BCRA CREDIT RATING AGENCY

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„Investbank” AD

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BANK'S FIANCIAL STRENGHT RATING	Update	Update
Date of Rating Committee:	28.11.2018	29.11.2019
Date of Publication:	30.11.2018	03.12.2019
Long-term Rating:	B-	B-
Outlook:	stable	negative
Short-term Rating:	C	C
Long-term National-scale Rating:	B- (BG)	B- (BG)
Outlook:	stable	negative
Short-term National-scale Rating:	C (BG)	C (BG)

BCRA – CREDIT RATING AGENCY AD (BCRA) is the third fully recognized rating agency in the EU, registered pursuant to Regulation No. 1060/2009 of the European Parliament and of the Council. The credit ratings, assigned by the BCRA are valid throughout the EU and are fully equal to those, of the other agencies, recognized by the European Securities and Markets Authorities, without any territorial or other limitations.

The „BCRA - Credit Rating Agency“ (BCRA) affirms the following ratings to **„Investbank“ AD**:

- **Long-term** financial strength rating **B-, short-term** rating **C;**
- **Long-term** National-scale rating **B- (BG), Short-term** national-scale rating **C (BG)**

and changes the outlook from “stable” **to “negative”.**

BCRA's officially adopted Sovereign Rating Methodology has been applied (*https://www.bcra-bg.com/files/bank_methodology_2018_en.pdf****).***

The report has been prepared and the rating – assigned, based on the information, made available by the rated bank, Bulgarian National Bank, National Statistical Institute, the database of BCRA, consultants and other sources of public information.

Operating Environment

Sovereign Risk

The Government of the Republic of Bulgaria is committed to speeding up the process of joining the euro area by officially submitting a letter of intent. In August, the Council of Ministers approved an Action Plan including measures for realizing Bulgaria's intentions to join the Exchange Rate Mechanism II and the Banking Union which, despite initial expectations, did not happen in July 2019.

The economy growth slowed down from 3.8% in 2017 to 3.1% in 2018, driven mainly by the domestic demand – consumption and investments. In the first quarter of 2019, the Domestic demand (consumption and investment) contributed positively to GDP dynamics. In the first quarter of 2019, the registered economic growth rose by 2.1 p.p. up to 5.2% on an annual basis, mainly driven by final consumption.

The country registers a decline of the external debt, and at the end of December 2018, the BNB's international reserves amounted to 25 072 million and provided 150.5% coverage of the monetary base - a solid buffer used by the central bank to ensure the stability of the currency board. Indicators of reserves adequacy remain high.

The upward trend in wages and the unemployment reduction retain while employment growth decelerates at the domestic labour market.

The annual average inflation rate (measured by HIPC) maintained its gradual uptrend from 2018 (2.6%) reaching 3.0% as of mid-2019.

Public finance indicators remain stable, backed by the favourable macroeconomic environment. The government debt followed a favourable downward trend and amounted to 20.4% of GDP at the end of 2018. The country has a significantly lower level of government debt than the Maastricht convergence criterion of 60% and is among the three EU countries with the lowest levels. New debt issued in January-August 2019 amounted to BGN 900.6 million, with the

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proceeds being used to finance part of the amount for the government's purchase of new weapons in the army (F-16 fighters).

Banking System

The Ministry of Finance's Action Plan in the process of country's accession to the Banking Union included an asset quality review and stress tests of several Bulgarian banks, the results of which were announced on July 26, 2019. The ECB's[1] comprehensive assessment showed that, in testing the adverse macroeconomic scenario, in two of the six banks, there was a capital shortfall the same conclusion being made for both institutions in the 2016 BNB AQR. As it did three years ago, the Bulgarian National Bank stated that follow-up actions would be conducted to further strengthen the capital position of banks in strict compliance with the BNB mandate and the relevant regulatory framework.

In the mid-2019, 25 banks operated in the Bulgarian market (5 of which are 5 foreign branches). The consolidation trend in the system continues. In the first quarter of 2019 DSK Bank EAD acquired the Bulgarian business of Societe General Group, namely Societe General Expressbank AD. Following the change of ownership and prior to the final merger, the bank will operate as a separate credit institution at the local market, under the brand of Expressbank AD. A similar development is observed in the ownership change of Piraeus Bank Bulgaria AD, which, became part of Eurobank Bulgaria AD after the sale of its shares in June 2019.

The Bulgarian banking system is characterized by:

- Continued improvement in the quality of bank portfolios;
- Accelerated growth of bank assets on an annual basis;
- Significant growth in the profit for 2018;
- A retained steady upward trend in the attracted funds in the form of deposits (except for credit institutions);
- Deposits in BGN dominating the currency structure of the attracted funds;
- Mostly unchanged deposit structure, with the largest share of deposits from individuals and households;
- At the end of 2018, the size of the gross loan portfolio marked a five-year record-high growth of 8.6% and rose by 7.2% in the first half of 2019. The change was mainly attributable to household loans;
- Non-financial institutions are dominating the structure of loans and advances (except for credit institutions) with a share of 57.3%;
- The main indicator of liquidity in the banking system since the beginning of 2018 has been the liquidity coverage ratio (LCR). The indicator reached 294.1% at the end of 2018 and 260.6% as of the end of Q2 2019, which was significantly higher than the Eurozone average (140.9% as of the end of March 2019, according to the ECB);
- The capital adequacy of the banking system retains its good levels.

„Investbank“ AD

Shareholders Structure and Management

In 2018, Investbank increased its capital by BGN 10 million and all shares are registered by the majority shareholder "Festa Holding" AD. After the decision is entered in the Commercial Register (07.08.2018), the capital amount becomes BGN 131 667 thousand, distributed in the same number of shares, each with a face value of BGN 1. The changes in the shareholder structure led to an increased share of Festa Holding AD to 55.36%, with a corresponding decrease in the shares of the other shareholders.

There are no changes in the Supervisory Board and as of September 2019, the members are the following:

- Petia Ivanova Barakova-Slavova – Chair;
- „Festa Holding“ AD, … 103123984, official representative Zlatomir Dimitrov;
- Dimitrijka Lazarova Andreeva

In the review period, Ivaylo Vassilev Sotirov was released as a member of the Management Board and Radoslav Simeonov Velkov was nominated. Thus, the composition of the MB is as follows:

- Zdravka Rumenova Russeva – Chair of the MB and Executive Director;
- Vesela Ivanova Koleva-Djidjeva – member and Executive Director;

[1] *ECB Press Release is available at: https://www.bankingsupervision.europa.eu/press/pr/date/2019/html/ssm.pr190726~1b474e3467.bg.html*

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- Ivan Tsvetkov Bachovsky – member and Executive Director;
- Radoslav Simeonov Velkov – member and Executive Director.

The Bank reports uncovered fully set targets for growth in assets and credit portfolio, high revaluation of the expenses incurred, excess of the planned level of net interest income and unfulfilled reduction of the administrative expenses in the planned volume.

For the period 2019 – 2022, a growth of loan portfolio is planned, in line with the interest income decline, growth in the attracted funds from clients and increase of net interest income and income from fees, which will offset the increase of administrative expenses.

A total number of employee declines, the structure of the departments is preserved, while the high turnover of staff continues.

Capital Adequacy

The increase of capital, together with the total amount of profit result in a sustainable capital position and total capital adequacy of 19.45% (16.58 as of the end of 2017). The process is maintained by a decelerating increase of the risk-weighted assets to the capital base, followed by a reduction in the first half of 2019.

The non-adjusted and adjusted leverage declined in the review period, although remaining at levels higher than the banking system and the Group II banks.

The retained levels of *net classified exposures to capital base ratio* also exceed the levels of the banking system and Group II of banks.

In 2018, the *return on equity* indicator reached high values, extremely exceeds those of the banking system and Group II banks (backed by the high value of profit from the acquisition of Victoria Commercial Bank).

Resources

In the period under review, a divergent change is observed in the resource base of Investbank, with considerable increase by 7.98% on an annual basis, in line of growth in deposits from citizens and households (6.86%) and corporate deposits (14.81%), followed by a decline in first half of 2019 of 7.95% (BGN 149 million), with a decrease of the attracted funds from corporate clients (by 24.22%).

In structural terms, the resource base is dominated by deposits from citizens and households, which share increased to 72.5% as of the end of June 2019 (68.1% at the end of 2017), on the account of deposits from non-credit institutions, holding a share of 24.7% as of the end of the first H 2019 (compared to 30% as at end of 2018).

The deposits in BGN dominate the portfolio with a share of 59-60% and at the same range is the level of the term deposits.

The share of the deposits of natural persons in the total deposit base is increasing and is at higher levels compared to the banking system and the Group II banks.

The concentration in the resource base is increasing. The share of the 15-th biggest depositors increased to 20.9% as of December 2018 (from 13.4% as of the end of 2017), while at the end of June slightly declined to 18.9%.

Assets Quality

At the end of 2018, the **amount of the assets** of Investbank registered annual growth of 8.6% compared to the past year, when the growth of 2.0% is posted. This is a result of the acquisition of the assets of Victoria Commercial Bank, reported in the first quarter, after the completion of the merger, compared to the individual reported data of the two banks as at the previous third quarter (30.09.2018). The period is marked by hikes in the amount of the assets before the merger – a growth of 12.8% for the ninth months of the year, compared to the end of 2017 when is achieved the highest balance above BGN 2.2 billion. However, the consolidated balance at the end of the year declined compared to the individual amount of Investbank' s assets from that period - by 3.7% in the quarter. For the six months of 2019, the assets registered a new decline of 6.6% compared to the end of 2018. During the period, the assets of the banking system are growing at a constant rate - 7.9% for 2018 (6.2% in 2017) and 2.9% in the first half of 2019.

The **investment portfolio** declined by an accelerated pace (12.2%) at the end of 2018 compared to its increase (by 7.5%) in the first half of 2019. Thus, its weight in the assets structure fell below 30% for the first time since 2016. Indeed, the structural changes are not as much significant taking into account the decreased total amount of assets in the last period. The share of investments in the assets significantly exceeds the average of the banking system (13.0%) at the end of 2018 and 13.8% as of June 2019) and Group II banks (13.3% in 2018 and 11.1% as of the end of June 2019). To the highest degree, in nominal terms, the *Debt instruments* in investment assets are dominating, and are a structural element – a share of above 80% for the past period (decreasing from nearly 95% at the beginning of the five-year analysed period). They

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consist of 98% Government securities. Following the high growth of the investment properties of nearly 7 times in 2016, in the next two years is reported a growth, albeit slighter – 5.4% in 2017 and 8.1% in 2018, reaching a share of 14.5%. In the period under review are registered significant changes of reclassifications and transfers between investment properties, non-current assets for sale and other assets, which total amount increases as a result of the measures for the realization of collaterals.

After the registered biggest decline on an annual basis from 2016 by 11.3%, in 2017, the **gross loan portfolio** remained with almost zero growth - 0.04% and lasting downward trend for the period of the annual review - at the end of 2018, the decline is 3.2% compared to the end of 2017, and in mid-2019, when it decreased by 2.7%. In a comparative aspect, the gross loans of the banking system gradually increase and following the minimal growth of 0.6% in 2016, in 2017, they increased by 3.0% followed by a more robust rise of 8.6% annually. In the first half of 2019 alone, the growth is 3.7% compared to the end of 2018, in contrast to the trend of the rated bank. In terms of the share of gross and net loans in total assets, the bank remains significantly below the average for the system and for the Group II Banks.

In terms of the **structure** of the gross portfolio, there are no changes in the update period. The portfolio is dominated by loans to companies (slightly below 80%). There is an increase in loans to households, registering a growth of 8.6% in 2018 and 3.7% in the six months of 2019, with their relative share increasing to nearly 20% of total loans. The term structure is characterized by a decrease in the average maturity, with short-term exposures already dominating - those up to 6 months, which from 12.1% in 2017 doubled in weight to 24.6% in 2018 and 36.1% at the end of the half-year of 2019. The structure of the corporate loan portfolio is improving in terms of industry diversification.

The tendencies and dynamics in gross **non-performing loans** during the update period preserved the unfavourable upward trend from the previous period. After the last decrease at the end of 2015, down by 1.9% compared to the previous one, in 2016 an increase of 11.3% was registered, which decelerated over the next two years. A growth of above 4% is posted for 2017 and 2018, to reach a record-high increase of 21.1% of non-performing loans for the first half of 2019. A relatively long period of more than three years had no improvement but a sharp deterioration, (particularly in the last period) of the quality of Investbank’ loans, measured as an amount of non-performing loans and as a ratio of these loans to the gross loan portfolio, which is exceeding significantly the average of the banking system. The *coverage of the gross loan portfolio with impairments* is increasing in the last period and is exceeding the average levels of the system, which is due to the substantial share of non-performing loans, as well as to the decline of gross loans. However, the coverage of non-performing loans is more than twice lower than the average of the banking system, while the evaluation in a comparative aspect, is based on radically opposite processes occurred in both, the rated bank and the system, namely: the system is marked by steady improvement of loans’ quality, declining loan impairments corresponding to the reduced amount of non-performing loans portfolios and impact on declining coverage of gross loans and increased coverage of deteriorated loans.

Quality of Income

In the review period, Investbank posts reduction in the operating profit – in 2018 – by 15.3% on annual basis and in the first half of 2019 – by 24.7% compared to the first half of 2018.

The observed negative changes in the operating result for 2018 is a result of declines in net interest income and non-interest income by 7.0% in line with a decline in operating expenses. The reduced interest income is affected by the decrease in the revenues from interests.

The registered net financial result for 2018 is a high amount of net profit of BGN 22.7 million, compared to the negative one in the previous year – a loss of BGN 29.3 million (as a result of the high value of the impairments). The registered profit is a result of the merger of Victoria Commercial Bank and Investbank. Thus, the profit is realized from the favourable purchase (negative reputation) at the amount of BGN 22.6 million. The current financial result, as of the first half of 2019, is exceeding twice the one of the same period of the previous year, affected to the highest degree of the much lower size of accrued impairments.

The achieved values of gross interest spread and net interest margin decline, remaining considerably lower than the average of the banking system and Group II banks, affected from the lower values of the *return on interest-bearing assets* and higher as a price of the *interest liabilities*.

The value of non-interest income and operating expenses are decreasing, as is decreasing the non-interest income to the average assets ratio. There is a trend of improvement in the coverage of operating

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expenses from net income from fee and commission, but the achieved values are still lagging behind the average for the system and for the Group II banks.

The high amount of net profit for 2018 results in achieving the highest value of the *Return on Assets* for the period of past five years (1.10%), which however remains below the average of the banking system (1.66%) and Group II banks (1.21%).

Liquidity

In the review period, the outpacing growth of the equity (18.5%) compared to total liabilities (8.6%) led to an increase in the ratio *share of equity in total liabilities* by 0.7 p.p., reaching 8.5% at the end of 2018. The latter is significantly lower than the average of the banking system (13.1%) and Group II banks (11.9%). As of the end of the first half of 2019, however, its increase (reached 9.7%), resulting to an additional decrease in the gaps compared to the average levels of the rest of participants in the banking system.

By value of *Total loans to total deposits*, the bank remains at the lowest levels compared to the reference group of banks[2] and much lower levels compared to the system average and Group II banks.

LCR for supervisory purposes remains well above the minimum required (over three times at the end of the period). The Bank is maintaining a sufficiently high proportion of liquid assets that determine this level. The stable financing structure is preserved, in which the loan portfolio is financed by clients' deposits. The levels of NSFR are above the internal and regulatory requirements.

Size and Systems

In the review period, Investbank, albeit the acquisition of Victoria Commercial Bank, concedes one position (outpaced by ProCredit Bank) in the ranking for 2018 of the banks by size of assets held and in the first half of 2019, concedes one more position (outpaced by Municipal Bank). In the review period, the decline in the size of gross loan portfolio led the bank to concede one position in the ranking of the banks by size of loans, outpaced by BACB (in 2018). Taking the next position, International Asset Bank reports a steady growth of the portfolio and significantly shortens the gap with the rated bank. In the ranking by the amount of the deposit base (excluding deposits of banks), the rated bank yielded two positions in the first half of 2019 (effect of the decrease in the value of the resources), being outpaced by Municipal Bank and ProCredit Bank, which in the last three years witnessed a steady growth in deposits.

The basic banking and additional operating systems used by Investbank AD have sufficient capabilities to service all operational processes. Their maintenance is carried out in a systematic approach and in accordance with the Bank's Development Strategy, and they are used in a protected environment. Successful migration of the database of the merged bank has been reported.

During the review period, ***Investbank AD*** *maintained a relatively stable financial position, with significant growth in the proportion of non-performing loans in the portfolio, with a low level of revaluation coverage.*

Positive impact on the Bank's rating *could have the following: the steady increase of the operating result and the generated profit, allowing higher levels of accumulated impairments and improvement in the quality of the loan portfolio, as well as the successful realization of the acquired fixed assets (loan collaterals).*

Negative impact on the assigned rating *could have the shrinkage or realization of a negative operating and/or financial result, a decrease in the profitability, a further deterioration in the quality of loan portfolio and a deterioration of the capital adequacy and liquidity indicators.*

[2] two institutions at above places and two - at below places in the ranking by value of assets

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FINANCIAL STRENGHT RATING
„Investbank" AD
Long-term/Short-term rating: **B- / C**
Outlook: ***negative***
Long-term/Short-term national-scale rating: **B- (BG) / C (BG)**
Outlook: ***negative***

Main Financial Indicators:

(хил.лв.; %)		*6.2019*	*2018*	*2017*	*2016*	*2015*	*2014*
Balance Sum		1 982 976	2 122 039	1 954 129	1 916 189	1 955 963	1 913 558
Gross Loans		826 888	850 164	878 351	877 994	989 726	877 063
Equity		192 039	180 266	152 187	181 542	176 474	183 287
Total Interest Income		16 135	43 476	53 558	63 963	70 559	67 053
Net Financial Result		5 357	22 647	-29 333	1 038	1 633	1 606
Total Capital Adequacy	according to Ordinance *8 (repealed)*						21.41%
	According to CRD IV	19.45%	18.66%	16.58%	19.14%	18.70%	
Net Interest Margin		1.85%	2.15%	2.39%	2.07%	1.32%	0.48%
Return on Assets		1.22%	1.10%	-1.55%	0.05%	0.08%	0.09%
Gross Classified Exposures / Total Loans		39.22%	31.50%	29.28%	28.11%	22.41%	25.79%
Нетен коефициент на генериране на просрочия		9.71%	1.70%	1.64%	3.29%	-0.67%	-12.48%
Liquidity Ratio – according to Ordinance 11 *(repealed)*				37.47	35.90	34.47	35.17
Liquidity Ratio – *according to maturity ladder*		34.45	42.71				
Liquidity Coverage Ratio		329%	440%	538%	479%		

**Rating History:*

FINANCIAL STRENGHT RATING*	Update	Update	Update	Update
Date of Rating Committee:	12.10.2015	26.10.2016	22.11.2017	28.11.2018
Long-term Rating:	**B-**	**B-**	**B-**	**B-**
Outlook:	**stable**	**In development**	**stable**	**stable**
Short-term Rating:	**C**	**C**	**C**	**C**
Long-term National-scale Rating:	**B (BG)**	**B (BG)**	**B (BG)**	**B- (BG)**
Outlook:	**stable**	**In development**	**stable**	**stable**
Short-term National-scale Rating:	**C (BG)**	**C (BG)**	**C (BG)**	**C (BG)**

The ratings displayed in the table are assigned under the preceding Methodology for assigning a financial strength rating to banks and are not directly comparable with the ratings assigned after the entry into force of the current methodology as of September 2015

FINANCIAL STRENGHT RATING*	Initial Rating 4.2009	Monitoring 18.11.2009	Update 03.5.2010	Monitoring 07.12.2010	Update 25.5.2011
Long-term Rating:	**BBB-**	**BBB-**	**BBB-**	**BBB-**	**BB**
Outlook:	***stable***	***negative***	***stable***	***negative***	***negative***
Short-term Rating:	**A-3**	**A-3**	**A-3**	**A-3**	**B**
FINANCIAL STRENGHT RATING*	Monitoring 14.09.2011	Update 19.12.2012	Monitoring 10.05.2013	Update 18.12.2013	Update 13.10.2014
Long-term Rating:	**B+**	**B+**	**B-**	**C**	**B-**
Outlook:	***negative***	***negative***	***negative***	***stable***	***stable***
Short-term Rating:	**C**	**C**	**C**	**C**	**C**