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AIB Group plc

AIB sells a portfolio of nonperforming loans, a credit positive

From Credit Outlook

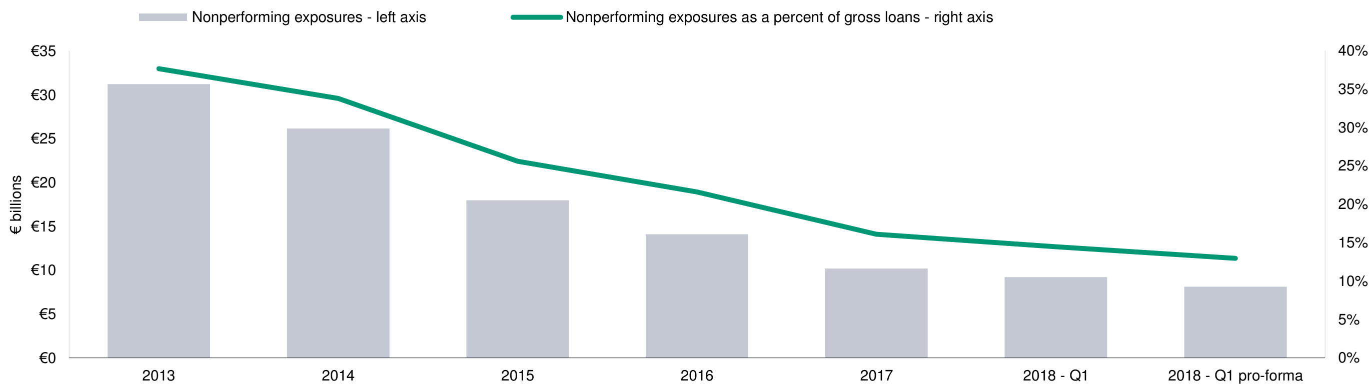
Last Wednesday, AIB Group plc (AIB Group, Ba2 positive), the holding company of Allied Irish Banks p.l.c. (AIB, Baa1/Baa2 positive, ba1) [1], announced that it had agreed to sell a portfolio of nonperforming loans to Irish credit management company Everyday Finance DAC as part of a consortium arrangement with Everyday and affiliates of US distressed debt fund Cerberus Capital Management. The transaction is credit positive because it allows the bank to de-risk its balance sheet while freeing up some capital. We estimate that the transaction adds about 30 basis points to AIB's ratio of tangible common equity to risk weighted assets to more than 18%.

The loan portfolio has a gross balance sheet value of €1.1 billion, which represents risk-weighted assets of €800 million, and we expect that the sale will lower AIB's nonperforming exposure (NPE) ratio to under 13% from 14% as of 31 March 2018. The sale marks an important step in AIB's de-risking strategy, which targets normalised NPE levels of 5% by the end of 2019. AIB indicated that it would receive an €800 million cash consideration for the loans, and that the sale would free up some provisions held against the assets.

Although AIB was one of the most severely affected institutions in the global financial crisis and subsequent recession, its efforts to restore its balance sheet have been significant in terms of loan deleveraging, reducing its gross loans by 35% during 2011-17. The bank's asset quality has improved in recent years, helped by a return to more favourable economic conditions and house price inflation in Ireland.

NPEs fell dramatically from their peak at the end of 2012 (see exhibit), driven primarily by loan restructurings and a steep slowdown in the number of performing loans becoming impaired, owing to Ireland's favourable economic environment. Restructurings began in 2012, but picked up in 2014 when the economy began improving. However, problem and restructured loans remain high, and asset quality remains a relative weakness for AIB.

Exhibit 1
AIB's nonperforming loan exposures



Source: AIB financial statements

The bank intends to reduce its stock of nonperforming exposures and align it with European norms by the end of 2019. However, we expect that AIB will not include home loans in asset sales, and that it will favour pursuing case-by-case restructurings where possible, which has constituted 95% of its nonperforming-loan reductions so far. The €1.1 billion portfolio AIB is selling to Everyday consists mainly of commercial property and investments, and excludes private homes and family farms. Like other domestic banks, we expect that AIB's legacy portfolio of residential mortgages will require a long time to wind down, given banks' current low level of repossessions, which we expect will not change anytime soon.

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Endnotes

1 The bank ratings shown in this report are AIB's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

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