MOODY'S
INVESTORS SERVICE

Credit Opinion: Corporate Commercial Bank AD

Global Credit Research - 30 May 2014

Sofia, Bulgaria

Ratings

Category	Moody's Rating
Outlook	Negative(m)
Bank Deposits	B1/NP
Bank Financial Strength	E+
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	b2

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Key Indicators

Corporate Commercial Bank AD (Consolidated Financials)[1]

	[2]12-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total Assets (BGN million)	6,740.9	5,637.2	4,044.4	2,702.8	2,041.8	[3]34.8
Total Assets (EUR million)	3,447.5	2,882.5	2,067.6	1,381.9	1,044.0	[3]34.8
Total Assets (USD million)	4,750.5	3,800.3	2,684.1	1,853.9	1,497.8	[3]33.5
Tangible Common Equity (BGN million)	591.0	414.0	357.5	297.7	254.7	[3]23.4
Tangible Common Equity (EUR million)	302.3	211.7	182.8	152.2	130.2	[3]23.4
Tangible Common Equity (USD million)	416.5	279.1	237.3	204.2	186.8	[3]22.2
Net Interest Margin (%)	1.4	2.1	2.4	3.3	3.3	[4]2.5
PPI / Average RWA (%)	2.2	2.4	2.8	4.3	4.7	[5]3.3
Net Income / Average RWA (%)	1.4	1.5	2.2	3.8	4.0	[5]2.6
(Market Funds - Liquid Assets) / Total Assets (%)	-20.3	-19.8	-26.5	-28.0	-21.0	[4]-23.1
Core Deposits / Average Gross Loans (%)	130.3	141.6	156.4	140.9	124.8	[4]138.8
Tier 1 Ratio (%)	11.0	8.4	10.0	11.3	12.6	[5]10.7
Tangible Common Equity / RWA (%)	11.1	9.3	11.3	13.7	14.7	[5]12.0
Cost / Income Ratio (%)	41.0	39.7	36.8	31.5	31.9	[4]36.2
Problem Loans / Gross Loans (%)	1.2	0.6	0.4	0.2	0.2	[4]0.5
Problem Loans / (Equity + Loan Loss Reserves) (%)	8.7	4.2	2.3	0.9	1.1	[4]3.5

Source: Moody's

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

Opinion

SUMMARY RATING RATIONALE

The B1 deposit rating assigned to Corporate Commercial Bank AD (CorpBank) is one notch higher than its baseline credit assessment (BCA) of b2 and reflects our assessment of the likelihood of support from the Bulgarian authorities. This assessment is based on CorpBank's increasing systemic importance as the fourth-largest deposit-taking institution, with a 9% market share in deposits as of December 2013, according to the Bulgarian National Bank.

CorpBank's standalone BFSR of E+, which is equivalent to a BCA of b2, reflects (1) the bank's rapid credit expansion in Bulgaria's challenging operating environment which increases the risk of asset quality pressure; (2) moderate capital buffers (with a Tier 1 ratio of 11.4% at year-end 2013); (3) high borrower concentration levels which expose the bank to downside risks in case of default of a large borrower; and (4) modest profitability (with return on average assets at approximately 1.2% in FYE2013). An additional factor that weighs negatively on the bank's risk positioning and on its rating is the concentrated ownership within the bank (with 50.7% of shares controlled by a Bulgarian company, which is ultimately owned by a local businessman), and `key man' risk.

At the same time, the rating also reflects CorpBank's solid liquidity buffers and its growing and increasingly diversified deposit base in Bulgaria. Also, Corpbank has so far maintained a more resilient loan book quality than its peers, with non-performing loans (NPLs defined as impaired loans + loans 90 days past due) at 1.4% of loans in December 2013.

Rating Drivers

- Rapid credit expansion in Bulgaria's challenging operating environment increases asset quality pressures

- Moderate capital buffers available to absorb unexpected losses

- Downward pressure on profitability owing to reduced interest rate margins and elevated provisioning expenses

- Concentrated ownership continues to weigh negatively on the risk positioning assessment

- Solid liquidity buffers and a diversified funding base

Rating Outlook

The bank's long-term deposit rating carries a negative outlook. The negative outlook reflects our view of the risk that the seasoning of the loan portfolio may lead to further asset-quality and profitability pressures, which could, in turn, weaken the bank's capital levels.

The negative outlook also takes into account the recent adoption of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) regulation in the EU. In particular, this reflects that, with the legislation underlying the new resolution framework now in place and the explicit inclusion of burden-sharing with unsecured creditors as a means of reducing the public cost of bank resolutions, the balance of risk for banks' senior unsecured creditors has shifted to the downside. Although our support assumptions are unchanged for now, the probability has risen that they will be revised downwards to reflect the new framework. For further details, please refer to our Special Comment entitled "Reassessing Systemic Support for EU Banks," published on 29 May 2014.

What Could Change the Rating - Up

The outlook could be changed to stable if profitability metrics stabilise and loan concentrations are reduced.

What Could Change the Rating - Down

Downward pressure might develop on the ratings if the bank's asset quality, capitalisation and profitability levels were to weaken beyond current expectations.

DETAILED RATING CONSIDERATIONS

CORPBANK'S RAPID EXPANSION IN BULGARIA'S CHALLENGING OPERATING ENVIRONMENT INCREASES RISKS OF ASSET QUALITY DETERIORATION

CorpBank's rapid credit expansion within Bulgaria's challenging operating environment increases the risk of potential asset quality deterioration. Between 2011-13 the bank expanded its loan book by an annual average growth rate of 33%, compared with a 2.9% growth rate for the banking system. Although we recognise that the bank maintains better asset quality metrics compared to its Bulgarian peers - with the bank's NPLs accounting for 1.4% of gross loans as of December 2013 (compared to an NPL ratio of 17% for the system as published by Bulgarian National Bank) - we note that the stock of NPLs increased by 94% in absolute terms in 2013. According to the bank's 2013 financial statements, we also note that the total renegotiated loans accounted for around 5.5% of gross loans as of year-end 2013.

The bank's increasing exposure to the real estate sector (up by 90% in 2013) represents an additional source of risk. This exposure accounted for 9.4% of total loans or 75% of Tier 1 capital as at year-end 2013, while including loans to the construction sector (some of which relate to infrastructure projects), aggregate exposure approximated 20% of loans or 161% of Tier 1. Bulgaria's construction production index and the housing prices, which we track as leading indicators for asset quality in the system, show that this sector remains under stress, with falling construction output and the housing prices, although the contraction is lower than that reported in 2009.

Also, we note that as a reflection of the recent rapid growth, a significant portion of CorpBank's loan portfolio is unseasoned and exposed to the effects of Bulgaria's subdued economic conditions. In Q4 2013, Bulgaria's real GDP grew by a modest 1.2% year-on-year (according to the National Statistics Institute), while the unemployment rate increased to around 13% (approximately double the levels recorded in 2009). Although we anticipate that Bulgaria's economic performance will improve slightly in the coming years, we expect that growth rates will remain well below pre-2008 levels of around 6% annual GDP growth.

MODERATE CAPITAL BUFFERS AVAILABLE TO ABSORB UNEXPECTED LOSSES

With a Tier 1 ratio of 11.4% as at end-2013 and a total capital adequacy ratio (CAR) of 13.4%, CorpBank has moderate buffers available to absorb losses. Although the bank raised new equity in 2013, we expect that CorpBank's Tier 1 ratio will remain below the banking system average Tier 1 ratio of 16% as of December 2013. Risks associated with the bank's moderate capital buffers are exacerbated by CorpBank's loan concentrations, which although typical for corporate-focused banks in Bulgaria, expose the bank to downside risks in the event of default of a large borrower. We anticipate that Corpbank will continue to be challenged to reduce loan concentrations levels, given the challenging operating environment in Bulgaria which will continue to impact credit demand from SMEs and retail loans.

In January 2014, CorpBank signed an agreement for the acquisition of 100% of the capital of Credit Agricole Bulgaria (which accounted for 6% of CorpBank's total assets or 0.5% of banking system assets) with the aim to keep it as a separate entity (rather than merging each other), which will be rebranded and developed as retail bank (subsidiary of CorpBank). The subsidiary will offer a broad range of products to small companies and SMEs and will cross sell retail products and services to existing CorpBank corporate customers and their employees. While details of the transaction are still to be made public, according to management, the acquisition will be funded by own funds of CorpBank and will have limited impact on the bank's liquidity and capital metrics. According to the bank, capitalisation will remain above the regulatory minimum, after the transaction is concluded in Q2 2014.

PROFITABILITY REMAINS UNDER PRESSURE OWING TO DECLINING MARGINS AND ELEVATED PROVISIONING EXPENSES

CorpBank's profitability remains under pressure and continues to weigh negatively on the ratings. According to unconsolidated results for FYE2013, CorpBank's return on average assets ratio was approximately 1.2% (2012: 1.2% and 2010: 3.1%). Also, the pre-provision income-to-average assets ratio stood at 1.8% in 2013 (2012: 1.9% and 2010: 3.6%).

The pressure on profitability stems from: (1) compressed interest-rate margins; although according to management, margins improved in 2H 2013, they remain under pressure owing to higher funding costs, as the bank continues to diversify its funding base (interest margins fell to 1.4% in 2013 from 2% in 2012 and 3.2% in 2010); and (2) increasing loan-loss provisioning charges. We estimate that provisioning expenses absorbed 26% of pre-provision income in 2013 (compared with a 31% respective ratio in 2012 and 4% ratio in 2010). Although we recognise that a portion of the bank's provisions are allocated towards loans that are `impaired on a portfolio basis' and perform regularly, the bank's provisioning requirements remain elevated, with credit costs accounting for a sizeable portion of the bank's pre-provision earnings. Bulgaria's persistently challenging operating conditions indicate that provisioning charges will remain elevated, resulting in sustained pressure on the bank's profitability.

Despite the aforementioned factors affecting Corpbanks's profitability, we note that the bank managed to increase the trading profits in 2013 (up by 79% year-on-year) and partially offset the negative impact on operating profitability from net interest income.

CONCENTRATED OWNERSHIP CONTINUES TO WEIGH NEGATIVELY ON THE RISK POSITIONING ASSESSMENT

The concentrated ownership within the bank and the `key man' risk continue to weigh negatively on its risk positioning assessment. Around 50.7% of Corpbank's shares are controlled by a Bulgarian company which is owned by a local prominent businessman, who is the chairman of the five-member supervisory board. The State General Reserve Fund of the Sultanate of Oman, which currently controls around 30.4% of the bank's shares and has two representatives on the board, has been the second-largest shareholder and a strategic investor in the bank since 2009. Also, in April 2013 Bank VTB JSC (deposits Baa2; stable, BFSR D-/BCA ba3; stable) acquired a 9% stake in the bank and is currently the third-largest shareholder with no representation on the board. Despite the ability of the bank to attract foreign investors, we consider that the dominance of one shareholder in the bank's ownership structure and the limited number of independent board directors to remain key factors that weigh negatively on the bank's risk positioning assessment.

SOLID LIQUIDITY BUFFERS AND DIVERSIFIED FUNDING BASE

CorpBank's ratings continue to be supported by its sound liquidity buffers and by its increasingly diversified funding base. During the past two years, CorpBank increased and diversified its deposit base by attracting a higher share of retail deposits and reducing reliance on state-owned deposits with contribution to total deposits, currently at low levels. As at end-December 2013, retail deposits comprised 73% of total deposits, compared to 58% at year-end 2012. Total customer deposits, contributed 89% of total funding as of year-end 2013, while the loans-to-customer deposits ratio was 85%, one of the lower ratios among Bulgarian banks. We expect that the bank will maintain a well-diversified funding structure, with retail deposits dominating the bank's funding base over the next 12-18 months.

Also, CorpBank maintains solid liquidity buffers which partly mitigate pressure on the rating. As at end-December 2013, liquid assets (defined as the sum of cash, balances with banks and liquid securities) as a percentage of total assets was approximately 30%. Despite the rapid loan book growth, we anticipate that the bank will maintain good liquidity metrics, with liquid assets remaining broadly at current levels.

Global Local Currency Deposit Rating (Joint Default Analysis)

We assign a global local currency (GLC) deposit rating of B1 to CorpBank. The rating reflects the incorporation of one notch of support uplift based on our assessment of the likelihood of systemic support from the Bulgarian authorities. This assessment is based on CorpBank's increasing importance in Bulgaria as the fourth-largest deposit taking institution, with a 9% market share in deposits as of December 2013, according to the Bulgarian National Bank.

Foreign Currency Deposit Rating

CorpBank's foreign currency deposit ratings of B1/Not Prime ratings are at the same level as the local-currency deposit ratings, and are unconstrained by Bulgaria's foreign currency deposit ceiling of Baa2.

ABOUT MOODY'S BANK RATINGS

A deposit rating, as an opinion of relative credit risk, incorporates the Bank Financial Strength Rating as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognise the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the GLC rating for a bank, the JDA methodology also factors in the rating of the support provider, Moody's assessment of the probability of government support for the bank in case a stress situation occurs and the degree of dependence between the issuer rating and the systemic support indicator.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. An Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to a high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be reminded that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt obligations may also be constrained by the country ceiling for foreign currency bonds and notes, however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Corporate Commercial Bank AD

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (70%)						**D-**	
Factor: Franchise Value						**E+**	**Improving**
Market share and sustainability				**x**			
Geographical diversification					**x**		
Earnings stability					**x**		
Earnings Diversification [2]							
Factor: Risk Positioning						**E**	**Weakening**
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+**	**Weakening**
PPI % Average RWA (Basel II)		3.21%					
Net Income % Average RWA (Basel II)	2.52%						
Factor: Liquidity						**C+**	**Neutral**
(Market Funds - Liquid Assets) % Total Assets	-24.76%						
Liquidity Management				x			
Factor: Capital Adequacy						**B+**	**Weakening**
Tier 1 Ratio (%) (Basel II)		9.91%					
Tangible Common Equity % RWA (Basel II)	11.43%						
Factor: Efficiency						**A**	**Neutral**
Cost / Income Ratio	36.03%						
Factor: Asset Quality						**A**	**Neutral**
Problem Loans % Gross Loans	0.36%						
Problem Loans % (Equity + LLR)	2.48%						
Lowest Combined Financial Factor Score (9%)						**C+**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**D+**	
Aggregate BCA Score						**baa3/ba1**	
Assigned BFSR						**E+**	
Assigned BCA						**b2**	

[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.

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