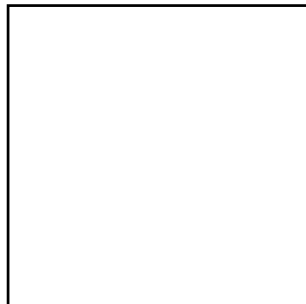
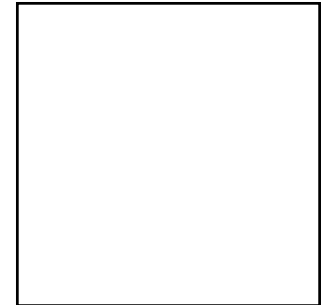
VI Almaty Interbank Conference of CIS and Baltic States  
20-22 September 2005, Almaty

**FitchRatings**  
KNOW YOUR RISK



**Kazakhstani banking sector: sound fundamentals but risks remain**

James Watson  
Director, Financial Institutions  
Fitch Ratings, Moscow



## Highlights

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- > Sector has expanded rapidly and significant growth potential remains
- > Sector is well regulated for an emerging market and with quite a high level of consolidation
- > Sound performance, moderate market risk exposures, reasonable liquidity and low related party business are rating positives for most banks
- > However, ratings are constrained by a still relatively high-risk operating environment, rapid credit growth, significant loan concentrations and moderate core capital ratios

## Kazakh Bank Ratings

Issuer	LT FX	Outlook	ST FX	Individual	Support
<b>KAZAKHSTAN</b>					
Development Bank of Kazakhstan	BBB-	Stable	F3	-	2
Bank Turan Alem	BB	Stable	B	C/D	3
Halyk Bank of Kazakhstan	BB	Stable	B	C/D	3
Kazkommertsbank	BB	Stable	B	C/D	3
Aliance Bank	B+	Stable	B	D	4
ATF Bank	B+	Stable	B	D	4
Bank Caspian	B+	Stable	B	D	5
Bank Centercredit	B+	Stable	B	D	4
Temirbank	B	Stable	B	D	5

## Operating Environment - Highlights

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- > Strong GDP growth (2004: 9.4%; 2005F: 8.5-9%) has contributed to increased demand for banking services, fuelling expansion of the sector . . .
- > . . . while also creating a more favourable credit environment and thus supporting asset quality
- > Upgrades of the Kazakhstani sovereign (LTFC 'BBB-', LTLC 'BBB') have been driven primarily by improvements in public finances
- > Exchange rate stability has reduced currency risks for banks . . .
- > . . . and moderate, stable inflation has helped to reduce interest rate volatility, while also putting pressure on margins

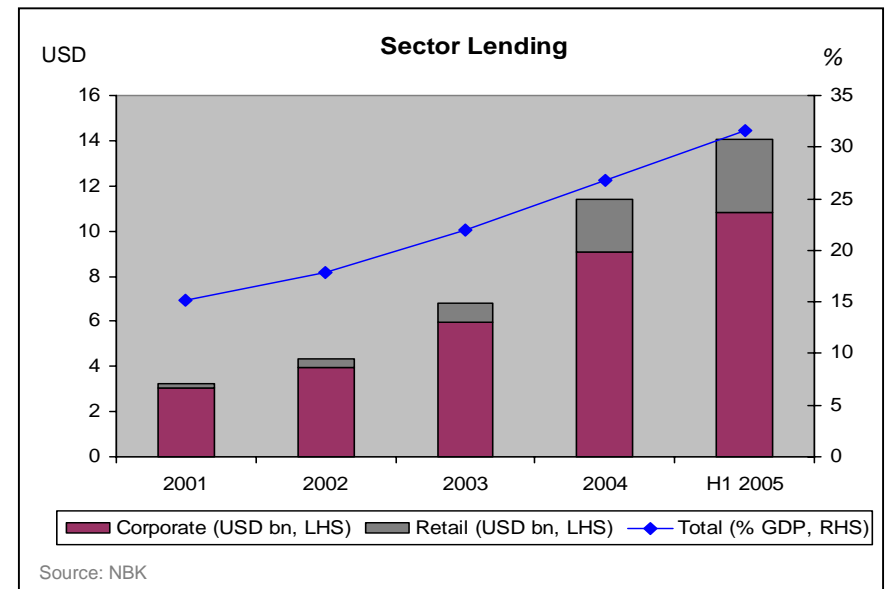
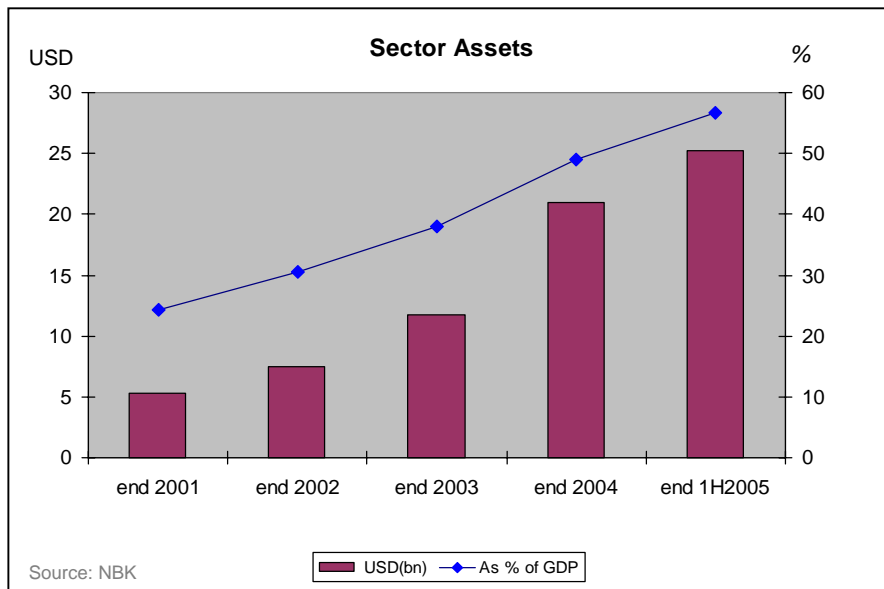
## Banking Sector Regulation

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- > Strong track record of banking sector supervision by Kazakhstani regulators
- > FMSA committed to introducing international best practice in sector regulation; Basel II to be phased in by 2009
- > Sector consolidation and IFRS adoption are key factors facilitating regulation, compared to other major CIS markets
- > Sound minimum capital requirements, rigorous loan classification and provisioning procedures and enforcement of related party lending limits are important aspects of regulation

## Sector Growth

- > Banking sector growth has been substantial in recent years, both in absolute terms and relative to GDP



## Sector Growth Potential

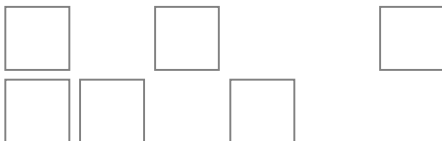
> Considerable growth potential remains ...

Private Credit* (% of GDP), end-2004	
<b>Selected 'A' rated countries:</b>	
Chile	63.1
China	140.6
Czech Republic	33.4
Hungary	46.9
Malaysia	97.9
<b>Average for 'A' rated countries</b>	<b>73.9</b>
<b>Selected 'BBB' rated countries:</b>	
Croatia	57.5
<b>KAZAKHSTAN</b>	<b>28.2</b>
Mexico	16.5
Poland	27.8
Russia	24.6
Thailand	75.4
<b>Average for 'BBB' rated countries</b>	<b>43.7</b>
<b>Selected 'BB' rated countries:</b>	
Brazil	27.6
Egypt	49.6
India	32.8
Indonesia	28.1
Turkey	20.5
Ukraine	24.9
<b>Average for 'BB' rated countries</b>	<b>31.4</b>

Source: Fitch Ratings

> ... but this is tempered by the fact that the large oil and gas sector is not a major borrower from the banking sector

\*Year-end stock of domestic credit to the private sector and non-financial public sector enterprises by deposit money banks



## Sector Structure

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- > Sector is highly consolidated, with top three banks having c.58% of assets, and top six banks c.79%, at end-1H05
- > High degree of consolidation facilitates sector regulation, increases economies of scale and helps to diversify risk concentrations
- > Significant market shares of top banks are also a key driver of Fitch's view of likely support from authorities
- > Minimal state ownership has helped to create level playing field . . .
- > . . . although fierce competition is eroding margins and could be weakening underwriting standards at smaller banks
- > Foreign banks not yet major players, although acquisitions of top domestic banks are possible in the short- to medium-term



## Corporate Governance

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- > Banks are generally closely held; no liquid market in equity of any Kazakhstani bank
- > Predominance of large single shareholders can weaken corporate governance, expose banks to political risks and reduce their capital flexibility
- > However, shareholders are usually not closely involved in day-to-day bank management, and related party business is generally low
- > Board oversight stronger at banks with minority foreign shareholders

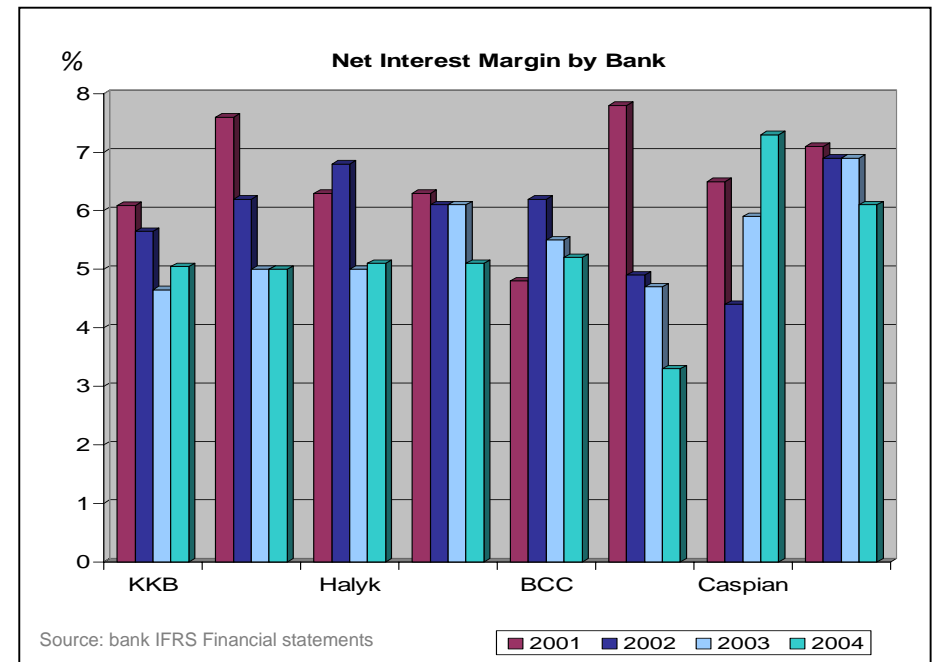
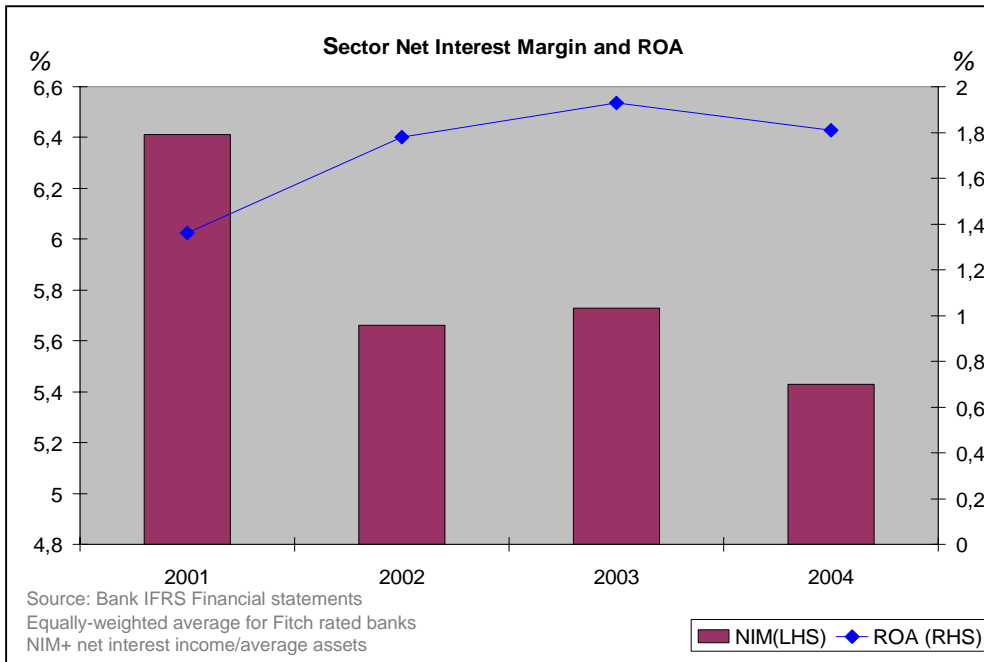
## Performance

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- > Bottom-line performance ratios have been strong, with most leading banks reporting 2004 ROA in the 1.5-2.5% range
- > Profitability achieved notwithstanding high provision charges caused mainly by strong loan growth
- > Revenue structures are generally sound, with trading and non-core operations not major contributors to income
- > Corporate lending margins have fallen, but this is being partially offset by expanding volumes of higher-margin SME and retail business
- > Asset quality and operating efficiency will be key drivers of future performance; auxiliary asset management, pension fund and insurance businesses may also help to diversify revenue streams

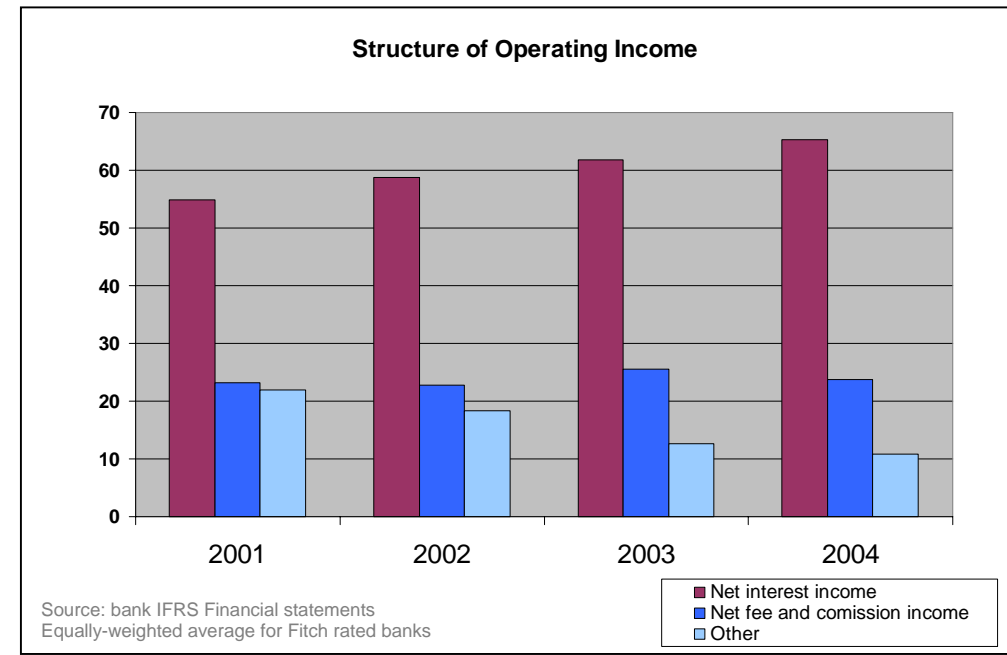
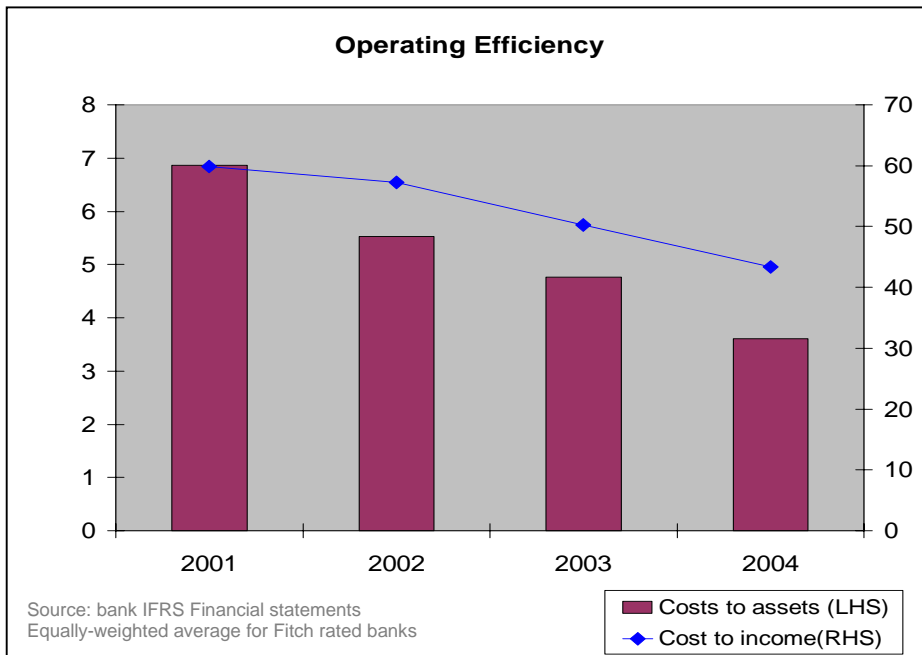
## Performance

Bottom-line profitability has remained strong despite reduction in corporate lending margins



## Performance

Improved operating efficiency has supported performance...



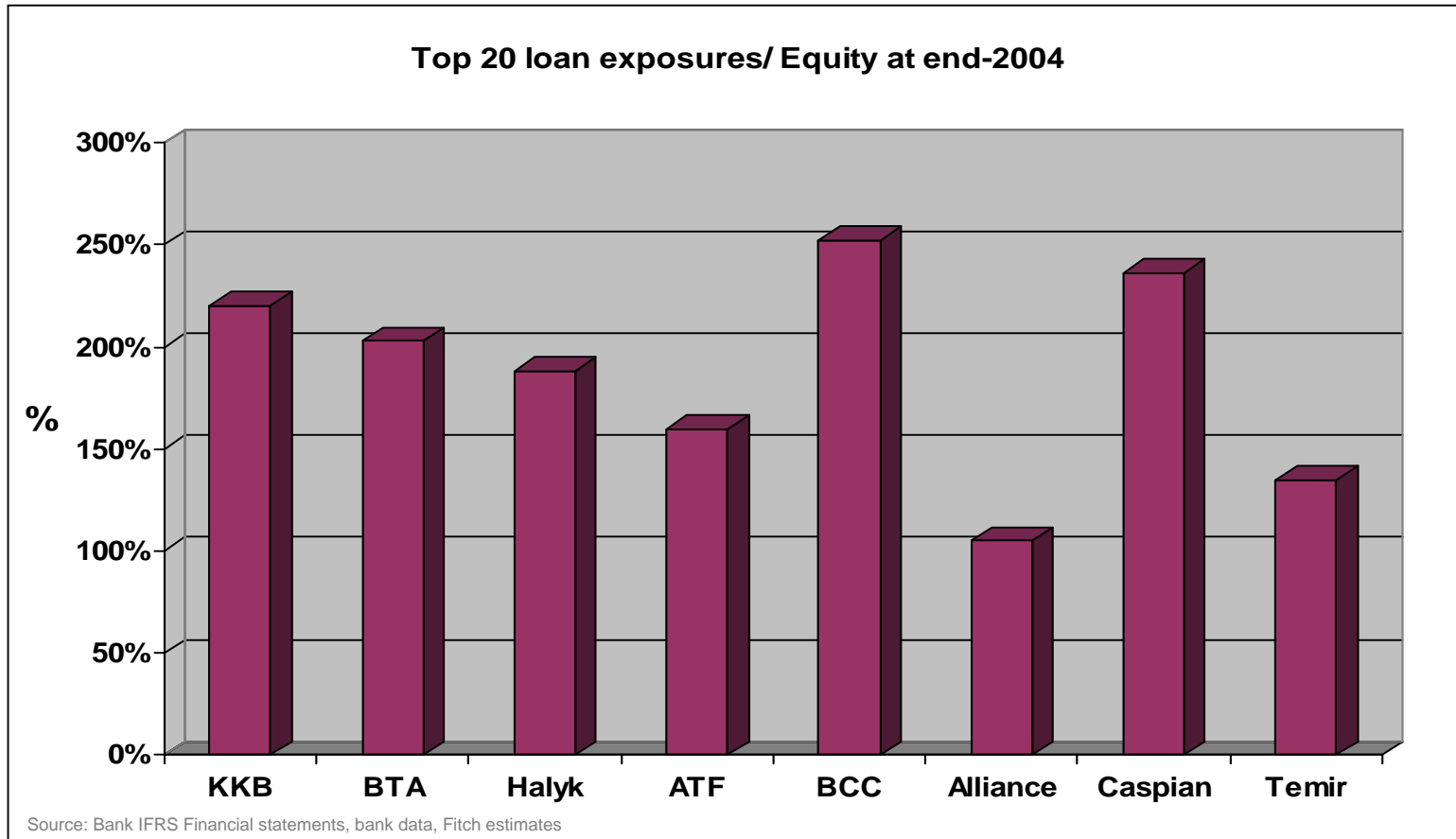
...while revenue structures have gradually improved

## Credit Risk

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- > Favourable credit environment has supported asset quality for last few years and NPL levels have been low . . .
- > . . . but loan impairment could increase as fast-growing portfolios season, or in case of an economic slowdown
- > Lending to potentially more high-risk sectors, such as SMEs, construction and agriculture, has increased, while retail portfolios are, to date, also untested
- > Exposures to other CIS markets, where banks have poorer market knowledge and legal systems might be less reliable, have also risen
- > Substantial increase in longer-term lending raises importance of customer and collateral assessments
- > Loan concentration levels remain high relative to equity, although related party exposures are normally not significant

## Loan Concentrations



## Market Risk

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- > Market risk exposures of Kazakhstani banks are generally moderate
- > Securities portfolios contain mainly domestic sovereign and highly-rated foreign debt
- > Portfolio durations can be high, although interest rate exposures should be considered in context of overall balance sheet structures
- > Interest rate derivatives increasingly used to hedge risk of floating rate liabilities
- > Foreign exchange positions tend not to be significant and exchange rate has been stable; 'ratchet-effect' of FX-linked KZT loans used by some banks to hedge risks

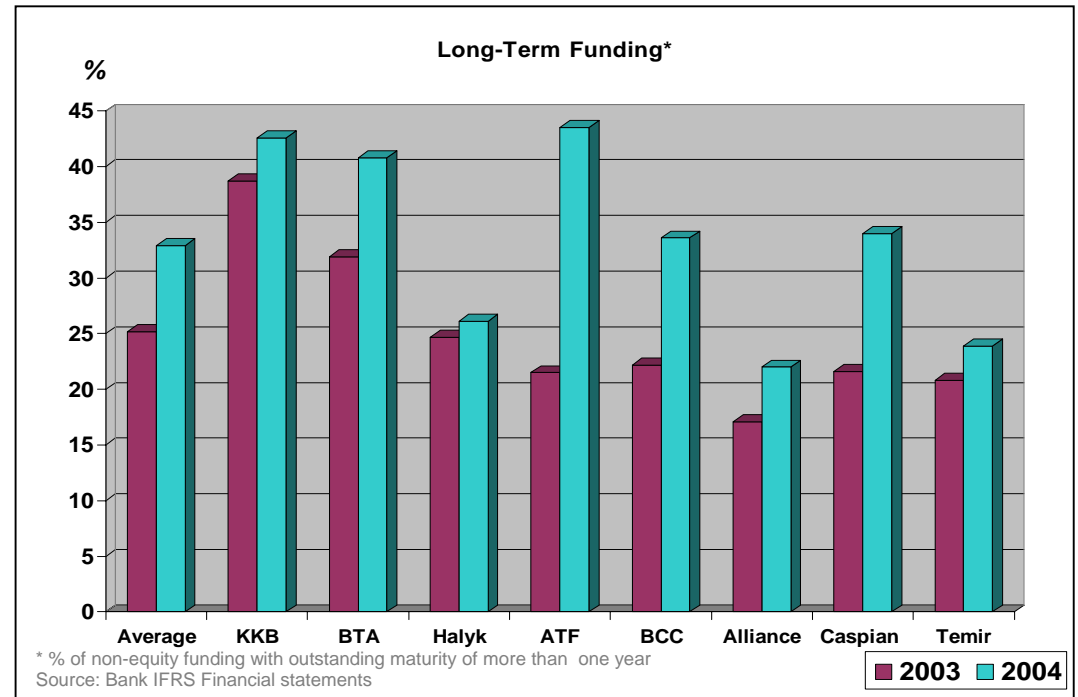
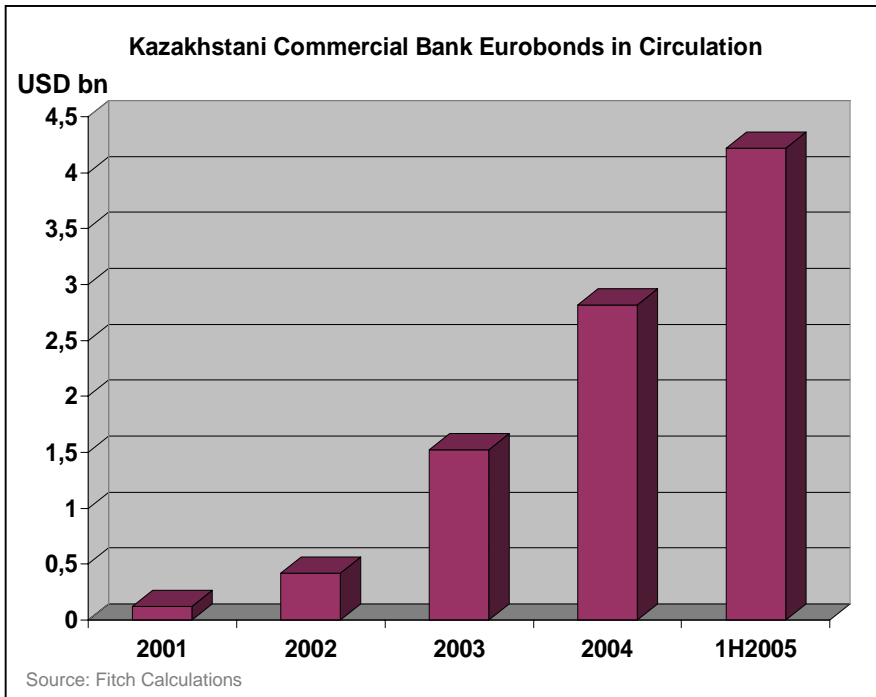
## Liquidity and Funding

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- > High liquid assets ratios, with interbank and securities exposures generally of good quality
- > Good access of all leading banks to longer-term international debt and bank funding
- > Maturity mismatches not as substantial as in many Russian and Ukrainian banks
- > Retail term deposits remain 'putable', but bank funding has proved relatively stable to date



## Liquidity and Funding

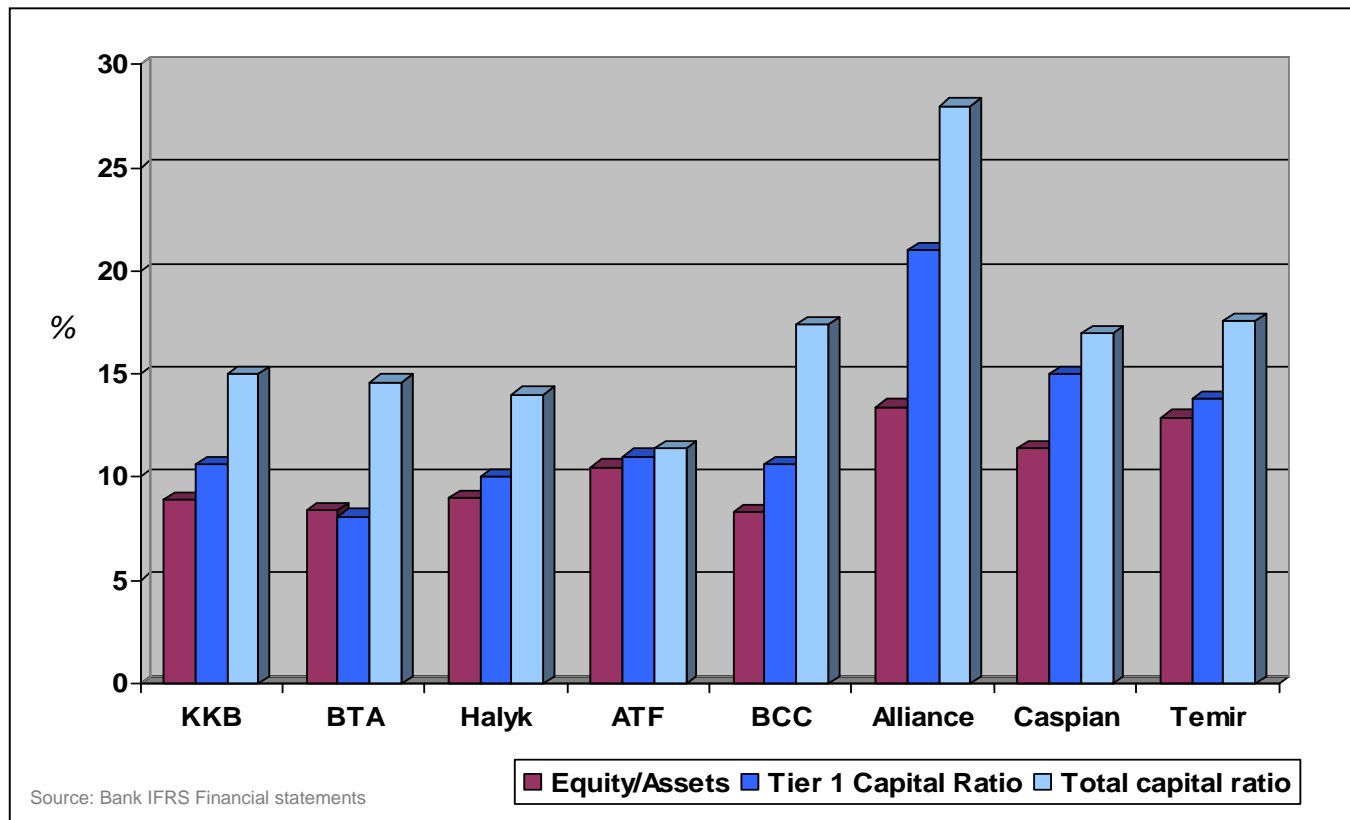


## Capital

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- > Total capital ratios are reasonable at most rated banks, and the aggregate sector ratio was a sound 15.9% at end-2004
- > However, core equity is on the low side in some cases, especially given loan concentrations and growth rates
- > Internal capital generation is not usually sufficient to finance business expansion (average ROE of 19% vs. asset growth of 67% in 2004)
- > Core shareholders not always able to make additional equity contributions, and may not be willing to dilute stakes
- > Subordinated debt and hybrid capital can be placed on both domestic and international markets
- > Low related party exposures and reasonable fixed asset ratios mean that capital quality tends to be satisfactory

## Capital Ratios at End-2004



## Key Rating Drivers

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The following are some of the main factors which will determine the direction of Kazakhstani bank ratings in the short- to medium-term:

- > the level of sovereign ratings, as changes could affect the rating support floors for leading banks
- > further improvements in the operating environment, in particular in respect to the credit risk of Kazakhstani borrowers
- > banks' ability to effectively manage growth and preserve asset quality as balance sheets continue to expand
- > maintenance of sound capital ratios
- > diversification of risk concentrations, especially as regards single borrowers

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