

Fitch Ratings

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

to 'b-' Ratings Endorsement Policy

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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

capital-intensive projects in the tourist industry, incomplete disclosure of the shareholder structure, and the quite high-risk nature of some loan exposures.

Reserve coverage of NPLs had fallen to 39% at end-H112 from 67% at end-2010, with unreserved NPLs equal to 46% of equity (unreserved NPLs and watch loans together exceeded equity). Fitch is therefore concerned about the quality of capital, while the Tier 1 and total capital ratios, at 10.8% and 12.9% respectively, at end-H112, were only slightly above the regulatory required and/or recommended minimums. Pre-impairment profit is moderate, and net of accrued interest was negligible in H112, limiting the bank's ability to strengthen its solvency through internal capital generation.

The VR is supported by FIBank's strong retail deposit franchise, the virtual absence of refinancing risk and the bank's currently comfortable liquidity. At the same time, Fitch notes that the relatively high rates that FIBank has paid to date for its customer funding significantly constrain margins and performance. Furthermore, a marked deterioration in asset quality could lead to greater instability in the deposit base.

RATING SENSITIVITIES: VR

The VR could be downgraded further in case of continued deterioration in FIBank's loan performance and underlying asset quality, resulting in increased pressure on the bank's capitalisation. The VR could be upgraded if the bank is recapitalised. However, Fitch does not expect this given the absence of equity injections in recent years.

The rating actions are as follows:

Long-term IDR: affirmed at 'BB-', Outlook Stable

Short-term IDR: affirmed at 'B'

Viability Rating: downgraded to 'b-' from 'b'

Support Rating: affirmed at '3'

Support Rating Floor: affirmed at 'BB-'

Contact:

Primary Analyst
Banu Cartmell
Director
+44 20 3530 1109
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Secondary Analyst
Keranka Dimitrova
Associate Director
+44 20 3530 1223

Committee Chairperson
James Watson
Managing Director
+7 495 956 6657

Media Relations: Hannah Huntly, London, Tel: +44 20 3530 1153, Email: hannah.huntly@fitchratings.com.

Additional information is available at www.fitchratings.com. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Global Financial Institutions Rating Criteria' dated 15 August 2012, are available at www.fitchratings.com.

Applicable Criteria and Related Research: Global Financial Institutions Rating Criteria

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