

Fitch Ratings

Fitch Affirms First Investment Bank AD at 'BB-', Outlook Stable; Downgrades VR

to 'b-' Ratings Endorsement Policy

18 Sep 2012 12:54 PM (EDT)

Fitch Ratings-London-18 September 2012: Fitch Ratings has affirmed First Investment Bank AD's (FIBank) Long-term Issuer Default Rating (IDR) at 'BB-' with a Stable Outlook. At the same time, Fitch has downgraded FIBank's Viability Rating (VR) to 'b-' from 'b'. A full list of rating actions is at the end of this comment.

RATING ACTION RATIONALE AND DRIVERS: IDRS, SUPPORT RATING AND SUPPORT RATING FLOOR

The affirmation of FIBank's IDRs are based on Fitch's view that there continues to be a moderate probability of support from the Bulgarian authorities in case of need, which is reflected in the Support Rating of '3' and Support Rating Floor (SRF) of 'BB-'. Bulgaria's Long-term foreign currency IDR is 'BBB-' with a Stable Outlook.

Following earlier discussions with the Bulgarian National Bank, Fitch understands that the propensity of the authorities to support FIBank, as a systemically important bank, remains strong. FIBank's market shares in assets, especially corporate loans, and retail deposits continue to increase. At end-H112, FIBank was the fourth-largest bank in Bulgaria with an 8% market share in total assets, and the second-largest retail deposit taker with a 14% market share.

In assessing support, Fitch also considers the Bulgarian authorities' ability to support FIBank. The agency views favourably the country's low government debt (Fitch forecasts this to stand at 18.5% of GDP at end-2012), significant available fiscal reserves (6.8% of GDP at end-May 2012) and the relatively small size of FIBank's balance sheet (total assets at 7.6% of GDP at end-2011). Fitch also notes that 80% of FIBank's customer accounts are covered by deposit insurance, and the bank's uninsured liabilities, with respect to which the authorities' would take the decision on support, comprised a low 23% of total liabilities (about 1.7% of GDP) at end-H112. In addition, 83% of these uninsured liabilities are customer deposits, which Fitch understands have been placed primarily by domestic clients.

At the same time, weaknesses in the bank's corporate governance and potentially high related party and relationship lending, in Fitch's view, could give rise to somewhat greater uncertainty about the authorities' readiness to support the bank in all circumstances.

RATING SENSITIVITIES: IDRS, SUPPORT RATING AND SUPPORT RATING FLOOR

The IDRs, Support Rating and SRF are sensitive to any change in Fitch's view of the Bulgarian authorities' willingness or ability to support FIBank in case of need. The ratings could be downgraded in case of any prolonged delay in providing assistance, should this be clearly needed, or if the Bulgarian sovereign ratings are downgraded. A marked change in FIBank's liability structure to include more wholesale funding could also increase uncertainty with respect to support and result in a downgrade. An upgrade of FIBank's ratings is unlikely in the foreseeable future.

RATING ACTION RATIONALE AND DRIVERS: VR

The downgrade of the VR to 'b-' reflects further deterioration in reported asset quality, and weaker reserve coverage and therefore capitalisation. The VR considers weaknesses in corporate governance, weak underlying asset quality, potentially high related party and relationship lending, high loan concentrations and weak performance. However, the VR also considers FIBank's broad and to date stable deposit base.

The reported regulatory non-performing (NPL) ratio, which incorporates 90+ days overdue and loss loans, increased to 8% at end-H112 compared to 5.8% at end-2011 and 4.2% at end-2010. This ratio was still notably lower than for the banking system as a whole (16.9% at end-H112). However, in Fitch's view, FIBank's underlying asset quality may be significantly weaker. Watch loans (overdue by 30-90 days) are a quite stable 7%-9% of the portfolio (7.4% at end-H112) and Fitch calculates interest accrued but not received in cash as 11% of total interest income in H112. Furthermore, the ratio of renegotiated and restructured loans to total loans is high, although some restructured loans may already be classified as NPLs and some renegotiations may not necessarily reflect a deterioration in loan quality.

In Fitch's view, FIBank's loan book is highly concentrated, with exposures to the largest 20 borrowers equal to 3.4x Fitch core capital (FCC) at end-H112. Amortisation of these loans is very limited, and some borrowers have been granted additional facilities, further increasing concentrations. Within the largest borrowers, there are already some signs of deterioration, with some exposures showing delays in repayment and others classified in categories lower than 'standard'. Three loans, EUR55m each, granted for the acquisition of a metals plant in Q211 equated to 71% of the bank's equity at end-H111. This remains a concern for Fitch.

In Fitch's view, the risk of related party and relationship lending is high, given the two founding shareholders' interest in

