FITCH: LARGE IRISH BANK RESULTS SOLID; NPL REDUCTION STILL KEY

Fitch Ratings-London-02 March 2018: Allied Irish Banks (AIB) and Bank of Ireland Group (BOIG) reported solid 2017 results, but asset quality remains a key constraint on both banks' ratings, Fitch Ratings says. Rating upgrades would be largely dependent on continued improvements in asset quality.

The banks' full-year 2017 results, announced this week, confirm further improvements in key financial metrics since the half-year results. Net interest margins remain healthy at both banks (AIB: 2.58%; BOIG: 2.29%), while their fully loaded common equity Tier 1 ratios continue to improve (AIB: 17.5%; BOIG: 13.8%) and remain comfortably above regulatory requirements. These improvements are broadly consistent with our expectations.

Both banks' stock of non-performing exposures fell, helped by a supportive economy, asset sales and general progress in reducing legacy impaired assets.

We upgraded AIB by one notch to 'BBB-'/Positive in November 2017, reflecting improved asset quality and capitalisation, and ongoing earnings stability. We said that there was scope for a further upgrade if the bank continued to reduce its problem loans. AIB made strong progress in the second half of the year, reducing non-performing exposures by nearly EUR2 billion to EUR10.2 billion (end-1H17: EUR12.1 billion). But they are still high at 16% of gross loans (end-1H17: 19%).

We also upgraded BOIG by one notch to 'BBB'/Stable in November. BOIG's stock of non-performing exposures dropped to EUR6.5 billion at end-2017 from EUR8.1 billion at end-1H17, but they remain high at 8% of gross loans, particularly compared to more highly rated peers. This limits medium-term rating upgrade potential, which is reflected in our Stable Outlook for the bank.

Both banks are targeting significant further reduction in non-performing exposures but this will take time. AIB has stated that it is looking to reduce exposures to EUR3 billion-EUR4 billion, or about 5% of gross loans, by end-2019, which would be in line with the European average. While the pace of reduction is likely to slow as the banks work through the smaller exposures that remain, mainly residential mortgages, we expect the economic environment in Ireland to remain supportive and help drive further asset quality improvements.

Profitability has improved in recent years, with both banks benefiting from lower funding costs and improving loan mixes. However, revenues and profitability are likely to face headwinds, including exposure to low-yielding tracker mortgages, modest loan growth, the gradual normalisation of loan impairment charges, and costs related to technology and digitalisation.

Capitalisation has strengthened considerably since 2015, supported by improving internal capital generation, significant deleveraging and, in AIB's case, the conversion of perpetual government-held preference shares to equity in 2016. We expect both banks to maintain comfortable buffers over minimum regulatory requirements while they work through their non-performing loans, although their level of unreserved impaired loans leaves them exposed to an unexpected fall in collateral prices.

Upside to BOIG's ratings is limited in the medium term given its weaker asset quality than higher-rated peers. AIB's ratings could be upgraded if it continues to make progress in reducing its stock of problem loans over the next 24 months while maintaining sound capitalisation, funding and liquidity and continuing to generate adequate profitability. Both banks' ratings could come under

pressure if the economic effect of the UK's decision to leave the EU is particularly severe for Ireland, negatively affecting AIB and BOIG's asset quality or capitalisation.

Contact:
Marc Ellsmore
Director, Financial Institutions - Banks
+44 20 3530 1438
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

David Prowse
Senior Analyst, Fitch Wire
+44 20 3530 1250

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.
Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch’s factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch’s ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.