

REPLACING LEVERAGE WITH CAPITAL

Kazakhstan's banks are divided between those that are cash-strapped and looking at restructuring, and cash-rich survivors trying to find new lending opportunities.

WRITER *Philip Alexander*

After the drought, the flood is hitting Kazakhstan's banking sector. A number of the country's largest banks now have loan-to-value ratios of less than 100%, have reduced the size of their loan books and foreign liabilities, and are increasingly worried about how to put their liquidity to work and earn a return.

Of course, it is a rather selective flood. Two of the country's erstwhile top four banks, BTA and Alliance, have had to be bought out by national wealth fund Samruk-Kazyna and restructure their debts. Temirbank, a retail banking specialist previously owned by BTA, has been separated and restructured because the parent company does not have the funds to recapitalise it.

Alliance completed a deal with creditors in March 2010, with Temirbank crossing the line just days later. Both deals won the approval of more than 90% of all creditors (not just those voting), and involved reducing the banks' debt burdens by about 80%. Foreign creditors now own 20% of Temirbank and 33% of Alliance, respectively.

Their successful emergence from default – and the willingness of foreign creditors to buy into the banks' new equity – are testimony to a firm government response that stopped contagion spreading further across the banking system and is ultimately winning back foreign investor confidence.

Daulet Saudabayev, who was deputy finance minister as the liquidity squeeze and real estate slump began to take hold in 2007 and 2008, recalls the ministry's round-the-



Rescue call: BTA had to be bought out by national wealth fund Samruk-Kazyna



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clock response at the time. “We had two teams at work, a day team to handle routine tasks and a night team that was responding to enquiries from anxious investors in the US time zone,” says Mr Saudabayev.

WINNING BACK FOREIGN CAPITAL

Marcia Favale-Tarter, a former UBS investment banker and portfolio manager at hedge fund giant Brevan Howard, who became an independent adviser to the Kazakh government in 2009, says keeping foreign investors fully engaged in the country as partners in the restructuring was a central priority of the crisis response. For this reason, steering committees of creditors were formed for BTA, Alliance and Temirbank to gain creditor buy-in, even if it meant a more extended restructuring process.

“We made a decision to keep investors in the banks, and allow them to participate in the banks' recovery by offering equity, asset recovery notes and new debt securities. We did not want people to cash in and walk >>

away – which is what can happen if one offers only a cash tender or provides a direct bailout substituting private bank debt with sovereign exposure.

“It was our strategy from the outset not to provide a sovereign guarantee or bailout to creditors. Instead, we provided the tools for investors to share in any upside along with Samruk-Kazyna,” says Ms Favale-Tarter.

Both Alliance and Temirbank are seeking foreign strategic investors who will ultimately buy out Samruk-Kazyna, and BTA remains in discussions with Russia’s Sberbank. The creditor committees have representatives on the banks’ new boards of directors and are helping to draft new corporate governance guidelines.

“It is good for foreign creditors to participate actively. We aim to build an efficient bank, and improving operational services is a major part of that. We need to look at the best foreign banks and pursue the same level of services, reducing costs and operational risks,” says Yerzhan Shaikenov, the new chairman of the Temirbank board.

Several of the strongest banks in Kazakhstan are now fully or partly foreign-owned. Among the top six banks, UniCredit owns ATF Bank, and South Korea’s largest retail bank Kookmin upped its stake in Bank CenterCredit (BCC) to 42% in 2010.

“Kookmin brought us some know-how, especially on IT and systems, and is helping us develop the credit card business on a larger scale,” says Timur Ishmuratov, a member of the BCC management board.

Among the second tier, private equity fund Baring Vostok bought 51% of Kaspi Bank’s controlling group in 2007. Kazinvestbank (KIB) is 25% owned by the European Bank for Reconstruction and Development and 10% by Citigroup Venture Capital International. In April 2010, KIB was shortlisted along with the local subsidiary of HSBC to buy the Kazakh assets of Royal Bank of Scotland that are being divested as part of the parent’s restructuring.

Among the smaller banks, India’s Punjab National Bank (PNB) bought a 63% stake in Dana Bank in February 2010, while Metrocombank, which failed to close a deal with PNB in 2009, is apparently close to finding another strategic investor.

CUTTING FOREIGN LEVERAGE

The government is keen to encourage this foreign investment in the banking sector, with the Regional Financial Centre of Almaty (RFCA) playing a co-ordinating role. And the desire for foreign capital is not just about improving operational efficiency. Arken



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Arystanov, chairman of the regulatory agency for the RFCA and a member of the board for the national Agency of Financial Regulation (AFN), says the country is paying particular attention to the global debate on building counter-cyclical capital buffers in the financial system.

“We want to reduce speculation by the banks, for example, offshore lending or business that is not really transparent for shareholders, and we want a more balanced and stable banking model,” says Mr Arystanov.

To this end, the AFN is planning new regulation that would limit the foreign borrowings of Kazakh banks to two times their total capital. This is especially significant for Kazkommertsbank (KKB), now the country’s largest bank by assets after the fall of BTA and which was particularly leveraged before the crisis.

Abu Dhabi investment fund Alnair Capital now controls just under 30% of the bank after raising its stake in December 2009, but KKB also required a capital injection from

Samruk-Kazyna in late 2009 that gave the sovereign wealth fund slightly less than 25% of the bank.

Sergei Mokrousov, who was appointed to the board of KKB in December 2009 after previously running the bank’s financial institutions group, says the bank’s efforts to deleverage have been dramatic. “The peak of redemptions came in 2008 and 2009, right in the middle of the crisis but now behind us. In the two years since 2007, we repaid about \$6bn. Maturities in 2010 are just \$150m, before increasing again from 2011 to around \$1bn per year, which is still much less than the peak,” says Mr Mokrousov.

KKB’s loan-to-deposit ratio is still high at 169%, but this represents a huge decline from 264% at the end of 2007, leaving the bank less vulnerable to international market developments. Conversely, the stagnant asset base led to a 2% decline in interest income in 2009, despite higher interest rate margins. Mr Mokrousov says new loan origination will be on the mind of management in 2010.

“We have no growth plans for this year as yet but we monitor the situation as a big player in the corporate loan market,” he says.

The AFN’s leverage rule would also apply to foreign subsidiaries in the country, which might have less favourable consequences. Simen Munter, the CEO of HSBC in Kazakhstan, says it calls into question the existing model of a Kazakh subsidiary taking advantage of its parent’s lower cost of funding.

“Effectively, the new regulations will make it more difficult for foreign banks to enter Kazakhstan because they will have to build a local deposit franchise. The alternative is to lend directly from overseas, but HSBC is on the ground because we believe it gives us a much better understanding of what is happening,” says Mr Munter.

PUTTING LIQUIDITY TO WORK

Some foreign-owned banks have already moved to ensure good liquidity from local funding sources. ATF Bank raised a Tg15bn (\$100m) domestic bond in March 2010. None of Kaspi Bank, KIB, or locally owned Eurasian Bank has outstanding wholesale debts (Kaspi and KIB have some loans from multilaterals).

Meanwhile, BCC grew retail deposits by 50% in 2009, taking its loan-to-deposit ratio down to 91%, from 150% in 2008. Halyk Bank is also well funded, thanks to a legacy retail network from its Soviet-era status as the state savings bank. For those banks with good liquidity from local funding sources, the field is relatively clear for expanding market share on the lending side as well. >>

“We are very liquid now – it is a nice issue, but still an issue. We need to decide where to place it, so we plan to increase our lending by about 15% to 20% in 2010,” says Mr Ishmuratov of BCC.

Retail banking, especially the mass market consumer segment, is one choice for loan growth, given relatively low penetration to date. Since Mikhail Lomtadze became CEO of Kaspi Bank on behalf of Baring Vostok in 2007, he has focused the bank on this sector, which now accounts for 20% of the total loan book. Kaspi recorded the largest growth in interest income of any major Kazakh bank in 2009, at 25%. Mr Lomtadze says the government’s creation of a mandatory centralised bureau of bank credit data helps make the mass market model highly effective.

“It is hugely different from other Commonwealth of Independent States countries. You can check if any borrower has a negative credit history and there is centralised pension data, which gives you an idea of an individual’s income. Our consumer non-performing loan rate is 5% at most, better than some mortgage

portfolios, although our approval rate for new clients is only 50%, which we hope to raise as the economy improves,” says Mr Lomtadze.

ELUSIVE CORPORATE CLIENTS

By contrast, corporate lending is taking much longer to revive, despite the strength of banks like BCC and Halyk.

“We estimate that the healthiest banks in Kazakhstan have a liquidity excess of \$5bn. It should be natural for them to resume lending but the level of lending today is more or less at the same level as 2004, at about \$2bn per month. The peak was more than \$10bn,” says Jean-Christophe Lermusiaux, head of research for Visor Capital, the country’s largest independent investment bank.

Alexander Picker, CEO at ATF Bank, believes agribusiness offers the potential for banks to diversify corporate exposure away from the extractive industries. He says improvements in management quality could generate significant returns from operations that are already large-scale.

“The huge plains in the north of Kazakhstan are striking compared to the smallholdings in Europe. A German client who manufactures agricultural machinery told me they sell products here they cannot sell in Germany, and there is also a huge opportunity for the fertiliser industry,” says Mr Picker.

Michael Eggleton, who became CEO of Eurasian Bank in October 2009, explains his caution about venturing too far into uncharted waters, even though the bank now has a loan-to-deposit ratio of just 74%.

“We want clients with a strong track record. We are not looking to fund greenfield investments if repayment depends on refinancing or the sale of the business. But we do not mind funding a new project if we are confident it can repay out of its own revenue stream,” says Mr Eggleton.

Similarly, KIB CEO Adnan Ally Agha says the bank’s core focus is on obtaining a niche share of the business from some of the largest Kazakh companies. This means not only the resources sector but also associated industries, such as parts suppliers and engineers. The bank is also moving into the top tier of agribusiness and consumer non-durables.

“We are not going to go head to head with the large banks on risky transactions such as real estate financing. We want a 20% to 30% market share of each large customer by offering superior quality of service. Our fixed costs are very low for the industry, they do not grow as the number of customers grows because of our modular structure,” says Mr Agha, a former Citigroup executive.

Mr Lermusiaux says the reluctance to tread too far into the small and medium-sized enterprise (SME) sector is understandable, as the downturn pushed many companies into the red, and their managers will have to demonstrate the skill to generate a recovery.

“Many small companies have a high proportion of general and administrative costs in their accounts, and they were waiting for the economy to improve rather than asking why costs were so high,” says Mr Lermusiaux.

FILLING THE GAP

For this reason, the remedy for Kazakh banks is also appropriate for the wider economy: fresh capital, especially when allied with management expertise, will be preferable to leverage. The government is aware Kazakh entrepreneurs need convincing to allow strategic investors into their companies, and has started a specialised private equity fund of funds, Kazyna Capital Management (KCM), under the auspices of Samruk-Kazyna. Two of its five sub-funds focus on SMEs.

“Local businesses are not so familiar with fund procedures, the need to comply with due diligence and transparency. One of our roles is to educate companies about the kind of information that fund managers need to know,” says Abay Alpamyssov, executive chairman of KCM.

And, of course, both private equity funds and private individuals will benefit from the means to exit through the stock market, which is vital to reducing the dependence on bank lending.

“We have a good level of savings in Kazakhstan but the banking system still controls 80% of financial assets in the country as people have not yet been educated about the stock market,” says Mr Saudabayev, who became an independent investment consultant after leaving the Kazakh finance ministry.

Stefan Scholz, the head of investment banking at Visor Capital, says a growing number of companies are genuinely looking at listing as a way to interact with new investors, because they need alternative means to raise money.

“Traditionally, the way for corporates to build business was to obtain bank loans and then look to sell, but the opportunity for that model has largely gone. So people are looking to raise equity through initial public offerings, but they need time to prepare,” says Mr Scholz.

When they do list, the demand will be there. The country’s private pensions system is well regulated and funded, with employees paying in 10% of their salary, amounting to inflows of about \$100m every month. **IB**



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