

FitchRatings

Fitch Revises Outlooks on Russia's Home Credit and Finance Bank and its Kazakh Sub to Negative Ratings Endorsement Policy

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Fitch Ratings-Moscow-22 April 2014: Fitch Ratings has revised the Outlook of Russia-based Home Credit and Finance Bank (HCR) and its Kazakh subsidiary, SB JSC Home Credit and Finance Bank (HCK), to Negative from Stable. Their Long-term Issuer Default Ratings (IDRs) have been affirmed at 'BB' and 'BB-', respectively. A full list of rating actions is available at the end of this comment.

KEY RATING DRIVERS - HCR's IDRS, VIABILITY RATING (VR)

The revision of the Outlook on HCR's Long-term IDRs reflects the weakening operating environment in Russia and its potential further negative impact on the bank's performance. The Outlook also considers the already challenging operating conditions for the Russian consumer finance sector in general and HCR in particular, as portfolio seasoning and higher household leverage have caused credit losses to widen significantly. At the same time, the ratings remain supported by HCR's considerable resilience against potential shocks, given its high margins, solid capital buffer and strong liquidity.

HCR's credit losses - defined as non-performing loans (NPLs, 90 days overdue) originated in the period divided by average performing loans - increased to 17% in 2013 from 14% in 1H13 and 10% in 2012. Positively, vintage analysis suggests the quality of 2H13 loan generations improved moderately, as HCR tightened its underwriting standards and focused on lower-risk clients. However, the sustainability of this trend is yet to be tested, and risks remain on the downside given expected sluggish performance of the Russian economy this year. HCR may also find it challenging to compete for better-quality borrowers with larger corporate banks which target the same clientele, but may offer lower rates and larger loan tickets.

Profitability remained sound in 2013 (return on average equity (ROAE) of 21%, down from 51% in 2012), but in Fitch's view is likely to come under greater pressure in 2014, and may be close to breakeven. This is due to (i) a reduction in insurance-related fees, which are booked upfront at loan origination and comprised 33% of pre-impairment profit in 2013, but are likely to decrease significantly in 2014 as Fitch expects close to zero loan growth judging by 1Q14 loan growth in statutory accounts; (ii) a moderate contraction of margins due to the growing share of lower-risk, lower-yield lending in HCR's portfolio and a gradual increase in funding costs in line with recent market trends; and (iii) a likely further increase in loan impairment charges, at least in 1H14, as weaker vintages issued in 2H12-1H13 continue to season. Management expects performance to improve by end-2014 after a weaker 1H14, although in Fitch's view that could be challenging given the tougher environment and the ongoing rebalancing of the business model.

HCR's capitalisation is solid with a Fitch Core Capital (FCC) of 15.5% at end-2013 and on-balance sheet NPLs (12% of gross loans at end-2013) fully reserved. Regulatory capital is tighter (total capital ratio of 14.8% at end-1Q14) because of increased risk-weightings on higher-yielding loans issued after July 2013. However, the bank has some flexibility to manage this by altering product structures and possibly also selling or originating on to the balance sheets of related entities higher-margin businesses.

Funding and liquidity remain a rating strength for HCR. Despite the moderate 12% outflow of customer funding in 1Q14, Fitch views HCR's deposit collection capacity as strong due to competitive rates and a wide branch network. HCR's deposit base (74% of end-2013 liabilities) is granular and is adequately covered by liquid assets (16% at end-1Q14). Liquidity risk is further mitigated by quick turnover of loans, with monthly proceeds from loan repayments of about RUB25bn, equal to 8% of liabilities. Following the repayment of a USD500m eurobond in March 2014, HCR's remaining refinancing needs for 2014 are a low RUB8bn (3% of total liabilities).

KEY RATING SENSITIVITIES - HCR's IDRS AND VR

Further significant deterioration of HCR's asset quality and/or profitability amid a more challenging operating environment could lead to a downgrade. Conversely, the stabilisation of performance and gradual recovery of asset quality metrics could lead to the Outlook being revised to Stable.

KEY RATING DRIVERS AND SENSITIVITIES - HCR'S SUPPORT RATINGS AND SUPPORT RATING FLOOR (SRF)

The SRF of 'No Floor' reflects that support from the Russian authorities, although possible given HCR's significant RUB212bn deposit base, is not factored into the ratings due to the bank's still small size and lack of overall systemic

importance. Although there is some track record of support from HCR's private shareholders future support cannot be relied upon.

KEY RATING DRIVERS - HCK'S IDRS, NATIONAL RATING AND SUPPORT RATING

HCK's Long-term IDRs are driven by support the bank could receive from its parent, HCR. The revision of the Outlook on HCK's ratings reflects the revision of the Outlook on HCR. Fitch's view of the probability of support is based on HCK's increasing importance for the parent (it accounted for 24% of HCR's consolidated earnings in 2013) and still small size (less than 7% of HCR's assets at end-2013), making it fairly easy to support. Fitch's view also takes into account HCR's full ownership, common branding and reputational risk for HCR in case of HCK's default.

The one-notch difference between HCR's and HCK's ratings reflects the cross-border nature of the parent-subsidiary relationship, HCK's so far limited track record of operations, and some uncertainty about the long-term commitment of HCR and the broader Home Credit group to support HCK in case of a prolonged deterioration of the operating environment in Kazakhstan.

RATING SENSITIVITIES - HCK'S IDRS, NATIONAL RATING AND SUPPORT RATING

Any negative action on the parent's Long-term IDRs would likely be matched by a similar action on HCK's Long-term IDRs. This would also impact the National Rating and could result in a change in the Support Rating.

KEY RATING DRIVERS - HCK'S VR

HCK's VR of 'b' is constrained by the bank's higher-than-average sensitivity to economic shocks resulting in potentially more volatile asset quality metrics and earnings through the cycle, its limited franchise, and a weak funding profile reflected in high single-name concentrations and dependence on parent facilities. The rating also reflects the bank's currently strong profitability, still adequate, although deteriorating, asset quality and solid capitalisation.

HCK's profitability remained strong in 2013 with a high 12.8% return on average assets (but down from 16.3% in 2012). However, HCK derives a large portion of its revenues from fees for selling insurance products to borrowers, which were equal to a high 52% of 2013 pre-impairment profit. Such fees are recognised upfront at loan origination and are likely to materially reduce as a result of borrowers switching to longer-term cash-loans, loan growth slowdown and reduction of the share of loans issued with attached insurance from the currently unsustainable close to 100% level.

HCK's credit losses picked up to 13% of average performing loans in 2013 from 8% in 2012 despite a benign operating environment and fast loan book growth, and the trend is likely to persist as borrower indebtedness grows and competition for quality customers intensifies. At the same time, the bank has significant capacity to absorb losses, underpinned by its wide net interest margin and currently strong fee income. Fitch estimates that HCK's breakeven loss-rate was a high 30% in 2013, although it would be around two times lower net of insurance commissions. HCK's strong 28% FCC ratio at end-2013 provides a further significant cushion to absorb losses.

HCK is reliant on funding provided by the group (35% of liabilities at end-2013) and corporate deposits (another 34%). The latter are highly concentrated with the largest two accounting for 19% of end-2013 liabilities. Positively, HCK is gradually diversifying its funding structure by increasing the share of retail deposits and tapping the local wholesale market with bond issuance. The bank's liquidity is supported by a rapidly amortising loan book, which generates around KZT10bn (20% of customer accounts) of cash per month.

RATING SENSITIVITIES - HCK'S VR

An extended track record of sound performance and growth supported by a more diversified funding base would be positive for the standalone profile. A significant deterioration of the operating environment in Kazakhstan, or weaker performance of the loan book diminishing HCK's ability to absorb further losses would be negative and could lead to downward pressure on the VR.

KEY RATING DRIVERS AND SENSITIVITIES - HCR'S AND HCK'S SENIOR AND SUBORDINATED DEBT RATINGS

The banks' senior unsecured debt is rated in line with their Long-term IDRs, reflecting Fitch's view of average recovery prospects, in case of default. The (new style) subordinated debt rating of HCR is notched once off its VR (which is in line with its Long-term IDRs) in accordance with Fitch's criteria for rating these instruments. Any changes to the banks' Long-term IDRs would likely impact the ratings of both senior unsecured and subordinated debt

The rating actions are as follows:

HCR

Long-term foreign and local currency IDRs: affirmed at 'BB'; Outlooks revised to Negative from Stable

Short-term foreign currency IDR: affirmed at 'B'

Viability Rating: affirmed at 'bb'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'No Floor'

Senior unsecured debt: affirmed at 'BB'
Subordinated debt (issued by Eurasia Capital SA): affirmed at 'BB-'

HCK

Long-term foreign and local currency IDRs: affirmed at 'BB-'; Outlooks revised to Negative from Stable

Short-term foreign currency IDR: affirmed at 'B'

National Long-Term Rating: affirmed at 'BBB+(kaz)'; Outlook revised to Negative from Stable

Viability Rating: affirmed at 'b'

Support Rating: affirmed at '3'

Senior unsecured debt: affirmed at 'BB-'/BBB+(kaz)'

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Additional information is available at www.fitchratings.com.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 31 January 2014, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

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