Moody's Investors Service

Credit Opinion: Corporate Commercial Bank AD

Global Credit Research - 24 Sep 2009

Sofia, Bulgaria

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Ba3/NP
Bank Financial Strength	D-

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Key Indicators

Corporate Commercial Bank AD

	[1]2008	[2]2007	2006	2005	2004	[3]Avg.
Total Assets (EUR million)	1078.81	905.65	514.14	267.85	183.82	[4]48.04
Total Shareholders Equity (EUR million)	98.02	77.25	35.50	21.93	14.58	[4]59.98
Return on Average Assets	2.08	1.67	0.86	0.99	1.29	1.38
Recurring Earning Power [5]	2.39	2.02	1.15	1.34	1.85	1.75
Net Interest Margin	3.06	3.23	2.59	3.78	5.06	3.55
Cost/Income Ratio (%)	40.61	46.57	71.55	75.08	69.11	60.58
Problem Loans % Gross Loans	0.10	0.32	0.92	--	--	0.45
Equity (%) Assets	9.09	8.53	6.91	8.19	7.93	8.13

[1] As of December 31. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate. [5] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a Bank Financial Strength Rating (BFSR) of D- to Corporate Commercial Bank ("CorpBank"), which translates into a Baseline Credit Assessment (BCA) of Ba3.

The D- BFSR mainly reflects the bank's small presence in Bulgaria (around a 3% share of banking system assets), its comfortable capitalisation, good liquidity and strong asset quality metrics. Having traditionally serviced the corporate sector, the bank's interest rate margins are lower than those of other players in the system and results in weaker-albeit-adequate profitability levels - relative to other retail-focused institutions.

A major constraint on CorpBank's rating is its high concentration levels, illustrated on both sides of the balance sheet, which make its funding structure more sensitive to deposit withdrawals and elevate the risks associated with the performance of individual borrowers.

Moreover, there is a system-wide constraint on all Bulgarian banks' ratings from weaker economic conditions in Bulgaria, which are expected to take their toll on asset quality metrics. More specifically, with the Bulgarian economy entering the recession, the likelihood of corporate defaults is expected to rise and lead to increased losses on most Bulgarian banks' corporate credit portfolios Delinquencies on the retail-oriented banks are also set to rise, due to higher unemployment rates and a likely decline in house prices against the background of reduced foreign investor demand for the country's real estate

In terms of the bank's corporate governance, we view positively the introduction of the State General Reserve Fund ("SGRF") of the Sultanate of Oman as a new major shareholder in March 2009. SGRF is a strong strategic investor participating in the bank's capital and has two representatives on the board of directors. That said, we note that CorpBank's shares are still majority-owned by one individual, weighing negatively on its risk positioning assessment. Key man risk also remains an issue.

CorpBank's global local currency (GLC) deposit ratings are Ba3/NP and derive from the BCA of Ba3 and Moody's assessment of a low probability of systemic support from the Bulgarian authorities in case of need.

Credit Strengths

- A small franchise in Bulgaria, with a good presence in corporate banking

- Good liquidity and strong asset quality metrics

- Comfortable capitalisation, despite business expansion

- Participation of a new and strong major shareholder in the bank's capital

Credit Challenges

- Weaker operating conditions in Bulgaria and internationally, which are expected to exert pressure on Bulgarian banks' asset quality metrics

- Strong competition in raising customer deposits in Bulgaria, putting pressure on interest margins and profitability

- Relatively low returns on its loan book and low interest rate margins reflects the predominance of corporate clients in the bank's credit portfolio

- Sizeable concentrations on both sides of the balance sheet and some corporate governance issues, which constrain the risk positioning assessment

- Fast credit growth in the system, raising concerns about the future performance of the loan portfolio, as loans start to season and enter an economic cycle

Rating Outlook

All the ratings carry a stable outlook.

What Could Change the Rating - Up

CorpBank's BFSR could be upgraded if the bank: (i) eases the credit concentrations on both sides of its balance sheet; (ii) expands and diversifies its funding base to support business growth; (iii) improves its profitability; and (iv) diversifies its shareholding structure further and increases the number of independent directors on the board.

The bank's GLC deposit rating is unconstrained by Bulgaria's support rating, and would be upgraded in tandem with the bank's BFSR up to country's rating ceiling. CorpBank's Ba3/NP foreign currency deposit ratings are also unconstrained and would mirror the GLC deposit rating, up to the country's foreign currency deposit ceiling.

What Could Change the Rating - Down

The BFSR could be downgraded if there is: (i) a material deterioration in the bank's credit quality metrics or its capital levels; (ii) a material weakening in the bank's deposit franchise dynamics and overall funding base; and/or (iii) a further increase in the cost of funds, leading to higher pressure on interest rate margins and profitability.

CorpBank's foreign and local currency deposit ratings are unconstrained by Bulgaria's ceilings, and these ceilings are unlikely to be lowered to an extent that would impact the ratings.

Recent Results and Developments

The H1 2009 results showed the bank's net income was up 43% year-on-year to BGN 29.190 million (EUR 14 925 million), mostly due to increased business volumes (loans went up by 10% during the first six months of 2009) and adequate interest rate margins.

Regulatory capital remained at a comfortable level, with tier 1 capital at 12.25% and total capital at 13.91% as of the end of June 2009.

DETAILED RATING CONSIDERATIONS

Detailed considerations for CorpBank's currently assigned ratings are as follows:

CorpBank has a BFSR of D-, which reflects its small presence in Bulgaria as the ninth-largest locally owned bank in the system, with around a 3% market share in banking assets. The rating captures the bank's comfortable capital levels, good liquidity and strong asset quality metrics. Having traditionally focused on corporate banking, the bank's interest rate margins are lower than those of other retail-focused Bulgarian banks.

The bank's ratings are constrained by: (i) weaker economic conditions in Bulgaria, which are likely to generate more problem loans across the system; (ii) the high concentration levels on both sides of the balance sheet; (iii) Bulgaria's highly competitive banking system, which challenges the ability of every bank to grow its funding and customer deposit bases; and (iv) some corporate governance issues that are captured in the risk positioning assessment.

As a point of reference, the assigned D- BFSR is three notches below the C- outcome generated by Moody's bank financial strength scorecard, and two notches below the adjusted score of D+. This reflects our assessment that a D- rating is currently a better reflection of the dynamics of the developing and challenging Bulgarian economy and CorpBank's own expanding position. Despite its strong asset quality metrics, we anticipate some deterioration on the back of the system's asset quality, particularly during this current down cycle throughout the country. These concerns are exacerbated by the bank's high borrower concentration, which elevates the sensitivity of its future credit portfolio performance in a weakening operating environment. The assigned rating also considers the bank's low revenue generation and the likelihood that funding costs will remain high as it continues to implement its growth strategy.

Qualitative Factors (70%)

Factor 1: Franchise Value

Trend: Neutral

CorpBank has a relatively small banking franchise in Bulgaria, with around a 3% share of total banking assets. Traditionally a corporate-focused bank, it has been mostly active in trade finance, energy production and distribution in Bulgaria as well as the infrastructure development segment. The bank's strategy is to continue to focus on servicing these sectors, although it wants to make further inroads in the SME market, which has been supported by EU funding. Moreover, it aims to expand its private banking business, an area that remains underdeveloped in Bulgaria. That said, like other banks in the system, we note that CorpBank's growth plans could be defied by weakened economic conditions in Bulgaria, which have led to increased unemployment and a higher number of corporate defaults. A challenging operating environment domestically, combined with intensified competition to raise customer deposits and support growth, duly resulted in reduced growth for the bank's loan portfolio in H1 2009, compared with FYE 2008. Management's ability to defend, and even grow, its market share under these conditions by attracting good-quality business and without elevating the bank's risk profile will be an important determinant in our assessment of franchise value going forward.

The franchise score of D- is constrained by the small contribution the bank's retail banking operations, asset management and fiduciary business make to its total profit, as well as its weak geographic diversification, with operations solely in the small Bulgarian market.

Factor 2: Risk Positioning

Trend: Neutral

We consider CorpBank's risk positioning to be moderate. Its risk management practices are assessed to be of adequate quality, with adequate involvement of the supervisory board in setting up the risk limits and the overall risk appetite of the institution. Several committees are in place to ensure the bank adheres to the limits set once a year by its supervisory board. Credit risk monitoring is carried out by stress testing to ensure risk control and oversight.

Nevertheless, we note that the rapid credit growth of recent years entails heightened credit risk, particularly as Bulgaria goes through a period of recession. Like other banks, CorpBank's loan portfolio has never before been through a full economic cycle, so the effectiveness of credit vetting procedures and the credibility of the assumptions used have not been tested in an economic downturn. A more immediate constraint on the bank's BFSR is its excessive borrower concentration. As of the end of June 2009, the bank's 20 largest funded and unfunded credit exposures represented close to 390% of its tier 1 capital. Although we note that this is a common situation for small corporate-focused Bulgarian banks, it does raise some concerns,particularly as banks operate in the challenging local environment.

In terms of the bank's corporate governance, we view positively the introduction of the SGRF of the Sultanate of Oman as a new major shareholder in March 2009. SGRF is a strong strategic investor participating in the bank's capital and has two representatives on the board of directors. That said, we note that CorpBank's shares are still majority-owned by one individual, weighing negatively on its risk positioning. Key man risk also remains an issue.

The supervisory board is composed of five members, two of which are considered to be independent. We therefore have no concerns about board independence or related-party exposure, which, although present, comprises an acceptable portion of tier 1 capital.

Market risk appetite is low and does not raise significant concerns for the bank.

CorpBank publishes financial statements under IFRS on a semi-annual basis and, as of 30 June 2008, these reports are made public. Public financial information and management analysis provide adequate disclosure regarding the bank's financial and business performance, but lack important information about borrower concentration risks and detailed disclosure as to the performance of the business lines. A more detailed public disclosure of the above issues would improve transparency.

Moody's assesses the bank's liquidity management to be of adequate quality. However, the modest diversification of its funding base raises some concern, particularly in view of the intense competition to attract funding. In particular, we draw attention to the large concentration levels in the bank's deposit base, with the 20 largest depositors comprising a high 41% of overall deposits as of June 2009; the top five comprise 16%. According to the bank, however, these funding resources are considered rather stable, as they are typically renewed in its books. This addresses some of our concern.

The bank scores D for risk positioning.

Factor 3: Regulatory Environment

Please refer to our latest Banking System Profile for Bulgaria for additional comments about the regulatory environment.

Factor 4: Operating Environment

Trend: Weakening

This factor is common to all banks in Bulgaria. The ongoing global economic crisis is expected to continue to have an adverse effect on the domestic economic environment.

More specifically, with the Bulgarian economy going through a period of recession, the likelihood of corporate defaults is set to continue rising and could lead to increased losses on most Bulgarian banks' corporate loan portfolios. Delinquencies on the system's retail loans are also set to rise, reflecting higher unemployment rates and a likely decline in housing prices on the back of reduced foreign investor demand for the country's real estate. The manufacturing industry and tourism sector have also been dented by the crisis.

Quantitative Factors (30%)

Factor 5: Profitability

Trend: Neutral

FYE2008 results showed the bank's recurring earning power and return on average assets standing at 2.4% and 2%, respectively, (compared to 2% and 1.7%, the year before). At these levels, profitability indicators are considered adequate but remain but remain below other retail-focused Bulgarian banks which enjoy wider interest rate margins. Moreover, this reflects the composition of the bank's balance sheet, which comprises a larger proportion of liquid, but lower-yielding, assets.

Fee & commission income makes a modest contribution to earnings. While this is common for most Bulgarian banks, we highlight a need to diversify their income streams beyond interest-related activities in order to protect their earnings from interest-rate-fuelled margin compression. This is particularly important in view of the intense competition for attracting customer deposits and the difficult conditions in the interbank and capital markets.

Non-interest expenses have been contained at low levels, despite higher infrastructure investments and the increasing number of personnel. They comprised a low 1.6% of total average assets during FYE2008.

Note that our profitability ratio calculations adjust the bank's risk-weighted assets by assigning a 50% risk weighting to government bonds to reflect the government's Baa3 local and foreign currency sovereign debt. Both adjusted and unadjusted profitability ratios produce an A score.

Factor 6:Liquidity

Trend: Neutral

CorpBank has comfortable liquidity levels that support its BFSR. As of the end of June 2009, its ratio of net loans to customer deposits totalled 73%, the lowest figure among Bulgarian rated banks, which provides it with scope to continue its business expansion, at least for the foreseeable future. Moreover, the loan portfolio comprised a low 64% of total assets as of the end of June 2009, one of the lowest ratios of all Bulgarian banks, with liquid assets accounting for an adequate 21% of the total balance sheet for the period.

Unlike many Bulgarian banks, CorpBank is a net interbank placer. As it has no access to parental funding, it has traditionally relied on customer deposits to finance its growth. As of the end of June 2009, customer deposits continued to fund a high portion of its total assets (at 88%, the ratio is much higher than those of foreign-owned peers). That said, we note that the bank's ability to continue attracting customer deposits to support its business objectives is now being challenged by the competitive environment in Bulgaria, which elevates the cost of funding for all banks.

Moody's assessment of CorpBank's liquidity management systems and procedures, combined with its liquidity ratios, gives it an overall C+ score for liquidity.

Factor 7: Capital Adequacy

Trend: Improving

CorpBank's capital levels have been supported by multiple capital injections in recent years from its major shareholder and from full profit retention, which has kept capitalisation comfortable. The bank's capitalisation was strengthened following the May 2007 IPO, with the free float of around 16% of its capital. As of the end of June 2009, tier 1 capital was a high 12.25% and total capital 13.91%, considerably higher than the respective regulatory requirements of 6% and 12%.

Moody's views positively the introduction of SGRF as the second-largest major shareholder in the bank's capital structure. In our view, SGRF is a strong strategic investor that is expected to continue to support the bank's business growth.

We note that CorpBank's risk-weighted assets reflect the adjustment mentioned under the Profitability section above. Even so, Moody's bank financial strength scorecard yields a A for capital adequacy.

Factor 8: Efficiency

Trend: Neutral

CorpBank's good efficiency levels reflect the low-cost structure of its operations and its elevated business volumes. The cost-to-income ratio was 41% at YE2008, one of the lowest among Bulgarian-rated banks. At the same time, costs comprised a low 1.6% of average assets. Going forward, we anticipate some cost pressure from higher infrastructure investments; however, it should be offset by increased business volumes and eventual productivity gains.

CorpBank scores B for efficiency.

Factor 9: Asset Quality

Trend: Neutral

Given its relatively recently origins as a start-up bank, CorpBank was never burdened by legacy problem loans, and it maintains good asset quality levels that underpin its rating. As of the end of June 2009, non-performing loan (NPL) balances (defined as loans overdue by more than 90 days) comprised a negligible 0.03% of total loans, and those were well-covered by loan loss reserves.

CorpBank has one of the lowest ratios of NPLs to total loans in the Bulgarian banking system; however, we recognise that this ratio is viewed in the context of a still-developing market economy and a rapidly expanding domestic credit portfolio that has not been tested through a downcycle. In our view, higher levels of delinquencies are, to some extent, anticipated, as loans start to mature and Bulgaria goes though a period of economic recession. These concerns are aggravated by CorpBank's high borrower concentration, which, although well-covered by collateral, elevates the sensitivity of its credit portfolio quality to the future performance of these clients.

In Moody's view, the rapid pace at which loans are underwritten by Bulgarian banks generally puts a strain on their risk management systems and elevates their risk profiles. This is also a growing concern as the level of the country's consumer indebtedness starts to rise. Such concerns about asset quality act as a constraint on all banks' ratings. Their managements' ability to maintain a clean loan portfolio, as well as to sustain asset quality metrics at a strong level once loans season and go through the current downcycle in the Bulgarian economic cycle, will be a key future rating driver.

The bank's score for asset quality is A.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns long-term and short-term global local currency (GLC) deposit ratings of Ba3/Not-Prime to CorpBank. The ratings do not incorporate any external support and are therefore set at the same level as the BCA of Ba3.

The introduction of the currency board in Bulgaria in 1997 has reduced the probability of complete systemic support. As a result, Moody's assesses a low probability of systemic support in the case of need, based on the bank's small size (it ranks ninth in terms of assets, with a share of around 3% of total banking system assets).

Notching Considerations

Ratings for any future junior obligations of CorpBank should be notched off the fully supported deposit rating, i.e. its GLC deposit rating, because Moody's believes there is no legal authority mechanism in place for Bulgarian bank regulators to impose losses on subordinated creditors outside a liquidation scenario.

Foreign Currency Deposit Rating

CorpBank's foreign currency deposit ratings of Ba3/NP are unconstrained by Bulgaria's foreign currency deposit ceiling.

Rating Factors

Corporate Commercial Bank AD

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (70%)						**D**	
Factor: Franchise Value						**D-**	**Neutral**
Market Share and Sustainability			**x**				
Geographical Diversification					**x**		
Earnings Stability					**x**		
Earnings Diversification [2]							
Factor: Risk Positioning						**D**	**Neutral**
Corporate Governance [2]				**x**			
- Ownership and Organizational Complexity	--	--	--	--	**--**		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management			**x**				
- Risk Management				x			
- Controls	x						
Financial Reporting Transparency			x				
- Global Comparability	x						
- Frequency and Timeliness				x			
- Quality of Financial Information				x			
Credit Risk Concentration	**--**	**--**	**--**	**--**	**--**		
- Borrower Concentration	--	--	--	--	--		

- Industry Concentration	--	--	--	--	--		
Liquidity Management				**x**			
Market Risk Appetite	**x**						
Factor: Operating Environment						**D**	**Weakening**
Economic Stability					**x**		
Integrity and Corruption				**x**			
Legal System			**x**				
Financial Factors (30%)						**B**	
Factor: Profitability						**B+**	**Neutral**
PPP % Avg RWA - Basel I		3.16%					
Net Income % Avg RWA - Basel I	2.60%						
Factor: Liquidity						**C+**	**Neutral**
(Mkt funds-Liquid Assets) % Total Assets	-47.14%						
Liquidity Management				x			
Factor: Capital Adequacy						**A**	**Improving**
Tier 1 ratio (%) - Basel I	11.96%						
Tangible Common Equity / RWA - Basel I	13.64%						
Factor: Efficiency						**B**	**Neutral**
Cost/income ratio		52.91%					
Factor: Asset Quality						**A**	**Neutral**
Problem Loans % Gross Loans	0.45%						
Problem Loans % (Equity + LLR)	2.33%						
Lowest Combined Score (9%)						**C+**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**C-**	
Assigned BFSR						**D-**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral