

Research Update:

**Russia-Based Sovcombank And
Rosevrobank 'BB-/B' Ratings Affirmed
On Progressing Merger; Outlook
Stable**

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Overview

- Sovcombank has increased its stake in Rosevrobank to 75.0% from 45.4%, and we understand that the legal merger will be completed within the next 18 months.
- Such a strategic and financial move is broadly in line with our expectations, as indicated by our decision to prospectively assess Rosevrobank as highly strategic to the merged group in March this year, before Sovcombank had majority control.
- We are affirming our 'BB-/B' ratings on Rosevrobank and our 'BB-/B' ratings on Sovcombank.
- The stable outlook on both Sovcombank and Rosevrobank reflects our expectation that the banks will maintain their credit metrics for the next 12-18 months as the merger process progresses. We expect the merger to be smooth, supported by Sovcombank's experience in integrating acquired companies and Rosevrobank's sound financial profile.

Rating Action

On May 7, 2018, S&P Global Ratings affirmed its 'BB-/B' long- and short-term issuer credit ratings on Sovcombank PJSC and Rosevrobank. The outlook on both banks remains stable.

We also affirmed our 'BB-' issue rating on Sovcombank's senior unsecured notes.

Rationale

On April 20, 2018, Sovcombank announced that it had increased its stake in Rosevrobank to 75% from 45.4%. We understand that the legal and operational merger of two banks will be completed within the next 18 months.

This announcement is in line with our previous expectations, even though, as of March 22, 2018, we expected that Sovcombank would increase its stake to 92% (see "Russia-Based Sovcombank And Rosevrobank 'BB-/B' Ratings Affirmed On Planned Merger; Outlooks Stable"). Our understanding is that two more shareholders in Rosevrobank, in addition to Mr. I. Brodsky, decided to remain shareholders of Rosevrobank and ultimately of the merged bank, causing the

acquisition structure to change. Other than that, Sovcombank is advancing this acquisition and the expected merger of the two entities in accordance with its growth strategy.

The affirmation of the ratings reflects our view that our inherent concerns regarding integration risks are balanced against both banks' sustainable financial metrics and Sovcombank's good track record of integrating acquired entities.

Since 2015, Sovcombank's strategy has been to gradually increase its stake in Rosevrobank, intending to acquire a controlling stake. Sovcombank's management considers Rosevrobank's business profile and client base as complementary to that of its own well-established business. In particular, management sees Rosevrobank's expertise in working with small and midsize enterprises (SMEs) as adding strength to the future merged bank.

In our view, the merger of Rosevrobank with Sovcombank fits well with Sovcombank's growth strategy. During the past two years, Sovcombank has made significant efforts to ensure the forthcoming integration is smooth. To finance the acquisition, in early March 2018, Sovcombank issued Tier 1 perpetual bonds of \$100 million, which we consider meet our requirements to be considered as having intermediate equity content, and Tier 2 debt of \$150 million. Additionally, on April 2, 2018, Sovcombank converted existing subordinated debt of about \$117 million into Tier 1 equity to support its consolidated capital buffer.

Once the consolidation is finalized, we anticipate that the combined bank will have a more diversified business model, greater access to corporate clients, and a wider client base.

Until the legal merger is finalized, and while the two banks continue to operate separately, we expect both banks to continue their normal activities in line with their current business profiles. Rosevrobank is expected to maintain its stable business position, supported by a track record of more than 10 years of sound revenue generation that we consider is better than the average for peers. We expect Rosevrobank to maintain credit costs of around 1%, supported by our expectation that nonperforming loans will not increase. We also anticipate that Rosevrobank will maintain its strong risk management practices. Although we understand that Rosevrobank will operate with thinner capital buffers in 2018, partly driven by a completed share buy-back and somewhat accelerated credit growth, we consider this a neutral factor for the ratings overall. In our base case, we expect that the acquisition and merger process will have a neutral impact on Rosevrobank's funding and liquidity metrics.

Over the next 18 months, we expect Sovcombank to continue its activities while developing and implementing an integration plan for a merged bank. We think that Sovcombank's experience of successfully acquiring and integrating other businesses over the past few years will help it successfully integrate Rosevrobank.

Outlook

Sovcombank

The stable outlook on Sovcombank reflects our opinion that it will maintain its credit metrics over the next 12-18 months, including good portfolio quality indicators and strong profitability, despite the still difficult, if recovering, economic environment in Russia. We do not anticipate any negative developments stemming from the announced acquisition.

We could consider lowering the ratings if, contrary to our current expectations, we observed that Sovcombank's portfolio quality had substantially deteriorated and the bank had to create new provisions substantially above sector-average levels. An inability to manage the larger and now-more-complex banking group, from a strategic or operational point of view, could also result in a negative rating action. A potential significant acquisition of new assets, that is not supported by adequate capital buffers, might prompt us to revise downward our assessment of the bank's capital position.

An upgrade is unlikely in the near term. For this to happen, the legal merger with Rosevrobank would need to be finalized, integration of the two banks would need to progress, and we would need to have assessed the consolidated bank's strategy and risk appetite.

Rosevrobank

The stable outlook on Rosevrobank reflects our view that the bank will be able to preserve its credit standing over the next 12-18 months, that is, during the merger and integration process. In particular, we expect the bank to continue to demonstrate strong profitability, supporting its capital buffers and maintaining the solid quality of its loan portfolio.

We could lower the ratings if we saw unexpected negative developments due to significant management turnover or deterioration of corporate governance procedures, which would hurt Rosevrobank's franchise. We would also consider a downgrade if the bank experienced material deposit outflows that depleted its currently adequate liquidity buffers, and it did not receive sufficient support from its new majority shareholder.

Any positive rating action on Rosevrobank will depend on the integration of the two banks, the evolution of Rosevrobank's status within the group, and our view of the combined group's systemic importance and creditworthiness.

Ratings Score Snapshot

Sovcombank

Issuer Credit Rating	BB-/Stable/B
SACP	bb-
Anchor	bb-
Business Position	Adequate (0)
Capital and Earnings	Moderate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average (0) and Adequate
Support	0
GRE Support	0
Group Support	0
ALAC Support	0
Sovereign Support	0
Additional Factors	0

Rosevrobank

Issuer Credit Rating	BB-/Stable/B
SACP	bb-
Anchor	bb-
Business Position	Adequate (0)
Capital and Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average (0) and Adequate
Support	0
GRE Support	0
Group Support	0
ALAC Support	0
Sovereign Support	0
Additional Factors	0

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 And Rosevrobank 'BB-/B' Ratings Affirmed On Planned Merger; Outlooks Stable, March 22, 2018

Ratings List

Ratings Affirmed

Rosevrobank

Issuer Credit Rating	BB-/Stable/B
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Sovcombank PJSC

Issuer Credit Rating	BB-/Stable/B
Senior Unsecured	BB-

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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