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Research Update:

Allied Irish Banks 'BB/B' Ratings Affirmed Despite Large 2013 Pretax Loss; Outlook Remains Negative

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Overview

- Allied Irish Banks PLC (AIB) reported weaker 2013 earnings than we expected, reflected in a pretax loss of €1.7 billion on the back of high loan impairment charges.
- We now estimate that AIB's year-end 2013 risk-adjusted capital (RAC) ratio will be well below the 3% threshold to which we ascribe a "weak" capital and earnings assessment.
- However, we acknowledge the financial flexibility afforded by the €3.5 billion of preference shares that AIB issued to the Irish government.
- We are therefore affirming our 'BB/B' long- and short-term counterparty credit ratings on AIB.
- The negative outlook reflects what we see as the lack of certainty on the scale and timing of a potential recovery in AIB's capitalization by our measures.

Rating Action

On March 7, 2014, Standard & Poor's Ratings Services affirmed its 'BB/B' long- and short-term counterparty credit ratings on Allied Irish Banks PLC (AIB). The outlook is negative.

In addition, we affirmed our 'BB/B' long- and short-term counterparty credit ratings on AIB's wholly owned subsidiary AIB Group (U.K.) PLC. The outlook on AIB Group (U.K.) is negative.

Rationale

The affirmation follows AIB reporting weaker 2013 earnings than we expected, reflected in a pretax loss of €1.7 billion on the back of high loan impairment charges. We now believe that AIB's year-end 2013 risk-adjusted capital (RAC) ratio will be well below the 3% threshold to which we ascribe a "weak" capital and earnings assessment. We have not lowered our long-term rating on AIB at this time because we believe that the bank has some financial flexibility arising from the preference shares that it issued to the Irish government, which we do not include in our capital calculations. We understand that the Department of Finance has indicated that it will enter into discussions with AIB in 2014 regarding its future capital structure, including the potential conversion of the preference shares into equity.

We estimate that AIB's 2013 RAC ratio will be well below the 3.0% we calculated at year-end 2012. This decline reflects our view that the large loss in 2013 will be only partly offset by what we expect to be lower Standard & Poor's risk-weighted assets as AIB's loan book fell in 2013. We note that AIB's regulatory ratios appear stronger than our RAC ratio. On Dec. 31, 2013, AIB reported a core Tier 1 ratio of 14.3% and an estimated fully loaded common equity Tier 1 (CET1) ratio of 10.5%. The CET1 ratio includes AIB's preference shares on a transitional basis. We estimate that in 2014, common equity would have to increase by about €1 billion for the year-end 2014 RAC ratio to be comfortably above our 3% threshold. This assumes no benefit from retained earnings or any movement in Standard & Poor's risk-weighted assets.

AIB's 2013 earnings performance was mixed, in our view, and weaker than we had expected. On the one hand, reported total operating income before exceptional items improved to €1.9 billion in 2013 from €1.4 billion in 2012. This primarily reflected an improvement in AIB's net interest margin to a reported 1.37% in 2013 from 1.22% the year before. (These figures exclude the impact of fees paid in relation to the Irish government's eligible liabilities guarantee.) AIB's operating expenses also fell, and therefore AIB has been able to report a pre-provision operating profit before exceptional items of €445 million in 2013, compared to a loss of €324 million in the prior year. We note that this level of operating performance is still quite weak compared to AIB's higher rated peers, although we project a further improvement in 2014 on the back of higher margins and a further fall in operating expenses.

On the other hand, AIB's impairment provisions remained elevated at €1.9 billion in 2013, down from €2.5 billion in 2012. The reported loan loss rate was a high 2.24%, down from 2.57% in the prior year. AIB has stated that in arriving in its impairment charge, it took into consideration the Central Bank of Ireland's Balance Sheet Assessment (BSA). We assume that impairment charges will be lower in 2014, in part because AIB has substantially applied the BSA and because the Irish economy and property markets are improving. However, we are uncertain about the pace and degree of improvement in AIB's loan portfolios.

Outlook

The negative outlook reflects what we see as the lack of certainty on the scale and timing of a potential recovery in AIB's capitalization by our measures.

We could lower the ratings if we do not project AIB's RAC ratio to be above 3% by year-end 2014. We would most likely reflect this projection in a downward revision of our capital and earnings assessment to "very weak" from "weak."

We could revise the outlook to stable if we observe a strong improvement in AIB's capitalization, combined with a robust recovery in its asset quality.

Finally, we note the European authorities' intention to avoid future bank bail-outs (government support) by using bail-ins (burden sharing with investors, potentially including senior unsecured obligations). We continue to monitor developments, and by end-April 2014 we plan to review our ratings on European banks such as AIB that benefit from systemic support. For more information, see "Standard & Poor's to Review Government Support in European Bank Ratings," published March 4, 2014, on RatingsDirect.

Ratings Score Snapshot

Issuer Credit Rating	BB/Negative/B
SACP	b+
Anchor	bb
Business Position	Adequate (0)
Capital and Earnings	Weak (-1)*
Risk Position	Adequate (0)
Funding and Liquidity	Average and Moderate (-1)
Support	+2
GRE Support	0
Group Support	0
Sovereign Support	+2
Additional Factors	0

*When a bank's anchor SACP, derived from our BICRA methodology, is in the 'bb' category and its common equity regulatory Tier 1 ratio is greater than the local regulatory requirements, a "weak" assessment of capital and earnings has a minus one-notch impact on the SACP, rather than two (see paragraph 88 of our bank criteria).

Related Criteria And Research

All articles listed below are available on RatingsDirect unless otherwise stated.

Related criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related research

- Standard & Poor's To Review Government Support In European Bank Ratings, March 4, 2014

Ratings List

Ratings Affirmed

Allied Irish Banks PLC	
AIB Group (U.K.) PLC	
Counterparty Credit Rating	BB/Negative/B
Allied Irish Banks PLC	
Senior Unsecured	BB
Subordinated	D
Commercial Paper	B
Allied Irish Banks N.A. Inc.	
Commercial Paper*	B
Commercial Paper*	BB

*Guaranteed by Allied Irish Banks PLC.

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Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.