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Research Update:

Russia's Gazprombank Upgraded To 'BB+/B' And 'ruAA+' On StandAlone Credit Profile Rise To 'b+'; Outlook Stable

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Overview

- Gazprombank's asset quality and funding profile are improving and compare well with those of domestic peers.
- The bank has substantially lowered its trading risk appetite, and made significant progress in divesting noncore assets in 2010. We expect this process to continue in 2011, leading to the release of economic capital to be reallocated to commercial banking activities.
- We are raising our long-term rating on Gazprombank to 'BB+' from 'BB', and our Russia national scale rating to 'ruAA+' from 'ruAA'.
- The stable outlook reflects our expectation that Gazprombank's financial profile will gradually improve in terms of quality and earnings, without material deterioration in asset quality indicators that we expect will remain better than the average for the Russian banking system.

Rating Action

On Aug. 11, 2011, Standard & Poor's Ratings Services raised its long-term counterparty credit rating on Russia's third-largest bank, Gazprombank, to 'BB+' from 'BB', affirmed its short-term rating at 'B', and raised its Russia national scale ratings to 'ruAA+' from 'ruAA'. The outlook is stable.

Rationale

The upgrade reflects our view that Gazprombank's stand-alone credit profile has improved to 'b+' from 'b', because of its improved credit portfolio, decreased appetite for market risk, and enhanced funding position. During times of crisis the bank's credit portfolio was resilient and performed better than peers'. After peaking at 3.9% in 2009, Gazprombank's gross nonperforming loan-to-total loan ratio fell to 2.1% in 2010. Credit risk cost remained at low to moderate levels throughout the crisis. The bank is less reliant on market funding, and its funding mix has improved substantially, with deposits accounting for 77% of its funding base at the end of 2010 compared with 45% in 2008. We believe the bank has substantially reduced its trading risk appetite since it incurred severe losses in 2008.

In 2010 the process of divesting noncore assets gained momentum with Gazprombank's sale of a stake in SIBUR Holding (decreasing its ownership to noncontrolling) and of its controlling stake in Sibneftegaz. We believe the group might sell the remaining 49.98% of SIBUR Holding it still owns in 2011.

We consider Gazprombank to be a government-related entity (GRE). In accordance with our criteria for rating GREs, our view of the "high" likelihood of timely and sufficient extraordinary government support is based on our assessment of Gazprombank's "very important" role as a bank of high systemic importance, its significant role in government support initiatives for the domestic banking sector and economy, and its role in servicing Gazprom's operations. We believe it has "strong" links with the Russian Federation through Gazprom's ownership, as demonstrated by a consistent track-record of government support. Based on our methodology for GREs, Gazprombank's long-term rating incorporates a three-notch uplift above its stand-alone credit profile.

The ratings on Gazprombank also reflect the following constraining factors:

- Weak capitalization with a Standard & Poor's risk-adjusted capital ratio (RAC) of 3.8% after adjustments for concentration risk on Dec. 31, 2010. Gazprombank has a strategic plan in place to maintain its No. 3 ranking among Russian banks--it had total assets of Russian ruble (RUR)1.952 billion at the end of 2010--by growing steadily. However, without external capital support, capitalization will remain a weakness. We understand that the plan is aiming for balanced growth of assets and equity. This implies that various scenarios are under consideration, including the possible conversion of subordinated loans into equity. We also understand the plan is for projected profitability to allow the internal generation of capital, in a context of prudent credit policy and moderate dividend policy.
- A still vulnerable and volatile earnings structure with a significant share of revenues coming from trading activities and nonrecurring operations. This was proved in 2010 when a RUR37.7 billion net profit from discontinued petrochemical operations and a RUR30.7 billion gain from the disposal of shares in Sibneftegas, Novatek, and utilities companies were the main contributors to the RUR66.3 billion net profit. Gazprombank's 2010 operating performance was affected by a difficult and competitive environment, meaning operating profit from continuing operations fell to RUR38.5 billion, including a RUR23.9 billion gain from the sale of shares in Sibneftegaz, from RUR56.7 billion in 2009.
- Some concentration risk was present at the end of 2010, with state-controlled companies accounting for 42.3% of total customer deposits and the 10 largest exposures accounting for RUR320.5 billion, or 30%, of the gross loan portfolio and 195% of total adjusted capital. This was partially offset by high-quality corporate borrowers, a substantial liquidity cushion, a low level of short-term debt, and wholesale market sensitive funding.

Outlook

The stable outlook reflects our expectation that Gazprombank's asset quality indicators will remain better than the Russian banking system average, adequate measures will be undertaken to increase the equity of the bank in proportion to the growth of risky assets, and earnings structure will gradually improve as core commercial banking revenues increase and volatility and market risk decrease.

We could take a positive rating action if the bank sizably improved its capitalization while maintaining other major financial indicators at current levels or higher. Further sales of noncore assets and a substantial improvement in the revenue structure toward a higher share of recurring revenues from commercial banking activities would also be positive rating factors.

We would consider lowering the ratings on the bank if current levels of capitalization fell and asset quality and profitability dropped. Other potentially negative developments would be a significant weakening in the risk profile of the bank and the return of high market risk appetite or any kind of change that would weaken its ties with and support from the Russian government.

Related Criteria And Research

- FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004
- Criteria: Bank Capital Methodology and Assumptions, Dec. 6, 2010
- Rating Government-Related Entities: Methodology and Assumptions, Dec 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Gazprombank		
Counterparty Credit Rating	BB+/Stable/B	BB/Positive/B
National scale	ruAA+/--/--	ruAA/--/--
Senior Unsecured	BB+	BB
National scale	ruAA+	ruAA
Certificate Of Deposit	BB+	BB
Commercial Paper	B	
GPB Eurobond Finance PLC		
Senior Unsecured*	BB+	BB
GazInvest Finance B.V.		
GPB Finance PLC		
Commercial Paper**	B	
Senior Unsecured**	BB+	BB

* Borrowed by Gazprombank
** Guaranteed by Gazprombank

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