

Research Update:

Ukraine-Based Bank Alliance Upgraded To 'CCC+' From 'CCC' On Resilient Performance; Outlook Stable

October 23, 2023

Overview

- We consider that Bank Alliance JSC operates in a highly vulnerable and weak economic and operating environment.
- However, Bank Alliance's creditworthiness has strengthened, in our view, thanks to the National Bank of Ukraine's measures to stabilize the banking sector, the management team's continued efforts to provide banking services to its clients, and a capital injection from shareholders that we expect to be finalized before year-end.
- We therefore raised our long-term issuer credit rating on Bank Alliance to 'CCC+' from 'CCC' and affirming the short-term rating at 'C'.
- The stable outlook reflects our opinion that Bank Alliance will likely continue performing resiliently despite a challenging macroeconomic outlook for Ukrainian banks, since we assume that the conflict with Russia will extend into 2024.

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Rating Action

On Oct. 23, 2023, S&P Global Ratings raised to 'CCC+' from 'CCC' its long-term issuer credit rating on Bank Alliance. The outlook is stable. We affirmed the 'C' short-term issuer credit rating.

At the same time, we raised the national scale rating on the bank to 'uaBB' from 'uaB'.

Rationale

We think Bank Alliance's likelihood of default over the next 12 months has receded. We anticipate that, over this period, the bank will be a going concern, supported by a capital injection in 2023 and manageable cost of risk. In addition, we understand that the potential restructuring of the government's commercial foreign currency debt will have no material impact on the bank's

financial profile. We believe the government has strong incentives to prioritize the servicing of its local currency-denominated debt. We therefore equalize the long-term rating on the bank with our 'CCC+' local currency sovereign credit rating and transfer and convertibility assessment on Ukraine, as well as the 'uaBB' national scale rating.

We expect Bank Alliance's performance over the next 12 months will remain resilient, similar to what was observed in the first half of 2023.

In line with the Ukrainian banking sector, Bank Alliance has delivered stronger-than-anticipated performance, despite extremely difficult operating conditions associated with the Russia-Ukraine war. The bank's performance indicators in the first half of 2023 showed some improvement from 2022, and we expect this resilience to continue over the next one to two years.

In the first half of 2023, the bank's net interest margin improved to annualized 4.2% while its cost of risk had dropped to 2.4% at mid-2023 from 11.9% at end-2022. Bank Alliance's asset quality - while being under pressure because of challenging operating environment - compares well with the sector with stage 3 loans at 17.7% (loan loss reserve coverage: 83%) as of 1 September, 2023, versus 36.7% for the sector at the same date. We attribute these positive developments to several factors, including:

- Despite the ongoing hostilities and the attacks on the energy infrastructure in the winter of 2022-2023, the Ukrainian economy has proved more resilient than we anticipated. Businesses and households appear to have gradually adjusted to the war-induced uncertainties and shortfalls in critical infrastructure, including in the transport and power sectors, and economic activity continued to pick up in second-quarter 2023.
- Foreign donors remain committed to Ukraine throughout 2023-2026. We expect at least \$43 billion and \$35 billion of financial assistance in the form of grants and concessional loans to be disbursed in 2023 and 2024, respectively. This helps meeting budgetary funding needs and supports economic agents' confidence while the operating environment remains extremely fragile.
- The National Bank of Ukraine (NBU) introduced measures aimed at supporting the stability of the banking sector and has been very active in monitoring the sector, and has adjusted regulation to support banks amid the fast-changing market conditions.
- The bank's management team successfully adjusted its operational activities to the changed operating environment, including by leaning on digital capabilities, to continue providing services to clients.

We consider that the capital injection from a minority shareholder will materially strengthen Bank Alliance's capital position.

We expect that the capital injection of about Ukrainian hryvnia (UAH) 215 million (approximately €5.6 million) will be finalized and registered as common equity by year-end. This will translate into a risk-adjusted capital ratio of 4.5%-5.0% over the next 12-18 months, which is neutral to our view of the bank's standalone credit profile. We expect the bank to be compliant with the regulatory capital adequacy requirements.

At the same time, despite a stronger economic rebound than we expected in 2023, Ukraine's medium-term macroeconomic outlook remains vulnerable and heavily dependent on the evolution of the war and international support.

Our current base-case assumption is that the active phase of the war will last into at least 2024. Given the substantial damage to physical and human capital, Ukraine's post-war economic growth, balance of payments, and fiscal outlook will also hinge on regaining access to the Black Sea, the easing of war-induced dislocations of the

labor market, continued international financial support, and effective reconstruction efforts. Consequently, the banking sector's performance will largely depend on the evolution of the macroeconomic conditions in Ukraine over the next few years.

For Bank Alliance, this means we expect a prolonged period of very difficult and highly uncertain operating environment resulting in high provisioning needs and continued pressure on the profitability.

Outlook

The stable outlook on the long-term global scale rating reflects our expectation that, over the next 12 months, the bank will sustain resilient performance as the government prioritizes its local currency financial obligations to ensure banking sector stability.

Downside scenario

We could take a negative rating action on Bank Alliance if:

- We lowered our local currency sovereign credit ratings and/or revised downward our transfer and convertibility assessment for Ukraine; or
- If the bank is unable to meet its financial obligations in full and on time. This could happen if the capital controls become markedly harsher, leading to depositors' inability to access their funds; or
- A material deterioration of the bank's liquidity in case there is insufficient support from the NBU.

Upside scenario

A positive rating action could follow if:

- We raise our local currency sovereign credit ratings and positively revised our transfer and convertibility assessment for Ukraine; and
- The bank continues to demonstrate resilience to the operating environment.

S&P Global Ratings acknowledges a high degree of uncertainty about the extent, outcome, and consequences of the military conflict between Russia and Ukraine. As the situation evolves, we will update our assumptions and estimates accordingly.

Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded

	To	From
Bank Alliance JSC		
Issuer Credit Rating		
Ukraine National Scale	uaBB/--/--	uaB/--/--

Upgraded; Ratings Affirmed

	To	From
Bank Alliance JSC		
Issuer Credit Rating	CCC+/Stable/C	CCC/Developing/C

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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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