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Sberbank displays commendable performance despite challenges

by LEE Yanru

2016 has been a challenging year for the global banking sector. Since the start of the year, share prices of US banks have plunged by more than 10%. European banks have nosedived by almost 30%. Likewise, Russian banks have mostly been unprofitable with the exception of Sberbank and VTB, the two largest banks in the Russian banking sector. Unlike most global banks which faced minimal restrictions in expanding their business worldwide, Russian banks were hampered due to sanctions thrusted on them by the United States (US) and the European Union (EU).

Restrictions on Russian banks' access to the EU and the US financial markets were first imposed after Russia's controversial involvement in the conflict in Ukraine on March 2014. Subsequently, on September 2014, further restrictions have been enforced to deny the Russian banks from raising long term loans in the EU and US capital markets. In view of these challenges, Russian banks have been depending on the domestic markets and are increasing turning towards Asian markets for alternative sources of funding. Unfortunately, this strategy has not been entirely successful due to the negative stigma attached to Russian banks. Asian investment bankers have been concerned about working with Russian banks considering the sanctions by the EU and US.

Despite the pessimistic outlook for the Russian banking sector, Sberbank, the largest player in the Russian banking sector has proved to be an anomaly through its latest display of commendable financial performance in Q1 2016. Possessing over RUB 25tn asset which accounts for almost one-third of the overall aggregated assets of the Russian banking industry, Sberbank is also a market leader in numerous lending businesses, such as mortgage lending and pension payments, holding more than 50% of market share in most of these businesses. With this advantage, Sberbank's financial success lies in capitalizing on the domestic financial market for sources of funding, a privilege that has been exclusive to smaller Russian banks.

Sberbank reported its largest quarterly profit on record in Q1 2016. The bank's financial statement also likewise reflects praiseworthy performance. (See Table 1) The rising net interest income and return on equity (ROE) highlight the result of the bank's heavy emphasis on investing in technology to improve efficiency, as well as in minimizing costs. Its improving liquidity is highlighted by the declining loan-to-deposit ratio. Its Tier 1 capital ratio is also increasing, reflecting the firm's improving financial strength and reduced exposure to credit risk.

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016
Net Interest Income (in RUB)	200,300	227,100	263,400	297,200	325,500
ROE (%)	12.43	10.03	9.42	10.18	13.54
Loan to Deposit Ratio (%)	115.32	112.28	105.08	100.59	103.8
Tier 1 Capital Ratio (%)	9	9.6	9.1	8.9	9.7

Table 1: Financial data for Sberbank. *Source: Bloomberg*

In recognition of the central bank's loose monetary policy, Sberbank has been consistently sticking towards cutting costs in order to increase its net interest income. Moreover, the declining interest rate may also be beneficial for Sberbank, because it leads to higher valuations of the financial assets under its possession, as well as potentially minimizing the credit risk exposure of the bank.

In addition, the improving macroeconomic environment also contributed to Sberbank's stellar performance. With slumping oil prices, growing political tension and restricted access to western capital markets, the Russian economy had been in a serious state of recession in 2015. Fortunately, the present dwindling contraction in economic growth and declining inflation rate (See Figure 1), indicate that the challenging economic recession could be over. Sberbank readjusted its forecast of Russia's GDP contraction from 2.2% to 0.7% this year. Likewise, the IMF, World Bank and Moody's rating agency have raised their forecast of Russia's economic growth for 2016 and 2017, citing surging oil prices and development of positive structural trends. Coinciding with the improving macroeconomic indicators, Sberbanks' net provision charge for loan impairment has also been falling, suggesting lower expenses in minimizing the bank's exposure to credit risk.

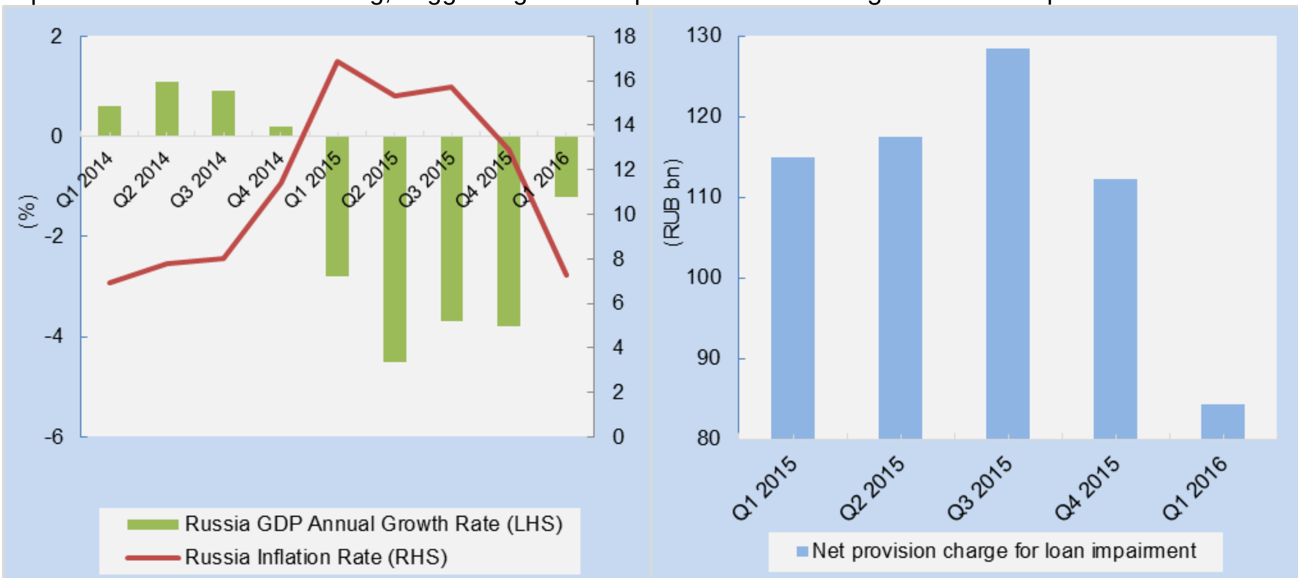

Figure 1: Russia GDP annual growth rate and inflation rate (left panel) and net provision charge for loan impairment (right panel)
Source: Federal State Statistics Service, Company Report

The RMI-CRI 1-year Probability of Default (PD) of Sberbank has reflected the improving credit profile. Its PD has nosedived from a level above 300bps in Jan 2015 to 32.53bps on Jun 17, 2016, coinciding with a surging market cap from below RUB 1.5tn on Jan 2015 to almost RUB 3tn on Jun 17, 2016. (See Figure 2)

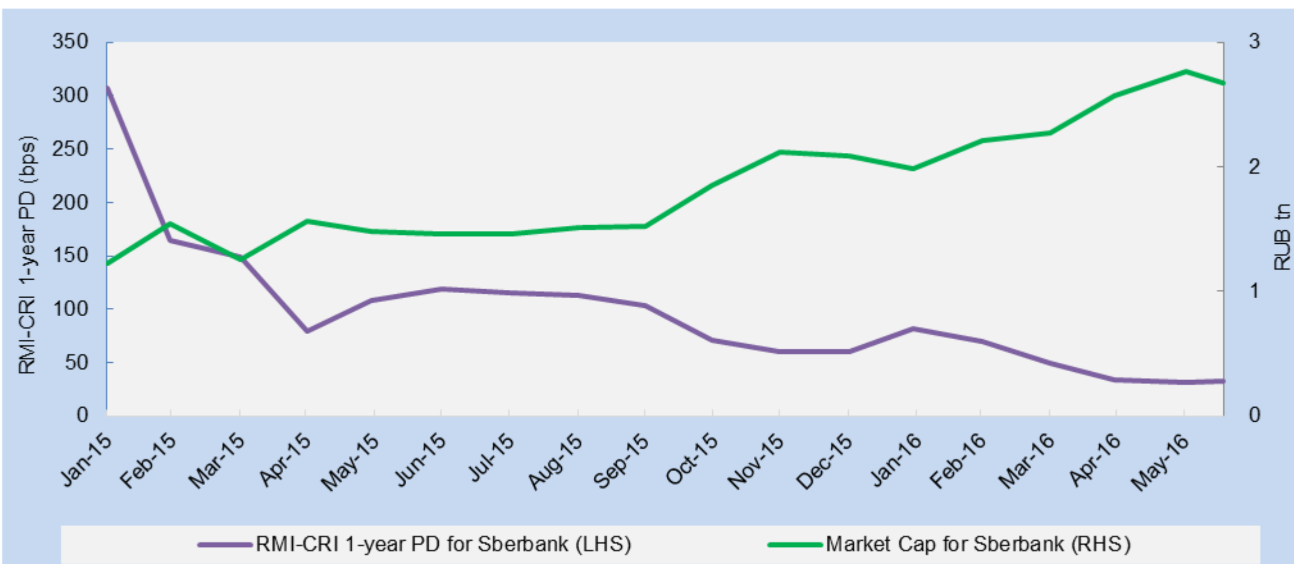

Figure 2: RMI-CRI 1-year Probability of Default and market cap for Sberbank. *Source: RMI-CRI, Bloomberg*

The improving macroeconomic backdrop, as well as Sberbank's dominant position in the banking industry may have played a huge role towards its current outstanding financial performance. However, the present outlook for the Russian banking sector remains poor. The CEO of Sberbank, Herman Gref affirmed the challenging outlook of the banking sector and highlighted the importance of Sberbank to remain innovative, in order to stay profitable.

Credit News

China seeks to renegotiate Venezuela loans

Jun 19. Chinese officials sought to renegotiate Venezuela's loans and met with the country's political opposition. The renegotiation was to ensure Venezuela political successors would honor Chinese debts in the post-Maduro era. Venezuela, facing a collapsing economy and political deadlock aggravated by the oil-price slump, had received an extension of its debt repayment backed by oil sales from China, its largest creditor, who had loaned Venezuela USD 65bn since 2005. BancTrust, a Latin American investment bank, said a Chinese debt restructuring could free up cash equivalent to about 650,000 barrels of oil per day and provide sufficient liquidity to help the government to improve staple goods supply. (FT)

Maxus Energy files for bankruptcy protection

Jun 18. Maxus Energy Corporation filed for bankruptcy protection after reaching an agreement with its parent, YPF SA. The deal involves YPF SA providing Maxus and its four other affiliates with USD 130mn. In turn, Maxus would drop any claims they may have against its parent for the river cleanup. Prior to Maxus's bankruptcy filing, OxyChem, who purchased part of Maxus held YPF responsible for Maxus's environmental obligations. YPF would also be providing Maxus a USD 63.1mn bankruptcy loan, as part of the proposed settlement, to keep Maxus running for the next 12 months for its creditors' benefits. The Environmental Protection had put the cleanup cost for the eight-mile area river at USD 1bn to USD 3.4bn (WSJ)

Suncor offers to buy USD 1.5bn of notes to trim debt load

Jun 16. In a released statement, Suncor Energy Ventures Holding Corp offered to purchase notes that will mature between 2019 and 2042 with coupons as high as 8.2%. The offer, set to expire on June 22, is aligned with Chief Executive Officer Steve William aims of maintaining enough cash for the company to tide though the commodity slump while allowing the company to fund projects such as the Fort Hills bitumen mine and purchases which includes the takeover of Canadian Oil Sands Ltd. (Bloomberg)

Gulf Chemical & Metallurgical files for bankruptcy protection

Jun 14. Gulf Chemical & Metallurgical Corporation (Gulf) and its Bear Metallurgical Co. unit filed for Chapter 11 bankruptcy protection on Tuesday to search for a buyer. Besides plunging profits due to sensitivity to metals markets, Gulf attributed its financial woes to the USD 10mn environmental penalties that Gulf was slapped with in 2010 and an additional USD 50mn to prevent future violations, rendering Gulf's sale outside of bankruptcy courts impossible. Gulf, which is owned by Eramet Group, a French mining and metallurgical company, reported USD 100mn to USD 500mn each in assets and debts. An Eramet unit agreed to provide up to USD 12mn fund to help cover the cost of the Chapter 11 case. (WSJ)

Toys 'R' Us gains approval to extend debt maturity

Jun 14. Following discussions of restructuring with creditors that began earlier this year, toy retailer Toys 'R' Us was given the green light to proceed with a refinancing agreement. The agreement involves holders of bonds maturing in 2017 and 2018 swapping their holdings for bonds that will mature in 2021, with the company looking to swap up to 89% of the current bonds for those with a longer maturity. Under the agreement, a new subsidiary, holding the equity of the company's operations in Europe, Japan and Australia, will be formed to secure the new debt. Chief Executive David Brandon stated that the refinancing would allow the company to focus on improving store operations and developing its online business while consolidating operations in house. (WSJ)

Top China coal region asks banks to lend a hand to its producers (Bloomberg)

Airbnb raises USD 1bn in debt (WSJ)

Aussie banks regain mojo as loans beat bonds by most since 2012 (Bloomberg)

Regulatory Updates

EU bank resolution plan ignored in Denmark after bail-in trauma

Jun 19. Denmark's financial regulators rejected the Europe's Bank Recovery and Resolution Directive (BRRD) as it establishes its own framework for handling banking insolvencies. The BRRD was formulated to allow smaller and non-systemic banks to fail if they are in trouble, differing from Denmark's tenet of handling insolvencies. Although Denmark was the first European country to adopt a resolution framework in 2010 and to implement it on its own bank, the policy came at a high cost as rating companies downgraded Danish banks, cutting them off from the capital market. The case of Roskilde Bank's insolvency further convinces the regulator not to enforce the BRRD in light of the insolvency's devastating aftermath despite its non-systemic nature. (Bloomberg)

Bank of Canada says regulation needed to check fintech risks

Jun 18. Bank of Canada Senior Deputy Governor Carolyn Wilkins showed support for fintech companies while at the same time promoted sound regulations on the rising financial technology. The central bank is currently experimenting with a digital currency and distributed ledger technology to see whether it could be used to move money between banks. The central bank already consulted with some fintech entrepreneurs and is currently working together with the nation's largest commercial lenders. Through the experiments, the central bank seeks to come up with better regulations to protect consumers and the financial market. (Bloomberg)

South Korea to ease capital control measures

Jun 16. In an attempt to mitigate capital outflows, South Korea is relaxing its capital control by allowing financial institutions to tap overseas markets. South Korea has seen weakening capital inflow since the monetary policy tightening in the US. In addition, political risk, such as the Brexit referendum, is feared to trigger greater capital outflows from the country. The Bank of Korea has mandated banks to hold 60% of their foreign currency exposure in high-quality asset in order to improve the liquidity of the banking sector. Earlier this month, the central bank lowered its benchmark rate to a record low of 1.25%, increasing concerns of capital outflows as the Fed is expected to gradually increase rates. (FT)

Saudi stocks regulator penalizes Deloitte unit after tainted IPO (WSJ)

US regulator approves IEX as national stock exchange (CNA)

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