

„Bulgarian American Credit Bank” AD

July 2016

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FINANCIAL STRENGTH RATING*	Initial Rating 26.07.2016
Long-term rating:	B
Outlook:	stable
Short-term rating:	B
National-scale long-term rating:	B+ (BG)
Outlook:	stable
National-scale short-term rating:	B (BG)

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

„BCRA – Credit Rating Agency“ (BCRA) assigns to „Bulgarian American Credit Bank” AD (BACB) the following ratings:

- Long-term financial strength rating: **B**, outlook: „**stable**”, short-term rating: **B**;
- National-scale long-term rating: **B+ (BG)**, outlook: „**stable**”, national-scale short-term rating: **B (BG)**.

BCRA uses the methodology, which is officially adopted for assigning bank financial strength ratings (http://www.bcra-bg.com/files/file_66.pdf).

To elaborate the report and assign the rating, the information, provided by the rated bank, BNB, NSI, BCRA’s database, consultants and other sources of public information is used.

The political situation at the time of preparation of the

report is characterized by momentary stability. The existence of disagreements in the ruling coalition during the parliamentary sessions causes problems when considering and voting on important questions. There is social unrest because of ambiguity and disagreement with what is happening in the political circles, as well as readiness for rapid response in the form of protests.

During October 2015, local elections were held in Bulgaria which did not lead to significant shifts in the political layers, at the same time the position of GERB strengthens at the level of local government in the country.

During 2015, the economy of the country reported a 3.0% real growth, as the greatest contribution has the export of commodities and services sustained by an increase in ultimate consumption. The reported real growth in GDI for the last year is nearly twice higher than the reached for the last two years – respectively 1.6% for 2014 and 1.3% for 2013.

During 2015, the flow of investments in the country increased compared to 2014 (by Euro 0.290 billion to Euro 1.575 billion) after the decrease observed in the interest of foreign investors following 2012, and more considerably – during 2014 after the increased uncertainty in the economic environment.

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During 2015, the favorable changes in the labor market remain the same - the unemployment rate (as well as the continuous unemployment as a percentage of the active population) maintains its downtrend after 2013.

During 2015, the deflationary processes (observed during 2014) remain the same. They are due to a decline in the international petroleum prices, weak economic activity in the region and in the country, as well as in internal economic developments in the major trading partners of Bulgaria.

The government budget improves slightly in 2015, reporting overstocks by October (included), but at the end of the year (November and December) reports a considerable deficit.

The government debt increases again in early 2016, after gaining certain stability and even reduction (presented as ratio debt-GDP) after the second half of 2015.

At the time of preparation of the report, the banking sector in Bulgaria is characterized by the following:

- Maintaining sustainable growth in the amount of deposits;
- A significant decline in lending;
- An ascending trend of net interest margin;
- Discontinuance of the ascending trend of the classified (non-performing¹) loans;
- Fluctuation in the value of the assets of the banking system through a decline during 2014 and an increase during 2015;
- The uptrend of bank profits continues.

During August 2016, a result should be announced of the review of assets and stability tests in the banking sector.

„Bulgarian American Credit Bank“ AD (BACB) is specialized in providing secured finance to small and medium enterprises and individuals.

The bank is registered in Sofia City Court under company file 12587/1996, account №35659, volume 397, register I, p. 180. It is registered as an issuer of publicly offered bonds in the Register of public companies and other issuers of securities of the Supervision Financial Commission.

The shareholding structure of BACB at the end of 2015 is the following:

<i>Shareholder</i>	<i>Share of the capital</i>
CSIF AD	61.43%
LTBI Holdings LLC	35.04%
Other Shareholders	3.53%
Total	100.00%

At the end of 2015, the bank has participations in the following companies:

<i>Company</i>	<i>Owned share of the capital</i>
„Capital Direct“ EAD	100.00%
„BACB Trade“ EAD	100.00%
„ERG Capital – 3“ ADSIP	4.60%
„Bulgarian Stock Exchange – Sofia“ AD	0.30%

„Bulgarian American Credit Bank AD has a two-tier management system, incl. Supervisory Board and Management Board. Their compositions at the time of assignment of the rating are as follows:

Supervisory Board:

- Tsvetelina Borislavova Karagyozova;
- Martin Boychev Ganey;
- Jason Lyle Cook.

Management Board:

- Vasil Stefanov Simov – Chair of Management Board and Executive Director;
- Ilian Petrov Georgiev – Member of the Management Board and Executive Director;
- Loreta Ivanova Grigorova – Member of Management Board and Executive Director;
- Silvia Kirilova – Member of Management Board.

The mission of BACB is directed to providing innovative financial decisions based on three interconnected and interdependent priorities: green banking, social banking and sustainable banking.

The main aims in the strategy are connected with establishment of a stable funding model, stable management of liquid position, adequate development of credit operations, reduction of illiquid and unprofitable assets, improvement of profitability and market share.

The levels of total capital adequacy of BACB decrease by 4.5 p.p. for the period 2011-2013. As a result of the indicated dynamics of maintained higher values compared to the average for the banking system

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(17.53%) and the banks from the second group (16.85%), at the end of 2013 these of the bank are lower than the average for the system (16.85%) and for the banks from second group (17.82%). As a result of changes in the regulatory framework, the trend has been overcome in 2014 and the total capital adequacy of the bank is higher than the average values for the banking system (21.95%) and the banks from the second group (24.07%). At the end of 2015, the level of total capital adequacy is very close to the average values of the system (22.18%) and the banks from the second group (21.25%), whereas at the end of March 2016, the value of the total capital adequacy of the bank slow down in a comparative aspect.

For the last five complete years, an ascending trend in the values of the non-adjusted and adjusted leverage of the bank has been observed. During the years until 2014 it is mainly due to the decline in equity, and for 2015 to the faster increase in the size of the assets. For the first quarter of 2016, as a result of the faster increase of equity compared to the assets, a decline in the leverage values is reported. In a comparative aspect by 2013 the levels of the adjusted leverage of the rated bank are lower than the average for the banking system, during 2014 it is much close to the average for the system, and for 2015 and first quarter of 2016 the increased values for the rated bank exceed considerably the average for the system.

The return on equity of the bank during the years from the beginning of the analysis by the end of 2014 is in the area of negative values due to the generated annual loss. Over the years, the negative financial result has reduced from BGN 37.96 millions for 2011 to BGN 8.93 for 2014. This dynamics leads to reporting of less negative values for the indicator Return on equity (from -20.8% for 2011 to -5.6% for 2014). The realized profits in 2015 and the first quarter of 2016 (BGN 824 thousand and 539 thousand) turn the trend and lead to the reporting of positive levels of the indicator (0.41% and 2.46%). In a comparative aspect, during the analyzed period (2011 - 03.2016), the values of the indicator are lower than the average for the system and the banks from the second group.

Irrespective of the decreasing value of the ratio equity to total sum of the assets, the bank takes a favourable position in a comparative aspect reporting higher values than these of the banking system and banks from the second group.

Over the last five complete years, the resource base of the bank reports a considerable growth in its total size,

increasing cumulatively by 56.4%. In a comparative aspect, the reported growth considerably exceed the banking system (18.0%) and the banks from the second group (12.0%). By separate positions the following changes are available – a cumulative growth of individuals and households (156.4%) and of deposits of non-credit institutions (149.8%), whereas of deposits of credit institutions and other borrowings a decline is observed (79.2% and 83.5%).

During the first quarter of 2016, the size of the resource base decreases considerably (0.4%).

During the period under review, large changes in the structure of borrowings haven't been observed, as it is dominated by borrowed deposits. During the period the deposits of individuals and households have the highest share, as their share varies from 60% to 70%. The second position is taken by deposits from non-credit institutions whose share is in the range from 26% to 34%. The share of deposits of credit institutions is characterized with relatively low levels over the entire period. In a comparative aspect, the structure of the resource base of the bank is similar with the resource base of the banking system and banks from the second group, as the share of deposits of physical persons of BACB is a little bit higher than the average for the sector and the bank from second group, and the shares of the deposits of non-credit and credit institutions are a little bit lower. During the first quarter of 2016, the structure of borrowings remains the same.

During the entire period, the currency structure of the deposits is dominated by deposits in currency different than BGN as their share decreases from 66.1% at the end of 2011 to 56.6% at the end of March 2016.

Regarding the maturity over the reviewed period, leading by share in the structure of deposits of non-credit institution and physical persons are the term deposits as their share decreases from 94.4% at the end of 2011 to 78.3% at the end of the first quarter of 2016.

During the period under review, there is relatively moderate concentration in the resource base and deposit base of the bank, as the shares of the 15th largest investors is characterized with volatile levels. During the period, the bank is financed mainly with borrowings from retail banking (RB) as its share in the overall resource varies from 75% to 87%.

To implement its activity, the bank uses the following funding sources:

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- Customers deposits;
- Debt securities;
- Loans from international banks and loans from international financial institutions;
- Loans under European programmes and financial institutions;
- Credit lines under partnership programmes.

For the period from 2011 to the end of 2015 the total sum of the assets of BACB increases by 35.4%. For the same period, the total sum of the bank assets reports corrected¹ growth of 20.3% and non-corrected – 13.9%. For the first three months of 2016, the change compared to the end of 2015 for the bank is insignificant – a minimum decline of 0.2%, compared to a decline of 0.4% for the banking system and growth of 2.3% for the banks from the second group.

The loans (~57%) have the largest share in the asset structure as the corporate loans dominate. BACB maintains a well diversified credit portfolio by sectors. Concerning the term structure of the credit portfolio of the bank a gradual increase is observed in the maturity of the loans in the prevailing corporate sector. In the structure of credit portfolio by residual size of loans is observed a change towards increasing the size of loans, with characteristics of a corporate portfolio as the diversification is very good during the entire period. The most significant of the characteristics of the loans portfolio with worse quality is that at the end of March 2016, 96.1% of all non-performing loans are loans given in the period until 2011 (incl.). It means that nearly 3.9% of the sum of the non-performing receivables are loans given after 2011 – this is the year during which the majority shareholder of the bank is changed. Comparatively, the share of worse loans of the bank exceed considerably the loans for the banking system and the banks from second group, as in spite of the fact that during the period there is an increase in the exceeding, at the end of the period the share of the impaired portfolio of the bank is ~2 times higher than the average for the system and for the banks from second group. At the end of 2015, the share of the 15th largest credit exposures amounts to 38% of the gross credit portfolio that shows presence of concentration in this respect.

A considerable growth over the period report the investments leading to an increase of their share in the

asset structure. Since 2014, the main share in the investments is taken by Debt instruments (~60%), as they are formed entirely by investments in government securities. The capital instruments and investments in associated, daughter and joint companies take an insignificant share during the entire period of the analysis.

An increase for the period is observed with Cash in hand and on current accounts in BNB, as their share in the asset structure also increases, as comparatively, it is lower than the average for the banking system. At the end of 2015, the increased liquidity of the banking system lead to introduction of negative interests for excess reserves in the central bank.

In the asset structure of the bank, there is a decline in the receivables from credit institutions which leads to a decline of their share in assets, as in a comparative aspect it is lower than the average for the banking system.

For last five years, BACB reports the highest value of return on interest bearing assets at the beginning of the period (2011), then during 2012, a decline is reported in the value of the indicator. Over the next three years, there is an increase in the value of the indicator. Over the first quarter of 2016, there are no considerable changes in return on interest bearing assets (a decline of 0.08 p.p.) and their value at the end of the period amounts to 5.07%, as in a comparative aspect it continues to be higher than the average for the banking system (4.89%) and the banks from the second group (4.79%).

After 2011, the rate of interest liabilities decrease by 3.33 p.p. over the next years and reach to 2.39% at the end of 2015. During the period 2011–2015 the average values of the rate of the interest liabilities for the banking system and the banks from the first group also report a decline (2.17 p.p. and 2.38 p.p.) and reach 1.19% and 1.50% at the end of 2015. During the first quarter of 2016, the rate of interest liabilities continues to decrease (by 0.36 p.p.) and its value at the end of the period amounts to 2.03%, as in a comparative aspect continues to be higher than the average for the banking system (1.03%) and for the banks from the second group (1.25%).

During 2012, the value of gross interest spread of BACB decreases by 1.62 p.p. compared to the past year

¹ The correction is related to take out the assets of Corporate Commercial Bank AD for the period 2011-2013, after they have been taken out from the banking system for 2014.

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(0.70%) and reports a negative value of 0.92% at the end of the year. As a result of the positive changes (an increase of the return of interest bearing assets and decrease and of the rate of interest liabilities) during the next years the gross interest spread reports constant growths and amounts to 2.76% at the end of 2015. In a comparative aspect, the values of the gross interest spread of the bank over the last five years are lower than the average for the banking system and the banks from the second group. The trend remains the same over the first quarter of 2016.

The dynamics is similar with net interest margin. A significant decrease is reported in 2012 and its value amounts to 0.28% at the end of the year. Over the next years, net interest margin reports permanent growths and amounted to 2.60% at the end of 2015. The average values of net interest margin decrease by 2013 for the banking system and by 2014 for the second group from banks, then there is an increase, and at the end of 2015 they amount to 3.75% and 3.41%. In a comparative aspect, the values of the bank over the past five years are lower than the average for the banking system and the banks from the second group. During the first quarter of 2016, the higher increase in gross interest spread of BACB compared to these of the average values of the banking system and the banks from the second group lead to further reduction of the differences.

During the first four years of the period 2011-2015 the bank reports a negative financial result, as on an annual basis a decline is reported (and its value of BGN -37 966 thousand (for 2011) reach BGN -9167 thousand (for 2014). During 2015, a positive financial result is reported in the amount of BGN 814 thousand. As a result of the dynamics the return on assets is characterized by negative values from 2011 (-5.28%) to 2014 (-1.19%), and for 2015 it amounts to 0.09%. During the first quarter of 2016, the positive trend started in 2015 maintains, as the value of the indicator increases by 0.32 p.p. and amounts to 0.41%. The significant increase is in line of the realized profit for the first quarter of 2016 (539 thousand). In a comparative aspect, during the period under review, the return on assets of the BACB is lower than the return on assets of the banking system and the bank from the second group as over the years the reported differences decrease.

During 2011, BACB reports a considerable decrease in the operating profit. The decline is mainly due to lower interest incomes, that is mitigated by higher other operating incomes. As a result of the considerable depreciations a loss is realized. Over the next 3 years

(2012, 2013 and 2014) the bank realizes a negative operating result (mainly in line of the decreasing interest incomes) and nevertheless of the decreasing expenses for depreciations, it continues to realize a loss from its activity. During 2015, as a result of the increased interest incomes on a yearly basis (13.2%), the decreased interest expenses (10.2%) and the increase in the realized net profit from financial assets and liabilities, defined by fair value in the profit or loss (77.3%) the bank realizes an operating profit. The lower expenses for depreciation of the financial assets (a decline of 32.6%), the lower size of the reported expenses for depreciation of non-financial assets and realized profit from non-current assets and groups of assets for disposal allow the bank to report a positive financial result for first time during the last five years. During the first quarter of 2016, the positive trend since 2015 remains the same, as an operating profit is reported (an operating loss for the first quarter of 2015). The reported positive operating result is in line of the increased incomes from interests (10.5%), decreased expenses for interests (38.4%) and decreased administrative expenses (13.9%), compared to the same period of the past year. The positive effect partially is mitigated by higher other operating expenses. The realized operating profit, lower expenses for depreciations and lower profit from non-current assets and groups of assets for disposal aid, during the first quarter of 2016, a net profit in the amount of BGN 539 thousand (a net loss of BGN 2 659 thousand for the first quarter of 2015) to be realized.

In a comparative aspect, over the last five years the values of the indicator operating profit to average assets are lower than the average for the banking system and banks from the second group. At the end of the first quarter the difference compared to the system amounts to 1.53 p.p., and compared to the banks from the second group to 0.58% p.p.

During 2011, insignificant growth of the share of the equity in liabilities and equity of BACB as the value is the highest for the last five years. Over the next four years a decrease is reported in the value of the indicator as the decrease is mainly in line of the decreasing equity as a result of the realized loss, whereas in 2015 is a result of the faster growth of the liabilities and equity (24.42%) compared to the decrease of equity (2.04%). In a comparative aspect, over the entire period, the value of the indicator of the bank is higher than of the banking system and the banks from the second group.

The liquidity ratio reports its highest value at the beginning of the period, and the lowest value at the end of 2014. Comparatively, by the end of 2013, BACB maintains higher liquidity levels compared to the average for the banking system and the banks form the second group and lower for the rest of the period.

The level of the indicator total loans to total deposits exceeds 100% during the first two years of the period.

BNB has recommended the ratio liquid assets under the Ordinance 11 to borrowings from individuals and households and institutions different than credit institutions to be at least 20%. BACB exceeds considerably the indicated level.

By size of assets during the past two complete years (2014 and 2015) BACB AD has ranked 16th (out of total 21 banks included² in the ranking).

By size of gross loans for past two years the bank ranks 14th.

By size of borrowed deposits, the bank repeats the ranking by size of assets occupying the 16th position at the end of 2014 and 2015.

Positive influence on the rating of „Bulgarian American Credit Bank” AD might cause stable improvement in the quality of the portfolio, increase in the generated profit and profitability indicators, keeping the stable capital adequacy and liquidity.

Negative influence on the rating might cause deterioration in the asset quality, increase in the expenses for depreciation, considerable reduction in the activity, as well as decrease in capital adequacy and deterioration of the bank's liquid position.

Main Financial Indicators

(thousand BGN)	3.2016	2015	2014	2013	2012	2011
Balance Sum	1 015 766	1 017 537	815 298	777 729	827 222	751 378
Equity	162 661	161 944	155 628	165 656	177 059	196 839
Total Interest Income	9 398	37 117	32 790	33 778	35 119	47 607
Net Financial Result	539	814	-9 167	-15 996	-19 807	-37 966
Net Interest Margin	2.89%	2.60%	1.78%	0.84%	0.28%	2.31%
Return on Assets	0.41%	0.09%	-1.19%	-2.00%	-2.45%	-5.28%

² In ranking by size of assets, loans and borrowings, the affiliates of foreign banks in Bulgaria and Bulgarian Development Bank /BDB/ do not participate.