FitchRatings

12 Nov 2020 | Rating Changed Outlook to Stable

Fitch Revises First Ukrainian International Bank's Outlook to Stable; Affirms IDR at 'B'

Fitch Ratings-Moscow-12 November 2020:

Fitch Ratings has revised Joint Stock Company First Ukrainian International Bank's (FUIB) Outlook to Stable from Negative. Its Foreign and Local-currency Long-Term Issuer Default Ratings (IDRs) have been affirmed at 'B'.

Key Rating Drivers

IDRs AND VIABILITY RATING

The revision of the Outlook to Stable reflects Fitch's expectation that FUIB's strong profitability should be sufficient to absorb moderate asset-quality deterioration in the medium term and the bank's capital buffer will remain comfortable, even in light of planned high dividend pay-outs. The impact of the coronavirus pandemic and associated lower economic activity in Ukraine on the bank's financial profile have been limited to date and the asset-quality deterioration has not been as severe as we had expected earlier in the year.

The Long-Term IDRs of FUIB are driven by its standalone strength, as reflected in its Viability Rating (VR) of 'b'. The ratings consider a challenging operating environment in Ukraine and the unseasoned nature of FUIB's portfolio of unsecured retail loans, which was the main driver of the bank's growth in recent years. These risks are counterbalanced by the bank's healthy profitability and capitalisation metrics and a stable funding profile.

FUIB's asset-quality metrics improved in 2020 due to large write-offs of legacy problem loans (amounting to 6% of loan book). Impaired loans (Stage 3 and purchased or originated credit-impaired (POCI), under IFRS 9) declined to 19% of gross loans at end-9M20 from 21% at end-2019 and were adequately reserved by 91% by total loan loss allowances (LLAs). FUIB's Stage 2 loans added another 5% of gross loans at end-9M20, almost equally split between corporate and retail exposures. Our base case assumes that the phasing out of debt-relief measures in September will not result in a rapid increase in FUIB's impaired loans.

The quality of FUIB's corporate loan book is undermined by a large volume of legacy impaired loans that were originated during the crises of 2008-2009 and 2014-2015. The majority of these are almost fully reserved and only limited recoveries are expected by the bank's management. Payment holidays on loan principal granted by FUIB to its corporate borrowers in 2020 in response to the pandemic were selective in nature and expired at end-September.

Economic activity has been gradually recovering in 3Q20 and according to FUIB's management, the majority of borrowers returned to their payment schedules. Fitch has identified only three potentially high-risk exposures in the bank's 25-largest groups of borrowers (which constituted 47% of gross corporate loans at end-1H20) that are not classified as impaired by the bank. The three high-risk borrowers were equal to a moderate 13% of the bank's Fitch Core Capital (FCC), net of specific reserves.

The quality of the retail loan book is untested, given FUIB's rapid growth in unsecured consumer finance and credit cards in recent years (47% in 2018 and 31% in 2019). Growth moderated in 9M20 to 7% (annualised), affected by the health crisis and weaker demand. Prudent underwriting of the retail lending helped FUIB to maintain its cost of risk below 5% in 9M20. Loans granted payment holidays were not material and these loans were classified as Stage 2, constituting 5% of gross retail loans at end-3Q20 or 6% of FCC, net of specific LLAs.

Profitability is a rating strength for FUIB. Its operating profit to risk-weighted assets (RWAs) was a strong 7.1% in 9M20 (annualised), helped by a wide net interest margin of 13.8%. Payment holidays did not affect the quality of earnings, as interest payments continued during the moratorium on principal payments. Non-interest income declined in 2Q20 because of lower economic activity, but recovered later in 3Q20, driving non-interest income-to-gross revenues to a reasonable 24% in 9M20 (29% in 2019). FUIB's pre-impairment profitability remained solid at 11% of average loans (annualised) in 9M20 and sufficient to absorb increased impairment charges during the same period (2.8% of average loans versus 0.6% in 2019).

Capital has remained strong with FCC-to-RWAs at19% at end-9M20, despite high distribution of dividends in 2Q20 amounting to UAH2 billion (or 5% of end-2019 RWAs). Regulatory Tier 1 and total capital ratios stood at 14.5% and 18.7%, respectively, at end-9M20, comfortably above the regulatory minimums of 7% and 10%, respectively. FUIB's dividend policy anticipates a 50% pay-out ratio starting from 2021, while retained earnings should be sufficient to maintain healthy capital buffers.

FUIB's funding profile is dominated by customer accounts at 91% of liabilities at end-9M20, almost equally split between corporate and retail clients. Corporate deposits are volatile and highly dependent on related parties (forming almost half of total corporate balances at end-9M20), while retail deposits have remained stable over time. The bank's liquidity buffer (cash and short-term interbank placements) was robust, at 30% of total customer deposits, net of repayments of short-term interbank debt. Unpledged sovereign debt securities added another 21%, but are considered a reliable source of liquidity, as local repo limits can be tight.

NATIONAL RATING

FUIB's National Long-Term Rating of 'AA-(ukr) reflects the bank's creditworthiness relative to Ukrainian peers'. The revised Outlook reflects the bank's resilient financial profile.

SUPPORT RATING AND SUPPORT RATING FLOOR

FUIB's Support Rating of '5' and Support Rating Floor (SRF) of 'No Floor' reflect Fitch's opinion that support from the Ukrainian authorities cannot be relied upon in case of need, due to the bank's limited market share and systemic importance. FUIB was added to the National Bank of Ukraine's (NBU) list of systemically important banks in 2019. This effectively means the gradual implementation of additional capital, liquidity and other regulatory buffers over the current regulatory minimum levels starting in 2020, while the bank cannot rely on extraordinary support from authorities, as stated by the NBU. Support from the bank's private shareholders is also not factored into the ratings.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- A marked weakening of FUIB's capitalisation either due to a return to aggressive loan expansion or through material asset-quality deterioration, with FCC declining below 13%, or regulatory capital ratios falling below a 1% buffer over the minimum levels.

- Significant weakening of earnings, including operating profit-to-RWAs declining to 2% or below.

- FUIB's impaired loan trends rising to historical levels, edging closer to a four-year average of 30%.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Upgrade of FUIB's ratings is currently unlikely, and would require an upgrade of Ukraine's sovereign ratings, as well as notable improvements in the operating environment.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

JOINT STOCK COMPANY FIRST UKRAINIAN INTERNATIONAL BANK; Long Term Issuer Default Rating; Affirmed; B; Rating Outlook Stable
; Short Term Issuer Default Rating; Affirmed; B
; Local Currency Long Term Issuer Default Rating; Affirmed; B; Rating Outlook Stable
; Local Currency Short Term Issuer Default Rating; Affirmed; B
; National Long Term Rating; Affirmed; AA-(ukr); Rating Outlook Stable
; Viability Rating; Affirmed; b
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)
National Scale Rating Criteria (pub. 08 Jun 2020)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
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