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Research Update:

Kazakhstan-Based Nurbank 'B/B' Ratings Affirmed; Outlook Stable

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Overview

- Nurbank has been able to significantly reduce its legacy problem loans in 2013-2014 and we expect the bank's nonperforming loans to remain below 15% in 2015.
- At the same time, the bank's profitability remains poor and insufficient to build up enough capital internally to match asset growth, resulting in gradual erosion of its capital base.
- Therefore, we are affirming our 'B/B' and 'kzBB+' ratings on Nurbank.
- The stable outlook balances our expectation that Nurbank will continue its new business generation and gradual reduction of legacy problem assets while maintaining capitalization and liquidity at current levels.

Rating Action

On Feb. 26, 2015, Standard & Poor's Ratings Services affirmed its 'B/B' long- and short-term counterparty credit ratings on Kazakhstan-based Nurbank JSC. The outlook is stable.

At the same time, we affirmed our 'kzBB+' Kazakhstan national scale rating on the bank.

Rationale

The affirmation reflects two opposite dynamics affecting Nurbank:

- Capital ratios that are continuing to weaken from previously strong levels, as profitability is not robust enough to build up capital internally and to match dynamic asset growth. We expect capitalization to remain at adequate levels in 2015-2016 though; and
- The clean-up of sizable legacy problem assets and reduction of exposure to the risky real estate and construction sectors, which has improved the bank's risk profile.

Nurbank is operating in the context of a deterioration of economic prospects in Kazakhstan and risks of further depreciation of the Kazakhstani tenge (KZT) in 2015, which could weaken Kazakh banks' asset quality and funding.

Overall, in our view the combined capital and risk positions remain a negative rating factor for Nurbank. We have revised our capital and earnings assessment to "adequate" from "strong", and our assessment of risk position to "moderate" from "weak," as defined in our criteria.

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We expect our risk-adjusted capital (RAC) ratio to be in the 7.0%-7.7% range in 2015-2016. Loan balances (new loan generation and movement of legacy problem loans off balance sheet) and provisioning expenses greatly influence our RAC ratio. If the bank's future growth and provisioning rates and its capital policy and philosophy differ from our current expectations, we could revise our RAC forecast.

Our forecast for 2015-2016 is based on the following assumptions for Nurbank:

- Loan growth of about 5%-10% annually.
- No shareholder capital injections.
- Low earnings contribution to the capital base with return on assets of about 1%.
- Cost of risk of 1.5%-2%.

Nurbank's profitability has been historically poor. In the first nine months of 2014, Nurbank achieved a modest ROA of 1% and return on equity (ROE) of 7.3%. We expect the more dynamic generation of new business and problem loan recoveries to support gradual profitability improvements in 2015-2016, but this will largely depend on the magnitude of the slowdown in Kazakhstan. However, we expect the bank's profitability to remain modest.

At the same time, from a ratings perspective, we consider that Nurbank's risk position has improved over the past two years from weak levels and is more in line with that of other Kazakh banks and peers in systems with economic risk similar to Kazakhstan's. This reflects a significant reduction in its problem loans, reduced exposure to the real estate and construction sector, asset quality in the loan portfolio generated since 2011 being at peers' levels, and moderate growth rates compared with other midsize banks.

In 2014, Nurbank significantly reduced its nonperforming loans (NPLs; loans over 90 days overdue) to 13.2% (KZT26.6 billion) as of year-end 2014, according to regulatory data, from 29.3% (KZT56.9 billion) as of year-end 2013. The bank was able to comply with the National Bank of Kazakhstan's target of a maximum of 15% NPLs for all Kazakh banks at year-end 2014. According to international financial reporting standards (IFRS), NPLs were 17.2% (KZT40.7 billion) as of year-end 2014. Restructured loans accounted for an additional 22% of total loans as of Dec. 1, 2014.

The bank achieved NPL reduction in 2014 through:

- Transfer of KZT2.6 billion of problem loans to the bank's special-purpose vehicle (SPV) for managing problem assets;
- Sale of KZT14.2 billion of loans to third-party collection companies;
- Write-off of KZT21 billion of problem loans; and
- Continued asset recoveries through sale of collateral and legal collection.

Asset quality in the portfolio generated since 2011, which accounted for 56% of total loans as of Dec. 1, 2014, is overall in line with peers'. NPLs were 9% for this portfolio, largely influenced by 27% NPLs in the point-of-sale consumer segment.

We note, however, that previously there have been delays with selling a few large legacy problem loans to third-party collection companies, which slowed down the balance sheet clean up in 2014. We will closely monitor the bank's further progress in this area.

The bank's exposure to the construction and real estate sectors is about 25% of total loans as of Dec. 1, 2014, which is in line with the system average. It declined from 39% as of June 1, 2012, following the sale of problem loans in this segment to third-party collectors and transfer to the SPV.

Individual loan concentrations compare well with those of peers in the Commonwealth of Independent States, whose average loan concentrations exceed 2x. We estimate that Nurbank's 20 largest loans accounted for 1.8x its total adjusted capital at mid-2014.

There have been no changes to the other factors that we take into account when assessing the SACP.

Outlook

The stable outlook on Nurbank balances our expectation that the bank will continue its new business generation and gradual reduction of legacy problem assets while maintaining capitalization and liquidity at adequate levels.

A negative rating action would follow if the positive trend in NPLs reverses, especially if we see above-peer growth in NPLs in the loan portfolio generated after 2011. We would also view negatively a further reduction of Nurbank's loss-absorption capacity, due, for instance, to aggressive balance sheet growth, higher provisioning expenses than we currently forecast, or material negative one-time items that reduced our projected RAC ratio to below 7%.

A positive rating action is unlikely over the coming 12-18 months, as we consider the weaker economic prospects in 2015 and volatility in the domestic currency will not be supportive of an improvement in Nurbank's financial profile.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	B/Stable/B	B/Stable/B
SACP	b	b
Anchor	bb-	bb-
Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Adequate (0)	Strong (+1)

Risk Position	Moderate (-1)	Weak (-2)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria And Research

Related Criteria

- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Ratings List

Ratings Affirmed

Nurbank JSC	
Counterparty Credit Rating	B/Stable/B
Senior Unsecured	B
Subordinated	CCC+
Kazakhstan National Scale	
Counterparty Credit Rating	kzBB+/--/--
Senior Unsecured	kzBB+
Subordinated	kzBB-

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