

Kazakhstan

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Kazakh banks: outlook for 2008

Investor trip notes

Banks

Following our trip to Kazakhstan, we remain positive on its banking system. We retain our Marketperform ratings on all the banks' bonds, expecting a gradual improvement in their performance over the medium to long term.

In this report, we summarise discussions we had with seven leading banks on the Kazakh banking situation, which have led us to the conclusions that:

- Deposit outflow seems to have stopped, with deposits having started to flow back into banks at the end of 2007.
- Changes in asset quality have been minor to date.
- Although the price correction took place as expected, its impact on the real estate sector and banks' loan portfolios was not significant.
- Banks should be able to repay debt due through the internal generation of cash flow from maturing assets.
- All the banks believe that the capital markets will remain closed for the whole of 2008 and deposits will be the major source of funding this year; they therefore expect much slower growth in 2008.

Meetings with the AFN and the NBK strengthened our opinion that:

- Problems in the real estate construction are manageable.
- The government's US\$4bn support programme has already kicked in, and the first funds are already being transferred to companies.
- Apart from the 'soft landing', the banking sector looks set to undergo a transformation in 2008, including possible acquisitions of Kazakh banks by foreign investors and some redistribution of market share towards players that are stronger and better positioned in terms of funding.

8 February 2008

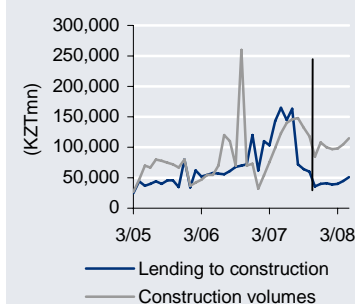
Asset size and market share of top 10 Kazakh banks (KZTbn)

| | Total assets | Growth (%YoY) | Market share (%) | Market share (%YoY) |
|----------|--------------|---------------|------------------|---------------------|
| KKB | 2,715 | 20 | 23 | -2 |
| BTA | 2,649 | 45 | 23 | 2 |
| Halyk | 1,567 | 60 | 13 | 2 |
| Alliance | 1,192 | 29 | 10 | 0 |
| ATF | 993 | -5 | 8 | -3 |
| BCC | 881 | 54 | 8 | 1 |
| Temir | 326 | 63 | 3 | 1 |
| Caspian | 257 | 31 | 2 | 0 |
| Nurbank | 204 | -1 | 2 | -1 |
| Tsesna | 150 | 74 | 1 | 0 |

Dynamics in banks' deposits (KZTbn)

| | Total dep | 4Q07 growth (%) | Mkt sh. (%) | Mkt sh. (%YoY) |
|--------------|-----------|-----------------|-------------|----------------|
| KKB | 1,686 | 0 | 28 | 26 |
| BTA | 1,348 | 0 | 28 | 21 |
| Halyk | 1,115 | 21 | 79 | 17 |
| Alliance | 543 | 1 | 56 | 8 |
| ATF | 416 | -11 | 1 | 6 |
| BCC | 482 | 2 | 52 | 8 |
| Temir | 173 | -8 | 60 | 3 |
| Caspian | 84 | 13 | 28 | 1 |
| Nurbank | 65 | -17 | -38 | 1 |
| Tsesna | 99 | 1 | 103 | 2 |
| System total | 6,424 | 2 | 36 | - |

Construction loans vs volumes



Source: ING estimates

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Trip summary

Based on impressions from our trip, we believe that all bank-issuers should have the ability this year both to repay maturing debts without refinancing or external support and to conduct their business in a normal way, albeit at a significantly reduced pace, **under stable macro environment conditions**. This depends on:

- Maintaining depositors' trust in the banking system (which has started to return after August's run on deposits and now leads the positive growth trend in deposits – both corporate and retail).
- Stability in the real estate and construction sectors, ensuring the maintenance of good asset quality on the corporate lending side and the quality of mortgage portfolios.
- Ensuring the stability of the Tenge and keeping inflation under control.

These are all tasks of the Kazakh government rather than individual banks. We therefore see risks for Kazakh banks as being more sovereign in nature, rather than depending on banks' individual situations. The large gaps between individual banks' spreads therefore seem unjustified given the real risks.

There are definitely differences in banks' financial strengths, levels of indebtedness, debt repayment schedules, depositor base sizes and levels of exposure to the real estate sector (please see our *Individual banks* section at the end of the report for credit profiles of the seven top banks we visited). However, given the specifics of the Kazakh market (the significance of the real estate sector to the economy, the size of the banking system compared with the small base of depositors, the population's fragile trust in the system), we believe the health of the total banking system in the coming year will depend on the smooth functioning of all of its large players and on the continuously supportive policy of the government.

After several visits to the country, during which we talked to banks, officials and locals, we understand that the semi-unconditional support of the Kazakh government for all players **is the result of necessity rather than good will** – and is not dependent on the composition of the government or the personalities of the leaders. This is because:

1. The fragile trust of depositors can only be maintained through good functioning of the whole system, and the failure of one large bank would inevitably lead to mass deposit withdrawals from all banks and thus a 'domino effect'.
2. All the banks are directly or indirectly involved in the country's real estate sector, which is inevitably one of the largest sectors in the economy. Any widespread problems in the sector would therefore heavily affect not only the banking sector, but also the whole economy. This leads us to believe that the government is directly interested not only in supporting the construction sector, but also in helping it maintain an acceptable pace of growth before it can pick up again through growth from internal resources.
3. Although forex risks should now gradually reduce as a natural consequence of much more limited possibilities to borrow in foreign currencies abroad, the share of foreign currency-denominated assets and liabilities is still high. Maintaining the stability of the Tenge will therefore remain the government's priority.

The well timed, sizeable measures from the government to keep all three of these factors under control in 2H07 lead us to believe that the policy will continue, all the more so given that the hardest part is over and the next period should require less and less governmental intrusion.

We believe that having got through 2008 and part of 2009 in 'safe mode' (most debt repayments falling due, no refinancing possibilities), the banks will be able to pick up again as soon as the markets open up for borrowing, and steady growth in the economy and the population's income will gradually close the gap between the banks' size and their internal resources available to support it.

Moreover, the increasing diversification of Kazakh banks into the highly promising banking businesses of the neighbouring Russia, China and CIS countries is likely to influence banks' growth and profitability positively. Our long-term outlook on the Kazakh banking system is therefore very positive.

As for the state's position, although ratings agencies are reluctant to admit it, it is clear to us that there is strong Kazakh government support. The government has shown itself to be prepared to bail out the banking system without differentiating between names and has promised further support particularly to sectors that may have suffered from the banking slowdown, such as real estate and SMEs.

We believe Kazakhstan is in a unique situation to get this programme through:

- Because of the absolute presidential power, enabling the state to act quickly and allocate resources to targets without lengthy discussions.
- Because the country can comfortably finance this support thanks to the continuous inflow of cash from exporting natural resources and reserves created in previous years.

Now that discussions surrounding the Kashagan oil field seem to have been resolved, prospects for the Kazakh economy look even brighter, with oil output set to double or triple over the next ten years, far outstripping production growth in Russia, where reserves are much less easily accessible.

In addition, in contrast to Russia and other resources-rich countries, the development of Kazakhstan's massive reserves of oil, gas, gold and other commodities is only just beginning, which makes the country a great growth story.

To sum up, we remain positive on Kazakh banks over the longer term. We have Marketperform ratings on all the bonds we cover (see *Appendix 1* for our Emerging Markets Quote Sheet: Kazakhstan). Moreover, for investors not marking to market and able to hold debt for a longer term, we would see a possibility here of buying good credit at modest price levels with significant upside potential.

Real estate and construction

Credit crunch triggered a moderate price correction in the real estate markets of Almaty and Astana

All the banks are exposed to real estate in one way or another (see exposure figures for individual banks in the *Individual banks* section at the end of the report).

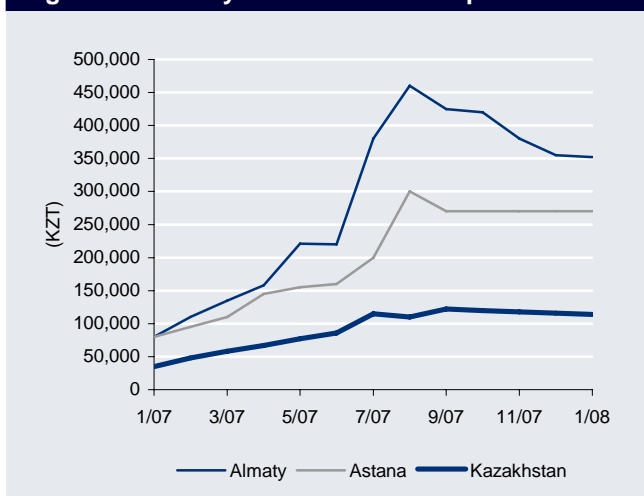
As many predicted, cutbacks in the credit market in August triggered a price correction. While there is no uniform source with exact price statistics, after discussing this matter with locals, banks and real estate agents, we understand that the price fall was not as dramatic or as homogeneous as expected.

According to our findings, real estate prices in Almaty and Astana started to fall in August-September 2007 and, as of January 2008, they stabilised at a new level:

- About 30% below the August 2007 level in the secondary market of lower-quality residential apartments.
- 10-15% lower in the new apartments market segment (the 'primary market') for middle- to higher-class residential properties.
- No correction in commercial real estate and elite-class residential apartments.

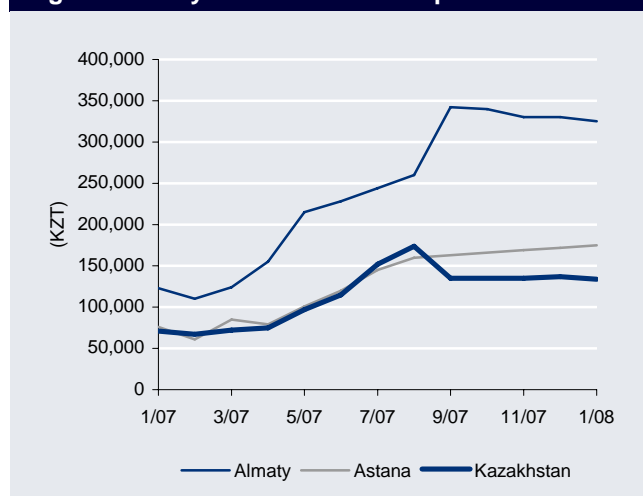
Figures 1 and 2 are based on information we received from our Kazakh contacts.

Fig 1 Secondary real estate market prices



Source: ING estimates

Fig 2 Primary real estate market prices



Source: ING estimates

However, as the market stagnates, prices quoted are often only indicative

However, many of our sources suggested that the current price level hardly demonstrates the real situation in the market as real estate quotes are often indicative, the number of deals closed is very low, and most sellers and buyers are preferring to wait until the situation resolves itself. The number of sell offers is about double the number of buy requests in the Almaty market, but very few sellers are agreeing to negotiate prices down, preferring to rent their apartments out or wait for prices to rise. The most commonly heard assumption is that the expected slowdown in new apartment supply will make the supply/demand disparity larger and push prices up again.

Commercial real estate and high-end residential estate prices are not affected by the correction

The market for commercial estate has so far not been affected and is unlikely to be affected as the problem of a shortage of suitable offices, trade facilities and

warehouses remains acute and new supply of commercial estate is likely to slow down in line with the slowdown in real estate construction.

Bankers have said that the price correction had been expected in Almaty and Astana for at least a year as markets seemed increasingly speculative in nature and to be obviously overheating. According to the Agency for Financial Supervision (AFN), as of 1 August, average prices per m² of residential and commercial real estate in Almaty were US\$3,715 and US\$5,475, respectively. We were told that high-end residential estate prices were as high as US\$7,700 per m².

Banks are used to being conservative in real estate-related lending, but have introduced even stricter conditions

Thus, all the banks were already cautious in their real estate-related lending policies prior to the crisis, often limiting their exposure to large construction companies. (KKB told us that KUAT, the largest economy-class residential developer, used to be its largest customer back in 2006, but that from the beginning of 2007, exposure was limited to a few highly profitable projects.)

Mortgage rates were very high prior to the crisis, with quite conservative lending practices, including a low LTV ratio (averaging 70% in 1H07) and a required cash deposit of 10-15% as of 1H07. After the August 2007 liquidity crisis broke, many banks stopped mortgage lending altogether and are only now slowly starting to lend again on even tighter terms.

Average mortgage rates have increased to 18-29% pa excluding fees and commissions (a 2-5% increase on August 2007 rates). The LTV ratio has corrected from an average 70% last summer to 50% now. Moreover, the required cash deposit has risen from an average 10-15% last summer to 30%. Many banks also require borrowers to have a long track record with the bank and to keep their salary (corporate) account with the bank.

The volume of mortgages, low in relation to other economies, has fallen further

As a result, the total volume of issued mortgages halved from August to December (according to the AFN), which probably also contributed to the stagnation in real estate sales.

Given all the factors above and the still very low volume of mortgages issued in relation to GDP and their very small share in banks' portfolios, we do not see any particular risk of asset-quality deterioration in mortgage lending.

Fig 3 Mortgage lending to GDP in various countries (%)

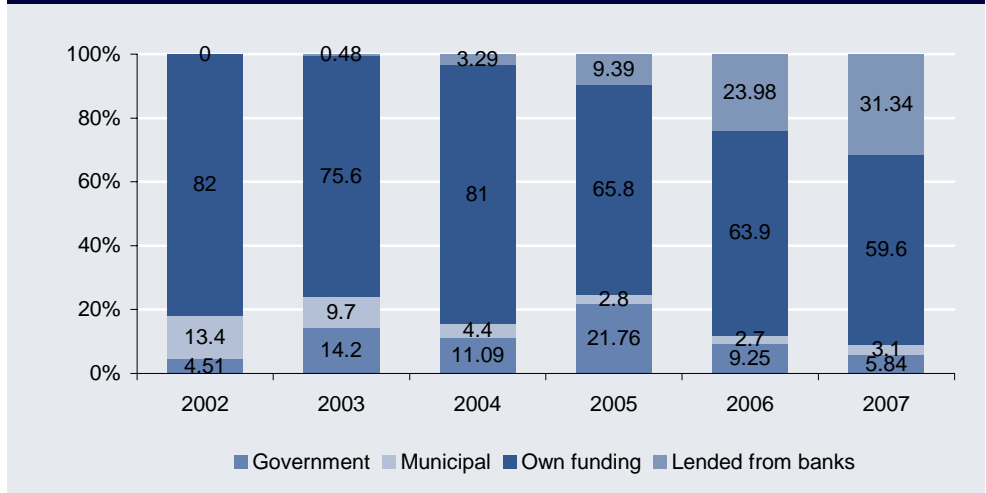


Source: ING estimates

Most construction projects are in Almaty and Astana

In terms of regional breakdown, the majority of construction projects are concentrated in Almaty and Astana (55-60% of total construction volume), so the problem of unfinished projects is an issue in these cities.

Fig 4 Sources of financing for real estate construction projects

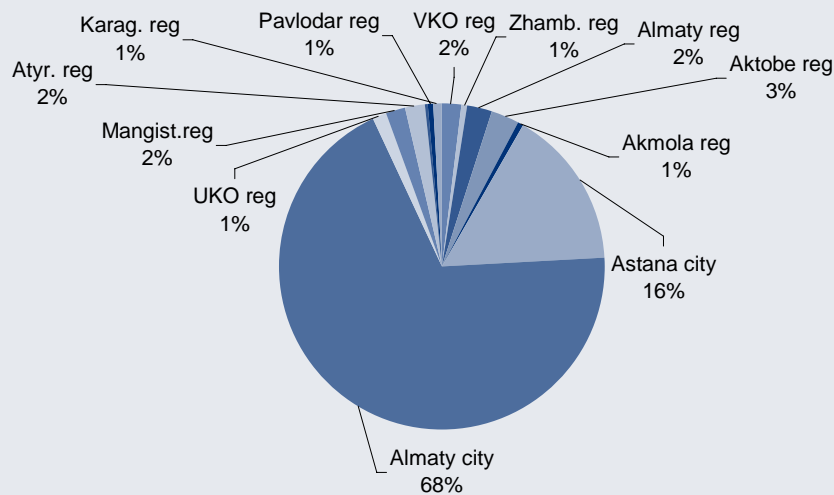


Source: ING estimates

59.6% of projects are financed from companies' own money

Moreover, more than half of the projects nationwide (59.6%) are financed from companies' own money, with projects with the highest share of borrowed funds likely to be concentrated in the two (old and new) capital cities.

Fig 5 Share of banks' lending to the construction industry by region



Source: ING estimates

Due to a large demand/supply disparity, we do not foresee a long-term price collapse in these two cities

One particular problem with Almaty is that because of its geographical location between mountains, there is very little land available in the city for new construction. Therefore, given skyrocketing prices for the remaining land that is available, many construction companies have gone about buying up plots in advance for future projects. This motivation seems also to have been the major driver of the high volume of new projects started by construction companies while old projects are still ongoing, which led to increasing leverage and a high share of uncompleted projects once borrowing was cut. We have been told that some construction companies are now being forced to sell land off to free up liquidity.

Nevertheless, given the limited availability of space in the 'Southern capital' (as Kazakh citizens call Almaty), its status as the most sought-after location for living, the ongoing migration of the population into the largest cities (particularly Almaty and Astana) and positive demographics, we do not foresee any long-term price collapse in these two cities. The local expectation is that prices will stagnate for six more months before starting to grow again.

Fig 6 Dependence of construction volumes on lending



Source: ING estimates

It is expected that the new price dynamics will be different from previous years. Many speculative property owners are likely to leave the market, selling their property as the market recovers, and prices for residential estate will be more differentiated by segment – with no increase in the prices of the cheapest apartments in the secondary market and prices for higher-quality new apartments starting to rise again as buyers' confidence recovers.

It is expected that some of the smaller construction-sector players may leave the market in 2008. However, these departures should be rather quiet, 'sell out, close down' affairs rather than insolvencies, as the owners of many of the companies have economic interests in other sectors and would rather avoid the negative publicity.

Separate development projects (already started) are up for sale as land plus corresponding permits. The larger players seem to be using this opportunity to buy on the cheap, which should lead to ongoing consolidation in the redistribution of assets in the sector and a higher concentration of capital.

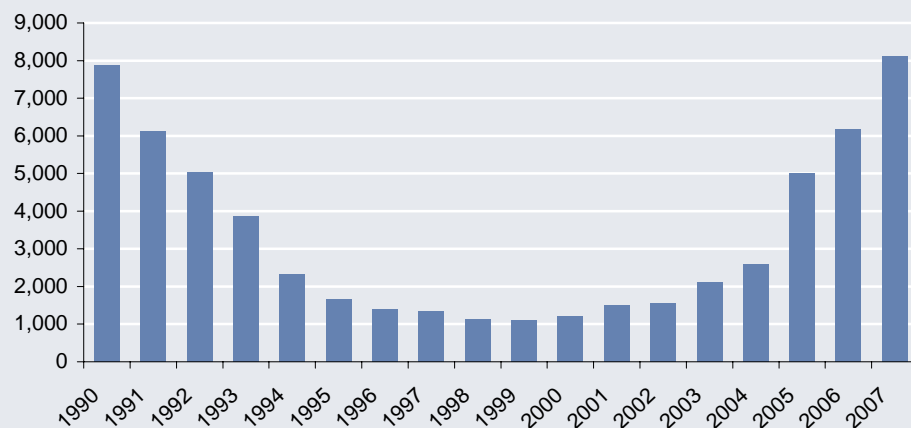
Huge gap between supply and demand of high-quality property will make real estate a booming sector for at least the next ten years

In conclusion on the real estate sector, we would like to quote one of the bankers with whom we spoke, who said that one must not forget that Kazakhstan is a young, developing country and therefore the whole country is – in fact – a construction site, with most residential, commercial, infrastructure and communications buildings still to be built. With property having been insufficient and of a low quality back in Soviet times, it all now has to be rebuilt, and the huge gap between scarce supply and steadily growing demand should trigger real estate and construction sector growth for at least the next ten years.

Our opinion: We cannot disagree with this banker that, aside from current problems in construction, the long-term outlook for the sector is extremely positive. Based on the information we have obtained, we believe the problems encountered during the price correction, construction companies' liquidity constraints and stagnation in the real

estate market are manageable, especially given the committed support of the government, and will not cause any significant damage either to the banking sector or to the economy as a whole.

Fig 7 Volumes of real state construction (000m²)



Source: National statistics bureau

Government support

Slowdown in lending mainly affected construction companies

As a direct result of the liquidity squeeze, banks raised lending rates and severely limited lending to retail and corporate customers – mainly construction companies. As a result, many construction projects in Almaty and Astana came to a standstill in September, and both capitals have seen demonstrations by the employees of large construction companies over severe delays in salary payments. (The KUAT and Basis-A corporations seem to have been particularly affected.)

The US\$4bn government programme announced in October aims to support real estate and construction companies

To tackle the problem, in October the government announced a US\$4bn programme of support for the real estate and construction sectors. We were unclear about the mechanism and principles for the distribution of funds and asked for clarification during our visit. We were told that of this US\$4bn, approved in November 2007, US\$1bn was sourced from the 2007 budget and US\$3bn from the 2008 budget, and that the government is now considering doubling the amount in 2008 on the back of positive results from the first projects carried out.

The funds should be directed as deposits to banks to fund specified construction projects in Astana and Almaty

According to the government, these funds were to be directed as deposits to banks to fund:

- Real estate developers, to help them complete housing construction projects.
- SME companies on reasonable conditions.
- Promising investment projects (infrastructure) that are of great significance to the economy.

It seems that banks received the first funds under the programme in December. The main conditions were:

1. Approval of the end-recipients of funds. (The list of construction companies and SMEs was approved by the government in November and includes a number of companies from Astana and Almaty.)
2. Funded projects had to have already been started (10-90% completion).
3. Banks had to lend to companies under preferential 9% interest rates.
4. Both bank and company had to invest their own funds in the project.

We have been told that although most of the companies and projects initially approved for government assistance were located in Astana, the list has now been widened by a significant number of Almaty-based companies. In total, the list to date includes:

1. Construction (400 projects approved).
2. SMEs (about 400).
3. Investment projects (infrastructure, 200 projects).

Most banks' responses to the government help have been positive

We have been told that banks may use the funds for funding companies and projects off-list – subject to approval of a separate application. So far, other than a few complaints about bureaucratic delays in approval of off-list projects, the majority of banks' responses to the government help have been positive. We were told that construction companies have now utilised about US\$1bn of the funds, and the breakdown of the remaining US\$3bn is expected to be as follows:

- Almaty – US\$1.2bn.
- Almaty region – US\$300m.
- Astana – US\$1.5bn

The Kazakh government may double the amount to US\$8bn this year

Some investors are concerned that given the volumes of real estate construction in the country, US\$4bn from the government may not be enough to revive the market. We believe that, apart from the fact that the Kazakh government may double the amount this year, one should bear in mind that these funds are going to be channelled through banks to companies and projects that have liquidity problems, not to all companies in general. Moreover, only the cities of Astana and Almaty are to be targeted; other regions appear to have suffered from neither price reductions nor high volumes of unfinished projects.

The DBK can also provide liquidity to banks, buying from them loans to the construction sector for infrastructure and industrial projects

Besides the US\$4bn construction sector assistance programme, the Development Bank of Kazakhstan (DBK) is going to assist banks. We were told that it has offered to buy up loans made by commercial banks to the construction sector for infrastructure and industrial projects to free up funds for home building. According to the DBK's policy, loans to be considered should be worth more than US\$5m and have a maturity of at least five years. The DBK plans to lend US\$250m for the first 12 projects already approved for refinancing under the programme. It approved 50 projects last year with a total value of US\$3.2bn.

The government also aims to increase residential real estate construction under its official 'State Residential Construction Programme 2008-10' from 26.1m m² to 28.0m m², to support the construction and building materials sectors.

Many construction companies have more than enough internal reserves for investments and do not need government help

In conclusion, during our visit to Kazakhstan, we were assured that the Kazakh real estate and construction sector is not dependent in its entirety on government financing. Given average interest margins of 128% in real estate construction as of 1 September, many companies have more than enough internal reserves for investment. With limited access to financial resources to borrow, they may curb their volumes of new projects, but their financial position should not deteriorate.

Government support is targeted at certain players in highly speculative low-class residential real estate in both the old and new capitals, which got into trouble through extremely high leveraging, pushing for advance investments in land and pursuing too many projects at the same time to capitalise on 'growth momentum'.

Our opinion: Based on the information we obtained, we believe the government is providing timely, sizeable support to the construction sector directly and indirectly (to banks in the form of deposits). We see a commitment from the authorities to continue with such support and, where necessary, to increase it to the level needed to ensure a soft landing of both the banking and the real estate sectors and support them in their transition to slower growth, supported by internal resources.

On 5 February, *Kazakh Interfax* reported that one of the largest Middle Eastern investment funds, Dubai International Capital, is planning to open a mortgage bank in Kazakhstan, possibly in the form of a joint venture with the government-owned Kazakhstan Mortgage Company, which has been supporting the state mortgage programme through the securitisation of mortgage loans issued by local banks. Such foreign investor interest in the real estate sector indicates a positive development in perception and a healthy long-term outlook.

Deposit funding

Kazakh banks are being forced to compete for a small internal pool of deposits

Although the market is concerned about the levels of banks' external debt as a major factor determining their future, our major concern since the outbreak of the August liquidity crisis has been that all the banks will now be forced to compete for an internal pool of deposits that may not be large enough to sustain their current asset size.

Fig 8 Share of deposit funding in banks' total liabilities (%)

| Year-end | 2006 | 2007 |
|--------------------|-----------|-----------|
| Kazkommertsbank | 64 | 69 |
| Bank TuranAlem | 63 | 60 |
| Halyk Bank | 72 | 78 |
| Alliance Bank | 42 | 52 |
| ATF | 42 | 46 |
| Bank Center Credit | 60 | 59 |
| Temirbank | 63 | 64 |
| Caspian Bank | 38 | 37 |
| Nurbank | 58 | 39 |
| Tsesna Bank | 65 | 76 |
| Total | 59 | 63 |

Source: AFN

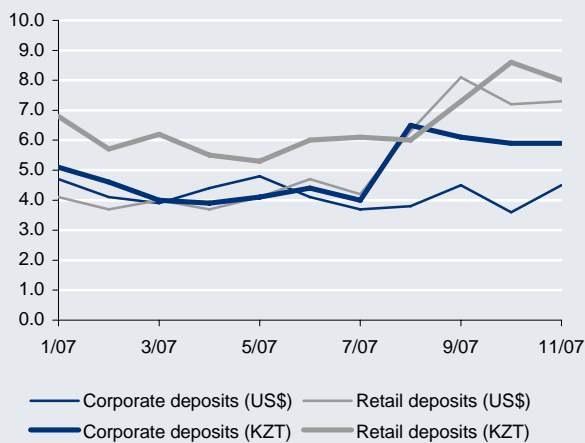
In terms of deposit raising, some banks may be better positioned than others

Clearly, banks that have historically derived most of their funding from deposits, such as Halyk and Tsesna, may be better positioned than their competitors through having a more developed branch network and established deposit collection procedures and deposit services in place.

We see Halyk in particular as being in a more favourable position than its competitors because of its historical status as a savings bank and its established presence in even the most remote rural areas, where it has little or no competition.

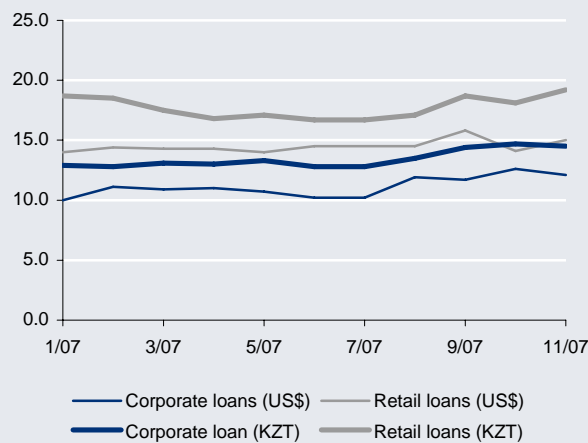
However, the concern we discussed with banks was the likelihood of a deposit 'price war', the first signs of which we have seen from the NBK's interest rate statistics (see Figures 9 and 10).

Fig 9 Average interest rates on deposits



Source: NBK

Fig 10 Average interest rates on loans



Source: NBK

All the banks are now offering higher deposit interest rates, but they do not want to engage in a 'price war'

Bankers we spoke with told us that although all the banks are indeed offering higher interest rates on deposits for both corporate and retail clients than they were at the beginning of the crisis, they are aware of the dangers of a deposit price war and would not hike deposit rates unreasonably. We have in fact been told that only a few banks would be able to raise deposit rates from current levels. One such is Alliance, which has a very high interest margin due to high lending rates in the consumer lending business.

Other banks aim to compete for depositors mainly by improving their services and IT systems, installing more ATMs to make banking more accessible to the population and providing bank depositors with preferential rights in other banking services, eg, taking retail loans or mortgages.

In year-end results, we did not see a significant redistribution of deposits among banks

In fact, despite a lot of noise around the August run on deposits and a 'flight to quality', we did not see a significant redistribution of deposits among banks, with individual banks maintaining more or less stable shares in the deposit market after the deposit base stabilised in November 2007. General deposit dynamics in the Kazakh banking system are as shown in Figure 11.

Fig 11 Deposit dynamics in the Kazakh banking system (KZTbn)

| Total dep | 2006 total dep | Market share (%) | 1Q07 total dep | 1Q07 growth (%) | 2Q07 total dep | 2Q07 growth (%) | 3Q07 total dep | 3Q07 growth (%) | 4Q07 total dep | 4Q07 growth (%) | (% YoY) growth | Market share (%) | Market share (%ch) |
|-----------------------------|----------------|------------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|------------------|--------------------|
| Total dep | 4,715 | 100 | 5,501 | 17 | 6,182 | 12 | 6,274 | 1 | 6,424 | 2 | 36 | 100 | 0 |
| Corporate deposits | | | | | | | | | | | | | |
| Kazkommertsbank | 1,122 | 30 | 1,339 | 19 | 1,449 | 8 | 1,392 | -4 | 1,381 | -1 | 23 | 28 | -3 |
| Bank TuranAlem | 849 | 23 | 972 | 14 | 1,143 | 18 | 1,086 | -5 | 1,087 | 0 | 28 | 22 | -1 |
| Halyk Bank | 414 | 11 | 360 | -13 | 500 | 39 | 568 | 13 | 767 | 35 | 85 | 15 | 4 |
| Alliance Bank | 238 | 6 | 411 | 73 | 437 | 6 | 446 | 2 | 446 | 0 | 87 | 9 | 2 |
| ATF | 345 | 9 | 372 | 8 | 324 | -13 | 347 | 7 | 277 | -20 | -20 | 6 | -4 |
| Bank Center Credit | 209 | 6 | 289 | 39 | 339 | 17 | 343 | 1 | 347 | 1 | 66 | 7 | 1 |
| Temirbank | 90 | 2 | 112 | 24 | 170 | 52 | 165 | -3 | 152 | -8 | 68 | 3 | 1 |
| Caspian Bank | 35 | 1 | 30 | -15 | 32 | 8 | 43 | 35 | 52 | 21 | 48 | 1 | 0 |
| Nurbank | 75 | 2 | 78 | 4 | 60 | -23 | 70 | 15 | 55 | -22 | -27 | 1 | -1 |
| Tsesna Bank | 33 | 1 | 55 | 69 | 63 | 14 | 72 | 14 | 71 | -1 | 116 | 1 | 1 |
| Banking system total | 3,681 | 100 | 4,317 | 17 | 4,813 | 11 | 4,868 | 1 | 4,976 | 2 | 35 | 100 | 0 |
| Retail deposits | | | | | | | | | | | | | |
| Kazkommertsbank | 191 | 19 | 233 | 22 | 311 | 33 | 295 | -5 | 305 | 3 | 59 | 21 | 3 |
| Bank TuranAlem | 202 | 20 | 224 | 11 | 264 | 18 | 259 | -2 | 261 | 1 | 29 | 18 | -2 |
| Halyk Bank | 207 | 20 | 231 | 11 | 254 | 10 | 352 | 39 | 348 | -1 | 68 | 24 | 4 |
| Alliance Bank | 112 | 11 | 119 | 7 | 126 | 5 | 94 | -26 | 97 | 4 | -13 | 7 | -4 |
| ATF | 68 | 7 | 100 | 47 | 115 | 15 | 120 | 5 | 139 | 16 | 104 | 10 | 3 |
| Bank Center Credit | 109 | 11 | 121 | 11 | 145 | 20 | 128 | -12 | 136 | 6 | 24 | 9 | -1 |
| Temirbank | 18 | 2 | 26 | 48 | 30 | 12 | 23 | -24 | 21 | -7 | 17 | 1 | 0 |
| Caspian Bank | 30 | 3 | 25 | -16 | 29 | 16 | 30 | 3 | 31 | 3 | 4 | 2 | -1 |
| Nurbank | 30 | 3 | 28 | -8 | 10 | -66 | 9 | -7 | 11 | 20 | -65 | 1 | -2 |
| Tsesna Bank | 16 | 2 | 19 | 21 | 23 | 20 | 26 | 14 | 28 | 5 | 74 | 2 | 0 |
| Banking system total | 1,034 | 100 | 1,184 | 14 | 1,369 | 16 | 1,406 | 3 | 1,448 | 3 | 40 | 100 | 0 |

Source: AFN

Deposits will be the main source of financing for the coming year with 36-62% growth projected

The AFN told us during our meeting that it is aware of the issue and hopes that banks' common sense will keep them away from a deposit interest-rate race. Furthermore, the State Deposits Insurance Fund has agreed to serve as an intermediary to help maintain the status quo among banks on deposit rates.

As for deposits becoming the main source of financing for the coming year, we expect growth in deposits in 2008 identical to that in 2007 (36% YoY), or – as a best-case scenario – in line with an annualised 1H07 figure before the liquidity crisis (62% YoY).

In any case, our 2008 Kazakh banking asset growth projections have not changed. We see a slowdown of the whole banking system as inevitable in 2008, with all players suffering from external funding cuts, including those banks with lower indebtedness/repayment rates.

Our opinion: We have noted a positive trend of deposits gradually returning to the system since November. However, as discussed in previous reports, the deposit base in Kazakhstan is not large enough to provide all banks with sufficient resources to replace external funding flows lost in the liquidity crunch. We therefore maintain our view that there will be a significant slowdown in growth on previous years.

Bank asset quality

The liquidity crunch forced banks into a fundamental review of their credit risk procedures and lending policies

Following the August liquidity crunch, banks were forced into a fundamental review of their credit risk procedures and lending policies. However, we have been concerned about:

- Possible increases in NPLs because of a slowdown in lending.
- Possible corporate loan quality deterioration as a result of problems in the construction sector.
- A possible deterioration in consumer loans as refinancing in other banks is no longer available (or considerably more expensive).

Fig 12 Lending dynamics

| | 2006 total loans | Market share (%) | 1Q07 total loans | 1Q07 growth (%) | 2Q07 total loans | 2Q07 growth (%) | 3Q07 total loans | 3Q07 growth (%) | 2007 total loans | 4Q07 growth (%) | Market share (%) | Market share (%ch) |
|--------------------|------------------|------------------|------------------|-----------------|------------------|-----------------|------------------|-----------------|------------------|-----------------|------------------|--------------------|
| Kazkommertsbank | 1,641 | 27 | 1,737 | 6 | 2,260 | 30 | 2,297 | 2 | 2,256 | -2 | 25 | -2 |
| Bank TuranAlem | 1,268 | 21 | 1,427 | 13 | 1,953 | 37 | 1,988 | 2 | 2,117 | 7 | 24 | 3 |
| Halyk Bank | 620 | 10 | 663 | 7 | 801 | 21 | 926 | 16 | 1,070 | 16 | 12 | 2 |
| Alliance Bank | 652 | 11 | 711 | 9 | 879 | 24 | 902 | 3 | 854 | -5 | 10 | -1 |
| ATF | 585 | 10 | 653 | 12 | 709 | 9 | 788 | 11 | 759 | -4 | 9 | -1 |
| Bank Center Credit | 431 | 7 | 494 | 15 | 615 | 24 | 697 | 13 | 660 | -5 | 7 | 0 |
| Temirbank | 160 | 3 | 203 | 26 | 255 | 26 | 287 | 13 | 275 | -4 | 3 | 0 |
| Caspian Bank | 131 | 2 | 138 | 5 | 153 | 11 | 178 | 16 | 194 | 9 | 2 | 0 |
| Nurbank | 142 | 2 | 146 | 2 | 145 | -1 | 147 | 2 | 149 | 1 | 2 | -1 |
| Tsesna Bank | 74 | 1 | 94 | 28 | 101 | 7 | 116 | 14 | 112 | -4 | 1 | 0 |
| Total | 5,992 | 100 | 6,574 | 10 | 8,233 | 25 | 8,702 | 6 | 8,868 | 2 | 100 | 0 |

Source: AFN

Banks report a slight deterioration in asset quality due to a lending slowdown and changes in collateral value (real estate)

Regarding our first concern, it seems the NPL increase was insignificant due to well designed lending policies and good debt collection. Moreover, despite some real estate and construction companies experiencing difficulties in autumn 2007, there was no evidence of companies defaulting on their obligations or being illiquid in either 3Q07 or 4Q07. Other economic sectors did not suffer from the liquidity crunch, as they have historically been independent of banks' borrowings or borrowing abroad on their own behalf (natural resources sector).

Although the volumes of NPLs have not changed, the total composition of the banks' loan portfolios has deteriorated slightly, which can mostly be attributed to changes in collateral value (the real estate price correction) and in the aggregate credit ratings of some corporate borrowers.

Fig 13 Asset quality according to AFN classifications (%)

| | Standard | | | Doubtful category 1 | | | Doubtful category 2 | | | Doubtful category 3 | | | Doubtful category 4 | | | Doubtful category 5 | | | NPL | | |
|----------|----------|------|------|---------------------|------|------|---------------------|------|------|---------------------|------|------|---------------------|------|------|---------------------|------|------|------|------|------|
| | 1Q07 | 3Q07 | 4Q07 | 1Q07 | 3Q07 | 4Q07 | 1Q07 | 3Q07 | 4Q07 | 1Q07 | 3Q07 | 4Q07 | 1Q07 | 3Q07 | 4Q07 | 1Q07 | 3Q07 | 4Q07 | 1Q07 | 3Q07 | 4Q07 |
| KKB | 53 | 31 | 33 | 40 | 55 | 51 | 1 | 1 | 3 | 3 | 11 | 9 | 1 | 0 | 0 | 1 | 0 | 2 | 1 | 1 | 2 |
| BTA | 71 | 52 | 50 | 25 | 45 | 45 | 1 | 0 | 0 | 1 | 1 | 4 | 1 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 |
| Halyk | 62 | 51 | 47 | 33 | 34 | 38 | 0 | 11 | 10 | 2 | 2 | 3 | 0 | 0 | 0 | 1 | 0 | 0 | 2 | 1 | 1 |
| Alliance | 91 | 68 | 65 | 4 | 7 | 9 | 2 | 23 | 24 | 0 | 0 | 0 | 1 | 1 | 1 | 1 | 0 | 1 | 1 | 1 | 1 |
| ATF | 89 | 85 | 89 | 8 | 10 | 7 | 1 | 2 | 0 | 1 | 1 | 1 | 0 | 1 | 1 | 1 | 0 | 1 | 0 | 1 | 1 |
| BCC | 79 | 63 | 66 | 16 | 31 | 27 | 1 | 2 | 1 | 2 | 2 | 4 | 1 | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Temir | 89 | 95 | 95 | 8 | 2 | 1 | 1 | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 1 | 1 | 1 |
| Caspian | 79 | 81 | 82 | 13 | 10 | 8 | 4 | 2 | 1 | 1 | 3 | 4 | 1 | 0 | 1 | 0 | 1 | 1 | 1 | 3 | 3 |
| Nurbank | 88 | 87 | 88 | 7 | 6 | 6 | 1 | 3 | 2 | 1 | 0 | 0 | 1 | 2 | 1 | 0 | 1 | 2 | 1 | 1 | 1 |
| Tsesna | 97 | 91 | 89 | 1 | 7 | 8 | 1 | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 1 | 1 | 1 | 1 |

Source: AFN

We asked for clarification of the system for asset quality classification used by Kazakh regulators

We asked banks and the AFN for clarification on the Kazakh bracket system for asset quality. Based on their explanation and our understanding (although the system implies quite a complex calculation based on a variety of factors), the simplified principles are as follows:

1. When interest payment is more than 30 days overdue, the whole loan principal should be classified as an NPL and a provision should be created in the amount of 100% of the loan principal.
2. Standard loans include loans to high credit-rated borrowers repaid in time with the value of collateral remaining unchanged.
3. The 'substandard 1' category includes standard loans where the bank has objective or subjective reasons to believe the credit rating of the borrower may decrease as a result of certain expected events.
4. 'Substandard 2' includes loans with a high-score borrower, unchanged collateral value, but history of at least one interest payment delayed by up to three days.
5. 'Substandard 3' includes loans the interest on which is repaid on schedule, but where the credit score of the borrower may have suffered from a deteriorated financial performance or negative publicity, or the value of collateral may have decreased from the initial level.
6. 'Substandard 4' includes loans the interest on which is repaid with delays of up to 30 days.
7. 'Substandard 5' includes loans with delays in repayment, with lowered credibility of the borrower and/or significantly lower value of collateral.
8. There are some special regulations in classification; for example, if a loan in foreign currency is granted to an entity (person) not having income in foreign currency, such a loan should be classified one notch lower. The same applies to uncollateralised loans.

According to monthly bank reports published by the AFN, we have seen a significant migration of loans to substandard categories 1, 2 and – to some extent – 3.

Banks see the current NPL situation as comfortable and do not see reasons for any significant change

The banks do not see this situation as worrying as it was logically expected: 1) because some Autumn 2007 problems in the real estate construction sector might have led to delays in loan repayments; and 2) the correction in real estate prices definitely led to a deterioration in the value of some forms of collateral (real estate is the major collateral for most collateralised loans in Kazakhstan).

Bankers told us that if they were to expect any worsening in asset quality, it would come from the corporate side (construction companies and SMEs) rather than from consumer loans, as increases in individuals' debt burden are being outpaced by growth in real wages and growing levels of savings. Our macro view is that high oil prices should continue to sustain strong wage growth.

Our opinion: We believe that AFN data reflects the real situation objectively, as besides the natural increase in NPLs, revealed by a slowdown in lending, we do not see reasons either in retail loan deterioration (the indebtedness of the population is still very low, plus the steady increase in real wages and inflation makes loan repayments more manageable) or on the corporate side (although some construction companies had liquidity shortages, they seem to be getting back on track now with the government aid and we have not heard of problems in other sectors of the economy, where bank lending has historically been considerably lower).

Forex risk exposure

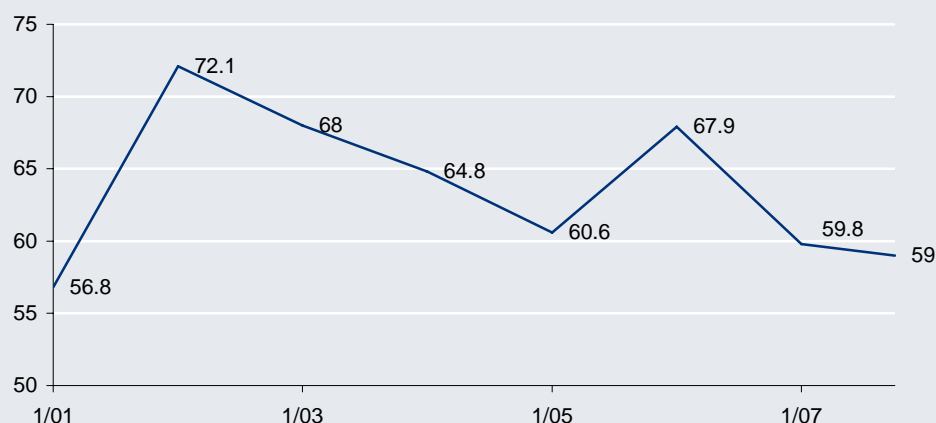
More than 50% of Kazakh bank loans and debts are denominated in foreign currency...

... but the FX exposure has reduced as a direct consequence of capital markets closure

According to the AFN, more than 50% of Kazakh bank loans are denominated in foreign currency, and many investors are therefore concerned about loan asset quality in case of a depreciation of the national currency similar to that which happened in August 2007 during the liquidity crisis.

The AFN told us that the high volumes of foreign-currency lending (predominantly in US\$) have been one of its major concerns. It has been trying to curb FX borrowing by introducing strict regulation, including larger provisions and stricter lending limitations. However, banks have been motivated to lend in US\$ because of their high volumes of external borrowings in foreign currencies. Foreign-currency liabilities in total banks' liabilities have tended to decrease since 2006 (see Figure 14).

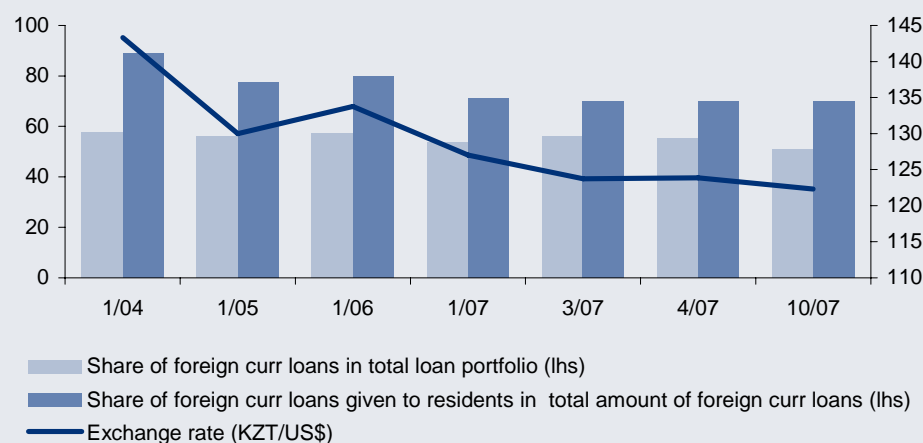
Fig 14 Share of FX liabilities in total liabilities (%)



Source: NBK

The 'silver lining' of the liquidity crunch was therefore a natural reduction in both borrowing and lending in foreign currencies (see Figure 15).

Fig 15 Foreign-currency lending



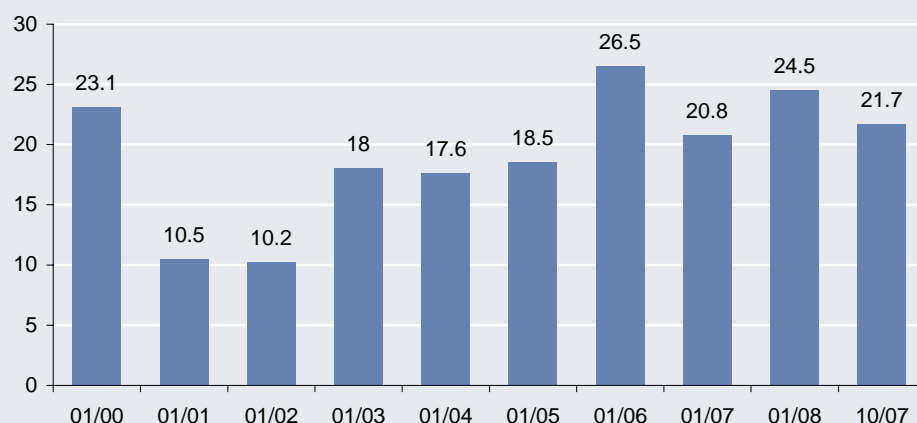
Source: NBK

Although discouraged by the AFN, significant lending to non-residents partially mitigates FX risks

The AFN expects this tendency to continue over the next year, as banks will be funded from internal deposits, the majority of which are in Kazakh Tenge.

Although the AFN and the Kazakh authorities have tried to discourage Kazakh banks from cross-border lending, a significant portion of loans over the last few years have gone abroad, mostly to real estate projects in Russia.

Fig 16 Share of claims to non-residents in total assets (%)



Source: NBK

As most cross-border lending was done in US\$, this to some extent mitigates the risk of banks' exposure to fluctuations in national-currency exchange rates. Another risk-mitigating factor is that the FX exposure of banks is well balanced in assets and liabilities and in maturities. The banks also told us that they never keep open FX positions on their books.

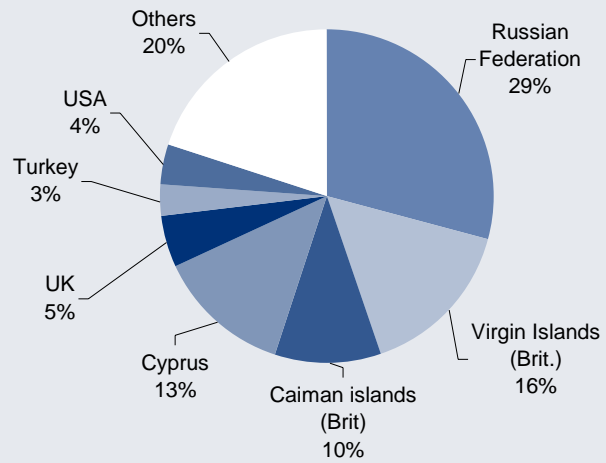
Fig 17 Share of non-KZT-denominated assets and liabilities on banks' balance sheets (%)

| | KKB 9M07 | BTA 6M07 | Halyk 9M07 | Alliance 3M07 | ATF 2006 | BCC 9M07 | Temir 2006 |
|-------------|-------------|-------------|---------------|------------------|-------------|-------------|---------------|
| Assets | 67.0 | 61.1 | 33.2 | 52.1 | 50.2 | 47.1 | 33.4 |
| Liabilities | 77.3 | 71.8 | 50.6 | 68.9 | 57.9 | 59.0 | 51.1 |

Source: Company data

Our opinion: Although the high FX exposure on banks' balance sheets represents a risk in the case of KZT depreciation, this situation is fairly typical for CIS banks (we see a very similar picture in Ukraine and Russia) and is partially mitigated by the National Bank's apparent commitment to avoiding any significant currency fluctuations and – uniquely for Kazakhstan – by the very high volumes of lending to non-residents not operating in the Kazakh market.

Fig 18 Distribution of loans to non-residents by country, 3Q07



Source: NBK

Refinancing possibilities

External markets have not closed completely and banks are still able to make some small bilateral deals

All the banks told us that markets have not closed completely and that they are still able to make some small deals – mostly bilateral and trade finance deals with long-term relationship banks. However, interest rates have gone up (in some cases doubled) and duration terms have decreased considerably (most deals are for under a year).

The banks are increasingly cooperating with development institutions, which was quite an unpopular option before the crisis – because of both high rates and the paperwork required. Recent deals in the market include those listed in Figure 19.

Fig 19 4Q07 external financing deals

| Borrower | Lender | Loan (US\$m) | Duration (years) | Conditions |
|----------|----------------------------------|--------------|------------------|----------------------------|
| KKB | IBD (Islam Bank for Development) | 50 | N/A | Grace period – 3 years |
| BCC | DEG | 40 | 7 | N/A |
| BCC | National City Bank | 30 | 7 | Grace period – 2 years |
| BTA | DEG | 8 | 5, 10 | 2 tranches of US\$41m each |

Source: ING estimates

However, given high interest rates and short loan tenors, Kazakh banks are not keen on external borrowing

One recent surprise was the US\$100m deal between the Kazakh state mortgage company and Credit Suisse. We believe conditions on this loan were far more favourable than for commercial banks, with interest at LIBOR + 2.52% for a seven-year loan with a three-year interest-free grace period.

Although it is difficult to obtain public information on interest on commercial banks' borrowings, we understand that interest rates are similar to bond pricing in the secondary market.

Given interest rates and borrowing durations, banks are not keen on borrowing and would prefer to generate cash internally for both investments and debt redemption.

Our opinion: Although the banks are perhaps not in the situation they would like, we are glad to see that they are realistic about their funding prospects and are adjusting their strategies for functioning in tight liquidity conditions. Although some banks might get smaller in terms of asset size, the whole banking sector looks set to benefit from banks constraining themselves from borrowing 'at any price' in the long term and this should help the markets gradually to return to more logical prices, as outstanding debt amounts are paid out.

2008 projections

It is obvious that the banking asset growth rates in 2005, 2006 and 1H07 were based on extensive foreign borrowing.

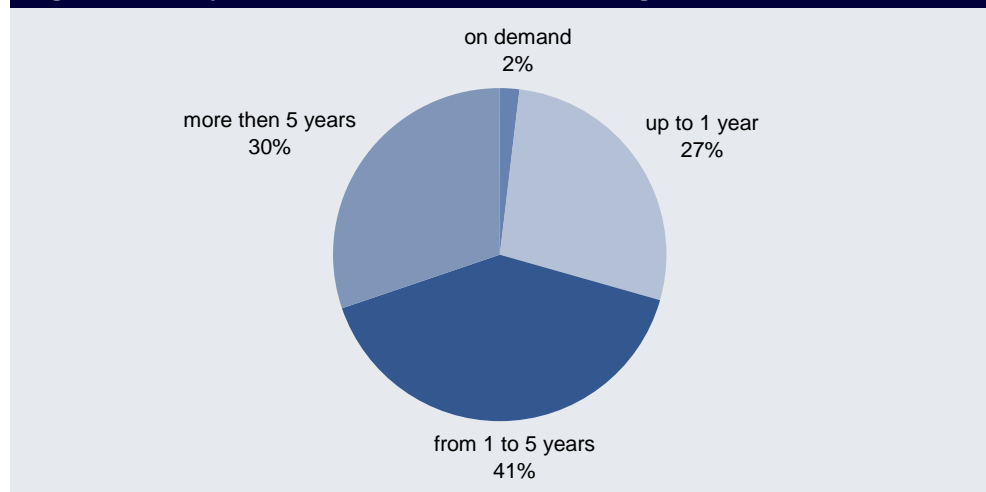
Fig 20 Kazakh banks' asset growth (2006-07)

| | 2006 | | 1Q07 | | 2Q07 | | 3Q07 | | 4Q07 | | | | Market share growth (%YoY) | Equity/assets YE (%) | |
|-----------------|----------------------|------------------|----------------------|---------------------|----------------------|---------------------|----------------------|---------------------|-----------------------|---------------------|---------------|------------------|----------------------------|----------------------|-----------|
| | Total assets (KZTbn) | Market share (%) | Total assets (KZTbn) | Asset growth (%QoQ) | Total assets (KZTbn) | Asset growth (%QoQ) | Total assets (KZTbn) | Asset growth (%QoQ) | Total assets (US\$bn) | Asset growth (%QoQ) | Growth (%YoY) | Market share (%) | | | |
| KKB | 2,269 | 26 | 2,336 | 3 | 2,776 | 19 | 2,750 | -1 | 2,715 | 22.6 | -1 | 20 | 23 | -2 | 10 |
| BTA | 1,825 | 21 | 2,103 | 15 | 2,536 | 21 | 2,515 | -1 | 2,649 | 22.1 | 5 | 45 | 23 | 2 | 15 |
| Halyk Bank | 977 | 11 | 960 | -2 | 1,261 | 31 | 1,384 | 10 | 1,567 | 13.1 | 13 | 60 | 13 | 2 | 9 |
| Alliance Bank | 925 | 10 | 1,121 | 21 | 1,357 | 21 | 1,232 | -9 | 1,192 | 9.9 | -3 | 29 | 10 | 0 | 13 |
| ATF | 1,047 | 12 | 980 | -6 | 953 | -3 | 1,050 | 10 | 993 | 8.3 | -5 | -5 | 8 | -3 | 8 |
| BCC | 571 | 6 | 665 | 17 | 809 | 22 | 907 | 12 | 881 | 7.3 | -3 | 54 | 8 | 1 | 8 |
| Temirbank | 199 | 2 | 249 | 25 | 321 | 29 | 340 | 6 | 326 | 2.7 | -4 | 63 | 3 | 1 | 17 |
| Caspian Bank | 196 | 2 | 206 | 5 | 212 | 3 | 235 | 10 | 257 | 2.1 | 10 | 31 | 2 | 0 | 12 |
| Nurbank | 206 | 2 | 209 | 2 | 190 | -9 | 203 | 7 | 204 | 1.7 | 0 | -1 | 2 | -1 | 19 |
| Eurasian Bank | 152 | 2 | 179 | 18 | 174 | -3 | 183 | 5 | 184 | 1.5 | 0 | 21 | 2 | 0 | 11 |
| Tsesna Bank | 86 | 1 | 119 | 38 | 134 | 13 | 152 | 13 | 150 | 1.3 | -1 | 74 | 1 | 0 | 13 |
| ABN Amro | 104 | 1 | 109 | 5 | 95 | -13 | 127 | 34 | 119 | 1.0 | -7 | 14 | 1 | 0 | 15 |
| Citibank | 83 | 1 | 80 | -4 | 84 | 5 | 98 | 16 | 82 | 0.7 | -16 | -2 | 1 | 0 | 11 |
| HSBC | 48 | 1 | 52 | 7 | 45 | -12 | 47 | 3 | 73 | 0.6 | 56 | 51 | 1 | 0 | 11 |
| Sberbank | 27 | 0 | 28 | 2 | 33 | 17 | 34 | 4 | 59 | 0.5 | 73 | 115 | 1 | 0 | 55 |
| Kazinvestbank | 25 | 0 | 27 | 6 | 30 | 13 | 43 | 41 | 58 | 0.5 | 36 | 129 | 0 | 0 | 17 |
| Eximbank | 22 | 0 | 34 | 57 | 43 | 26 | 41 | -5 | 38 | 0.3 | -6 | 76 | 0 | 0 | 30 |
| Alfa-bank | 23 | 0 | 25 | 7 | 25 | 1 | 27 | 8 | 25 | 0.2 | -5 | 10 | 0 | 0 | 27 |
| Zhilstroysberbk | 16 | 0 | 17 | 11 | 19 | 9 | 20 | 6 | 23 | 0.2 | 13 | 46 | 0 | 0 | 45 |
| Delta Bank | 12 | 0 | 13 | 2 | 13 | 4 | 17 | 26 | 20 | 0.2 | 21 | 63 | 0 | 0 | 29 |
| Demir Bank | 13 | 0 | 10 | -22 | 12 | 21 | 15 | 17 | 15 | 0.1 | 1 | 11 | 0 | 0 | 33 |
| KZI Bank | 5 | 0 | 6 | 19 | 7 | 9 | 9 | 35 | 9 | 0.1 | -5 | 67 | 0 | 0 | 32 |
| China Bank | 9 | 0 | 8 | -9 | 8 | 6 | 8 | 3 | 7 | 0.1 | -15 | -16 | 0 | 0 | 47 |
| Lariba Bank | 6 | 0 | 6 | -6 | 5 | -3 | 5 | 0 | 6 | 0.1 | 18 | 8 | 0 | 0 | 63 |
| Danabank | 8 | 0 | 8 | 2 | 7 | -10 | 6 | -9 | 6 | 0.1 | -1 | -17 | 0 | 0 | 38 |
| TPBK | 4 | 0 | 4 | 12 | 5 | 16 | 5 | 6 | 6 | 0.0 | 10 | 50 | 0 | 0 | 37 |
| Alma-Ata | 6 | 0 | 7 | 29 | 7 | -6 | 5 | -21 | 4 | 0.0 | -23 | -27 | 0 | 0 | 36 |
| Senim-bank | 2 | 0 | 2 | 20 | 2 | 11 | 3 | 7 | 3 | 0.0 | -4 | 37 | 0 | 0 | 70 |
| Express Bank | 3 | 0 | 3 | -3 | 3 | 7 | 2 | -21 | 2 | 0.0 | -3 | -20 | 0 | 0 | 86 |
| TAIB Bank | 2 | 0 | 2 | 19 | 2 | -14 | 2 | -2 | 2 | 0.0 | 4 | 5 | 0 | 0 | 64 |
| Kazinkombank | 2 | 0 | 2 | 13 | 2 | 7 | 2 | 3 | 2 | 0.0 | -11 | 12 | 0 | 0 | 83 |
| Zaman-bank | 1 | 0 | 1 | 3 | 1 | 4 | 2 | 11 | 2 | 0.0 | 1 | 20 | 0 | 0 | 97 |
| Pakistan Bank | 1 | 0 | 1 | 4 | 2 | 6 | 2 | -3 | 1 | 0.0 | -9 | -2 | 0 | 0 | 75 |
| Total | 8,875 | 100 | 9,573 | 8 | 11,174 | 17 | 11,469 | 3 | 11,683 | 97.4 | 2 | 32 | 100 | 0 | 12 |

Source: AFN

Domestic resources are not sufficient to sustain recent growth rates

However, domestic resources are insufficient to sustain recent growth rates, especially given debt repayments coming due in 2008. According to the National Bank, banks have to repay a total of US\$13.1bn in 2008 – although we believe this figure includes overnights, currency swaps and contingencies, so the adjusted scheduled repayments should be lower.

Fig 21 Maturity breakdown of external outstanding liabilities, as of 01/12/07

Source: AFN

Many banks have reduced lending activities to consolidate assets and pay off debts falling due without refinancing

A number of banks told us that they have curtailed their credit programmes to consolidate assets and pay off current liabilities. All the banks have revised their growth plans for 2008 – to growth in line with inflation on average (stagnation in real times).

We see three names that stand out as expecting to achieve positive growth in 2008:

1. Halyk Bank, with no debt repayments coming due in 2008, projects 30% asset growth on the back of continued deposit inflow and a continuous lending business.
2. ATF Bank expects a significant capital injection from new shareholder UniCredit in 2008 and has set itself the ambitious goal of getting into the top-three leadership league by 2010. Despite being positive on the bank over the medium term, we see 2008 as a rather calm year for ATF, given the unresolved dispute over preference shares, which prevents it from making a necessary equity increase (it now has the minimal allowed capitalisation and will have to be recapitalised to continue growing), and necessary 'adjustment' procedures to make its risk management, IT and other areas compatible with those of the international UniCredit group.
3. BTA could become a growth story in 2008 if it succeeds in selling Temir at a good price and invests the freed-up funds in geographical diversification. We see the bank's diversification policy as very positive, but we cannot spot any other source for the required resources than the potential proceeds of the Temirbank sale.

Some M&A deals are expected in 2008, while foreign players may use their preferential funding access to grow

We have also been told by many banks that new players may enter the Kazakh market in 2008. The banks told us that they were approached in 4Q07 by several foreign banks: at least four Western European banks, one large UK bank and – surprisingly – some Asian and Middle-Eastern banks and one large American bank. The most likely targets for acquisition are suspected to be BCC, Temir and maybe Nurbank.

Besides expected acquisitions of banks by external players, some foreign-owned banks are already present in Kazakhstan, having entered the market in 2007 or earlier. These players have sufficient resources and the potential to grow, especially given the difficulties the Top Four face in raising funding.

Many banks are aware of Russia's Sberbank as a rising strong competitor

Russia's Sberbank in particular, which entered the Kazakh market in autumn 2006 by buying the middle-sized Texakabank, has since 2H07 been becoming aggressively capitalised, intensively buying up premises in large cities for future branches and

recruiting the best banking specialists from Kazakhstan's top banks. This expansion fits with the recent statement from Sberbank Russia's new chairman Mr Gref that Sberbank aims to become the largest bank in Europe by 2015.

Fig 22 Foreign-owned banks in Kazakhstan as of 01/11/07

| Rank by assets | Name | Parent | Est/purchased | Assets, Market share (US\$bn) | Market share (%) | Equity (US\$bn) | Equity/assets, (%) |
|----------------|---|-------------------|---------------|----------------------------------|---------------------|--------------------|-----------------------|
| 5 | ATF Bank | UniCredit | 2007 | 8.79 | 9.28 | 0.68 | 8 |
| 12 | ABN AMRO Bank | ABN AMRO | 2001 | 1.01 | 1.07 | 0.1 | 10 |
| 13 | Citibank Kazakhstan | Citibank | 2001 | 0.65 | 0.68 | 0.07 | 11 |
| 14 | Sberbank of Kazakhstan (former Texakabank) | Russian Sberbank | 2006 | 0.49 | 0.52 | 0.27 | 55 |
| 15 | HSBC Bank Kazakhstan | HSBC | 2004 | 0.46 | 0.48 | 0.06 | 13 |
| 18 | Alfa Bank Kazakhstan | Russian Alfa Bank | 2002 | 0.2 | 0.21 | 0.05 | 25 |
| 21 | Demir Kazakhstan Bank | Israeli Hapoalim | 2001 | 0.13 | 0.14 | 0.03 | 23 |
| 22 | Bank of China in Kazakhstan | Bank of China | 2001 | 0.07 | 0.08 | 0.03 | 43 |
| 23 | Kazakhstan Ziraat International | Turkey | 2003 | 0.07 | 0.07 | 0.02 | 29 |
| 25 | Lariba Bank | Saudi Arabia | 2006 | 0.04 | 0.05 | 0.02 | 50 |
| 30 | Taib Kazakhstan | Bahrain | 2001 | 0.02 | 0.02 | 0.01 | 50 |
| 32 | Zaman Bank | Turkey | 2003 | 0.01 | 0.01 | N/A | N/A |
| 33 | Bank of Pakistan in Kazakhstan | Pakistan | 2005 | 0.01 | 0.01 | N/A | N/A |

Source: AFN, NBK

Our opinion: As we have highlighted in previous reports on Kazakhstan, a situation of funding constraints among local banks is an ideal time for large foreign players to enter the country's banking sector. We see BCC and Temirbank as the two most attractive targets for acquisition, with Nurbank and Caspian maybe joining them in the 'sale window' in 2008. We expect at least two M&A deals in 2008. Of all the foreign players in Kazakhstan (besides ATF), we believe Russia's Sberbank has the best opportunities to penetrate the top ten. However, we do not think this will happen in 2008 given its small asset size and the overall slowdown in the Kazakh economy caused by the liquidity crunch.

National Bank of Kazakhstan

We met with officials at the National Bank of Kazakhstan to discuss the central bank's view on the general macroeconomic situation in the country, its 2008 policy guidelines and the government's position on the current situation in the financial sector.

Tackling inflation vs liquidity support

2008 monetary policy will be conducted with the primary goal of containing inflation below 10%...

The NBK told us that monetary policy for 2008 will be conducted with the primary goal of containing inflation at below 10% (vs 18.8% YoY in December 2007), so it will continue to carry out moderate monetary policies.

It assumes that slower credit growth will lead to a corresponding slowdown in imports, and the decreased inflow of FX-denominated funds into the country through banks should help decrease inflation rates naturally.

... but anti-inflationary measures will not be aggressive, to ensure sufficient liquidity in the banking system

Considering that classic anti-inflation measures would imply lowering monetary aggregates and supporting a high cost of domestic borrowing, which would lead to a liquidity drain and slower GDP growth, we do not believe the NBK will be excessively tough in its anti-inflation policy. The NBK has also indicated that "it will monitor the situation on the financial markets closely to ensure there is a sufficient level of liquidity in the banking system to sustain banks' seamless functioning".

The NBK has also stated that it may impose restrictions on the convertibility of the KZT on the domestic cash market and that it could impose temporary restrictions on capital movements. No further details were given.

Under its base-case scenario, the NBK forecasts inflation of 9.9% in 2008 and 9.5% in 2009, mostly on lower GDP growth and decelerating money supply growth. We see 11-12% as more likely in 2008, but the 2009 target looks feasible.

KZT stability

The NBK will avoid any significant movements in KZT/US\$ exchange rates, but cannot guarantee to keep the Tenge at the 120 level

The NBK stressed its efforts to maintain KZT/US\$ exchange rate stability during the August 2007 liquidity crisis and said that although the KZT rate is officially floating, it is committed to preventing significant deviations in the exchange rate from the current level until at least the end of 2008. Under this scenario, the NBK states that it will not allow drastic movements in exchange rates, but it refused to set any guidance for the expected future value of the KZT – or set any limits on its movements.

In spite of this indirect statement, that supporting the KZT will be of minor priority, we believe the NBK will continue to support the exchange rate at close to current levels as Kazakhstan imports the majority of its food and consumer products. If the KZT were to depreciate significantly, import-led inflation would soar. Although increasing pressure on international reserves may not allow the NBK to keep the KZT/US\$ exchange rate at exactly the 120 benchmark, we expect the rate to remain broadly stable in 2008. Our macroeconomists expect the KZT to average 124/US\$ vs 123/US\$ in 2007.

Impact of the financial crisis on the economy and support to banks

The NBK told us that, according to government estimates, even in a globally slower environment, the economic growth rate for 2008 will not fall below 5%, supported by high prices for Kazakhstan's main exports, such as oil, metals and wheat.

***GDP forecast for 2008
cut from 8-9% to 5%***

The NBK realises that the cut in external borrowing influenced rates and volumes of lending to the real economy and will therefore affect the dynamics of economic growth; some slowdown of the economy is therefore to be expected, and the NBK's forecast for 2008 has been corrected down from the previously assumed 8-9%. The adjusted macroeconomic scenario assumes repayment of the maturing share of the banking sector's US\$45bn in external debt, with minimal refinancing, with GDP growth slowing to 5% in 2008 and 6.3% in 2009, which should slow import growth and stabilise the current account at a US\$5bn deficit in 2008 and balance it in 2009. This scenario assumes no refinancing available for the approximately US\$13bn in Kazakhstan banking sector debt expected to be due for repayment in 2008, which compares with the US\$30-40bn of official reserves and the oil fund.

***Kazakhstan's economy
should look healthy as
long as the oil price
does not decline below
US\$50-60 per barrel***

We were told that based on stress-testing scenarios, Kazakhstan's economy should look healthy as long as the oil price does not decline below US\$50-60 per barrel. The government will also continue with reforms intended to improve the country's investment climate to facilitate foreign investments in non-oil sectors such as electric power, rail and motor transport and telecommunications in order to raise the efficiency of the economy and improve general diversification.

***The National Bank will
continue to support the
banking system by
providing short-term
liquidity***

The National Bank will continue to support the banking system by providing short-term liquidity (the range of acceptable REPO collaterals has been widened to include Eurobonds, securities of national 'blue-chip' companies, and foreign sovereign and international financial organisations' securities), engaging in open market operations, providing loans to individual institutions and in certain cases currency swaps to ensure the 'soft landing' of the banking system and its gradual switch to slower growth from internal resources.

The NBK confirmed that the government may double its US\$4bn funding for the real estate and construction sector. It also noted that there are numerous government programmes for the stimulation of other sectors' development, such as the US\$1bn lending support for the agricultural sector through Kazagro.

All funds committed to such programmes come from the budget and not the oil fund as oil fund usage is strictly regulated by the constitution. To amend its usage for other purposes, parliament approval would be needed and funds would not be able to be used directly – they would first have to be transferred to the budget. Nevertheless, the NBK stressed that supporting the Kazakh economy in a global slowdown is the government's priority and, if need be, the oil fund could be used to facilitate sustainable development.

***The government may
consider buying
minority stakes in
commercial banks***

In addition, the government is currently discussing the possibility of buying minority stakes in commercial banks in exchange for liquidity support. In this case, the government would ensure better control under the banking system, which is known as having one of the most minor government presences in the CIS. However, the procedure is unclear and we cannot imagine commercial banks being interested in such government intrusion.

As for the availability of government resources, according to the NBK, the situation is as shown in Figure 23.

Fig 23 Net international reserves and National Oil Fund reserves of Kazakhstan

| | Net international reserves | | | National Fund of Kazakhstan | | | Total volume (US\$m) |
|--------|----------------------------|---------|---------|-----------------------------|---------|---------|----------------------|
| | Volume (US\$m) | %ch MoM | %ch YoY | Volume (US\$m) | %ch MoM | %ch YoY | |
| Dec-06 | 19,123 | 26.76 | 170.66 | 14,092 | 6.53 | 74.54 | 33,215 |
| Jan-07 | 20,897 | 9.28 | | 14,740 | 4.60 | | 35,637 |
| Feb-07 | 21,846 | 4.54 | | 15,539 | 5.42 | | 37,385 |
| Mar-07 | 21,560 | -1.31 | | 15,880 | 2.19 | | 37,440 |
| Apr-07 | 22,263 | 3.26 | | 16,438 | 3.52 | | 38,701 |
| May-07 | 21,755 | -2.28 | | 17,463 | 6.24 | | 39,218 |
| Jun-07 | 22,372 | 2.83 | | 17,643 | 1.03 | | 40,015 |
| Jul-07 | 23,397 | 4.58 | | 18,085 | 2.51 | | 41,482 |
| Aug-07 | 20,013 | -14.46 | | 18,356 | 1.50 | | 38,369 |
| Sep-07 | 18,421 | -7.96 | | 18,679 | 1.76 | | 37,100 |
| Oct-07 | 17,427 | -5.40 | | 20,056 | 7.37 | | 37,483 |
| Nov-07 | 18,117 | 3.96 | | 20,762 | 3.52 | | 38,879 |
| Dec-07 | 17,389 | -4.02 | -9.07 | 21,046 | 1.36 | 49.35 | 38,435 |
| Jan-07 | 19,155 | 10.15 | | 21,555 | 2.42 | | 40,710 |

Source: NBK

The government has a comfortable level of resources available to support the financial and real estate sectors

Given January's US\$1.6bn rise in foreign-currency reserves, we assume that the NBK has the flexibility to support the KZT against the US\$ and that the government has a comfortable level of resources available to support the financial and real estate sectors.

Note recent positive news on oil production: TengizChevroil has increased production by 90,000bpd to 400,000bpd after commissioning a gas injector and expects capacity to increase to 540,000bpd in the second part of the year after adding more facilities at the Tengiz field.

It is estimated that this move will allow TengizChevroil to increase production by 40% in 2008, which means 12.5% growth in 2008 crude oil and gas condensate production, compared with the rather modest 4.3% growth in 2007. This news is positive for Kazakhstan's macroeconomic outlook, as future cash flows and financial resources will help the government deal with financial issues more comfortably.

Agency for Financial Supervision (AFN)

The AFN claims to remain independent from political and economic interest

Regarding our concerns that the AFN is too political in its policymaking given the absolute presidential power in the country, AFN officials told us that it is actually in the best interests of the government to let it remain independent and that this independence can be seen in that none of its top governors are aligned to either political or business interests.

The AFN stressed during our meeting that although the liquidity crunch naturally limits foreign-currency borrowing and forces banks to improve their lending and risk management policies, it is going to continue to work towards improving the governance and transparency of the banking system.

It indicated that it understands our concerns about the risk of the false presentation of asset quality by banks, but that inspectors have carried out numerous and regular on-site checks on banks (every few months) and have failed to uncover any violations.

The AFN is working on increasing the number of staff to ensure more frequent inspections

However, now that maintaining sound asset quality and following reserve-building procedures is vital for banks' seamless functioning, the AFN is working on increasing the number of staff to ensure more frequent inspections.

The AFN said that the implementation in April 2007 of tougher asset classification rules, risk weights, collateral requirements and liquidity norms (K8 and K9 capital regulations) – although fiercely opposed by banks at the time – has put them in a stronger position to weather the more difficult environment they now face.

Postponed tightening of reserve requirements on the foreign borrowings will be coming into power in the year-mid 2008

The AFN also told us that the postponed tightening of reserve requirements on foreign borrowings will come into force in mid-2008, possibly including steps to increase other capital and provisioning norms, to ensure that external borrowing will not remain uncontrollable once markets open up.

In particular, in the short term, the AFN plans:

- To lower the maximum allowed ratio of single-borrower risks vs own capital.
- To tighten K8 and K9 requirements (external borrowings vs own capital and external borrowings and securities issued vs own capital), probably in July 2009.
- To improve the regulation of asset securitisation.

In general, we found the AFN to be open and transparent, and it helped clarify position by providing useful information on loan classification rules – see the *Bank asset quality* section). The AFN assured us that it is striving to become more international and that by the summer, international investors will be able to read its publications on banks' monthly financial reports in English.

In the mean time, information about banks provided on a monthly basis in Russian only is on the AFN's website at: <http://www.afn.kz/index.cfm?uid=E8EF1F6B-CEAA-956F-4FA4BF1FD775BAA7&docid=10>. We also found very useful for investors the AFN's press release on the 2007 results of financial institutions published at: http://www.afn.kz/cont/publish284761_3883.pdf (unfortunately, also Russian only).

Individual banks

Although the second half of 2007 clearly resulted in a lot of headaches for both banks and the regulator, we can see that all banks managed the situation well (with or without governmental help) and no bank looks set to be in crisis in 2008.

All the banks we met seem much more realistic in their assessment of the situation

All the banks we met seem much more realistic in their assessment of the situation than when we met them back in August-September last year, and admit that 2008 will not be rosy. They expect a difficult year ahead and are preparing to face a scarcity of funding, a further slowdown in growth and possible reductions in balance sheet size. Most are switching to 'safe mode', with strict liquidity management, reduced lending activities and saving liquid assets for scheduled debt repayments.

We were also pleased with the preparedness of both banks and regulators to enter into open and constructive dialogue with investors. Moreover, agency of financial supervision and the National Bank – which we still deem to be the best in the CIS – seem to be becoming more international and transparent.

Halyk Bank

Fig 24 Halyk Bank financials (KZTm)

| | 2006 | 1H07 | 9M07 | 1H07 | 9M07 | 2007 |
|---------------------------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Summary balance sheet | IFRS | IFRS | IFRS | KAS | KAS | KAS |
| Cash & central bank | 182,906 | 264,590 | 253,558 | 217,045 | 136,088 | 93,824 |
| Due from banks | 2,049 | 6,207 | 4,974 | 58,815 | 129,870 | 249,551 |
| Securities | 176,355 | 191,832 | 192,551 | 186,566 | 173,197 | 139,923 |
| Net loans | 596,216 | 780,372 | 905,102 | 748,735 | 864,203 | 989,283 |
| Total assets | 991,359 | 1,286,951 | 1,407,998 | 1,261,194 | 1,384,063 | 1,567,239 |
| Total assets (US\$m) | 7,806 | 10,522 | 11,640 | 10,311 | 11,442 | 13,028 |
| Customer deposits | 597,935 | 612,006 | 767,169 | 766,351 | 1,012,246 | 1,143,751 |
| Due to banks | 118,719 | 271,880 | 222,167 | 69,503 | 81,050 | 1,315 |
| Borrowings | 103,705 | 208,180 | 210,908 | 171,176 | 83,069 | 115,544 |
| Subordinated loan capital | 30,708 | 28,646 | 28,945 | 28,910 | 28,937 | 38,956 |
| Shareholders' equity | 120,628 | 141,157 | 152,941 | 127,002 | 138,115 | 141,290 |
| Summary income statement | | | | | | |
| Interest income | 80,647 | 54,850 | 89,331 | 54,384 | 88,502 | 131,109 |
| Interest expense | (34,183) | (24,187) | (39,706) | (19,359) | (32,737) | (51,699) |
| Non-interest income | 28,367 | 23,137 | 32,324 | 26,488 | 35,430 | 65,699 |
| Net income | 26,659 | 21,263 | 33,205 | 17,582 | 29,070 | 32,721 |

Source: Company data, AFN

Ownership: The bank is ultimately controlled by the President's daughter, Dinara Kulibayeva, and her husband, Timur Kulibayev, through JSC Holding Group Almex. In December 2006, it listed its GDRs through an initial public offering on the London Stock Exchange.

Exposure to real estate and construction (as of September 2007): According to data provided by the bank, at the end of 2007 mortgage loans stood at 15% of the gross loan portfolio, construction at 14% and real estate at 3%. For mortgage loans, as a rule Halyk requires a cash deposit (no interest, 15-20% of mortgage total volume) and the maximum LTV is 75% (of the real estate + cash deposit total).

Asset quality: The bank's credit portfolio is 50% large corporates, the majority of retail loans are salary-backed, and the bank does not feel comfortable going into the credit-card business.

2008 refinancing and debt repayment: Halyk could not tell us the exact amount of externally borrowed funds in its liabilities, but noted that as of the end of 2007 funding from customer deposits amounted to 65% of total liabilities – the highest level among the top ten banks. The share of external funds is therefore expected to be moderate.

The bank does not have any external debt maturing in 2008, and the breakdown of its future external liabilities is as shown in Figure 25.

Fig 25 Debt repayment schedule

| Type | Volume (US\$m) | Maturity |
|-----------------|----------------|-----------|
| Bilateral loan | KZT12.400bn | 20/08/09 |
| Eurobond | 200 | 07/10/09 |
| Syndicated loan | 400 | 25/04/10 |
| Syndicated loan | 300 | 20/09/10 |
| Bilateral loan | 30 | 04/09/11* |
| Eurobond | 300 | 13/05/13 |
| Eurobond | 700 | 03/05/17 |

*With an option for the lender to call the loan on interim maturity dates

Source: Company data

2008 growth projections: The bank expects 30% growth in assets in 2008, based on continuing deposit growth. To allow for the expansion, it plans to re-evaluate the cost of servicing its branch network, which is currently valued at about c.KZT17bn according to 1997 prices (the time of the last valuation). As most branch premises are owned by the bank rather than rented, and prices have gone up dramatically since the last valuation, Halyk Bank estimates that the cost of properties has at least doubled. The negative effect of such a revaluation would be the possible effect on taxation.

Funding: Halyk Bank said that it is still able to make use of the syndicated and bilateral loans market, but given increased pricing and decreased duration, deposits are a more economically feasible source of funding at the moment. The bank aims to increase the share of interest-free demand deposits; in 2007 it managed to raise the share of such deposits from 15% to 20%.

Halyk thinks it should be able to sustain the 2H07 deposit growth rate as it believes it has a competitive advantage in terms of deposit raising for the following reasons:

1. As the successor to the USSR savings bank, it has a reputation as a solid, reputable bank with strong state links.
2. It has the widest branch network in the country (three times larger than that of its nearest competitor) and the advantage of a countrywide presence, especially as in the most remote areas it faces little or no competition.

As at 31 December 2007, Halyk's branch network consisted of 670 outlets, comprising 22 regional branches, 125 district branches, 473 limited-service branches and 50 personal-service centres. It had 1,166 ATMs and 3,375 point-of-sale terminals.

3. It targets its own specific customer segment. While the larger banks target the middle and upper classes of the population, Halyk as a truly 'folk bank' targets the majority of low-income citizens, including pensioners. Its average deposit size (US\$400) is therefore far smaller than that of its competitors, but it exceeds the competition in terms of its number of depositors.

Besides retail, Halyk counts on corporate deposit growth from core customers in the commodities sector (metals, mining, etc).

The bank has a fairly high cost-to-income ratio (c.35%, compared with KKB's 20%) because of high branch network costs, but has managed to maintain interest margins flat at 6.5-6.8%. The same level is predicted for 2008. To increase its profitability, the bank would like to expand into supplementary business areas, such as insurance.

Halyk has been considering the possibility of bringing new deals to the market, given its very moderate borrowing volumes to date. We were told that if market dynamics do not change and the bank cannot make any new deals in 2008, it may consider buying back existing bonds.

Plans for 2008 include a continuing focus on large corporates, retail and SMEs as well as cross-border diversification. The bank has already received first approvals to establish subsidiary banks in Georgia and Mongolia. Its Russian subsidiary based in Chelyabinsk has changed its name from Bank Khlebny to NBK-Bank and is now considering establishing a presence in Moscow. Halyk also told us that it is interested in expanding into Azerbaijan and the Xinjiang Uigur Autonomous Region of China.

Alliance Bank

Fig 26 Alliance Bank financials

| | 2006 IFRS | 1H07 IFRS | 9M07 IFRS | 1H07 KAS | 9M07 KAS | 2007 KAS |
|---------------------------------|----------------|------------------|------------------|------------------|------------------|------------------|
| Summary balance sheet | | | | | | |
| Cash & central bank | 99,594 | 118,759 | 97,818 | 146,214 | 100,536 | 73,159 |
| Due from banks | 23,951 | 88,825 | 39,332 | 72,441 | 49,930 | 36,079 |
| Securities | 138,964 | 264,330 | 167,397 | 235,486 | 173,197 | 170,585 |
| Net loans | 634,547 | 829,426 | 884,756 | 784,562 | 864,203 | 794,376 |
| Total assets | 920,750 | 1,332,434 | 1,223,908 | 1,357,009 | 1,384,063 | 1,192,270 |
| Total assets (US\$m) | 7,250 | 10,894 | 10,118 | 11,095 | 11,442 | 9,911 |
| Customer deposits | 272,786 | 263,548 | 236,325 | 559,813 | 1,012,246 | 564,276 |
| Due to banks | 388,179 | 392,097 | 337,292 | 457,835 | 81,050 | 10,273 |
| Borrowings | 139,249 | 370,272 | 377,768 | 104,243 | 83,069 | 48,591 |
| Subordinated loan capital | 32,614 | 32,146 | 35,325 | 27,676 | 28,937 | 30,132 |
| Shareholders' equity | 80,038 | 136,328 | 147,058 | 138,777 | 138,115 | 155,702 |
| Summary income statement | | | | | | |
| Interest income | 80,193 | 81,101 | 130,338 | 86,408 | 88,502 | 186,429 |
| Interest expense | (40,350) | (41,120) | (64,116) | (34,421) | (32,737) | (78,550) |
| Non-interest income | 5,458 | 3,078 | 5,463 | 25,495 | 43,890 | 68,731 |
| Net income | 14,010 | 19,578 | 30,725 | 19,080 | 29,070 | 36,355 |

Source: Company data, AFN

Ownership: The bank is ultimately controlled by the Seisembayev brothers through Seimar Investment Group (an industrial-financial group with assets in other sectors). We were told by various Kazakh sources that the brothers also have significant assets in sectors of the Kazakh economy such as oil & gas, agriculture, paper production and real estate.

From our conversation with the bank, we got the impression that the shareholders are committed – if necessary – to selling assets not only on the balance sheet but also at the group level (real estate, warehousing facilities, plants) and placing funds in the form of deposits on the bank's accounts to support its liquidity.

Alliance's shareholders have already demonstrated their commitment to the bank by increasing their shareholding to 74.7% by using secondary LSE share placement proceeds in July and placing the residual US\$220m in cash as a deposit with the bank.

Exposure to real estate and construction (as of September 2007): Alliance has probably the lowest exposure among the big banks. Real estate loans represent 3.3% of the total loan portfolio, construction 4.9%, and mortgages 8%. The average LTV for 3Q07 was 61.6%, lending was conducted to buy existing property only (no pre-paid projects).

As some of its customers are SMEs in the construction sector, it passed about 14 construction projects to state holding Kazyna to be considered for funded lending under the US\$4bn programme.

Asset quality: In terms of asset quality, Alliance has seen a very minor deterioration on the corporate and SME side and almost no change on the retail lending side. It is therefore pursuing a policy of reducing its focus on the corporate and SME business in favour of retail, which it sees as positive for asset quality. In general, the bank expects about 3.8% NPLs as of year-end 2007 and projects this number to rise to 4.5-5% as of year-end 2008 because of a significant slowdown in lending.

2008 refinancing and debt repayment: Alliance told us that it is not counting on the markets opening up before 1H09 and therefore plans to repay debts falling due from internal sources, all the more so as it is a specialised consumer lending bank, has a portfolio of liquid, short-term loans and – thanks in particular to very high interest on consumer loans charged – the cash generated is more than sufficient to cover payments coming due. The bank provided us with the schedule of repayments shown in Figure 27.

Fig 27 Schedule of maturing debt repayments for 2008 (US\$m)

| | 1Q08 | 2Q08 | 3Q08 | 4Q08 | 2008 |
|----------------|-------|-------|-------|-------|-------|
| Eurobonds | 0 | 150 | 0 | 0 | 150 |
| Bilateral | 36 | 22 | 146 | 108 | 312 |
| Syndicates | 131 | 334 | 0 | 81 | 546 |
| Securitisation | 3.6 | 3.6 | 3.6 | 3.6 | 14 |
| Total | 170.6 | 509.6 | 149.6 | 192.6 | 1,022 |

Source: Company data

Alliance has US\$1,022m of outstanding debt in 2008, both syndications and bilaterals. June sees the largest repayment, of US\$500m, with the rest distributed equally across the year. Only US\$600m of debt is due in 2009, and remaining debt for the following years is distributed in gradually declining amounts.

Alliance told us that it does not plan to raise new debt or syndications – only small bilateral and multilateral deals with relationship banks.

In spite of speculation caused by the misinterpretation of a statement in one of Alliance's conference calls in October, the bank does not expect any premature repayments as covenants are included only in syndications (not in bonds), and most of them are related to capital adequacy (the bank is very well capitalised with a Tier 1 CAR of more than 10% (8% required)).

**Alliance tried to buy
back its bonds in
October**

Alliance projects about US\$150m in monthly cash generation to cover the maturing repayments falling due. It has also built up considerable liquid reserves (about 20% of the balance sheet, c.7% cash on corresponding accounts, 14% on highly liquid securities – US T-Bills and the Kazakh sovereign) to feel able comfortably to cover possible positions. Alliance told us that it was going to buy back its bonds in October at the lowest price point, but it was only able to buy about US\$60m due to the unavailability of bonds in the market. Shareholders now tend to opt for a gradual repayment to improve the bank's reputation in the market.

2008 growth projections

Alliance told us that its loan book has declined by 6% since November and it plans a further decrease in 2008, mostly by gradually closing its corporate and SME business arms.

Alliance is not going to pursue an expansion strategy, as this is no longer viable given current market conditions. Its strategy is therefore now to become a niche retail lending bank similar to Russian Standard in Russia (aside from funding, which Alliance now derives from customer deposits). It is planning to move aggressively into the credit-card business as a very lucrative product in its own right and a supplementary way of attracting deposits (credit cards are usually linked to salary accounts).

Comfortable with its high profitability and strong brand name, Alliance is no longer striving for leadership, but is going to focus on reaching the highest possible profit margins by maintaining a healthy loan portfolio quality.

In order to secure its consumer retail position, the bank is going to install 12,000 new ATMs – to give it the largest ATM base in the country. It is planning gradually to decrease cooperation with the post office for the generation of new deals, but retain the relationship to use the post office as its primary debt collection channel.

Competitive advantage: As for dangers of increased competition from other banks moving increasingly into retail, Alliance believes it has a competitive advantage of having a credit history with more than two million customers with high income, who are potential borrowers. (Other banks have yet to create such a position, which takes years.) Alliance told us that it considers only 8.5% of population as 'bankable' in terms of consumer lending – having stable high incomes.

Funding in 2008: The major source of funding in 2008 is set to be customer deposits, in which Alliance saw a positive reversal in the trend in November and December after the deposit flight in September 2007. The bank increased the interest rates it pays on deposits to about 15% in KZT, 12.5% in US\$ and 11% in euros in order to attract more depositors, and this policy has obviously paid off with deposit inflows increasing. The bank expects 15-18% growth in the deposit base in 2008; in its lending policies, it targets a 300% loan-to-deposit ratio.

Alliance told us that it had 24 branches and 199 mini-branches at the end of 2007 and may consider widening the branch network. It also told us that it is not actively seeking a sale, as has at times been discussed in the market, but would consider attracting a strategic partner with experience in consumer banking that would understand its business model and agree to participate as a minority shareholder.

Kazkommertsbank

Fig 28 KKB financials (KZTm)

| | 2006 IFRS | 1H07 IFRS | 9M07 IFRS | 1H07 KAS | 9M07 KAS | 2007 KAS |
|---------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Summary balance sheet | | | | | | |
| Cash & central bank | 209,005 | 162,572 | 210,984 | 190,589 | 210,255 | 191,179 |
| Due from banks | 197,191 | 188,115 | 113,094 | 157,483 | 123,862 | 195,035 |
| Securities | 325,603 | 276,464 | 210,634 | 290,571 | 175,333 | 137,453 |
| Net loans | 1,678,840 | 2,372,658 | 2,425,057 | 2,037,748 | 2,070,330 | 1,992,393 |
| Total assets | 2,444,302 | 3,042,889 | 3,008,447 | 2,775,853 | 2,750,237 | 2,715,109 |
| Total assets (US\$m) | 19,246 | 24,878 | 24,871 | 22,695 | 22,737 | 22,569 |
| Customer deposits | 687,806 | 951,015 | 827,828 | 1,793,385 | 1,809,044 | 1,719,727 |
| Due to banks | 884,301 | 831,077 | 838,695 | 359,329 | 375,092 | 54,415 |
| Borrowings | 492,976 | 817,585 | 881,982 | 199,408 | 150 | 75,734 |
| Subordinated loan capital | 78,922 | 104,090 | 103,982 | 96,880 | 96,553 | 101,233 |
| Shareholders' equity | 263,926 | 292,602 | 301,400 | 241,589 | 259,285 | 268,645 |
| Summary income statement | | | | | | |
| Interest income | 147,250 | 137,379 | 224,657 | 126,600 | 206,641 | 291,116 |
| Interest expense | (83,115) | (76,631) | (122,511) | (60,989) | (104,321) | (143,691) |
| Non-interest income | 28,697 | 19,954 | 36,549 | 63,160 | 121,335 | 159,509 |
| Net income | 27,810 | 25,149 | 40,836 | 21,159 | 38,567 | 48,075 |

Source: Company data, AFN

Ownership: Based on information we have had from various banks, Kazkommertsbank (KKB) is indirectly controlled by Kazakh businessman Mr Subkhanberdin, 8.45% is held by the EBRD, and 45% of common shares are in free float, held by various domestic and foreign minority shareholders.

We have heard from various sources that the controlling shareholder is likely also to have various substantial assets in other sectors of the Kazakh economy, such as natural resources extraction. During our visit, KKB told us that this shareholder is committed to supporting it, recently increasing his stake through a purchase from the holding company.

We queried whether the bank had been offered support from the EBRD – as its minority shareholder – since the outbreak of the crisis. According to KKB, it has never received cash, but some advice was offered on the risk management side. We had been told by other market players earlier that it is unfortunately not the EBRD's policy to financially support the companies in which it holds minority stakes.

Exposure to real estate and construction: KKB has the following sector exposures in its loan book: real estate – 6.7% of the total portfolio; construction – 21.6%; and mortgage lending – 10.9% of total loans/60% of retail loans. The usual average LTV ratio on mortgages is 65-70%. In 4Q07, it declined to 50% due to market circumstances.

The bank told us during our meeting that the KUAT corporation was its largest customer at the end of 2006. However, due to the increased leverage of the company, KKB judged that it was becoming increasingly risky, gradually reducing relations with KUAT to finance more viable projects. Its exposure is now very moderate.

Regarding KUAT, we were surprised to find out during this trip that contrary to the widely held view, KUAT is not controlled by Nazarbayev's daughter but belongs to a local businessman with a Korean background. Furthermore, Basis A, another big player, seems not to be aligned to the presidential family. There are a few real estate

companies that actually seem to be owned by Ms Nazarbayeva. However, these are not countrywide players but niche, elite-class developers such as Elite-Stroj.

Back to KKB, the bank told us that it received deposits from Kazyna in December for lending to KUAT (economy-class residential real estate), Basis A (elite-class residential properties) and BI (an Astana-based property developer).

Percentage of external funding in liabilities: KKB told us that roughly half its liabilities are external.

The 2008 debt redemption schedule provided by the bank looks as shown in Figure 29.

Fig 29 2008 debt redemption schedule

| Loan | Maturity | Amount (US\$m) |
|---|-----------|----------------|
| Partial prepayment of US\$850m syndication | 28/02/08 | 454 |
| Amortising Tranche B US\$1.3bn syndication | 11/03/08 | 69 |
| Interbank loan | 02/05/08 | 0 |
| Commercial papers of Kazkommerts International B.V. | 16/05/08 | 250 |
| Amortising Tranche B US\$1.3bn syndication | 09/06/08 | 69 |
| Syndication | Sep. 2008 | 600 |
| Amortising Tranche B US\$1.3bn syndication | 07/09/08 | 69 |
| Amortising Tranche B US\$1.3bn syndication | 14/12/08 | 69 |
| Senior Eurobond denominated in SG | 24/02/09 | SG60m |
| Senior Eurobond | 03/05/09 | 500 |
| Senior Eurobond denominated in ¥ | 06/07/09 | ¥25bn |
| Tranche B US\$1.0bn syndication | 18/12/09 | 302 |
| Senior Eurobond denominated in € | 23/03/11 | €300m |
| Bilateral loan | 20/06/11 | 52 |
| Bilateral loan | 18/07/11 | 52 |
| Interbank loan | 19/12/11 | 0 |
| Interbank loan | 22/12/11 | 0 |
| Bilateral loan | 19/12/11 | 104 |
| Bilateral loan | 22/12/11 | 130 |
| Senior Eurobond denominated in £ | 13/02/12 | £350m |
| Senior Eurobond | 16/04/13 | 500 |
| Subordinated loan participation notes | 08/04/14 | 100 |
| Senior Eurobond | 07/10/14 | 400 |
| Senior Eurobond | 03/11/15 | 500 |
| Subordinated loan participation notes | 26/07/16 | 200 |
| Senior Eurobond | 29/11/16 | 500 |
| Senior Eurobond denominated in € | 13/02/17 | €750m |
| Subordinated loan participation notes | 13/06/17 | 250 |

Source: Company data

Although the syndicated loans market is still open to KKB and it was able to sign a couple of small bilaterals in December 2007 (US\$250m, duration of one to three years), the general price level is very high and the loans have considerably shorter tenors.

KKB told us that it is aware of bulk loan repayments upcoming for the middle of 2008, and given the very high price of refinancing, it plans to repay the loans from maturing assets. Thus, the base-case scenario is that assets are unlikely to decline in 2008, but growth will probably be very slow (but – as it hopes – still positive, depending on deposit dynamics). As asset and liability maturities are well matched in its books, KKB is feeling comfortable with making repayments without government help. As for monthly cash flow from loan repayments, KKB kindly provided us with October-December 2007 historical data (see Figure 30).

Fig 30 Cash flow from maturing assets (US\$m)

| | October 2007 | Nov-Dec 2007 |
|-------------------------|--------------|--------------|
| Planned loan repayments | 683 | 1,331 |
| Actual cash flow | 836 | 1,803 |

Source: Company data

Funding: Over the period of markets remaining closed (2008-09), KKB sees deposits as its only significant source of funding. It already has a strong position in this field (especially in corporate deposits). KKB told us that it is aware of limits of deposit funding, but it still expects growth in deposits from corporate customers. At the end of 2007, it had 190 branches, as planned; 50 further branches will be opened according to plan by 2010 to further penetrate the retail market.

Asset quality: KKB expects some natural rise in NPLs, because of the slowdown in lending portfolio growth, but this deterioration will not be significant.

As for its 2008 plans in terms of lending policy, priority will be given to trade, mining and gasoline production.

The bank is planning to move further into the retail loans market (retail loans now account for 20% of the portfolio vs 80% corporate). However, the retail expansion will not be aggressive, at least not in 2008.

Bank TuranAlem

Fig 31 BTA financials (KZTm)

| | 2006 IFRS | 1H07 IFRS | 9M07 IFRS | 1H07 KAS | 9M07 KAS | 2007 KAS |
|---------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Summary balance sheet | | | | | | |
| Cash & central bank | 319,213 | 325,828 | 227,696 | 167,481 | 179,097 | 195,648 |
| Due from banks | 87,452 | 91,721 | 104,433 | 166,476 | 126,568 | 121,806 |
| Securities | 271,257 | 230,412 | 201,118 | 258,902 | 143,847 | 104,699 |
| Net loans | 1,343,414 | 2,162,973 | 2,259,404 | 1,758,721 | 1,795,327 | 1,916,137 |
| Total assets | 2,075,142 | 2,925,215 | 2,918,607 | 2,536,384 | 2,514,577 | 2,648,603 |
| Total assets (US\$m) | 16,340 | 23,916 | 24,129 | 20,737 | 20,789 | 22,017 |
| Customer deposits | 528,192 | 744,196 | 663,997 | 1,402,512 | 1,421,079 | 1,372,383 |
| Due to banks | 625,146 | 859,776 | 792,942 | 485,426 | 447,852 | 1,168 |
| Borrowings | 614,646 | 842,262 | 895,718 | 119,849 | 58,210 | 104,299 |
| Subordinated loan capital | 92,452 | 88,299 | 87,534 | 137,895 | 137,834 | 139,551 |
| Shareholders' equity | 194,618 | 361,089 | 437,809 | 316,326 | 384,970 | 404,282 |
| Summary income statement | | | | | | |
| Interest income | 132,689 | 134,335 | 225,086 | 108,772 | 182,666 | 260,888 |
| Interest expense | (81,225) | (77,007) | (128,004) | (56,172) | (91,542) | (127,490) |
| Non-interest income | 62,991 | 34,401 | 48,407 | 39,030 | 65,654 | 99,805 |
| Net income | 38,498 | 40,368 | 56,367 | 26,405 | 36,471 | 48,683 |

Source: Company data, AFN

Ownership: Surprisingly for a bank that we view as probably the most investor-friendly in terms of the disclosure of financial information and approachability, Bank TuranAlem's (BTA's) ownership structure is non-transparent. The EBRD, IFC, FMO and East Capital are listed as minority shareholders, but we do not believe their influence is very significant. Market speculation suggests that the family of the late CEO, Yerzhan Tatishev, shares ownership with the current Chairman of the Supervisory Board, Mukhtar Abylazov.

BTA told us at our meeting that it is planning to disclose its shareholder structure in 2008. However, given the rather long track record of such assurances, we remain quite pessimistic on this. In any case, we were told by the bank that shareholders are highly committed to supporting the bank and may contribute personal assets and assets at the group level to doing so should the need arise.

Real estate and construction exposure: According to the 9M07 IFRS financials, BTA had the following exposure: 8.49% of the total loan portfolio to real estate; 12.79% to construction; and 10.36% to mortgages. Average LTV ratios were 68% in 1H07, 61% in 3Q07 and 64% at the year-end.

Asset quality: As the loan book is well diversified across industries, BTA has not seen much deterioration in asset quality, with the exception of changes in collateral value due to price correction, and does not expect any considerable changes in the near future.

Debt refinancing and repayment plans: As of the end of 2007, the percentage of external funding in the bank's liabilities was 62% (non-consolidated).

BTA kindly provided the debt refinancing and redemption schedule shown in Figure 32.

Fig 32 Debt redemption schedule (US\$m)

| | Syndicated loans | Bonds | Credit agreements | Securitisation | Total |
|-----------------------|------------------|-------|-------------------|----------------|-------|
| Mar-08 | 531 | | | | 531 |
| May -08 | 3 | | | | 3 |
| Jun-08 | 28 | | | | 28 |
| Jul- 08 | 67 | | | | 67 |
| Sep-08 | 193 | | | | 193 |
| Nov -08 | 178 | 200 | | | 378 |
| Total for 2008 | 998 | 200 | 0 | 0 | 1,198 |
| Total for 2009 | 674 | 742 | 388 | 0 | 1,803 |
| Total for 2010 | 537 | 600 | 824 | 38 | 1,999 |
| Total for 2011 | 12 | 701 | 0 | 150 | 863 |
| Total for 2012 | 0 | 0 | 123 | 150 | 273 |

Source: Company data

Funding: The bank told us that its deposit interest rates are 9% in KZT and 6% in US\$. BTA may slightly increase rates in line with the market, but it understands that a price war is dangerous. It therefore intends to compete for deposits by improving service quality (investing in IT systems, improving the service, increasing the efficiency of the retail network). As of 1 January 2008, BTA had 22 branches and 289 cash settlement units (non-consolidated information).

Although – as for other banks – the market for external borrowings remains tiny, short-term and expensive for BTA, it told us that it is increasingly looking to the Middle East for funding opportunities; in particular, it finds Islamic banking an interesting direction.

Nevertheless, we understand from our conversation that the bank will rely on its own cash-flow generation for debt repayments and therefore expects 2008 still to be positive, but considerably slower than in previous periods. The bank's base-case scenario is for growth at twice the rate of GDP, or about 10%.

Plans for 2008: BTA's general policy in 2008 is to concentrate on profit rather than growth. Nevertheless, it forecasts significant corporate business growth, as its core customers are in areas of the economy where strong growth is expected. Besides traditional banking services, it is planning to widen its scope, offering customers financial advice and risk management consulting and engaging in structural finance projects.

Furthermore, following the general tendency, BTA would like to increase its retail business (which currently accounts for less than 50% of the loan book). It wants gradually to raise this to 50%, but no aggressive expansion is planned for 2008.

Another, no less important objective for 2008 is continuing geographical diversification. BTA has always viewed itself as a CIS rather than a Kazakh bank. Its ambitions now extend to Turkey (with the acquisition of a minority stake in Turkish Sekerbank, which BTA wants to increase to a controlling stake) and to applying for a licence in China. BTA told us that it sees great prospects in its Chinese business, but according to Chinese regulations, it must operate for at least three years in a lending business in China before being allowed to engage in deposit-raising activities. BTA is also expanding aggressively in Ukraine, where it has a subsidiary bank and has recently bought a large insurance company.

In general, BTA sees a great future in diversification. We cannot disagree, but the key to success is to obtain the necessary funding. In this regard, BTA sees the sale of Temirbank as an opportunity. Given controversial statements from BTA regarding the Temirbank sale, we requested clarification and were told that BTA is indeed keen to sell it and that a large international investment bank is to be appointed to facilitate the sale. The controversy in the statements from BTA's chairman was caused by the market's misunderstanding of its motivation for the sale (some implied an acute lack of liquidity); the statements were actually intended to calm down negative speculation. BTA told us that it is not desperate to sell Temir and will wait for a good price offer – another year if need be.

Bank Center Credit

Fig 33 BCC financials (KZTm)

| | 2006 IFRS | 1H07 IFRS | 9M07 IFRS | 1H07 KAS | 9M07 KAS | 2007 KAS |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Summary balance sheet | | | | | | |
| Cash & central bank | 55,094 | 56,723 | 104,084 | 62,671 | 109,560 | 59,318 |
| Due from banks | 48,705 | 39,386 | 94,819 | 25,867 | 56,280 | 84,816 |
| Securities | 53,401 | 91,814 | 44,068 | 98,464 | 67,834 | 87,586 |
| Net loans | 403,728 | 590,204 | 651,665 | 579,815 | 638,436 | 610,621 |
| Total assets | 571,718 | 792,266 | 910,772 | 808,626 | 907,452 | 880,774 |
| Total assets (US\$m) | 4,502 | 6,478 | 7,530 | 6,611 | 7,502 | 7,321 |
| Customer deposits | 222,051 | 335,457 | 305,799 | 486,010 | 518,510 | 536,051 |
| Due to banks | 172,342 | 191,729 | 317,299 | 120,986 | 173,030 | 10,534 |
| Borrowings | 102,670 | 171,025 | 178,642 | 44,116 | 54,918 | 75,317 |
| Subordinated loan capital | 31,870 | 38,177 | 38,280 | 37,138 | 37,111 | 42,932 |
| Shareholders' equity | 40,488 | 52,098 | 66,085 | 50,836 | 64,440 | 69,996 |
| Summary income statement | | | | | | |
| Interest income | 48,984 | 39,361 | 66,332 | 39,238 | 66,073 | 92,849 |
| Interest expense | (29,047) | (23,624) | (38,122) | (19,876) | (32,193) | (45,219) |
| Non-interest income | 10,182 | 7,006 | 11,838 | 13,123 | 30,532 | 48,031 |
| Net income | 9,946 | 5,595 | 10,276 | 5,093 | 9,541 | 137,443 |

Source: Company data, AFN

Ownership: Bank Center Credit (BCC) is controlled by Kazakh businessman Bakhtybek Bayseitov with a 51% stake, while an approximate 13% stake is owned by the management team.

On the afternoon of Monday, 28 January, Reuters reported that Korea's Kookmin had agreed to buy a 30% stake in BCC for KRW600bn (US\$635m) with an option to buy a further 20.01% for KRW400bn (US\$423m) within three years.

At our meeting with the bank the next morning, we were surprised to learn that no such deal had been signed. Our meeting with the AFN that followed did not bring much clarification either, as the agency had not received any documents asking for approval of a deal.

While respecting the confidentiality of deals of this nature, we did learn from BCC that it is negotiating the sale of the stake. However, it did not confirm Kookmin's name, or give us any guidelines for the timing of a possible deal's completion. We would suggest that BCC may be negotiating with a few buyers and that the premature statement regarding a deal with Kookmin may have been the result of a misunderstanding between the parties. In any case, we are still awaiting clarity on this issue. Should the deal go ahead, it would be supportive for both the bank's credit and its liquidity position.

Other banks confirmed that BCC is likely to be the next bank to be acquired by a foreign party, as it is in very good financial shape and its size and wide branch network make it a very attractive target. They commented that BCC would also be highly motivated to sell now while the business is blooming, as in the stagnant market for the next year it will be increasingly hard for smaller players to retain market share, competing with large local banks and foreign banks entering the market.

We were also told that BCC's controlling shareholder has a Korean background and good business connections with the local Korean community in Kazakhstan (some large business assets in Kazakhstan are controlled by ethnic Koreans, such as the

KUAT real estate company and other oil, gas and metal production assets), so it would make sense for BCC to go into partnership with a Korean bank.

Real estate and construction exposure: As of 3Q07, industrial construction loans accounted for 8.5% of the total loan portfolio and residential construction loans for 7.4% (total exposure of 15.9%). As of 3Q07, mortgage loans to individuals made up 49.6% of total loans to individuals, or 21.2% of the total loan portfolio.

BCC told us that average LTV ratios for the 2005, 2006 and 2007 year-ends were 51.9%, 49% and 51%, respectively.

Refinancing and repayment in 2008

According to BCC, external funding accounted for 40.3% of total liabilities as of 4Q07, with the following repayments due: US\$200m of eurobonds in February 2008; US\$500m of eurobonds in 2011; US\$500m of eurobonds in 2014; and US\$292m of syndicated loans in July 2008.

The bank does not consider repayment to be an issue as it generates enough cash flow from redemptions in the loan portfolio (US\$125-140m in monthly inflows), and transactions for US\$350-400m are being negotiated with ADB, the EBRD, IFC, DEG and FMO.

2008 growth projections: Like other banks, BCC has a 10-15% growth scenario, so close to flat when factoring in inflation. The bank is ranked fourth in the current account business, and based on its franchise, it is planning to move into the credit-card segment to increase profitability.

Funding: Although BCC was able to attract some financing in 2H07 (a KZT50bn loan from ADB, a US\$40bn subordinated loan from DEG and a US\$30m loan from National Citi Bank under OPIC guarantee), it plans to rely on the existing depositors' base as its main source of funding in 2008.

As of 3Q07, BCC had 20 branches and 160 retail outlets – a well spread network despite its modest size. In 2008, around 28 outlets are due to be opened.

2008 plans: BCC plans to continue its development in the retail and SME businesses. Given its tendency to be conservative in terms of consumer lending and international borrowing, the bank believes it will benefit from this strategy of being less dependent on the international markets and will therefore suffer from fewer liquidity problems.

Temirbank

Fig 34 Temirbank financials (KZTm)

| | 2006 IFRS | 1H07 IFRS | 9M07 IFRS | 1H07 KAS | 9M07 KAS | 2007 KAS |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Summary balance sheet | | | | | | |
| Cash & central bank | 17,564 | 43,864 | 27,451 | 39,913 | 23,105 | 24,297 |
| Due from banks | 13,332 | 8,386 | 12,255 | 8,152 | 8,761 | 8,811 |
| Securities | 14,130 | 22,356 | 23,880 | 25,856 | 31,128 | 29,984 |
| Net loans | 148,462 | 238,778 | 273,143 | 233,415 | 261,577 | 250,607 |
| Total assets | 198,362 | 320,210 | 347,303 | 321,070 | 340,262 | 325,933 |
| Total assets (US\$m) | 1,562 | 2,618 | 2,871 | 2,625 | 2,813 | 2,709 |
| Customer deposits | 53,463 | 89,010 | 81,074 | 200,571 | 230,637 | 202,083 |
| Due to banks | 40,248 | 45,805 | 67,369 | 22,523 | 18,389 | 2,154 |
| Borrowings | 76,794 | 140,023 | 148,013 | 34,924 | 25,015 | 44,764 |
| Subordinated loan capital | 5,099 | 5,079 | | 483 | 505 | 476 |
| Shareholders' equity | 22,376 | 39,085 | 47,518 | 43,852 | 53,327 | 54,431 |
| Summary income statement | | | | | | |
| Interest income | 15,660 | 18,303 | 31,315 | 19,435 | 31,721 | 42,238 |
| Interest expense | (8,235) | (9,349) | (16,593) | (7,313) | (13,096) | (18,904) |
| Non-interest income | 3,516 | 2,640 | 3,506 | 4,924 | 8,943 | 8,682 |
| Net income | 2,999 | 3,242 | 6,206 | 5,264 | 7,926 | 8,883 |

Source: Company data, AFN

Ownership: In 1995, Temirbank was acquired by Astana Holdings, which also controls the BTA group. Despite Temir having been consolidated by TuranAlem in late 2006 and its key management positions being filled by BTA people, the two banks have developed as completely independent market players.

Now that the market's short-term growth possibilities are limited, BTA management is (logically) considering selling Temirbank to a foreign investor and investing the funds in cross-border diversification, rather than holding a competitor in the Kazakh banking sector (both banks have strong retail businesses). Given its size, strong brand and business focus on the much sought-after retail, we would view Temirbank as the second-most attractive acquisition target after BCC.

Exposure to real estate and construction (based on preliminary results for end-2007) is: 2.3% of the loan portfolio to real estate; 9.4% to construction; and 25.3% to mortgage lending. The LTV ratio for the end of 2007 equalled 49.88%. Temirbank made use of the government's US\$4bn programme – as it has about 20 projects approved for the programme in Astana and one in Almaty, of which 15 are already financed with US\$70m.

Kazakh Mortgage Company (KMC) recently announced that it may buy back mortgages issued on its behalf. As about 60% of Temirbank's mortgages are issued on behalf of KMC, Temir may expect about US\$100m in cash from mortgage transfers to KMC in 2008.

Refinancing and repayment plans for 2008: External borrowings in Temirbank's liabilities equal 59.4%. The debt redemption schedule kindly provided by the bank is shown in Figure 35.

Fig 35 2008 debt redemption schedule (US\$m)

| | April 2008 | June 2008 | Oct 2008 | 2009 | 2011 |
|--------------------|------------|-----------|----------|--------|--------|
| Temir Capital B.V. | | | | 150 | |
| Temir Capital B.V. | | | | | 300 |
| Temir Capital B.V. | | | | | 0.95 |
| Standard Bank Pls | | 130 | | | |
| FMO N.V. | 0.625 | | 0.625 | 1.25 | |
| Total: | 0.625 | 130 | 0.625 | 151.25 | 300.95 |

Source: Company data

Funding: Temir expects deposits to be its main source of funding in 2008. It feels quite comfortable with the situation as it now has the fourth-largest share of retail deposits (deposit composition is 70% retail/30% corporate). The bank lost some deposits in autumn 2007, but may see deposit growth again, as confidence in deposits seems to have been gradually returning since November.

As of 1 January 2008, Temir had 21 branches and 119 sales outlets. It is planning to double its ATM network in 2008 and increase the number of ATMs by 360. All the necessary equipment is to be bought from the 2007 budget, and machines are expected to be installed by March 2008.

Plans for 2008: Temir plans slow but positive growth, gradual modernisation of the retail business and the implementation of modern technology (internet banking, mobile phone banking). It is planning to implement a new product – the so-called Temir Card – a combination of a debit and deposit card. It is also planning to continue its expansion into the SME sector.

The bank confirmed its status as ‘the bank for sale’, with a team at BTA appointed to manage its relations. We believe its compact size, strong retail franchise and well-known branch should mean that BTA will not be left on the shelf for long.

ATF Bank

Fig 36 ATF Bank financials (KZTm)

| | 2006 IFRS | 1H07 IFRS | 1H07 KAS | 9M07 KAS | 2007 KAS |
|---------------------------------|------------------|----------------|----------------|------------------|----------------|
| Summary balance sheet | | | | | |
| Cash & central bank | 218,047 | 103,828 | 100,257 | 102,839 | 129,737 |
| Due from banks | 71,858 | 29,587 | 22,475 | 40,388 | 19,053 |
| Securities | 205,195 | 73,780 | 91,388 | 64,827 | 42,008 |
| Net loans | 523,653 | 721,237 | 682,897 | 758,067 | 733,521 |
| Total assets | 1,047,338 | 961,197 | 952,615 | 1,049,962 | 992,519 |
| Total assets (US\$m) | 8,247 | 7,859 | 7,789 | 8,680 | 8,250 |
| Customer deposits | 360,380 | 397,338 | 441,068 | 516,636 | 480,822 |
| Due to banks | 449,791 | 326,917 | 173,851 | 196,313 | 1,980 |
| Borrowings | 137,608 | 120,012 | 156,904 | 119,177 | 119,806 |
| Subordinated loan capital | 30,106 | 41,974 | 42,357 | 54,320 | 54,240 |
| Shareholders' equity | 57,225 | 62,293 | 63,960 | 82,355 | 78,845 |
| Summary income statement | | | | | |
| Interest income | 52,524 | 53,370 | 47,412 | 75,363 | 103,390 |
| Interest expense | (34,883) | (37,846) | (23,141) | (35,882) | (50,745) |
| Non-interest income | 8,007 | 7,101 | 9,338 | 18,275 | 23,037 |
| Net income | 4,263 | 4,040 | 4,645 | 11,183 | 8,876 |

Source: Company data, AFN

Ownership: ATF Bank has been majority-owned by Unicredit since June 2007. ATF told us that a lot of restructuring processes are ongoing, including implementing a new IT system, risk management policies and UniCredit's scoring systems to be used in the consumer lending business.

Exposure to real estate and construction: Loans to construction make up 12.8% of the total portfolio, real estate 8.7%, and mortgages to individuals 10.1%.

Debt refinancing and repayment for 2008: According to ATF, the share of external funding in its liabilities stood at 45% as at end-2007. It kindly provided us with the debt redemption schedule shown in Figure 37.

Fig 37 Debt redemption schedule (US\$m)

| | Jan 2008 | Mar 2008 | Apr 2008 | May 2008 | Jun 2008 | Jul 2008 | Aug 2008 | Sep 2008 | Oct 2008 | Nov 2008 | Dec 2008 | Total 2008 | Total 2009 | Total 2010 | Total 2011 | Total 2012 |
|-----------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|---------------|---------------|---------------|---------------|---------------|
| Bilateral loans | 11.52 | 4.32 | 550.30 | 4.48 | 16.17 | 8.52 | 6.73 | 10.85 | 88.29 | 8.26 | 18.35 | 727.80 | | | | |
| Treasury | - | - | - | - | - | - | - | - | - | - | - | 433.05 | | | | |
| Securitisation | - | - | - | - | - | 8.33 | - | - | 8.33 | - | - | 16.67 | | | | |
| Total maturing | 11.52 | 4.32 | 550.30 | 4.48 | 16.17 | 16.85 | 6.73 | 10.85 | 96.63 | 8.26 | 18.35 | 1,177.52 | 625.49 | 386.44 | 19.13 | 260.66 |

Source: Company data

Growth plans for 2008: We learned from the bank that the dispute with preferred shareholders over the exchange policy remains unsolved and UniCredit seems keen to pursue the matter in court rather than settle. As a consequence, ATF's growth may be hindered for a while as its capitalisation is now at the lowest acceptable level (8%). To facilitate growth, an injection of US\$300m in new capital from UniCredit is planned for 2008; however, this cannot be completed before the preferred share issue is resolved.

Strategy: ATF told us that UniCredit is committed to its development and has quite ambitious plans concerning it becoming a leading bank within a few years. UniCredit seems to be retaining ATF's traditional business focus on corporate clients and high-net-worth individuals and looks set to pursue the same strategy as ATF, ie, active expansion in all three segments: retail, corporate and SME.

Appendix 1

Emerging Markets Quote Sheet: Kazakhstan

| Issuer | Security name | Curr | Maturity | Coupon | Amount,m | Fitch | S&P | Moody's | Bid | YTW, % | Rec |
|---------------------------|--------------------|------|------------|--------|----------|-------|------|---------|--------|--------|---------------|
| Alliance Bank | ALLIBK 9 06/27/08 | USD | 27/06/2008 | 9.000 | 150 | BB- | - | Ba2 | 99.88 | 9.22 | Marketperform |
| Alliance Bank | ALLIBK 9 11/22/10 | USD | 22/11/2010 | 9.000 | 200 | BB- | - | Ba2 | 90.88 | 13.00 | Marketperform |
| Alliance Bank | ALLIBK 9 3/4 02/11 | GBP | 14/02/2011 | 9.750 | 250 | BB- | - | Ba2 | 84.42 | 16.77 | Marketperform |
| Alliance Bank | ALLIBK 8 3/4 04/11 | USD | 20/04/2011 | 8.750 | 250 | BB- | - | Ba2 | 88.52 | 13.27 | Marketperform |
| Alliance Bank | ALLIBK 7 7/8 02/12 | EUR | 01/02/2012 | 7.875 | 750 | BB- | - | Ba2 | 80.11 | 14.86 | Marketperform |
| Alliance Bank | ALLIBK 9 1/4 09/13 | USD | 25/09/2013 | 9.250 | 350 | BB- | - | Ba2 | 85.44 | 12.97 | Marketperform |
| Alliance Bank (perp) | ALLIBK 9 3/8 04/49 | USD | 19/04/2016 | 9.375 | 150 | - | - | B2 | 73.67 | 15.07 | Marketperform |
| Astana-Finance | ASTAFI 7 5/8 02/09 | USD | 16/02/2009 | 7.625 | 125 | BB+ | - | Ba1 | 97.77 | 10.00 | Marketperform |
| Astana-Finance | ASTAFI 9 11/16/11 | USD | 16/11/2011 | 9.000 | 175 | BB+ | - | Ba1 | 95.15 | 10.59 | Marketperform |
| ATF Bank | ATFBP 8 7/8 11/09 | USD | 09/11/2009 | 8.875 | 200 | BBB+ | BB+ | Baa2 | 102.06 | 7.57 | Marketperform |
| ATF Bank | ATFBP 8 1/8 10/10 | USD | 28/10/2010 | 8.125 | 200 | BBB+ | BB+ | Baa2 | 100.70 | 7.82 | Marketperform |
| ATF Bank | ATFBP 9 1/4 04/12 | USD | 12/04/2012 | 9.250 | 200 | BBB+ | BB+ | Baa2 | 101.95 | 8.68 | Marketperform |
| ATF Bank | ATFBP 9 1/4 02/14 | USD | 21/02/2014 | 9.250 | 450 | BBB+ | BB+ | Baa2 | 101.55 | 8.91 | Marketperform |
| ATF Bank | ATFBP 9 05/11/16 | USD | 11/05/2016 | 9.000 | 350 | BBB+ | BB+ | Baa2 | 98.95 | 9.18 | Marketperform |
| ATF Bank (perp) | ATFBP 10 11/29/49 | USD | 10/11/2016 | 10.000 | 100 | - | B+ | Ba1 | 98.48 | 10.26 | Marketperform |
| Bank Caspian | BCCRD 7 7/8 10/08 | USD | 17/10/2008 | 7.875 | 150 | B+ | - | Ba3 | 98.87 | 9.60 | -- |
| Bank Center Credit | BCCRD 8 02/14/08 | USD | 14/02/2008 | 8.000 | 200 | BB- | - | Ba1 | 99.99 | 11.16 | Marketperform |
| Bank Center Credit | BCCRD 8 02/02/11 | USD | 02/02/2011 | 8.000 | 300 | BB- | - | Ba1 | 96.32 | 9.45 | Marketperform |
| Bank Center Credit | BCCRD 8 5/8 01/14 | USD | 30/01/2014 | 8.625 | 500 | BB- | - | Ba1 | 90.82 | 10.75 | Marketperform |
| Bank Center Credit (perp) | BCCRD 9 1/8 03/49 | USD | 03/03/2016 | 9.125 | 100 | - | - | Ba3 | 81.20 | 12.95 | Marketperform |
| Dev Bank of Kaz | DBKAZ 7 3/8 11/13 | USD | 12/11/2013 | 7.375 | 100 | BBB | BBB- | A2 | 111.15 | 5.11 | Marketperform |
| Dev Bank of Kaz | DBKAZ 6 1/2 06/20 | USD | 03/06/2020 | 6.500 | 100 | BBB | BBB- | A2 | 109.37 | 5.44 | Marketperform |
| Halyk Bank | HALYK 8 1/8 10/09 | USD | 07/10/2009 | 8.125 | 200 | BB+ | BB+ | Baa3 | 101.16 | 7.36 | Marketperform |
| Halyk Bank | HALYK 7 3/4 05/13 | USD | 11/05/2013 | 7.750 | 300 | BB+ | BB+ | Baa3 | 96.76 | 8.52 | Marketperform |
| Halyk Bank | HALYK 7 1/4 05/17 | USD | 03/05/2017 | 7.750 | 700 | BB+ | BB+ | Baa3 | 87.72 | 9.26 | Marketperform |
| Nurbank | NURBAN 9 04/28/08 | USD | 28/04/2008 | 9.000 | 150 | - | B | B1 | 99.00 | 13.58 | Marketperform |
| Nurbank | NURBAN 9 3/8 10/11 | USD | 17/10/2011 | 9.375 | 150 | - | B | B1 | 86.06 | 12.69 | Marketperform |
| Kazkommerts | KKB 7 11/03/09 | USD | 03/11/2009 | 7.000 | 500 | BB+ | BB | Ba1 | 96.79 | 9.04 | Marketperform |
| Kazkommerts | KKB 5 1/8 03/23/11 | EUR | 23/03/2011 | 5.125 | 300 | BB+ | BB | Ba1 | 85.73 | 10.76 | Marketperform |
| Kazkommerts | KKB 7 5/8 02/13/12 | GBP | 13/02/2012 | 7.625 | 350 | BB+ | BB | Ba1 | 86.56 | 12.06 | Marketperform |
| Kazkommerts | KKB 8 1/2 04/16/13 | USD | 16/04/2013 | 8.500 | 500 | BB+ | BB | Ba1 | 92.95 | 10.28 | Marketperform |
| Kazkommerts | KKB 7 7/8 04/07/14 | USD | 07/04/2014 | 7.875 | 400 | BB+ | BB | Ba1 | 88.03 | 10.57 | Marketperform |
| Kazkommerts (sub) C09 | KKBGR 7 3/8 04/14 | USD | 07/04/2014 | 7.375 | 100 | BB | B+ | Ba2 | 88.52 | 11.88 | Marketperform |
| Kazkommerts | KKB 8 11/03/15 | USD | 03/11/2015 | 8.000 | 500 | BB+ | BB | Ba1 | 84.15 | 11.11 | Marketperform |
| Kazkommerts (perp) C15 | KKB 9.2 11/29/49 | USD | 09/11/2015 | 9.200 | 100 | BB | B- | Ba3 | 77.15 | 14.14 | Marketperform |
| Kazkommerts (sub) C11 | KKB 8 5/8 07/27/16 | USD | 27/07/2016 | 8.625 | 200 | BB | B+ | Ba2 | 79.47 | 13.50 | Marketperform |
| Kazkommerts | KKB 7 1/2 11/29/16 | USD | 29/11/2016 | 7.500 | 500 | BB+ | BB | Ba1 | 79.83 | 11.15 | Marketperform |
| Kazkommerts | KKB 6 7/8 02/13/17 | EUR | 13/02/2017 | 6.875 | 750 | BB+ | BB | Ba1 | 77.28 | 10.98 | Marketperform |
| Temirbank* | TEMIR 9 1/4 03/09 | USD | 23/03/2009 | 9.250 | 150 | BB- | - | Ba2 | 96.70 | 12.50 | Marketperform |
| Temirbank* | TEMIR 9 11/24/11 | USD | 24/11/2011 | 9.000 | 300 | - | B+ | Ba2 | 86.54 | 13.66 | Marketperform |
| Temirbank* | TEMIR 9 1/2 05/14 | USD | 21/05/2014 | 9.500 | 500 | BB- | B+e | Ba2 | 85.04 | 13.06 | Marketperform |
| Bank TuranAlem* | BTAS 0 11/23/08 | USD | 23/11/2008 | 0.000 | 200 | BB+ | BB | Ba1 | 95.00 | 11.49 | Marketperform |
| Bank TuranAlem* | BTAS7 1/8 12/21/09 | GBP | 21/12/2009 | 7.125 | 200 | BB+ | BB | Ba1 | 92.42 | 11.89 | Marketperform |
| Bank TuranAlem* | BTAS7 7/8 06/02/10 | USD | 02/06/2010 | 7.875 | 600 | BB+ | BB | Ba1 | 96.86 | 9.41 | Marketperform |
| Bank TuranAlem* | BTAS6 1/4 09/27/11 | EUR | 27/09/2011 | 6.250 | 500 | BB+ | BB | Ba1 | 86.06 | 11.11 | Marketperform |
| Bank TuranAlem* | BTAS7 3/4 04/25/13 | USD | 25/04/2013 | 7.750 | 250 | BB+ | BB | Ba1 | 88.87 | 10.58 | Marketperform |
| Bank TuranAlem* | BTAS 8 03/24/14 | USD | 24/03/2014 | 8.000 | 400 | BB+ | BB | Ba1 | 87.77 | 10.78 | Marketperform |
| Bank TuranAlem* | BTAS8 1/2 02/10/15 | USD | 10/02/2015 | 8.500 | 350 | BB+ | BB | Ba1 | 88.71 | 10.84 | Marketperform |
| Bank TuranAlem (perp)* | BTAS8 1/4 01/29/49 | USD | 25/01/2016 | 8.250 | 400 | B+ | B- | Ba3 | 69.79 | 14.84 | Marketperform |
| Bank TuranAlem* | BTAS8 1/4 01/22/37 | USD | 22/01/2037 | 8.250 | 1000 | BB+ | BB | Ba1 | 85.47 | 10.82 | Marketperform |

*Previously Buy (since 06/11/07). Downgrade owing to price movements.

Source: ING

Disclosures Appendix

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