

## Sovcombank's Rating was Affirmed At 'ruA'

May 24, 2019

Expert RA has affirmed its 'ruA' credit rating on Sovcombank. The outlook for the rating is Stable.

The rating reflects the bank's strong market position and corporate governance practices, adequate liquidity position and asset quality, and its fair capital adequacy. The rating strongly benefits from the mid-high probability of receiving extraordinary support by Sovcombank, in financial and administrative matters, from the federal authorities due to its business scale and deposits structure.

PJSC Sovcombank is a large universal bank (13<sup>th</sup> place by assets in Expert RA ranking as of Apr 4, 2019), specializing in retail and corporate banking as well as investment banking. Sovcombank's wide geographic scope and extensive network infrastructure (2,600 branches in 75 Russian regions) support its strong position in the consumer lending. The Bank's ownership structure has changed due to attracted sovereign and private funds as well as the co-founders' of RosEvroBank (merged with Sovcombank in November 2018). The bank's major beneficial owners are Sergey and Dmitry Khotimskiy brothers (holding in common 35.8%), who are the members of Sovcombank's Supervisory Board and Management Board.

**Sovcombank's market position is strong.** In our view, the bank has a well-diversified revenue base (its Herfindahl-Hirschman Index is 0.24), and a robust competitive position in both the SME and retail segments of the nationwide banking market (in 2018, Sovcombank was the largest issuer of SME guarantee facilities in the Russian banking sector). The bank's position in retail banking is supported not only by its extensive branch network, but also by the Halva installment card project that has been quickly gained popularity in the past two years and is now used by more than 3 million customers. We also positively assess the bank's low related party exposure (related party-linked assets to capital ratio was less than 3% last year).

**Sovcombank's capital position is fair and its operating efficiency is strong.** On the one hand, the capital is not much resilient to asset quality shocks (as of Apr 1, 2019, the bank's N1.2 ratio measuring its loss absorption buffer was around 5% of assets exposed to credit or market risks and off-balance-sheet liabilities, before capital increase or exposure reduction). On the other hand, the bank has a strong earnings generation capacity (ROE=17.6% and ROA=2.1% on net profit according to IFRS financial statement for 2018), that allows to maintain a capital buffer, and its operating expenses adequately covered with its net interest and net commission income (134% in 2018). We positively mention a decrease in Sovcombank's average funding costs after RosEvroBank acquisition and expect the synergy potential to be fully captured in the next 12-18 months. In addition, the pressure on Sovcombank's capital buffer is likely to decline after the Halva Project reaches the breakeven point in 2019, as expected.

**Sovcombank's asset quality is adequate.** The bank's assets are mostly represented by securities and loans. The retail loan portfolio is adequately diversified by product, with decreased unsecured loans share (which declined from 38% to 33% in 2018, according to the bank's 2018 IFRS financial statements), due to rapidly growing mortgage and auto-/real-estate-backed loan portfolio. The bank's corporate loan and corporate bond portfolios are poorly diversified (around 22% of its corporate loans and bonds were represented by the metals industry, and 52% by three key sectors on Jan 1, 2019, according to the bank's IFRS financial statements). At the same time, we assess the aggregate loan portfolio quality as adequate: Sovcombank reported 88% of its loans falling in the I and II risk categories (as of Apr 1, 2019). The bank's securities portfolio is mostly comprised of high investment grade bonds (on Apr 1, 2019, more than 60% of the bank's holdings, which accounted for 26% of its gross assets, were backed by issuers rated ruA+ or better on Expert RA rating scale).

**Sovcombank's liquidity position is adequate.** The bank has a sufficient balance sheet liquidity cushion (the liquid assets to deposits ratio was 12% as of Apr 1, 2019), while the share of top-10 depositors in total customer deposits is modest. As of Apr 1, 2019, top-10 depositors/depositor groups, excluding Express-

Volga subsidiary bank, accounted for less than 10% of Sovcombank's net liabilities. The balances of customer deposits maturing within 30 days tend to become more resilient to shocks after RosEvroBank acquisition: the liquid assets to liabilities up to 30 days ratio (N3 ratio with and without stable components was 93% and 51% respectively as of Apr 1, 2019). The fact that the bank's liquidity position became more dependent on customer current deposits is offset by those deposits being historically resilient to shocks. In addition, the bank has a range of additional sources of liquidity; e.g. funds raised under REPO deals ( the ratio represented around 10% of its liabilities as of Apr 1, 2019 incl. securities pledged as collateral and 4801-U transactions).

**The bank's corporate governance and strategic planning policies are strong.** The bank's senior managers have long track records in different financial market segments and proven business reputations. The accomplishment of its strategic objectives in the past few years enabled the bank to diversify its business and strengthen its position in different banking markets. Sovcombank's business scale and dynamics make it a credible candidate for becoming a systemically important Russian bank and we note that Sovcombank Group grows faster than its peers. In addition, Sovcombank manages to keep its business profitable and integrates acquired banks in its business model. The bank's conservative policy with respect to issuing unsecured consumer loans is likely to mitigate potential losses on its retail banking products, while the consistently strong corporate loan quality, access to RosEvroBank's customer base, and the integration of merged banks' IT-systems, to be completed later in 2019, allows Sovcombank to increase its income.

As of 01.04.19 Sovcombank's net assets totaled RUB 996.6 billion, equity reached RUB 103.2 billion net profit was RUB 9.5 billion.

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PJSC SOVCOMBANK's credit rating was first published in Nov 28, 2008. Previous press-release on this rated entity was published on May 30, 2018.

The rating is a Russian national scale long-term credit rating. Neither the credit rating nor the outlook for it is expected to be revised before the publication of this press release.

The credit rating was assigned using Expert Ra Methodology For Assigning Credit Ratings To Banks (<https://raexpert.ru/ratings/methods/current>) that came into force on Apr 12, 2019.

The assigned rating and the rating outlook reflect all of the meaningful information about the rated entity, available to Expert RA, which Expert RA believes to be reliable. Key sources of information used in Expert RA's rating analysis are data coming from the Bank of Russia, PJSC SOVCOMBANK, as well as Expert RA's data. Information used by Expert RA in its rating analysis was adequate in terms of the rating methodology application.

The credit rating was assigned under a rating contract, and PJSC SOVCOMBANK participated in the rating process.

The Rating Committee quorum requirement was met to permit voting on the bank's rating. The lead rating analyst presented to the Rating Committee the key rating factors, and the members of the Rating Committee expressed their opinions and ideas. The Chairperson of the Rating Committee allowed each member to express his/her opinion before voting.

Expert RA has not been providing services other than rating services to PJSC SOVCOMBANK in the past 12 months.

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