

Bulgarian-American Credit Bank AD

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FINANCIAL STRENGTH RATING*	Review	Review
Date of Rating Committee:	16.04.2020	19.04.2021
Date of Publication:	17.04.2020	20.04.2021
Long-term rating:	BB-	BB-
Outlook:	stable	positive
Short-term rating:	B	B
Long-term National-scale rating:	BB+ (BG)	BBB- (BG)
Outlook:	stable	positive
Short-term National-scale rating:	B (BG)	A-3 (BG)

***Notes:**

- 1) To become familiar with the full rating history, please, see the table at the bottom of the document;
- 2) Prior to the present publication the credit rating and rating outlook was disclosed to the rated entity or related third party. Following that disclosure amendments in the credit rating and rating outlook have not been executed;
- 3) During the last 2 years, BCRA Credit Rating Agency AD has not provided ancillary services to the rated entity or a related third party.

BCRA – CREDIT RATING AGENCY (BCRA) is the third qualified rating agency in the EU, registered under Regulation (EC) No. 1060/2009 of the European Parliament and the Council. The credit ratings, assigned by BCRA, are recognized throughout the EU and are fully equal with the other ratings, recognized by European Securities and Markets Authority (ESMA), without any territorial or other limitations.

At a session of the Rating Committee held on **19.04.2021** a review of the report for the credit rating of **Bulgarian-American Credit Bank** has been discussed. The session was run by D.Sc. (Econ.) Kiril Grigorov, in his capacity as a Chairman of the Rating Committee. Following a discussion on changes in the factors affecting the rating during the review period, the members of the Rating Committee **took the following decision:**

„BCRA – Credit Rating Agency“ (BCRA)

- **affirms:** a long-term financial strength rating: **BB-** and **changes** the outlook from “stable” to “**positive**”;
- **affirms** a short-term rating **B** ;
- **upgrades** the long-term national-scale rating from BB+ (BG) на **BBB- (BG)** and changes the outlook from “stable “ to “**positive**” ;
- **Upgrades** the short-term national-scale rating from B (BG) to **A-3 (BG)**,

expressing the opinion on the sustainability achieved during the annual review and the consolidation of the positive changes - high growth rates of attracted funds and assets, improvement of financial results and profitability indicators, as well as maintaining stable levels of capital adequacy and liquidity.

The officially adopted by BCRA Methodology for assigning of a rating to a bank has been used: (https://www.bcra-bg.com/files/bank_methodology_2018_en.pdf)

The users of the rating can find information on the meaning of each rating category, including definitions of default in the published Global rating scale on the BCRA’s website:

(https://www.bcra-bg.com/files/global_scale_en.pdf).

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

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Operating Environment

Sovereign Risk

The emergence of the worldwide COVID-19 pandemic and addressing the issue turned into one of the main priorities in Bulgaria as well as in all its political and economic partners. The country was in a state of emergency from the 13th of March to the 13th of May 2020 due to the unprecedented crisis, and the government took a number of legislative measures to curb the negative economic impact.

The COVID-19 pandemic and the measures taken to limit the infection have adversely impacted the economic activity in the country. The preliminary annual data for 2020 show a decline in Bulgaria's GDP of 4.2% after an increase of 3.7% achieved in 2019. A significant slowdown has been observed in the dynamics of household consumption, lending, the external sector indicators, as well as in inflation processes. In 2020, the unemployment rate rose to 5.1% (from 4.2% a year earlier).

Bulgaria has entered the current crisis with a stable financial position and a low government debt level. According to the preliminary data of the Ministry of Finance, the forecasted balance of the CFP reached a deficit of BGN 3.5 billion or 3% of the projected GDP since the government provided financial aid to the sectors most affected by the crisis. The government debt rose to 24.7% of the GDP as of September 2020 due to the fiscal measures taken to overcome the crisis and the decline in GDP, however, remained low in a comparative aspect.

Banking System

On the 10th of July 2020, the Bulgarian lev was included in the Exchange Rate Mechanism II. In parallel, the ECB's decision to establish close cooperation with the BNB was announced. Starting October 1, 2020, the ECB commenced the direct supervision of the significant institutions in the Republic of Bulgaria. The Bulgarian banks that fulfil the criteria are UniCredit Bulbank AD, DSK Bank AD, United Bulgarian Bank AD, Eurobank Bulgaria AD, and Raiffeisenbank (Bulgaria) EAD.

Currently, the banking sector remains stable. The capital ratios and liquidity of banks are at high levels being supported by the steady growth of the deposit base.

Lending to the non-financial sector has been slowing down in the conditions of uncertainty during the first half of 2020, largely for enterprises. At the same time, under

the Procedure for Deferral and Settlement of Liabilities Payable to Banks and their Subsidiaries – Financial Institutions requests from households and enterprises for deferral of liabilities amounting to BGN 8,1 billion or 83.1% of the filed so far were approved as of end-June 2020, or 12.3% of the total gross loans and advances.

The profit generated in 2019 was high, thus, securing additional capitalisation and a reserve for maintaining the stability of the sector. Therefore, the BNB decided to fully capitalise that profit as one of the measures to further strengthen the capital of banks in the context of the crisis related to COVID-19. The reported financial result, as of the end of 2020, amounts to BGN 815 million lower by 51.4% on an annual basis. The net income from interests, fees and commissions retained their importance but at an annual decline in both sources. At the same time, the value of the impairments incurred doubled compared to the same period in 2019.

The development of economic processes in the country, including in the context of the pandemic of COVID-19, have been analysed in detail by BCRA - Credit Rating Agency. A Rating Rationale of the Sovereign Rating assigned by BCRA to the Republic of Bulgaria is available on our official website:

<https://www.bcra-bg.com/en/ratings/bulgaria-rating>

„Bulgarian-American Credit Bank“ AD

Shareholder Structure and Management

During the review period, there are no changes in the capital of the Bulgarian-American Credit Bank (BACB). There are minor changes in the shareholder structure, presented in the table below.

<i>Shareholder</i>	<i>Capital share</i>	
	<i>31.12.2020</i>	<i>31.12.2019</i>
CSIF AD	61.56%	61.56%
LTBI Holdings LLC	35.71%	35.70%
Other shareholders	2.73%	2.74%
Total:	100%	100%

In 2020, there is one change in the **composition of the Supervisory Board**, where Serge Lioutyi is exempted and replaced by Peter Atanassov. Currently, the Supervisory Board has the following members:

- Tzvetelina Borislavova Karagyozyova
- Martin Boichev Ganey
- Peter Georgiev Atanassov

The Management Board is unchanged:

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- Vassil Stefanov Simov – Chairman and Executive Director
- Ilian Petrov Georgiev – member and CEO
- Loreta Ivanova Grigorova – member and Executive Director
- Alexander Dimitrov Dimitrov – member and Executive Director
- Silvia Kirilova Kirilova – member and Chief Legal Advisor

The management of the Bank declares its intention to realise a sustainable development strategy and maintain the diversification of the loan portfolio. The Bank will be increasing the share of natural persons and SMEs, and provide exposures to corporate clients and sectors with stable indicators, such as renewable energy sources, financing of projects, approved under the operating programmes of the EU and expansion of the services and product range in segment.

The expected impact related to the COVID-19 crisis on the bank's activity is expressed in a possible deterioration of the portfolio's quality, a decline in the profitability, slowdown in lending, lower liquidity, reduction of the market value of securities portfolio and corporate investments, decrease of revenues from fees and commissions, as well as other revenues. A number of measures have been taken to limit the impact of the crisis on the Bank's operations. BACB is the first bank to sign an agreement and grant the first loans under the Bulgarian Development Bank program to support small businesses, affected by the pandemic.

Capital Adequacy

At the end of 2020, the **equity** of the bank, amounted to BGN 209 469 thousand, posting a growth of 5.9% on annual basis (lower by 8.1% compared to the one for the previous year) and preserving the financial results as the only growth drive.

Throughout the analysed period (2016 – 2020), the **capital base** followed a steady upward trend and at the end of the period (2020) posted a total accumulated growth of 24.2% compared to the end of 2016. The last two years marked higher growth rates (6.3% for 2020 and 6.8% for 2019 on annual basis), compared to the previous two years (with maintained rates of 4.4% and 4.8% respectively). The capital base of the bank is consisting only of Common Equity Tier 1 capital.

In 2020, the value of **risk-weighted assets** (RWA)

declined slightly (by 0.8%) following the substantial steady upward trend in the last four years of the reviewed period. The dynamic is formed in line with the reduced exposures, which are subject to risk weighting, impacted by the adjustments in risk treatment of some exposures, according to Regulation 2020/873¹ of the EU entered into force at the end of June 2020, in response to the COVID-19 pandemic. The structure of the RWA remains dominated by the exposures, subject to risk weighting with a minor decline of their share to 93.9% at the end of 2020 (94.9% a year earlier).

The increase of the capital base and the slight decline of RWA result in a rise of the level of the **capital adequacy** (equal to the total capital and Tier 1 capital) up to 16.3% at the end of 2020 (15.3% a year earlier). In a comparative aspect, the Bank remains significantly below the average levels of the banking system and the banks in Group II in the review period.

The increase of the value of assets outpaces the increase of the equity and the well-maintained upward trend in the **non-adjusted levels of the leverage**. The level of the indicator of 8.92, reached in 2020, is already above the averages for the banking system (8.08) and banks in Group II (7.87).

The positive decline from the previous four years (2016-2019) in **non-performing exposure to the capital base ratio** (74.4% at the end of 2019) continued in 2020, and at the end of the year declined to 72.0%. The continuous increase of the capital base and the decline of non-performing exposures have a one-way impact on the adjustment. In comparative terms, the level of the ratio remains significantly above the average level of the banking system (14.5%) and the banks in Group II at the end of 2020. A negative positioning below the constant decelerating average levels of the system is observed during the entire period of five years (2016-2020).

The level of **return on equity (RoE)** was declining in the last year (2020), with decelerating pace (from 7.5% to 6.3%) compared to the system (from 11.8% to 6.3%) and particularly to the banks in Group II (from 9.4% to 1.5%). The level reached is close to the system's average (improved) and is slightly higher than the average for the banks in the reference group².

During the five years of the review period, the Bank maintains a minimal downward trend in the **Leverage levels for supervisory purposes**, which however

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:L:2020:204:FULL&from=EN>

² Municipal Bank, Investbank, International Asset Bank and D Commerce Bank

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remain considerably above the required minimum.

Resources

The last financial year (2020) is characterized by continued **growth in the funds attracted by BACB** (by 12.5%), which is lower than the rates registered in the previous two years (18.7% for 2019 and 16.4% for 2018, respectively). The increase registered in 2020 is ahead of the reported total for the banking system (8.8%), while the banks in Group II registered a decrease (of 6.7%) of the total deposit base (after a slight downward trend in the previous two years).

The **structure of attracted funds** (consisting of deposits) is already dominated by deposits of corporate clients (with a share of 54.9% at the end of 2020, after 48.6% a year earlier), while deposits from individuals and households account for a share of 42.7% (48.5 % at the end of 2019). Deposits from credit institutions remain insignificant (2.3% at the end of 2020). At the end of 2020, the decreased level of retail deposits (43.8% of total deposits from individuals and non-credit institutions) is far from the level of the banking system (62.2% at the end of 2020 and 62.7 % at the end of 2019). For a second consecutive year, the share is below the average levels of the banks in Group II (55.7% and 58.4%, respectively). In terms of the maturity structure of the deposit portfolio, at the end of 2020, sight deposits prevailed with a share of 51.1% in the total value of deposits from non-financial institutions (46.2% at the end of 2019). The dynamic is due to the increased volume of the corporate portfolio, dominated mainly by **sight deposits** (84.9% at the end of 2020) however, the attracted funds from individuals remain strongly dominated by time deposits (with a share of 86.2 % by the end of 2020). The BGN component dominates the deposit base with a share of 51.9% at the end of 2020.

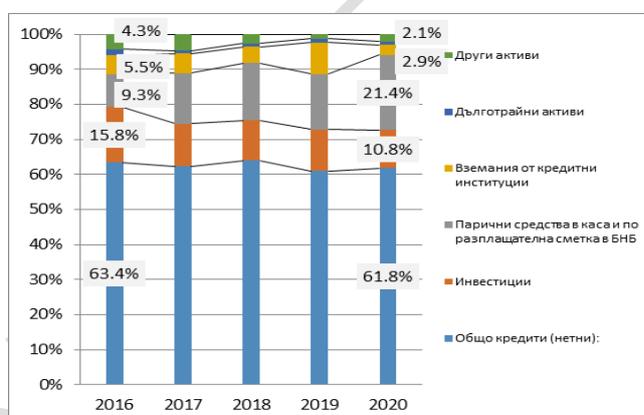
In the review period, the deposit base of the Bank has a relatively high concentration.

Asset Quality

For the review period, the *total value of assets* of BACB continued to report steady growth, which for a fourth consecutive year preserves levels above 10% on an annual basis. At the end of 2020, the increase of assets is due to all types and groups of the bank's assets, except for the less dominant in the structure - Receivables from credit institutions and fixed assets. The largest contributors to the increase of assets are *Cash and cash balance in the current account with the BNB*, with an increase of 51.8% (BGN 136.6 million in nominal terms), as well as loans with an annual growth of 11.9%

(gross) or BGN 132.3 million nominal increase. *Investments* also increased but less - by BGN 4.8 million (by 2.4% per annum), and remained in third place (by 10.8% share) in the *structure of assets*, dominated by loans (net) by 61.8% share, followed by of *Cash and cash balance with the BNB*, which have a relative weight of 21.4%.

Chart № 1: Asset Structure of BACB in the period 2016 - 2020



The size of the **Gross loan portfolio** increases throughout the whole review period, stabilizing its high growth at about and above 10% yearly – 11.9% in the last year, compared to 9.6% in 2019. These growth rates are constantly higher than the average for the banking system – 4.8% in 2020 (8.8% in 2019) and the reference group.

In structural terms, there are no changes in the main features of loans, due to the profile of the bank, which is corporate, namely – maintaining in the loan structure a significant share of 81.8% of *loans to enterprises* and gradual acceleration of the growth of retail loans with a share of over 15% of the portfolio (16.9%, 12.4% in 2019).

BACB has a well-diversified corporate loan portfolio by sectors.

The amount of *non-performing loans* at the end of 2020 preserved the constant downward trend, albeit at a slower pace, compared to the previous years – 1.3% for 2020, 6.6%, and 9.0% in the previous two years. The ratio of *non-performing loans in the gross loan portfolio* also maintains a steady descending trend, which marks the whole review period – a decline from the high rate of 36.5% for 2016 to the much lower of 17.5% at the end of 2020, and 19.8% for 2019. In 2020, the improvement of this indicator, which is most important for the quality of assets, is due to both, the reduction of non-performing loans and largely, to the

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high growth of gross loans. In structural terms, most of the "inherited" loans continue to stand out - 64.0% of the bad loans at the end of 2020 were disbursed until 2011, but progressively reduced compared to previous years - 76.5% for 2019 and 83.5% for 2018.

At the end of 2020, the *coverage of the gross loan portfolio with impairments* remains significantly higher than the average for the banking system and that for the banks of the second group. However, *the coverage of classified loans by total impairments* for 2020 continues to be much lower than that of the compared groups and with a slight downward trend.

The share of the biggest loan exposures registers a slight decline, however remains high, and is forming a certain concentration.

Quality of Income

For 2020, the Bulgarian-American Credit Bank reported a high increase in the amount of operating profit (at 32.4% annual growth for 2019) to BGN 33,407 thousand, which is the highest registered value for the last 5 years. The result is due to the favourable changes in the three main groups of its basic elements: increase in net interest income by 5.4% for the year, with a stronger increase in non-interest income - by 26.2%, as well as a decrease in operating expenses by 18.3%.

The net interest income slightly decelerates the growth from the previous year (11.8%), due to a greater extent of the reduction of the interest expenses (by 16.3%) at a lower growth of the interest income – 2.1% rate. The general trend reported on average for the banking system is a decline of the income (of 3.5%), as a result of the shrinkage of income from interests (-0.3%) and growth of interest expenses (+23.4%), placing the bank at a favourable position in comparative terms.

Non-interest income posts high growth of 26.2% annually, influenced by other operating revenues and net gains, resulting from the write-off of financial assets, rather than from main interest income, namely *from taxes and commissions*. The net income from taxes and commissions posts an annual decline of 3.3%. The decelerating trend is lower than the one for the banking system (-6.1%) and reflects the amendments in the regulatory framework.

For 2020, the net financial result of Bulgarian-American Credit Bank is a profit of BGN 12,895 thousand, a decrease of 9.9% compared to the profit for 2019 - BGN 14,317 thousand. In addition to the significantly increased operating result and lower operating

expenses, the dynamics of the financial result (following the operating) are influenced by the contributions to restructuring funds and deposit guarantee schemes (reported in the previous year as an expense in the operating result), and the robustly increased impairment expenses - with an increase to BGN 9.0 million (compared to BGN 3.3 million in 2019).

In 2020, the steady downward trend in *the return on interest-bearing assets* of BACB continues - up to 3.52%, but the value of the indicator from 2017 is steadily higher than the average for the banking system and the banks in Group II (3.20% for both groups in 2020).

The *price of the interest-bearing liabilities* also decreased, which characterises the entire analysed period, and in the last year, declined - by 0.15 pp. to 0.40%. Thus, the bank is already much closer to the lowest average values for the system from previous years, and in the last year, the indicator is by 0.05 pp. higher (with a difference of more than 1.5 pp. at the beginning of the analysed period).

The indicators *Gross interest spread and Net interest margin* were declining in the last two years – to 3.12% and 3.08%, respectively. This is a result of the stronger rise of the profitable assets to the interest income. Despite that, for the second year in a row, the values of both indicators are higher, compared to the banking system and the banks in Group II (on average by 0.3pp.), while at the beginning of the period, lag with a higher rate by 0.8 pp.

In terms of the indicator *Return on assets*, which registered the highest value of 0.95% in 2019, the bank lagged behind the average levels for the banking system 1.53% and the banks in Group II. In 2020, despite the reported decline to 0.75%, the bank has positioned favourably for the first time, compared to the strongly decreasing average rate of the banking system – to 0.69% and 0.19% for the banks in Group II.

The **favourable trends** of the profitability indicators **continued over the last year**. On the one hand, the Bank remained well-positioned by most of the indicators related to the return on assets and interest spreads (gross or net) while on the other – indicators connected to the non-interest income (incl. net fees and commission income) have been lagging. The rest of the indicators have been converging to the system's average under the combined influence of different factors through the analysed period. The total assets have constantly grown at a decline in the interest-

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bearing share in the last two years, and the increased impairment expenses have influenced the net profitability dynamics.

Liquidity

In terms of the **liquidity coverage (LCR) for supervisory purposes**, the Bank maintains the downward trend that characterises the entire review period (2016-2020), resulting from the steady growth in net outflows, which is not offset by the increase of the liquidity buffer. The level of the indicator is above the minimum required, and at the end of the period, the value is the lowest for the last five years (1.39).

In 2020, the Bank reported an increase of the **current assets held** (by 10.0% on an annual basis, following the significant rise of 38.6% for the previous year), as a result of the significant increase in cash and cash balances with central banks (by 51.8% in 2020, 13.8% for 2019). Thus, in structural terms, the share of cash became highly dominant in current assets - 87.9% at the end of 2020 (63.7% a year earlier).

After the gradual growth in four years in a row to the end of 2019, in 2020, there was a slight reduction in the level of **Current assets to attracted funds** ratio. Thus, the Bank is positioned below the averages of the banking system and the banks in Group II, while compared to the

reference group the ratio lags significantly behind the Municipal Bank and International Asset Bank and is slightly above the levels of the other two banks in the group, namely, Investbank and D Commerce Bank.

In the review period, **total loans to total deposits** remained declining (relatively marginal by 1.5 pp.), the value reached in 2020 was above the average levels of the sector (a decline by 2 pp. to 59% in the last year) and is significantly above the levels of the banks in the reference group.

Size and Systems

In the period of update, the BACB does not change its position compared to the other banks³ in the system by the **size of assets and loan portfolio** (although moved one place ahead, as a result of the consolidation process in the system). In terms of **attracted deposits**, the Bank lags behind one position, outpaced by International Asset Bank, which realized significant growth of the deposit base in 2020.

The Bank has sufficient information products and systems, allowing secured and reliable maintenance of databases and constant service of key processes. The management declares in continuing the investments to improve the quality, capabilities, and security of the bank's IT infrastructure.

During the period, the Bulgarian-American Credit Bank AD continues to report improvement in the activities and the results achieved. In addition to the positive trends of most indicators, the bank is in a favourable position compared to the average levels of the banking system.

A positive impact on the Bank's rating could have the following: a steady improvement of the quality portfolio, increase in the generated profit and income indicators while maintaining stable levels of capital adequacy and liquidity.

A negative impact on the assigned rating could have a deterioration of the quality of the loan portfolio and a considerable decline in the capital adequacy and liquidity indicators due to the adverse effects on bank's customers related to the COVID-19 pandemic.

³ According to BNB data

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Main financial Indicators:

(BGN'000; %)	2020	2019	2018	2017	2016
Balance Sum	1 869 029	1 670 726	1 420 303	1 240 099	1 072 892
Gross loans	1 240 931	1 108 642	1 011 311	887 697	806 712
Equity	209 469	197 730	182 960	176 285	168 171
Total interest income	47 705	46 716	42 803	39 064	38 098
Net financial result	12 895	14 317	12 202	7 830	5 952
Total capital adequacy	16.34%	15.25%	16.14%	18.35%	19.17%
Net interest margin	3.08%	3.25%	3.27%	3.01%	3.03%
Return on assets	0.75%	0.95%	0.93%	0.67%	0.57%
Gross non-performing loans / Total loans	17.47%	19.81%	23.25%	29.12%	36.50%
Net ratio of arrears generation	-0.32%	-2.01%	-3.71%	-7.05%	-3.01%
Liquidity coverage ratio	139%	183%	192%	258%	262%

***Rating History:**

FINANCIAL STRENGTH RATING	Initial rating	Review	Review	Review	Review
Date of Rating Committee:	26.07.2016	25.07.2017	26.07.2018	15.04.2019	16.04.2020
Date of Publication:	27.07.2016	26.07.2017	30.07.2018	17.04.2019	17.04.2020
Long-term rating :	B	B+	B+	BB-	BB-
Outlook :	stable	stable	positive	stable	stable
Short-term rating :	B	B	B	B	B
Long-term National-scale rating:	B+ (BG)	BB- (BG)	BB (BG)	BB+ (BG)	BB+ (BG)
Outlook:	stable	stable	positive	stable	stable
Short-term National-scale rating:	B (BG)	B (BG)	B (BG)	B (BG)	B (BG)