MOODY'S
INVESTORS SERVICE

CREDIT OPINION
19 July 2018

Update

Rate this Research

RATINGS

Domicile	Kostroma, Russia
Long Term CRR	Ba2
Long Term Debt	Not Assigned
Long Term Deposit	Ba3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the *ratings section* *at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*

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Sovcombank PJSC

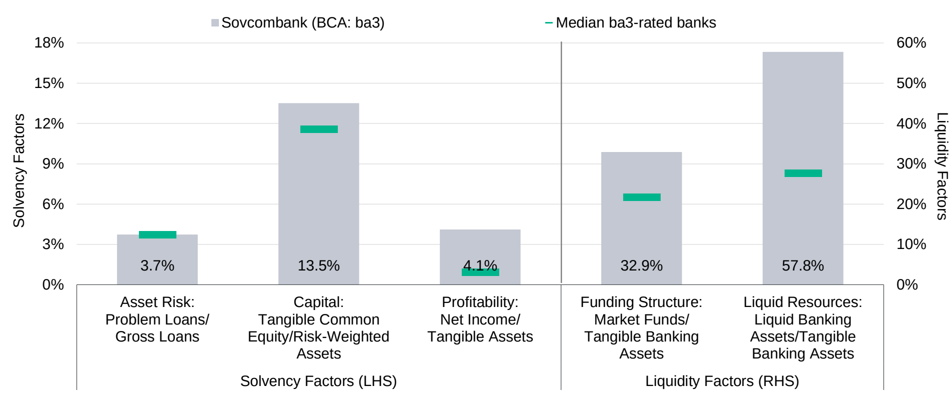
Update to credit analysis

Summary

Sovcombank PJSC's (Sovcombank) long-term local- and foreign-currency deposit ratings of Ba3 are based on the bank's ba3 Baseline Credit Assessment (BCA) and do not incorporate any probability of external support.

The ba3 BCA reflects Sovcombank's (1) strong loss-absorption capacity, illustrated by its high pre-provision profitability, robust capital buffers and adequate provisioning that together provide a considerable buffer to withstand potential asset risks; (2) sound asset quality indicators, supported by good portfolio diversification and an increased portion of secured retail loans; and (3) adequate funding and liquidity profiles. At the same time, the bank's BCA is influenced by its high exposure to market risk and somewhat volatile earnings, as well as a one-notch qualitative adjustment for corporate behaviour related to its M&A growth strategy.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

» Good loan book quality and ample loan-loss reserves

» Strong loss-absorption capacity supported by healthy capital buffers and robust profitability

» Ample liquidity

Credit challenges

» Exposure to market risk

» Reliance on interbank funding under repo

» High appetite for M&A

Outlook

Sovcombank's long-term deposit ratings carry a stable outlook, reflecting our expectation that the bank's profitability and capital will remain robust in line with its current ratings over the next 12-18 months.

Factors that could lead to an upgrade

» A material strengthening of Sovcombank's banking franchise, along with a longer track record of sustainable and robust financial performance, driven by recurring income

» Reduced exposure to market risk

Factors that could lead to a downgrade

» A substantial deterioration in the bank's asset quality, capitalisation or liquidity profile

» Aggressive growth via M&A leading to acquisition of a relatively (to capital) large and risky assets

Key indicators

Exhibit 2

Sovcombank PJSC (Consolidated Financials) [1]

	12-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (RUB billion)	689	565	468	202	125	53.4[4]
Total Assets (USD billion)	12	9.3	6.4	3.4	3.8	33.3[4]
Tangible Common Equity (RUB billion)	79	53	25	11	12	59.3[4]
Tangible Common Equity (USD billion)	1.4	0.9	0.3	0.2	0.4	38.4[4]
Problem Loans / Gross Loans (%)	3.7	3.7	5.5	10.9	9.4	6.6[5]
Tangible Common Equity / Risk Weighted Assets (%)	13.5	11.9	6.9	6.4	14.2	10.6[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	10.8	12.9	26.3	47.9	33.6	26.3[5]
Net Interest Margin (%)	5.6	5.5	5.4	10.6	9.9	7.4[5]
PPI / Average RWA (%)	8.5	10.6	12.9	7.5	14.2	10.8[6]
Net Income / Tangible Assets (%)	4.1	5.3	4.1	-0.5	2.9	3.2[5]
Cost / Income Ratio (%)	37.8	26.7	24.4	56.8	41.5	37.4[5]
Market Funds / Tangible Banking Assets (%)	32.9	37.8	60.4	32.7	22.9	37.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	57.8	55.8	61.0	32.3	47.1	50.8[5]
Gross Loans / Due to Customers (%)	70.9	74.9	116.0	81.7	82.8	85.2[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel I periods presented

Source: Moody's Financial Metrics

Profile

Sovcombank PJSC is a universal bank that offers a range of commercial and retail banking services to large corporations, small and medium-sized enterprises (SMEs), government entities and individuals. As of 31 March 2018, Sovcombank was the 14th-largest bank in

Russia in terms of total assets, 10th by retail deposits and the 8th by net profit. With more than 2,300 offices, Sovcombank operates one of the largest retail distribution networks in Russia, covering over 1,000 towns and villages across 73 Russian regions.

Over the last four years, Sovcombank's total assets increased more than fivefold, through both organic growth and an active M&A policy. The list of financial institutions that were acquired and merged into Sovcombank over 2014-17 includes the Russian subsidiaries of GE Money Bank, ICICI Bank (an Indian lender) and Garanti Bank (a Turkish lender), as well as Metcombank and Express-Volga Bank. In addition, in early 2017, Sovcombank took over the mortgage business from Nordea Bank.

In Q1 2018, Sovcomcombank has acquired an additional stake in RosEvroBank, which increased Sovcombank's direct share in the bank's capital to 75%. Sovcombank expects to merge with RosEvroBank by YE2018. Following the consolidation of the latter, Sovcombank's assets will increase by around 30%.

Russia-China Investment Fund, established by Russian sovereign fund RDIF and China Investment Corp., plans to acquire a minority stake at Sovcombank jointly with a consortium of leading Middle Eastern funds.

Detailed credit considerations

Good loan book quality and ample loan-loss reserves

Good asset quality has been, and will remain, a relative credit strength for Sovcombank, supported by the bank's good loan book diversification with a significant exposure to creditworthy customers from the corporate and subsovereign sectors and an increased focus on secured loans in the retail segment.

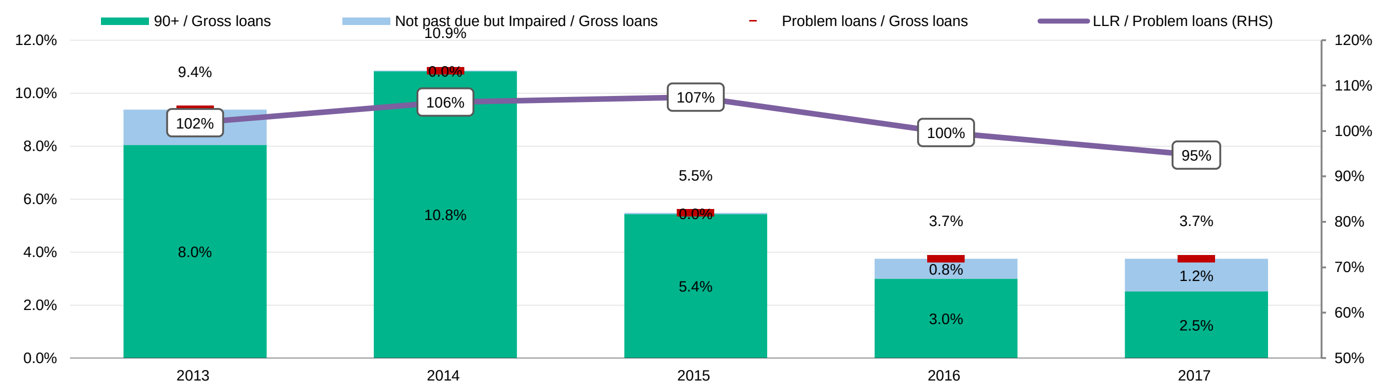
As of 31 December 2017, Sovcombank's problem loans (impaired corporate and retail loans overdue more than 90 days) accounted for 3.7% of gross loans (or 2.8%, including illiquid securities that are classified as loans to customers in the bank's IFRS report), flat compared with year-end 2016, and were 95% covered by loan-loss reserves.

As of the same date, the bank's loan book was almost evenly split between the corporate and retail segments. In 2017, Sovcombank's retail loan portfolio augmented by 1.7x or RUB57 billion, mainly as a result of (1) the acquisition of Metallurgical Commercial Bank (previously focused on car lending), which added RUB22 billion of auto loans or about 40% of the overall increase; and (2) the bank taking over a mortgage portfolio amounting to RUB16 billion from Nordea bank. Hence, the bank's share of secured loans increased to 60% as of December 2017, up from 29% as of year-end 2016.

Targeted for merger RosEvroBank, has better than Sovcombank asset-quality metrics. As of 31 December 2017, the bank's problem loans (defined as all overdue more than 90 days loans and category IV corporate loans) accounted for 2.5% of gross loans and were 340% covered by loan-loss reserves. Therefore, we expect the combined entity to maintain good asset quality and benefit from the two banks' asset diversification.

Exhibit 3

Good asset quality, with problem loans adequately covered by loan loss reserves



Source: Sovcombank's IFRS reports

Sovcombank's asset risk profile also reflects the bank's sizeable investments in Russian securities. As of 31 March 2017, the bank's securities portfolio accounted for around 47% of total assets or over 350% of its equity. The portfolio, which predominantly consisted of Russian Eurobonds and bonds issued by government related issuers rated Ba with a relatively short duration, bears limited credit risk but is a source of market risk for Sovcombank. While it is not our central scenario, the bank's securities portfolio could face increased volatility if the operating environment deteriorates, exerting negative pressure on the bank's profitability and capital. In addition, the generally low liquidity of Russian corporate bonds could adversely affect the valuation of Sovcombank's securities portfolio, which is classified as financial assets at fair value through profit or loss.

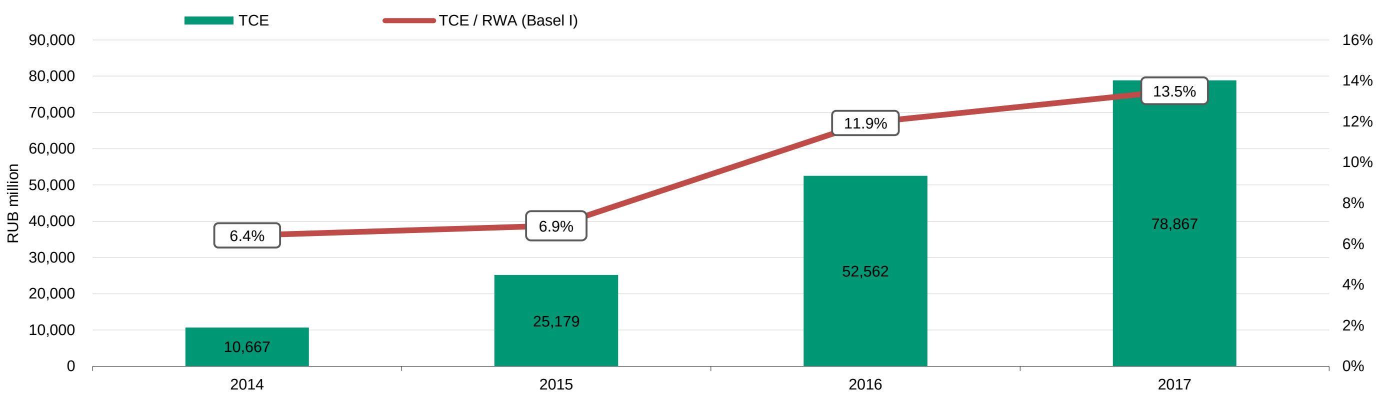
Our scorecard-adjusted asset risk score of b1 reflects the above risks.

Strong loss-absorption capacity, supported by solid capital buffer and conservative earnings retention policy

Sovcombank's capital position is supported by its healthy profitability and conservative earnings retention policy. As of 31 March 2018, the bank reported Basel I total capital adequacy ratio at 19.5% and Tier 1 ratio at 14.4%, an improvement from 16.5% and 14.2% respectively at year-end 2017. The quality of the bank's capital is also strong, given that it has no significant exposure to non-core assets or related parties.

Over the last three years, Sovcombank's shareholders' equity grew by more than sevenfold, twice as fast as its total assets, supported by strong internal capital generation. In 2015-16, the increase was largely attributed to the revaluation of the bond portfolio. Starting from the second half of 2016, Sovcombank has consistently reported strong recurring profitability, reducing its reliance on one-off gains.

Exhibit 4
Strong capital adequacy



Source: Sovcombank's IFRS reports

The acquisition and subsequent consolidation of RosEvroBank will result in a temporary decline in Sovcombank's capital metrics. However, we estimate these metrics to restore by year-end 2018 to the levels commensurate with the bank's Ba-rated peers, supported by retained earning. For this reason, we score capital at ba2, in line with macro-adjusted score.

Robust profitability, supported by healthy net interest margin and increased reliance on recurring earnings

Sovcombank's profitability will remain solid over the next 12-18 months, but gradually decline (normalise) in the longer term (in particular, in the absence of significant gains from its securities portfolio and exchange rate revaluation) because the bank expands its business, reducing reliance on non-recurring profitability and its high yielding fixed income portfolio will be gradually replaced with lower yielding assets. We also expect the bank to create more provisions for its retail loan portfolio under IFRS9.

Recent M&A deals have already positively affected Sovcombank's performance and will improve its market position in auto loan, mortgage and bank guarantee businesses, strengthening its recurring earnings - generating capacity in the long term. In addition, Sovcombank's profitability will remain supported by its fees and commissions from issuing on-line guarantees to companies supplying goods and services to the State and State-owned companies in Russia. Sovcombank has been among the leading players in this rapidly growing market and its income stream from this sector has already improved after the bank acquired RTS-tender - a leading electronic trading platform for goods and services operating in a State procurement market in Russia.

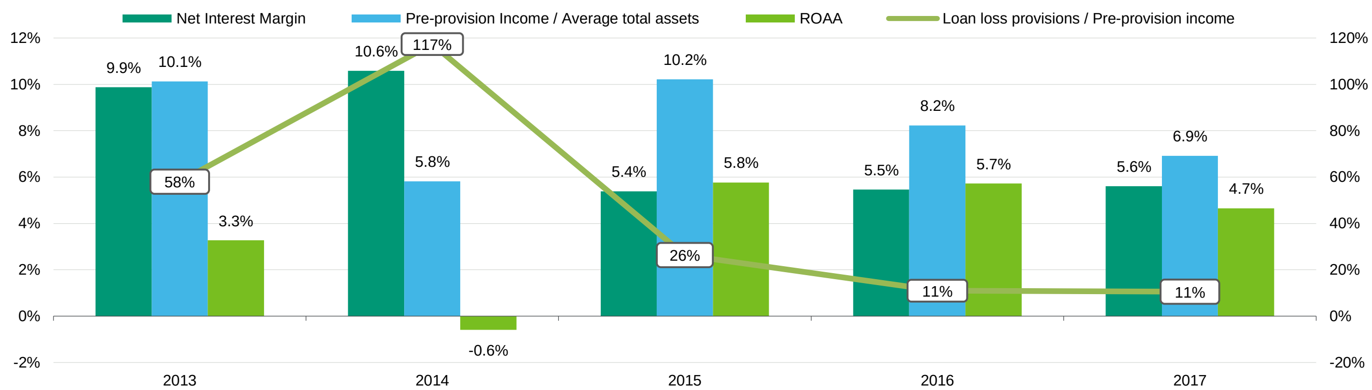
For 2017, Sovcombank posted net income of RUB29.6 billion, virtually flat compared to 2016 when the latter adjusted for one-off gain from business consolidation. Return on average assets (ROAA) moderated to 4.7% in 2017 from 5.7% a year earlier, mainly as a result of rapid asset growth, but remained well above that of Russian banking sector average and Ba-rated global peers. Recurring revenue from net interest income and fees and commission income together accounted for 77% of the bank's net revenue in 2017, up from 71% in 2016 and 62% in 2015.

For Q12018, Sovcombank posted net income of RUB5.1 billion (translates to RoAA of 3%) down from RUB8.4 billion reported in Q12017.

The bank's operating expenses surged by 65% in 2017, boosted by significant marketing costs and expenses associated with its business expansion. As a result, Sovcombank's cost-to-income ratio increased to 38%, a deterioration compared with the around 25% reported in 2015-16.

Concurrently, the bank's bottom-line profitability continued to be supported by a low cost of risk of 2.1%. An improvement from 2.5% reported in 2016 was driven by (1) the stabile operating environment in Russia (Ba1 positive), and (2) changes in the bank's lending mix.

Exhibit 5
Solid profitability metrics



Source: Sovcombank's IFRS reports

Targeted for merger, RosEvroBank, posted net income of RUB6.2 billion in 2017, which translated into an ROAA of around 3.4%. RosEvroBank's profitability metrics are similar to those of Sovcombank and benefit from a large portion of recurring sources of income, strong operating efficiency and a low cost of risk.

The baa1 macro-adjusted score generated by the scorecard can withstand a 50% decline in net income, which is beyond our central scenario. Therefore, we do not make any negative adjustment to the bank's profitability score.

Good liquidity and funding profiles

Sovcombank's liquidity profile will remain good over the next 12-18 months, supported by growing deposit base and reduced reliance on the wholesale funding, along with a healthy buffer of liquid assets.

As of 30 March 2018, customer accounts and deposits accounted for 70% of Sovcombank's total liabilities and mainly comprised small-denomination retail customer deposits, reflecting the bank's strength in the mass consumer market.

In Q12018, the bank has significantly decreased it's reliance on repo related funding to 17% from 30% of total liabilities, which is backed by its portfolio of fixed-income securities. For this reason, we made a two-notch upward adjustment in our scorecard and assigned ba3 score for funding. Following the merger with RosEvroBank, the combined entity's funding will become more diversified, with an increased share of corporate deposits coming from the latter, which also justifies the above named adjustment.

Additionally Sovcombank has maintained a sufficient buffer of liquid assets – over 23% of total assets – as of end - Q3 2018, consisted mainly unpledged securities and cash. We assigned a combined liquidity score of ba3 to reflect a good liquidity buffer and reduced reliance on wholesale (repo) funding.

Growth strategy and execution risks result in qualitative adjustment

We apply a one-notch negative adjustment to Sovcombank's overall sound financial profile to reflect its appetite for M&A growth. Although the bank has a good track record of M&A deals in previous years and recent acquisitions led to improved business diversification and entrenched market positions for Sovcombank, we consider such a rapid expansion growth strategy (if continues) to be potentially risky, especially in the potentially volatile macroeconomic environment.

Besides, the successful integration of a large number of acquired entities and business lines requires a transformation in Sovcombank's operations across areas such as information technology, customer service and risk management. Establishing this expertise will not only present cost pressures but will also present execution risk as the enlarged entity matures.

Therefore, Sovcombank's assigned standalone BCA is ba3.

Notching considerations

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment of Sovcombank is positioned at Ba2(cr).

The CR Assessment, prior to government support, is positioned one notch above the Adjusted BCA of ba3 and therefore above deposit ratings, reflecting our view that its probability of default is lower than that of senior unsecured debt and deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved to limit contagion, minimise losses and avoid disruption of critical function.

Counterparty Risk Rating (CRR)

CRRs are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

Sovcombank's global CRRs are positioned at Ba2, one notch above the bank's Adjusted BCA. This reflects the rating agency's view that CRR liabilities are not likely to default at the same time as the bank fails and will more likely to be preserved in order to minimize banking system contagion, minimize losses and avoid disruption of critical functions.

Rating methodology and scorecard factors

Exhibit 6

Sovcombank PJSC

Macro Factors		
Weighted Macro Profile	**Weak +**	**100%**

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	4.3%	ba3	↓	b1	Market risk	
Capital						
TCE / RWA	13.5%	ba2	← →	ba2	Expected trend	
Profitability						
Net Income / Tangible Assets	4.1%	baa1	← →	baa1	Earnings quality	
Combined Solvency Score		ba1		ba2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	32.9%	b2	↑↑	ba3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	57.8%	baa2	↓↓	ba2	Asset encumbrance	
Combined Liquidity Score		ba2		ba3		
Financial Profile				ba2		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				-1		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint:				Ba1		
Scorecard Calculated BCA range				ba2-b1		
Assigned BCA				ba3		
Affiliate Support notching				0		
Adjusted BCA				ba3		

Instrument class	**Loss Given Failure notching**	**Additional Notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Rating	1	0	ba2	0	Ba2	Ba2
Counterparty Risk Assessment	1	0	ba2 (cr)	0	Ba2 (cr)	--
Deposits	0	0	ba3	0	Ba3	Ba3

Source: Moody's Financial Metrics

Ratings

Exhibit 7

Category	Moody's Rating
SOVCOMBANK PJSC	
Outlook	Stable
Counterparty Risk Rating	Ba2/NP
Bank Deposits	Ba3/NP
Baseline Credit Assessment	ba3
Adjusted Baseline Credit Assessment	ba3
Counterparty Risk Assessment	Ba2(cr)/NP(cr)

Source: Moody's Investors Service

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