MOODY'S
INVESTORS SERVICE

**Credit Opinion: Corporate Commercial Bank AD**

**Global Credit Research - 11 Aug 2011**

*Sofia, Bulgaria*

## Ratings

| Category | Moody's Rating |
|---|---|
| Outlook | Stable |
| Bank Deposits | Ba3/NP |
| Bank Financial Strength | D- |
| Baseline Credit Assessment | Ba3 |
| Adjusted Baseline Credit Assessment | Ba3 |

## Contacts



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## Key Indicators

**Corporate Commercial Bank AD (Consolidated Financials)[1]**

| | [2]12-10 | [2]12-09 | [2]12-08 | [2]12-07 | [3]12-06 | Avg. |
|---|---|---|---|---|---|---|
| Total Assets (BGN million) | 2,702.8 | 2,041.8 | 2,106.1 | 1,771.3 | 1,005.6 | [4]28.0 |
| Total Assets (EUR million) | 1,381.9 | 1,044.0 | 1,077.0 | 905.6 | 514.1 | [4]28.0 |
| Total Assets (USD million) | 1,853.9 | 1,497.8 | 1,497.1 | 1,324.0 | 678.0 | [4]28.6 |
| Tangible Common Equity (BGN million) | 297.7 | 254.7 | 190.9 | 150.7 | 69.0 | [4]44.1 |
| Tangible Common Equity (EUR million) | 152.2 | 130.2 | 97.6 | 77.0 | 35.3 | [4]44.1 |
| Tangible Common Equity (USD million) | 204.2 | 186.8 | 135.7 | 112.7 | 46.5 | [4]44.7 |
| Net Interest Margin (%) | 3.3 | 3.3 | 2.6 | 2.8 | 1.7 | [5]2.7 |
| PPI / Avg RWA (%) | 4.5 | 4.7 | 3.6 | 2.6 | 1.7 | [6]3.9 |
| Net Income / Avg RWA (%) | 3.9 | 4.0 | 3.1 | 2.2 | 1.3 | [6]3.3 |
| (Market Funds - Liquid Assets) / Total Assets (%) | -25.1 | -17.3 | -35.4 | -52.7 | -55.4 | [5]-37.2 |
| Core Deposits / Average Gross Loans (%) | 140.9 | 124.8 | 189.6 | 274.1 | 231.0 | [5]192.1 |
| Tier 1 Ratio (%) | 11.9 | 12.6 | 11.2 | 12.0 | 12.2 | [6]11.9 |
| Tangible Common Equity / RWA (%) | 14.4 | 14.7 | 12.7 | 14.2 | 13.4 | [6]14.0 |
| Cost / Income Ratio (%) | 31.5 | 31.9 | 41.3 | 46.6 | 71.5 | [5]44.6 |
| Problem Loans / Gross Loans (%) | 0.2 | 0.0 | 0.1 | 0.3 | 0.9 | [5]0.3 |
| Problem Loans / (Equity + Loan Loss Reserves) (%) | 0.9 | 0.1 | 0.5 | 1.5 | 4.5 | [5]1.5 |

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel II & IFRS reporting periods have been used for average calculation

## Opinion

### SUMMARY RATING RATIONALE

Moody's assigns a standalone Bank Financial Strength Rating (BFSR) of D- to Corporate Commercial Bank AD (CorpBank), which maps to Ba3 on the long-term scale.

The D- BFSR mainly reflects CorpBank's moderate presence in Bulgaria, with approximately 4% share of total banking system assets, and its adequate financial fundamentals which are underpinned by comfortable liquidity, adequate profitability and strong asset quality metrics. Although non-performing loans (NPLs) have been on an upward trajectory during 2010 and Q1 2011, in line with other banks in the system, CorpBank continues to maintain superior asset quality metrics compared to most of its Bulgarian peers, which reflects the nature of its loan book comprising a number of prominent enterprises active in the energy and infrastructure development segment (sectors that typically carry lower risk in Bulgaria). The bank's overall capitalisation is adequate and supportive of its rating, but remains lower than that of other rated Bulgarian banks.

Overall, CorpBank appears to be relatively less affected by Bulgaria's economic slowdown than several other banks. Nonetheless, an upward movement in its rating continues to be constrained by the elevated credit risks that it assumes by operating in Bulgaria's still challenging operating environment with a high unemployment rate and a gradual but modest economic recovery (real GDP growth forecast at 3% for FYE2011). Also, although the bank reduced, to a large extent, the credit borrower concentration levels in its books, the 20 largest funded and unfunded corporate exposures continue to account for a sizeable portion of the bank's Tier 1 capital, which is another constraint to its rating. Additionally, CorpBank's funding base remains concentrated among a small number of local corporates, which render its funding structure more sensitive to deposit withdrawals.

The bank is 30% owned by the State General Reserve Fund (SGRF) of the Sultanate of Oman, which was introduced into the bank's shareholding structure in March 2009. SGRF is a strong strategic investor that participates in CorpBank's capital and has two representatives on its five-member supervisory board of directors. Nonetheless, CorpBank's shares continue to be controlled by one local businessman, a factor that weighs negatively on the bank's risk-positioning assessment. Although it is managed by a team of experienced bankers, "key-man" risk continues to be an issue for CorpBank.

CorpBank's global local currency (GLC) deposit rating of Ba3 does not incorporate any systemic support and is at the same level as the standalone credit strength of Ba3 (mapped from the D- BFSR). The bank's foreign-currency deposit ratings are set at Ba3/Not Prime and are unconstrained by Bulgaria's foreign-currency deposit ceiling of Baa2.

**Rating Drivers**

- CorpBank has a small but growing franchise in Bulgaria, with good market penetration in the energy and infrastructure development segments

- Good liquidity and strong asset quality metrics underpin the bank's BFSR

- Bulgaria's operating environment remains challenging, with a high unemployment rate and a gradual but modest economic recovery

- Interest rate margins are on a downward trajectory and reflects the bank's relatively expensive cost base

- Although capital levels are adequate and sufficient to absorb losses, it is lower than other rated Bulgarian banks

- High funding and credit concentration levels (although to a lesser extent than before) and some corporate governance issues that weigh negatively on the bank's its risk-positioning assessment

**Rating Outlook**

All CorpBank's ratings carry a stable outlook.

**What Could Change the Rating - Up**

CorpBank's BFSR could be upgraded if it: (i) further diversifies its shareholding structure and increases the number of independent members on supervisory board. (ii) further increases its capital base, (iii) further eases the concentrations on both sides of its balance sheet (with top 20 loans declining below 150% of Tier 1); and (iv) expands and diversifies its funding base to include a higher level of retail deposits which are more granular.

CorpBank's Ba3 GLC deposit rating could be upgraded following an upgrade of the BFSR. CorpBank's Ba3/Not Prime foreign-currency deposit ratings are unconstrained by the country's foreign-currency deposit ceiling. As a result, any upward movement in CorpBank's foreign-currency deposit ratings would mirror any upgrade in the bank's GLC deposit rating.

**What Could Change the Rating - Down**

The BFSR could be downgraded if there is: (i) a reduction in CorpBank's capitalisation, (ii) a material deterioration in its credit quality metrics; and (iii) a material weakening in its deposit franchise dynamics and overall funding base.

**Recent Results and Developments**

Based on non-consolidated results published by the Bulgarian National Bank (BNB) for the three months ending March 2011, CorpBank's net income declined by 29% year-on-year to BGN15.012 million (EUR 7.676 million). This was mainly due to lower net interest income (down 4%) and reduced trading income. At the same time, provisioning expenses (part of which relate to the performing loans) rose 106% year-on-year and comprised 16% of the bank's pre-provision earnings during Q1 2011.

Although NPLs rose during 2010 and Q1 2011, they remained below 1% of total loans at end-March 2011. The bank's Tier 1 and total capital ratios stood at an adequate 12.7% and 13.6%, respectively, as at end-March 2011.

**DETAILED RATING CONSIDERATIONS**

Our detailed considerations for CorpBank's currently assigned ratings are as follows.

The D- BFSR mainly reflects CorpBank's moderate presence in Bulgaria and its adequate financial fundamentals underpinned by comfortable liquidity, adequate profitability and strong asset quality metrics. CorpBank continues to maintain superior asset quality metrics compared to most of its Bulgarian peers, which reflects the nature of its loan book comprising a number of prominent enterprises active in the energy and infrastructure development segment (sectors that typically carry lower risk in Bulgaria). The bank's overall capitalisation is adequate and supportive of its rating, but remains lower than that of other rated Bulgarian banks.

Overall, CorpBank appears to be relatively less affected by Bulgaria's economic slowdown than several other banks. Nonetheless, an upward movement in its rating continues to be constrained by the elevated credit risks that it assumes by operating in Bulgaria's still challenging operating environment with a high unemployment rate and a gradual but modest economic recovery (real GDP growth forecast at 3% for FYE2011). Other rating constraints include the bank's sizeable credit and funding concentration levels in its books and some corporate governance issues relating to the large holding of shares in the bank by one individual. Although it is managed by a team of experienced bankers, "key-man" risk continues to be an issue for CorpBank.

As a point of reference, the assigned 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 volatile and challenging Bulgarian economy and CorpBank's position in the market. Moreover, its high borrower concentration and "key-man" risk weigh on its risk-positioning assessment, and position the bank in the D- category. The assigned rating also reflects CorpBank's developing franchise in Bulgaria and the challenges in diversifying its deposit base and maintaining high interest rate margins in the highly competitive banking market that is dominated by a large number of foreign-owned banks.

Qualitative Factors (70%)

Factor 1: Franchise Value

Trend: Improving

CorpBank has a moderate position in Bulgaria with around 4% market share in banking system assets. The bank has expanded its presence and built its market share during 2010 and Q1 2011.

Traditionally a corporate-focused bank, it is mostly active in trade finance, energy production and distribution in Bulgaria, and in infrastructure development. Its niche position in Bulgaria derives from its long-established relationships with its customers, most of which are prominent enterprises active in these sectors. CorpBank's strategy is to continue to explore growth opportunities in the SME market, which has been supported by EU funding. It also plans to expand its private banking business, an area that remains underdeveloped in Bulgaria. Its ability to defend and continue to grow its market share - by attracting good-quality business and without elevating its credit risk profile - will be an important determinant in our assessment of franchise value going forward.

The franchise value score of D- is constrained by the limited geographic diversification and the small contribution of its retail banking operations, asset management and fiduciary business to its total profit. The rating is also constrained by CorpBank's weak geographic diversification, with operations solely focused on the small Bulgarian market.

Factor 2: Risk Positioning

Trend: Neutral

We regard CorpBank's risk positioning as moderate. Its risk-management practices are 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 that CorpBank adheres to the limits set once a year by its supervisory board. Credit-risk monitoring is carried out using stress testing to ensure risk control and oversight.

CorpBank has managed to protect the quality of its loan portfolio in recent quarters. On the one hand, this reflects the profile of its corporate clients, a large portion of which are prominent names in the field of energy production and infrastructure development (segments that are relatively low risk), while, on the other hand, it also reflects the prudent risk-management practices that CorpBank has in place.

Nonetheless, a key constraint on its risk positioning assessment is its high credit borrower concentration in its books. Although to a lesser extent than before the 20 largest funded and unfunded credit exposures continue to dominate the bank's loan book, and accounted for around 270% of its Tier 1 capital as at end of March 2011. Although we note that this level of exposure is a common situation for small corporate-focused Bulgarian banks, it continues to raise concerns under challenging local operating 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. Although SGRF is not considered to be an active investor, it is a strong long-term strategic investor that participates in CorpBank's capital and has two representatives on the five-member supervisory board. With the introduction of the new shareholder, the scope of competencies of the supervisory board has been extended. Nonetheless, we note that CorpBank's shares continue to be majority owned by one individual, which weighs negatively on its risk positioning. In our view, "key-man" risk remains an issue for this bank. The supervisory board has five members, two of which we consider to be independent. We therefore have no concerns about board independence or related-party exposure, the latter of which, although present, comprises an acceptable portion of Tier 1 capital.

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

CorpBank publishes financial statements under IFRS semi-annually. Public financial information and management analysis provide adequate disclosure regarding CorpBank's financial and business performance, but lack important information about borrower concentration risks and detailed disclosure as to the performance of the business lines. In our view, a more detailed public disclosure of the above-mentioned issues would improve transparency at CorpBank.

Moody's considers CorpBank's liquidity management to be adequate. However, the modest diversification of its funding base raises some concerns, particularly in view of the high concentration and the considerable amount of deposits from state-owned companies. We estimate that customer deposits fund a high 80% of total assets (at the end of December 2010), while the five largest depositors comprise a sizeable 22% of its total deposits.

According to management, these deposits are relatively stable and reflect the long-term relationships that CorpBank has with these customers; at the same time, we note that a high reliance on this funding type raises the risks of deposit withdrawal and elevates the costs on its overall funding base. This is because these accounts are relatively more expensive compared with other retail deposits or funds attracted by other foreign-owned banks from their parents.

CorpBank scores D for risk positioning.

Factor 3: Regulatory Environment

Please refer to our most recent Banking System Outlook on Bulgaria, published in May 2011, for additional comments on the regulatory environment.

Factor 4: Operating Environment

Trend: Neutral

This factor is common to all banks in Bulgaria. The economic stability sub-factor captures the country's economic volatility based on the standard deviation of its nominal GDP growth rate over the past 20 years. The score also takes into account integrity and corruption based on the World Bank's Government Effectiveness Index, and also an assessment of the effectiveness of the legal system (based on the ease with which property can be foreclosed). Although the authorities have taken measures to expedite foreclosure, it appears that the process is not applied consistently and delays can still occur. At the same time, the country's weak integrity and corruption scores and EU reports highlighting corruption in the country have led us to adjust Bulgaria's legal system score to D from C, thereby lowering the country's overall operating environment score to D- from D. For further details, please refer to the latest Banking System Outlook on Bulgaria.

Quantitative Factors (30%)

Factor 5: Profitability

Trend: Neutral

Based on CorpBank's FYE2010 results, net income grew by 17% year-on-year during 2010, mainly on the back of higher net interest income (up 17%) and elevated fee income (up 6%). Also, on the cost side, the bank managed to constrain the growth in its operating expenses which rose 9% during 2010. As a result, the bank's recurring earning power and return on average assets during FYE2010 totalled an adequate 3.6% and 3.1% respectively.

The increase in loan volumes during 2010 (up 20%) was the main reason behind the growth in interest and fee income. While we view positively CorpBank's ability to outpace the systemic credit growth in 2010 (which totalled a modest 4%), we also highlight our concerns regarding its credit expansion in Bulgaria's still fragile operating environment that is gradually recovering from the economic recession of 2009. The fact that a sizeable portion of the loan book growth derives from exposures to export- oriented companies partly explains the increase in credit volumes, with the export sector recovering at a higher rate than the other economic segments in Bulgaria. Meanwhile, the unemployment rate remains high while the real estate sector continues to be under stress. As at year-end 2010, loans extended in the risky construction and real estate sector accounted for a sizeable 21% of total loan portfolio.

We calculated CorpBank's risk-weighted assets by assigning a 50% risk weighting to government bonds to reflect the government's Baa2 local- and foreign-currency sovereign debt rating. Both adjusted and unadjusted profitability ratios produce an A score.

Factor 6:Liquidity

Trend: Neutral

CorpBank has comfortable liquidity levels that underpin its BFSR. As of the end of December 2010, its ratio of net loans to customer deposits was 81%, one of the lower ratios among Bulgarian banks. At the same time, liquid assets accounted for an adequate 33% of the total balance sheet at year-end 2010.

On the funding side, CorpBank has no access to parental funding; therefore, unlike most of its peers it has traditionally relied on customer deposits to finance growth. At the end of 2010, customer deposits funded a high 80% of its total assets, a ratio that is higher than those of its foreign-owned peers. As noted above, CorpBank's deposit base is highly concentrated, which raises the sensitivity and the risks of a large deposit outflow. According to CorpBank's management, these deposits are stable and typically roll over in its books when they mature, which partly mitigates our concerns.

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

Factor 7: Capital Adequacy

Trend: Neutral

CorpBank's capital levels is at comfortable levels and underpins its rating. Its capitalisation was strengthened following the May 2007 IPO, with the free-float of around 16% of its capital. At the end of March 2011, its Tier 1 capital stood at a comfortable 12.7%, and its total capital was 13.6%, higher than the respective regulatory requirements of 6% and 12%.

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

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

Factor 8: Efficiency

Trend: Neutral

CorpBank has good efficiency levels that reflect the low-cost structure of its operations. Its cost-to-income ratio of 32% during 2010 was the lowest among most Bulgarian banks. Non-interest expenses grew by a modest 9% during 2010 and were below 2% of average assets.

Based on the above-mentioned considerations, CorpBank scores A for efficiency.

Factor 9: Asset Quality

Trend: Neutral

CorpBank maintains good loan portfolio quality, which is one of its main strengths. NPL balances (loans 90+ days overdue) remained below 1% of total loans as the end of 2010. At the same time, loan loss reserves (LLRs) more than fully covered the problematic assets.

CorpBank has one of the lowest ratios of NPLs to total loans in the Bulgarian banking system. However, in our view, this ratio should be viewed in the context of an expanding credit portfolio in a volatile and a still challenging operating environment. 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.

CorpBank's ability to continue to maintain a clean loan portfolio, and to sustain good asset quality metrics, coupled with Bulgaria's recovery from the recession, represent important drivers for the bank's ratings.

The bank scores A for asset quality.

**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. In accordance with Moody's Joint Default Analysis (JDA) methodology, the ratings do not incorporate any external support and are therefore at the same level as the standalone strength 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 4% 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/Not Prime are unconstrained by Bulgaria's foreign currency deposit ceiling of Baa2.

## 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-** | **Improving** |
| **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 | | | | | x | | |
| - Key Man Risk | | | | x | | | |
| - 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** | | | | | **x** | | |
| - Borrower Concentration | | | | | x | | |
| - Industry Concentration | | x | | | | | |
| **Liquidity Management** | | | | **x** | | | |
| **Market Risk Appetite** | **x** | | | | | | |
| **Factor: Operating Environment** | | | | | | **D-** | **Neutral** |
| **Economic Stability** | | | | | **x** | | |
| **Integrity and Corruption** | | | | **x** | | | |
| **Legal System** | | | | **x** | | | |
| **Financial Factors (30%)** | | | | | | **B+** | |
| **Factor: Profitability** | | | | | | **A** | **Neutral** |
| **PPI / Average RWA - Basel II** | 3.95% | | | | | | |
| **Net Income / Average RWA - Basel II** | 3.40% | | | | | | |
| **Factor: Liquidity** | | | | | | **C+** | **Neutral** |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **(Mkt funds-Liquid Assets) / Total Assets** | -25.92% | | | | | | |
| **Liquidity Management** | | | | x | | | |
| **Factor: Capital Adequacy** | | | | | | **A** | **Neutral** |
| **Tier 1 Ratio - Basel II** | 11.46% | | | | | | |
| **Tangible Common Equity / RWA - Basel II** | 13.40% | | | | | | |
| **Factor: Efficiency** | | | | | | **A** | **Neutral** |
| **Cost / Income Ratio** | 34.89% | | | | | | |
| **Factor: Asset Quality** | | | | | | **A** | **Neutral** |
| **Problem Loans / Gross Loans** | 0.10% | | | | | | |
| **Problem Loans / (Equity + LLR)** | 0.51% | | | | | | |
| **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