Research Update:

Ukraine-Based Bank Alliance Assigned 'B-/B' Ratings; Outlook Stable

October 30, 2019

PRIMARY CREDIT ANALYST

Annette Ess, CFA
Frankfurt
(49) 69-33-999-157
annette.ess
@spglobal.com

SECONDARY CONTACT

Natalia Yalovskaya
London
(44) 20-7176-3407
natalia.yalovskaya
@spglobal.com

Overview

- Our view of Bank Alliance's creditworthiness reflects the bank's niche corporate franchise in Ukraine, with individual high lending and funding concentrations in the corporate segment, low capitalization, and its unproven ability to manage planned rapid asset growth.
- We classify Ukraine's banking sector in group '10' under our Banking Industry Country Risk Assessment (BICRA).
- We are assigning our 'B-/B' long- and short-term ratings to Bank Alliance.
- The stable outlook over our rating horizon for the next 12 months reflects our expectation that the bank's majority shareholder has ability and will support the bank with liquidity and capital injections in case of deposits outflows or notable asset quality deterioration in order to avoid bank default.

Rating Action

On Oct. 30, 2019, S&P Global Ratings assigned its 'B-/B' long-and short-term issuer credit ratings to Ukraine-based Bank Alliance. The outlook is stable.

We also assigned our 'uaBBB-' national scale rating to the bank.

Rationale

The long-term rating on Bank Alliance reflects our 'b' anchor, the starting point for rating commercial banks operating in Ukraine. We derive the anchor from a combination of our economic risk score of '10' and an industry risk score of '9' under our BICRA for Ukraine.

The economic risk in the Ukrainian banking system remains one of the highest in a global comparison, despite notable improvements in the macroeconomic environment over the past four years and expected macroeconomic stability in 2019-2021. We expect the Ukrainian economy to expand at an average 3.0% over the coming two years, supported by domestic demand, reducing inflation, and a slight depreciation of the hryvnia. We believe that the Ukrainian economy continues to be in a prolonged correction phase, but its impact on the banking system has subsided thanks to normalized credit costs. We view extremely high credit risk as a key weakness for the banking system. The system's reported nonperforming loans (NPLs; loans over 90 days overdue) stand at about 52%, mainly reflecting very weak assets quality at state-owned banks, high related-party lending, substantial share of loans in foreign currency, and still-pending mechanisms for orderly NPL resolution.

We think that the industry risk for banks in Ukraine has reduced but still remains very high in global terms. We believe that banking regulation and supervision have materially strengthened over the past four years under the management of new governors of the National Bank of Ukraine (NBU). The NBU is striving to preserve its independence and harmonize the regulatory framework with the EU standards, and it demonstrated predictability and consistency of regulatory actions. Although the banking system has been substantially cleaned up of weaker banks, a high share of state-owned banks and, although not our base case, possible unfavorable court decisions regarding Privatbank's nationalization is tipping the system's stability. The funding profile of the banking system is stable with expected core customer deposits to net loans remaining well in excess of 100% supported by healthy growth in deposits and net banking sector external debt close to zero.

We view Bank Alliance's franchise in the Ukrainian banking system as small and evolving and dependent on the reputation of its majority shareholder Mr. Alexander Sosis and his willingness to support the bank with capital and liquidity injections in case of unfavorable developments. We consider that the bank's ability to manage its rapid growth and restrain its risk appetite is still untested.

We expect Bank Alliance to remain a niche player focusing on small and midsize enterprise (SME) business in the next 12 months and to continue its rapid growth, however from a very low base. With assets of Ukrainian hryvna (UAH) 2,912 million (about $122 million) and off-balance-sheet commitments of about UAH2,500 million as of Sept. 30, 2019, the bank ranked No. 31 in the Ukrainian banking sector by assets among 76 registered banks, and it holds 0.2% of the market.

We expect Bank Alliance's capitalization, as measured by our risk-adjusted capital (RAC) ratio, to weaken to about 3.6%-3.7% by year-end 2021 from 4.5% at year-end 2018 due to planned rapid balance sheet growth and uncertain equity capital injections. In our base-case forecast for 2019-2021, our RAC ratio is based on our assumptions that:

- Loans and off-balance-sheet credit equivalents will grow to UAH4 billion each by year-end 2021;
- The bank will receive a capital injection of UAH60 million in fourth-quarter 2019;
- The net interest margin will decrease to about 6.0-6.5%;
- Cost of risk will stand at about 2.5%;
- The bank will report ROA of about 2.5%-3.5%; and
- Full earnings retention.

In our view, the bank has a low margin over minimum regulatory requirements for capital adequacy. Its total capital adequacy ratio was 11.1% above the minimum of 10.0% and its Tier 1 ratio was 8.4% above the minimum of 7% as of Sept. 30, 2019.

We believe that the bank's ability to manage rapid growth in loans and off-balance-sheet credit exposures and to create an adequate risk management framework will largely determine its asset quality in the future. Currently the bank has very low NPLs, reflecting limited operations before

2017.

The loan portfolio is concentrated in wholesale trading companies, mainly trading chemicals, gas and consumer goods, as well as transport (airlines) and agricultural companies. The top 20 loans accounted for 59% of total loans and 3.0x total adjusted capital at mid-2019, which is in line with peers. Bank's asset quality can worsen rapidly if a few of its large loans become NPLs. A mitigating factor for prospective asset quality is short loan tenor--74% of loans had remaining term under one year. Also, 31% of its FX loans are given predominantly to companies with FX revenues. An additional credit risk is sizable business of providing guarantees and credit lines (about UAH2.5 billion) as of Sept. 30, 2019. NPLs in credit and off-balance-sheet portfolios were below 1% as of Sept. 30, 3019.

High corporate deposit concentrations represent a source of risk for unexpected deposits withdrawals, which largely depend on owner's reputation. Bank Alliance is exclusively funded by customer deposits, of which corporate deposits accounted for 67% at mid-2019 and retail deposits for the rest. The 20 largest depositors accounted for 46% of total deposits, while the top 3 depositors for 25% of total deposits as of Sept. 30, 2019.

We expect the main shareholder to support the bank with additional liquidity injections in the event of sizable deposits outflows. Cash and its equivalents accounted for 18% and Ukraine government securities (which can be repoed) for an additional 5% at Sept. 30, 2019. We estimate that broad liquid assets covered total customer deposits by 29% at Sept. 30, 2019. Cash and cash equivalents covered current accounts by about 50% on Sept. 1, 2019.

Outlook

The stable outlook reflects our expectation that, over the next 12 months, the majority shareholder will support Bank Alliance through liquidity and capital injections in case of deposits outflows and/or notable asset quality deterioration in order to avoid bank default.

Upside scenario

A positive rating action on Bank Alliance in the coming 12 months is unlikely because we do not envision material improvements to the bank's business position and capitalization within the outlook horizon.

Downside scenario

A negative rating action could follow if Bank Alliance's capitalization and asset quality weakened significantly below our base-case assumptions over the next 12 months because profit generation and/or capital injections lag balance sheet expansion and/or asset quality of largest exposures rapidly deteriorates and the bank's shareholder does not show sufficient support to the bank.

BICRA Score Snapshot

BICRA*: Ukraine

BICRA Group	10
Economic risk	10

BICRA*: Ukraine (cont.)

Economic resilience	Very high risk
Economic imbalances	Very high risk
Credit risk in the economy	Extremely high risk
Industry risk	9
Institutional framework	Very high risk
Competitive dynamics	Very high risk
Systemwide funding	Very high risk
Trends	
Economic risk trend	Stable
Industry risk trend	Stable

*Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores are on a scale from 1 (lowest risk) to 10 (highest risk). For more details on our BICRA scores on banking industries across the globe, please see "Banking Industry Country Risk Assessment Update," published monthly on RatingsDirect.

Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

New Rating	
JSC Bank Alliance	
Issuer Credit Rating	B-/Stable/B
Ukraine National Scale	uaBBB-/--/--

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.