MOODY'S INVESTORS SERVICE

Credit Opinion: Bank of Khanty-Mansiysk, JSC

Global Credit Research - 19 Aug 2011

Khanty-Mansiysk, Russia

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Ba3/NP
NSR Bank Deposits -Dom Curr	Aa3.ru/--
Bank Financial Strength	E+
Baseline Credit Assessment	B1
Adjusted Baseline Credit Assessment	Ba3
Senior Unsecured -Dom Curr	Ba3

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Key Indicators

Bank of Khanty-Mansiysk, JSC (Consolidated Financials)[1]

	[2]**12-10**	[2]**12-09**	[3]**12-08**	[2]**12-07**	[2]**12-06**	**Avg.**
Total Assets (RUB billion)	**168.3**	**130.8**	**116.4**	**84.4**	**69.5**	[4]**24.7**
Total Assets (USD billion)	**5.5**	**4.3**	**3.8**	**3.4**	**2.6**	[4]**20.2**
Tangible Common Equity (RUB billion)	**20.2**	**17.4**	**12.8**	**7.7**	**7.3**	[4]**29.0**
Tangible Common Equity (USD billion)	**0.7**	**0.6**	**0.4**	**0.3**	**0.3**	[4]**24.3**
Net Interest Margin (%)	**4.1**	**4.3**	**5.3**	**3.9**	**3.3**	[5]**4.2**
PPI / Avg RWA (%)	**3.4**	**3.4**	**0.7**	**--**	**--**	[6]**3.4**
Net Income / Avg RWA (%)	**2.2**	**0.5**	**-0.5**	**--**	**--**	[6]**1.4**
(Market Funds - Liquid Assets) / Total Assets (%)	**-7.1**	**3.3**	**12.5**	**-4.1**	**-10.7**	[5]**-1.2**
Core Deposits / Average Gross Loans (%)	**104.7**	**81.9**	**93.8**	**150.4**	**195.4**	[5]**125.2**
Tier 1 Ratio (%)	**13.3**	**14.3**	**9.0**	**--**	**--**	[6]**13.8**
Tangible Common Equity / RWA (%)	**13.0**	**14.3**	**9.0**	**--**	**--**	[6]**13.7**
Cost / Income Ratio (%)	**50.4**	**48.5**	**80.9**	**80.7**	**67.3**	[5]**65.6**
Problem Loans / Gross Loans (%)	**4.5**	**10.0**	**7.4**	**--**	**--**	[5]**7.3**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**17.4**	**34.2**	**39.5**	**--**	**--**	[5]**30.4**

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel I; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel I & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of E+ to Bank of Khanty-Mansiysk (BKhM), which translates into a baseline credit assessment (BCA) of B1. The rating is constrained by a large number of customer concentrations in the loan book, high volumes of related-party exposures that undermine economic capital as well as the risks associated with still challenging credit conditions in Russia. The rating is partially offset by the bank's strongly positioned franchise in its home region of Khanty-Mansiysk (KMAO; Baa3, stable), its sound regional expertise, healthy financial fundamentals and a strategy to diversify its business outside of its core region.

The bank's Ba3 local and foreign currency deposit ratings benefit from one-notch uplift from the bank's BCA of B1, incorporating a high probability of parental support from Nomos bank (owns 52% stake and rated Ba3/NP) given close strategic fit and importance of BKhM's performance to consolidated financial position.

At the same time, the bank's social and economic importance in its core region of KMAO, which owns a 44.2% stake in the bank, makes us believe that the region could exert willingness to support BKhM in case on distress, however, we assess such probability as low as the region has limited operational control over the bank and thus our assessment of regional support does not result in any uplift to deposit ratings of the bank

Credit Strengths

- High probability of parental support from Nomos Bank and low probability of support from KMAO in case of distress

- Visible regional franchise, especially in retail deposit taking and servicing budget and infrastructure settlements

- Strong business ties with a number of large corporates and a longstanding relationship with KMAO authorities support the franchise

- Implementation of a strategy to diversify the business outside the core region

- Healthy financial fundamentals

Credit Challenges

- Still challenging credit conditions in Russia and high competition on the market

- Vulnerable to changes in security prices financial performance

- Customer concentrations in the loan book remain high

- High volume of related-party transactions in recent years undermines capital

Rating Outlook

BKhM's ratings carry a stable outlook.

What Could Change the Rating - Up

For BKhM's BFSR to enjoy upward pressure, which we do not expect in the near term, the bank would need to display materially lower levels of concentration in loan book t (including related parties) and maintain good core profitability, asset quality and - more importantly - an adequate level of capital relative to risks taken.

What Could Change the Rating - Down

The BFSR (and thus the deposit ratings) could face downward pressure in the event of a deterioration in asset quality, a material decline in profitability and weakening capitalisation.

Recent Results and Company Events

As at 31 December 2010, BKhM reported total consolidated IFRS assets of RUB168 billion (US$5.5 billion) and consolidated net income of RUB3 billion (US$99 million).

DETAILED RATING CONSIDERATIONS

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

Bank Financial Strength Rating

Moody's assigns a bank financial strength rating (BFSR) of E+ to Bank of Khanty-Mansiysk (BKhM), which translates into a baseline credit assessment (BCA) of B1. The rating is constrained by a large number of customer concentrations in the loan book, high volumes of related-party exposures that undermine economic capital as well as the risks associated with still challenging credit conditions in Russia. The rating is partially offset by the bank's strongly positioned franchise in its home region of Khanty-Mansiysk (KMAO; Baa3, stable), its sound regional expertise, healthy financial fundamentals and a strategy to diversify its business outside of its core region.

As a point of reference, the assigned BFSR is one notch lower than the D- outcome of Moody's BFSR scorecard. Moody's believes the E+ rating is an appropriate measure of the bank's financial strength given the significant single-borrower concentrations in its loan book and an increased level of related-party transactions that exceed those of D- rated banks in Russia.

Qualitative Rating Factors (70% weighting)

Factor 1: Franchise Value

Trend: Improving

BKhM is a mid-sized player that ranked 20th in terms of total assets; 23rd in terms of equity; and 26th in terms of retail deposits among Russian banks as at 31 March 2011 (source: Interfax). BKhM was established as an institution for servicing the budget settlements of local authorities and government-related entities; it therefore holds a unique niche in the region, accumulating a 30% share of retail deposits, almost 100% of budget and government-related social programmes and almost 100% of utility and tax settlements.

BKhM is predominantly a corporate bank, with over 75% of total loans attributable to corporates as of 31 December 2010 (2009: over 75%). However, given its status as a government agent for social programmes, the bank has accumulated a significant mortgage portfolio - 13% of total loan book as at 31 December 2010 (2009: 15%). Loans originated under a regional programme, with an interest and price compensation package for borrowers. Together with other retail products such as auto and consumer loans, this segment contributed over 25% to the bank's pre-provision income in 2010 (2009: over 25%).

BKhM manages its business through a regionally oriented branch network covering all major industrial centres in its home market and number of large cities outside of KMAO. The bank's visibility in the region is supported by (i) its well-developed IT and payment solutions such as tax and public utilities payments; and (ii) its key role of servicing both budget and infrastructure settlements in the region. Going forward the bank aims to diversify its business outside of its core region by acquiring a number of smaller regional players and opening new branches in Ural and West Siberia. We view positively BKhM's intentions of developing a country-wide franchise as it would result in better diversification and sustainability of its performance going forward.

These considerations support a D- score for franchise value along with an improving trend.

Factor 2: Risk Positioning

Trend: Neutral

BKhM was established by the government of KMAO and is currently owned by the regional government (44.2% of voting shares), while the controlling 52% stake is owned by Nomos Bank (Ba3/NP). KMAO has declared its intention to sell residual stake in the bank and Nomos Bank has expressed willingness to participate in a tender for regional share,

The bank's supervisory board consists of 14 members including three formally independent members; however, we are of the opinion that the level of independent oversight over the bank's business and risk-taking culture still has room for improvement as we have observed a high volume of related-party lending (69% of Tier 1 capital as at YE2010 and 65% in 2009).

BKhM's risk management infrastructure and practices are appropriate for its size and market standing. However, we also consider that the level of risk management is at a development stage, with some management practices - such as full independence of the Chief Risk Officer and the risk function - not being implemented, due to the bank's focus on growth and maintaining current market shares over recent years; however, this is common for almost all Russian banks.

Credit risk concentration is very high. As of 31 December 2010, BKhM's aggregate exposure to the top 20 borrowers exceeded 270% of Tier 1 capital, reflecting the poor granularity of the bank's loan portfolio and its high susceptibility to the performance of a few customers. The top 20 exposures represented more than 1500% of the bank's pre-provision income (defined as net interest, net commission and other operating income) in 2010. The concentration risk is somewhat mitigated by the fact that 20% of top-20 exposures is attributable to leasing companies with more granular credit risks associated with final leases. At the same time, the bank's related-party exposures undermines the bank's economic capitalisation. We would be encouraged by a track record of business growth in more granular third-party segments to see it score higher for risk positioning. We do not expect concentrations to decrease materially going forward, given the bank's focus on business growth.

At the same time, the level of market risks (tradable instruments compared to capital) taken by the bank is somewhat high, rendering the bank's profitability vulnerable to the performances of certain instruments. Although the bank's exposure to default credit-linked notes and embedded put options has decreased over last two years, BKhM has acquired equities with hardly definable fair market value. Such exposure accounted for 25% of Tier 1 capital at YE2010

Based on the above-mentioned considerations, we assigned an D score and neutral trend for risk positioning.

Factor 3: Regulatory Environment

Refer to Moody's Banking System Profile on Russia, published in October 2010, for information on this factor.

Factor 4: Operating Environment

Trend: Neutral

This factor is common to all Russian banks. Moody's assigns an E+ score for the overall operating environment. Refer to Moody's Banking System Profile on Russia, published in October 2010, for information on this factor.

Factor 5: Profitability

Trend: Neutral

BKhM reported a net IFRS income of RUB3 billion (US$99 million) in 2010 (2009: RUB596 million (US$19.7 million)) which translates into healthy recurring ratios - RoAA of 2% and RoE of 15%. The year's performance was driven by stable flow of net interest and commission income, which contributed 64% and 18% to operating income, respectively, in 2010 (2009: 64% and 17%).

However, we believe that the unadjusted C+ score for profitability generated by Moody's scorecard is an adequate measure of the bank's profitability. We expect further pressure on interest margins given limited opportunities to lend at higher interest rates due to intense competition.

Factor 6: Liquidity

Trend: Neutral

BKhM's dependence on market funds is limited. The core of the bank's funding base is customer deposits (net loans-to-customer deposits ratio was 106% at YE2010 and 109% at YE2009); more importantly, the bank's customer deposit base is rather granular, with the top-20 depositors contributing less than 40% of customer funds and 27% of total non-equity funding. We note that the bank's retail deposit base demonstrated impressive growth of 40% in 2009 and consider this source as relatively sustainable in the current environment. The bank scores D+ for liquidity with a neutral trend.

Factor 7: Capital Adequacy

Trend: Neutral

The bank reported a Tier 1 capital adequacy ratio of 13.2% as at YE2010 (YE2009: 14.33%), which was supported by healthy internal capital generation in 2010. However, economic capitalisation is undermined by high single-name concentration in the loan book and increased volumes of related-party lending.

The score of A for capital adequacy was adjusted downwards to E+ to capture Moody's concerns over single-name concentrations.

Factor 8: Efficiency

Trend: Neutral

Due to a implementation of regional development strategy, BKhM operating expenses demonstrated 20% growth, but thanks to increase in earnings cost-to-income ratio remained on comfortable 50% level(51% in 2009). Given high dependence on one-off results as well as limited opportunities to shrink operating costs given its strategy to growth outside home region, we do consider operating expenses maintained on par with previous years thus maintain a neutral trend for the C score.

Factor 9: Asset Quality

Trend: Neutral

According to IFRS statements, the level of problem loans (with evidence of impairment) in the portfolio was about 4.5% as at YE2010 (2009: close to 10%) and more than 100% covered by loan loss provisions. Problem loans were somewhat diluted by 24% growth in lending in 2010 and unseasoned nature of newly originated facilities as well as the high level of single-name concentrations are the major area of concerns which we do not expect to be solved in the medium term.

We believe the D score for asset quality is a reasonable measure of the bank's asset quality and maintain a neutral trend.

Global Local Currency Deposit Rating (Joint Default Analysis)

The bank's Ba3 local and foreign currency deposit ratings benefit from one-notch uplift from the bank's BCA of B1, incorporating a high probability of parental support from Nomos bank (owns 52% stake and rated Ba3/NP) given close strategic fit and importance of BKhM's performance to consolidated financial position.

At the same time, the bank's social and economic importance in its core region of KMAO, which owns a 44.2% stake in the bank, makes us believe that the region could exert willingness to support BKhM in case on distress, however, we assess such probability as low as the region has limited operational control over the bank and thus our assessment of regional support does not result in any uplift to deposit ratings of the bank.

National Scale Rating

BKhM is rated Aa3.ru by Moody's Interfax on Russia's National Scale Rating (NSR). NSRs are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks.

Foreign Currency Deposit Rating

Moody's assigns a Ba3 foreign currency deposit rating to BKhM. The rating is assigned at the same level as the bank's GLC deposit rating and is not constrained by the country foreign currency deposit ceiling for Russia.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Bank of Khanty-Mansiysk, JSC

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (70%)						E+	
Factor: Franchise Value						D-	Improving
Market Share and Sustainability				x			
Geographical Diversification				x			
Earnings Stability					x		
Earnings Diversification [2]							
Factor: Risk Positioning						D	Neutral
Corporate Governance [2]				x			
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks				x			
Controls and Risk Management				x			
- Risk Management				x			
- Controls			x				
Financial Reporting Transparency			x				
- Global Comparability	x						
- Frequency and Timeliness				x			
- Quality of Financial Information				x			
Credit Risk Concentration					x		
- Borrower Concentration					x		
- Industry Concentration				x			
Liquidity Management				x			
Market Risk Appetite		x					
Factor: Operating Environment						E+	Neutral
Economic Stability					x		
Integrity and Corruption					x		
Legal System				x			
Financial Factors (30%)						C	
Factor: Profitability						C+	Neutral
PPI / Average RWA - Basel I		3.41%					
Net Income / Average RWA - Basel I			1.36%				
Factor: Liquidity						D+	Neutral
(Mkt funds-Liquid Assets) / Total Assets			2.91%				
Liquidity Management				x			
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio - Basel I	13.80%						
Tangible Common Equity / RWA - Basel I	13.68%						

Factor: Efficiency						**C**	**Neutral**
Cost / Income Ratio			59.95%				
Factor: Asset Quality						**D**	**Neutral**
Problem Loans / Gross Loans				7.32%			
Problem Loans / (Equity + LLR)				30.37%			
Lowest Combined Score (9%)						**D**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**D**	
Assigned BFSR						**E+**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral