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Sovcombank PJSC

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Sovcombank PJSC

SACP	bb-
Anchor	bb-	
Business Position	Adequate	0
Capital and Earnings	Moderate	0
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

\+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

\+

Additional Factors	0

Issuer Credit Rating
BB-/Positive/B

Major Rating Factors

Strengths:	Weaknesses:
• Well-diversified business lines due to strategic acquisitions. • Strong operating performance. • Experienced management team with a positive track record in banking acquisitions.	• Moderate capitalization levels despite capital infusions. • Vulnerable market environment in Russia.

Outlook: Positive

The positive outlook reflects S&P Global Ratings' expectation that, in the next 12 months, Sovcombank PJSC's credit quality could strengthen on the back of a sustained, fairly robust balance sheet in a domestic context, as well as clearer indications that the Russian authorities regard the bank as systemically important.

A positive rating action may follow if we consider Sovcombank has greater systemic importance in Russia. This may occur if the bank retains its market share in terms of assets and retail deposits. We would also take into account the Central Bank of Russia's (CBR's) confirmation of the bank's status as systemically important under the regulator's criteria. An upgrade will also hinge on sustainable levels of capitalization, with a risk-adjusted capital (RAC) ratio comfortably above 5%.

Even if Sovcombank becomes a systemically important bank, we may revise the outlook to stable if we expect the bank's capitalization, as measured by our RAC ratio, to move below 5%. This may stem from faster-than-expected growth via acquisitions or a fast buildup of bond portfolio accompanied by fairly aggressive dividend policy.

Rationale

We take into account Sovcombank's improved market share after it's most recent acquisition (Rosevrobank [REB]) of around 1.4% in retail deposits as of Feb. 1, 2019, and involvement in guarantee issuance for small enterprises for state purchases (around 25%-30% of the market share according to bank's own estimates). We also believe that as per the CBR's methodology, on Feb. 1, 2019, Sovcombank surpassed the quantitative cutoff threshold for systemic importance by a wide margin. We also incorporate into our analysis our expectation that, the bank's capitalization will likely remain moderate, based on assumptions of no further acquisitions or material increase in its corporate bond portfolio. In our opinion, the bank's risk position reflects its better-than-average performance in a domestic and global peer comparison. We also think that the bank's funding and liquidity metrics will likely remain in line with that of the sector.

Anchor: 'bb-' for a bank operating only in Russia

Our bank criteria use our Banking Industry Country Risk Assessment economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Russia is 'bb-', based on an economic risk score of '8' and an industry risk score of '8'.

Economic risks are higher for Russian banks than for peers in large emerging markets such as China, Brazil, and India. Although we now expect economic growth of 1.5% in 2019 and average growth of 1.8% in 2020-2022, we consider that the economic environment will remain challenging for Russian banks over the next two years. The economy still relies heavily on commodities and lacks the structural reforms that would improve the efficiency of its non-export sectors.

We expect lending growth of 12%-15% in 2019, on the back of a pronounced increase in retail lending toward an average 18%-20% in 2019. In our opinion, the increased credit demand seen in 2018 stemmed primarily from significantly delayed lending demand from corporate and retail clients. We expect new lending growth will likely moderate in 2019. A pick-up in new lending will strengthen the banking sector's profitability, to some extent compensating for the burden of substantial accumulated problem and restructured loans that continue to constrain the profitability and capitalization of many Russian banks.

Industry risks are also high. Access to external funding remains limited because of the economic sanctions imposed on several large banks and corporates. While deposit growth has slowed markedly, deposits remain the core funding source for the sector. Funding concentrations at small and midsize banks make them particularly vulnerable to deposit outflows. The dominance of state banks in the Russian banking sector has traditionally distorted competition and weighed on the creditworthiness of private sector banks. We expect state banks to continue enhancing their market positions in 2019-2020. We consider that banking regulation and supervision remain reactive rather than proactive. However, the central bank's efforts to clean up the banking sector have been positive for the sector's stability.

The banking sector has received significant government support in the form of capital, funding, and liquidity in the past. We anticipate that, over the coming years, government support will likely be available predominantly for large state-related banks and systemically important private banks.

Table 1

Sovcombank PJSC Key Figures

		--Year-ended Dec. 31--			
(Mil. RUB)	**2018***	**2017**	**2016**	**2015**	**2014**
Adjusted assets	858,544.0	685,496.0	561,544.0	466,043.0	201,363.6
Customer loans (gross)	524,087.0	275,270.0	246,147.0	185,138.0	127,844.3
Adjusted common equity	103,967.0	69,584.0	53,298.0	21,909.0	11,130.3
Operating revenues	47,791.0	67,086.0	59,887.0	45,365.0	24,897.8
Noninterest expenses	24,895.0	23,583.0	14,200.0	10,858.0	12,376.8
Core earnings	13,930.0	31,869.9	32,822.5	20,660.0	1,600.3

*Data as of Sept. 30. RUB--Russian ruble.

Business position: Well-diversified business lines with stronger market share in retail segment

Our assessment of Sovcombank's business positon as adequate is supported by good revenue diversification, growing franchise from a series of acquisitions, and strong operating performance over the years. The bank also has a wide distribution network with around 2,648 offices across Russia, catering to about 4.4 million clients. At Jan. 1, 2019 under Russian accounting standards, the group had a share of 1.03% of total systemwide assets, 0.7% in loans, and 1.4% of system-wide retail deposits. This compares with just 0.5% of retail deposits three years before, which we think also points to the bank's increasing systematic importance.

Sovcombank has established itself as a bank with a diversified business profile mainly benefitting from the strategic acquisitions made over the past 10 years. SME-focused REB was Sovcombank's last acquisition. In our view, the merger of REB with Sovcombank would further strengthen the bank's franchise and market positions by expanding the very well designed SME banking services to the merged bank's wider clientele. As a result, Sovcombank has three main business lines: corporate investment bank, which focuses on public sector clientele and large corporates; retail bank for low and moderate income clients in regions; and a bank for SMEs offering predominantly settlement services, guarantees, and other fee-generating products.

In 2018 a consortium of GCC sovereign wealth funds and Chinese and Japanese investors led by Russia Direct Investment Fund (RDIF) acquired a minority stake in Sovcombank. The sovereign funds made investments that led to the strengthening of the bank's capital base by Russian ruble (RUB) 9.7 billion in 2018, which will support the growth of Sovcombank's businesses. They also contributed another RUB 6 billion in 2019, and we view this is positive for the bank's credit quality.

In our opinion, the bank's management team is experienced and stable with a proven track record of successfully integrating acquired assets and new business lines over the past 10 years.

Table 2

Sovcombank PJSC Business Position

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Total revenues from business line (mil. RUB)	50,977.0	68,183.0	62,396.0	45,370.0	24,897.8
Commercial banking/total revenues from business line	54.7	51.5	58.6	55.3	N/A

Table 2

Sovcombank PJSC Business Position (cont.)					
		--Year-ended Dec. 31--			
(%)	2018*	2017	2016	2015	2014
Retail banking/total revenues from business line	57.2	50.3	42.8	44.7	100.0
Commercial & retail banking/total revenues from business line	111.9	101.9	101.4	100.0	100.0
Other revenues/total revenues from business line	(11.9)	(1.9)	(1.4)	N/A	N/A
Return on average common equity	22.0	41.7	79.0	99.7	7.7

*Data as of Sept. 30. RUB--Russian ruble. N/A--Not applicable.

Capital and earnings: Moderate capitalization supported by contained growth and infusion of funds

We expect that the bank will maintain its capitalization over the next 12-18 months within the 6.5%-7.0% range. RAC ratio as of Sept. 30, 2018 was at 6.1% supported by capital infusions. These metrics support our assessment of the bank's capital and earnings as moderate.

We understand that, in 2019, Sovcombank targets only modest growth rates of total assets, while seeking to reduce its corporate bond portfolio amid rising interest rates and the challenging environment. We also understand Sovcombank expects to pay only token dividends this year. Furthermore, we understand the bank is likely to resume expansion in 2020. As such, we anticipate the RAC ratio will remain around 6.5% over the next two years. We note, however, that our projections do not include any further acquisitions or rapid growth in the bond portfolio--events that could cause the RAC ratio to deteriorate to below 5%.

We expect the cost of risk (CoR) to remain in the 2.3%-2.5% range, which balances high CoR in consumer retail being offset by low risk in the mortgage portfolio. It is further supported by better-than-average corporate exposures via bond portfolio.

The bank has reported a strong adjusted return on equity on average of about 50% between 2014 and third-quarter 2018, which is much higher than peers'. We expect Sovcombank to continue its track record of stable core earnings in 2019-2020 and maintain its above-average return on assets.

Table 3

Sovcombank PJSC Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	2018*	2017	2016	2015	2014
Tier 1 capital ratio	12.2	14.2	12.7	7.6	7.9
S&P Global Ratings' RAC ratio before diversification	6.1	5.5	4.9	2.9	3.9
S&P Global Ratings' RAC ratio after diversification	5.1	4.8	4.6	2.7	3.7
Adjusted common equity/total adjusted capital	94.0	91.1	100.0	100.0	100.0
Net interest income/operating revenues	71.1	49.2	46.3	40.2	70.6
Fee income/operating revenues	30.5	26.9	21.3	21.4	37.5
Market-sensitive income/operating revenues	(5.9)	23.0	27.7	37.6	(19.1)
Noninterest expenses/operating revenues	52.1	35.2	23.7	23.9	49.7
Preprovision operating income/average assets	3.9	6.9	8.8	10.3	7.7

Table 3

Sovcombank PJSC Capital And Earnings (cont.)

	--Year-ended Dec. 31--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Core earnings/average managed assets	2.4	5.1	6.4	6.2	1.0

*Data as of Sept. 30. RAC--Risk-adjusted capital. N/A--Not applicable.

Table 4

Sovcombank PJSC Risk-Adjusted Capital Framework Data

(Mil. RUB)	**Exposure***			**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government & central banks	124,015	--	--	83,871	68
Of which regional governments and local authorities	88,630	--	--	81,229	92
Institutions and CCPs	108,657	--	--	155,311	143
Corporate	458,831	--	--	799,905	174
Retail	135,196	--	--	173,536	128
Of which mortgage	29,001	--	--	26,823	92
Securitization§	0	--	--	0	0
Other assets†	11,317	--	--	24,490	216
Total credit risk	926,646	--	--	1,237,113	134
Credit valuation adjustment					
Total credit valuation adjustment	--	--	--	0	--
Market Risk					
Equity in the banking book	1,844	--	--	20,370	1,105
Trading book market risk	--	--	--	0	--
Total market risk	--	--	--	20,370	--
Operational risk		--	--		
Total operational risk	--	--	--	125,786	--
(Mil. RUB)	**Exposure**			**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	--	--	1,383,270	100
Total Diversification/ Concentration Adjustments	--	--	--	209,375	15
RWA after diversification	--	--	--	1,592,644	115
(Mil. RUB)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments	--	82,170	14.2	76,383	5.5
Capital ratio after adjustments‡	--	82,170	14.2	76,383	4.8

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. RUB--Russian ruble. Sources: Company data as of 'Dec. 31 2017', S&P Global Ratings.

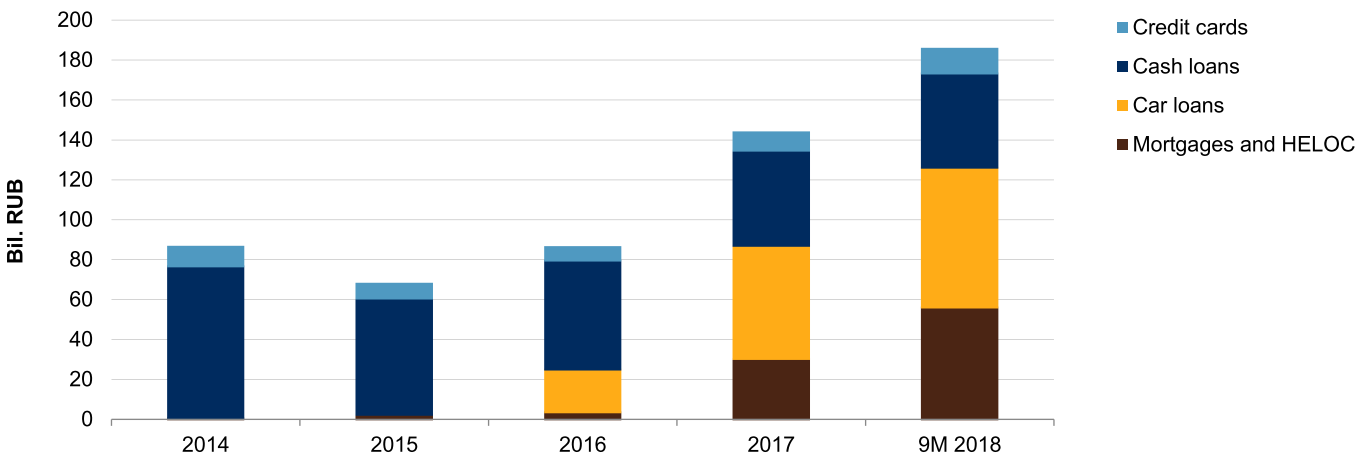
Risk position: Focus on high-quality corporates offsets risks from retail portfolio

We consider Sovcombank's risk position to be adequate balancing the bank's historically strong appetite for rapid non-organic growth with currently contained risk appetite and shift towards secured rather than unsecured lending activities.

Sovcombank's balance sheet expanded with a compound annual growth rate of 35.8% over 2014-2018, via acquisitions of portfolios and other banks. While this aggressive growth did not result in increased cost of risk, on the back of the quality of acquired businesses and portfolios, we believe this underscores the bank management's risk appetite. Nevertheless, we acknowledge that the acquisitions enabled the bank to diversify its exposures, notably in retail space (see chart 1).

Chart 1

SCB's Retail Portfolio Leans Toward Secured Lending
Breakdown of gross retail loans by product



HELOC--Home equity line of credit. Source: S&P Global Ratings.

We believe that Sovcombank's cost of risk has generally moderated over the past few years to levels comparable with the rest of the market on a like-for-like basis. Our base-case expectation is that it will stay at around 2.3%-2.5% over the coming two years. We note that, as of Sept. 30, 2019, the coverage of Stage 3 loans (2.4% of the loan portfolio) by specific provisions stood at 65%, a figure commensurate with an estimate 70% for the system.

We also take into account the reasonable credit quality of the group's bond portfolio of the group--75% are rated in our 'BB' category or above--and largely hedged interest rate risk.

Table 5

Sovcombank PJSC Risk Position

		--Year-ended Dec. 31--			
(%)	2018*	2017	2016	2015	2014
Growth in customer loans	120.5	11.8	33.0	44.8	91.2

Table 5

Sovcombank PJSC Risk Position (cont.)

	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Total diversification adjustment/S&P Global Ratings' RWA before diversification	21.6	15.1	7.3	6.9	4.2
Total managed assets/adjusted common equity (x)	8.3	9.9	10.6	21.4	18.1
New loan loss provisions/average customer loans	2.2	1.6	2.4	5.9	11.6
Net charge-offs/average customer loans	1.3	1.2	3.2	6.5	6.6
Gross nonperforming assets/customer loans + other real estate owned	2.5	2.3	2.4	5.0	8.2
Loan loss reserves/gross nonperforming assets	125.6	141.5	129.2	108.2	106.2

Note: The 2018 data refers to Stage 3 loans under IFRS9 definition. The data for 2017 and prior periods refers to loans past due more than 90 days. *Data as of Sept. 30. RWA--Risk-weighted assets. N/A--Not applicable.

Funding and liquidity: Stable and diversified deposit base with improved liquidity cushion

We expect Sovcombank to maintain its stable and diversified funding profile, with a stable funding ratio expected to remain above 100% for 2019-2020. We also expect the bank will maintain its adequate liquidity cushion over the next few years.

Our assessment of the bank's funding position reflects its good deposit diversification (with 70% of deposits being retail and predominantly small-ticket) and reasonable loan-to-deposit ratio of 92% as of the first nine months of 2018. Our stable funding ratio remained strong at 103% as of Sept. 30, 2018, indicating limited maturity mismatches. While the bank continues to rely on wholesale borrowing to fund its trading book the share of this funding declined materially over 2018 to reach 18% of the total mix compared with 32% at year-end 2017 with correspondent decline of asset encumbrance.

We assess the bank's liquidity position as adequate. While broad liquid assets (our measure of available liquidity which incorporates haircuts on asset classes) covered the short-term wholesale funding by 1.3x as of Sept. 30, 2018, we note that net broad liquid assets covered only 12.2% of short-term customer deposits, which is somewhat moderate compared with peers. This is largely due to the fact that Sovcombank's liquid buffer is composed largely of corporate bonds which we believe may be more volatile at times of stress.

Table 6

Sovcombank PJSC Funding And Liquidity

	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Core deposits/funding base	75.1	61.4	55.7	33.5	62.3
Customer loans (net)/customer deposits	92.6	74.2	86.3	120.5	99.4
Long-term funding ratio	81.5	69.6	64.5	51.8	67.9
Stable funding ratio	102.9	104.2	94.8	84.1	95.2
Short-term wholesale funding/funding base	21.3	35.0	39.4	51.1	34.0
Broad liquid assets/short-term wholesale funding (x)	1.3	1.2	1.0	0.8	0.9
Net broad liquid assets/short-term customer deposits	12.2	14.2	(2.8)	(43.9)	(6.3)
Short-term wholesale funding/total wholesale funding	82.3	88.2	89.0	76.8	90.1

Table 6

Sovcombank PJSC Funding And Liquidity (cont.)					
		--Year-ended Dec. 31--			
(%)	2018*	2017	2016	2015	2014
Narrow liquid assets/3-month wholesale funding (x)	1.5	1.3	1.0	0.8	0.9

*Data as of Sept. 30.

External support: None

No notches of uplift to the SACP.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Russia-Based Sovcombank Outlook Revised To Positive On Potential Rising Systemic Importance; Affirmed At 'BB-/B', Jan. 24, 2019

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	**8**	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	**bb-**	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of April 24, 2019)*

Sovcombank PJSC		
Issuer Credit Rating		BB-/Positive/B
Russia National Scale		NR/--/--
Issuer Credit Ratings History		
24-Jan-2019		BB-/Positive/B
14-Nov-2017		BB-/Stable/B
21-Nov-2016		B+/Stable/B
29-Dec-2015		B/Stable/B
02-Jun-2017	*Russia National Scale*	NR/--/--
21-Nov-2016		ruA/--/--
30-Sep-2014		ruA-/--/--
Sovereign Rating		
Russia		
Foreign Currency		BBB-/Stable/A-3
Local Currency		BBB/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.