Moody's Investors Service

Credit Opinion: Bank Zachodni WBK S.A.

Global Credit Research - 11 Feb 2010

Warsaw, Poland

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	Baa2/P-2
Bank Financial Strength	D+
Parent: Allied Irish Banks, p.l.c.	
Outlook	Stable(m)
Bank Deposits	A1/P-1
Bank Financial Strength	D
Senior Unsecured	A1
Subordinate	A2
Jr Subordinate	Ba3
Preferred Stock -Dom Curr	B1
Commercial Paper -Dom Curr	P-1
Bkd Other Short Term -Dom Curr	P-1

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Key Indicators

Bank Zachodni WBK S.A.

	[1]**2009**	[2]**2008**	**2007**	**2006**	**2005**	[3]**Avg.**
Total assets (PLN billion)	**56.49**	**57.84**	**41.32**	**33.04**	**29.31**	[4]**19.08**
Total assets (EUR billion)	**12.65**	**14.04**	**11.49**	**8.63**	**7.63**	**--**
Total capital (PLN billion)	**5.49**	**5.19**	**4.58**	**4.08**	**3.44**	[4]**15.21**
Return on average assets	**1.40**	**1.96**	**3.07**	**2.71**	**1.92**	**2.28**
Recurring earnings power [5]	**2.71**	**3.23**	**3.85**	**3.44**	**2.64**	**3.12**
Net interest margin	**2.96**	**3.78**	**4.05**	**3.59**	**3.50**	**3.73**
Cost/income ratio (%)	**51.34**	**51.63**	**53.79**	**55.32**	**61.38**	**57.52**
Problem loans % gross loans	**4.49**	**2.88**	**2.82**	**4.90**	**6.75**	**5.11**
Tier 1 ratio (%)	**10.95**	**9.56**	**11.70**	**15.31**	**15.89**	**13.11**

[1] As of June 30. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate. [5] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a D+ bank financial strength rating (BFSR) to Bank Zachodni WBK SA (BZ WBK), with a negative outlook, which translates into a Baseline Credit Assessment (BCA) of Baa3. The rating reflects BZ WBK's established market position, strong multi-channel distribution network, good track record in managing its cost base and historically above-average profitability. The rating is constrained by the bank's relatively high exposure to the risky real estate financing segment, high credit concentrations and its underdeveloped retail franchise.

BZ WBK's long-term global local currency (GLC) deposit rating of Baa2 is based on (i) the bank's BCA of Baa3, (ii) our assessment of a low probability of parental support from Allied Irish Banks plc (AIB, rated A1/P-1/D), which currently holds 70.36% of BZ WBK's share capital, and (iii) our assessment of a high probability of systemic support for the bank in the event of need. As a result of our support assessment, there is a one-notch uplift for BZ WBK's long-term GLC deposit rating from its BCA of Baa3. We note, however, that this one-notch uplift is due solely to the probability of systemic support since the parent's BFSR of D is low and does not appreciably influence the subsidiary's supported rating.

BZ WBK's foreign currency deposit rating is Baa2 and is not constrained by the sovereign foreign currency bank deposit ceiling of A2.

Credit Strengths

- Stable customer base and diversified franchise has proved resilient in the downturn

- Good cost control and efficiency maintained

- Above average profitability and high interest margins

- Significant market share in the mutual funds business and related fee income

Credit Challenges

- Retaining customer deposits in an increasingly price-sensitive and competitive market

- Sizeable exposures to real estate development and land financing

- Asset quality deterioration in the corporate portfolio

- Significant increase of FX mortgage exposures in the portfolio in 2008, although still low compared with peers

- Although not directly influencing the current supported ratings, we believe that AIB's potential divestment of BZ WBK could be challenging for the franchise value and customer confidence

Rating Outlook

All the ratings have negative outlook, which reflects our! view that deteriorating asset quality and higher provisioning needs could contribute to a further deterioration in BZ WBK's financial fundamentals.

What Could Change the Rating - Up

Due to the current negative outlook there is no upward pressure on the ratings at this stage. However, in the medium term, an upgrade could be triggered by a decrease in concentration risks, improvement in asset quality and stronger capital adequacy.

What Could Change the Rating - Down

A downgrade of BZ WBK's BFSR could be triggered by significant loan loss charges and pressure on capital. Inability to maintain its currently favourable loan-to-deposit ratio would also be an important rating driver.

Recent Results and Developments

BZ WBK recorded net profit of PLN640 million (EUR 152.2 million) in the first nine months of 2009, a decrease of over 21% compared with the same period of 2008. The trend was largely driven by higher provisioning and lower net interest and fee and commission income. The bank's total assets decreased by almost 2% to PLN56.4 billion (EUR 13.4 billion) over the period, mainly due to lower client deposits.

In June 2009 BZ WBK's BFSR was downgraded to D+ from C- and its long-term GLC deposit rating to Baa2 from A2. This rating action concluded the review for possible downgrade that was initiated in May 2009. The BFSR downgrade was driven by our expectation that the bank's profitability would be adversely affected by the economic downturn due to its sizeable exposure to commercial real estate investment and development, a sector with high potential for generating large losses in the current environment and implications of this for the bank's capitalisation. Due also to the simultaneous refinement of our assessment of systemic support, the bank's long-term GLC deposit rating was downgraded to Baa2 from A2.

DETAILED RATING CONSIDERATIONS

Detailed rating considerations for BZ WBK are as follows:

Bank Financial Strength Rating

Moody's assigns a D+ BFSR to BZ WBK, with a negative outlook, which translates into a BCA of Baa3. The rating reflects BZ WBK's established market position, strong multi-channel distribution network, good track record in managing its cost base and historically above-average profitability. The rating is constrained by the bank's relatively high exposure to the risky real estate financing segment, high credit concentrations and its underdeveloped retail franchise.

As a point of reference, the assigned rating is two notches lower than the outcome of Moody's bank financial strength scorecard, which generates a C score. We view the D+ BFSR as an appropriate measure of the bank's financial strength given the risks associated with the concentration in the loan portfolio and the difficult operating environment in Poland.

Qualitative Rating Factors (70%)

Factor : Franchise Value

Trend: Neutral

BZ WBK is the fifth-largest bank in Poland by assets with market shares of customer deposits and loans of 6.16%, and 4.82%, respectively, at end-Q3 2009). The bank has had a well-established franchise in corporates, focusing on large and medium-sized clients, where competition is strongest. However, in recent years, the bank has also been actively focusing on SMEs. Corporate activities represented 40.7% of BZ WBK's profit before tax in the first nine months of 2009.

The bank has tried to expand its relatively underdeveloped retail segment by growing its mortgage lending operations. At end-Q3 2009, mortgages represented over 16% of the total loan portfolio and grew by 23% year-on-year basis. Around 40% of its mortgages ware denominated in FX, which can increase the bank's risk profile in case of a heightened exchange rate volatility. BZ WBK has also expanded its retail deposit base, which increased by 15% in the first nine months of 2009.

The bank's retail franchise is supported by the fact that it has the third-largest branch network in Poland, which comprised 504 branches at end-September 2009. However, it faces stiff competition in the retail segment and still lags behind its immediate peers in terms of customer penetration. Retail activities represented 31.3% of BZ WBK's profit before tax in the first nine months of 2009.

The bank's other important business lines include leasing, which amounted to 8% of the total loan portfolio at end-Q3 2009; it is increasingly focusing on the leasing of machinery and equipment, alongside the leasing of new vehicles.

BZ WBK remains very active in asset management and mutual funds, where it has a leading market share, which stood at 11.61% at end-Q3 2009. Its assets under management started to grow in Q1 2009 after declining since beginning of 2008. BZ WBK has also a significant market share in brokerage, where it ranks third in the equity and bond markets.

AIB acquired its stake in 1999 and supported the subsidiary in risk management and managerial know-how. Although we note that AIB has been very supportive of its Polish subsidiary, given the difficulties that the Irish bank is facing in its domestic market, we do not rule out AIB selling BZ WBK. Although, the bank has its independent franchise and is not reliant on the parent in terms of market funding, we consider that the uncertainty of a new ownership may somewhat affect customer confidence if such divestment arrangements are announced. Although so far no such plans have been made apparent.

BZ WBK scores C+ for franchise value; given its relatively established position in the market, we regard this score adequate.

Factor: Risk Positioning

Trend: Neutral

Like its peers in the region, BZ WBK's overall risk profile has been adversely affected by the ongoing downturn. We note that the bank's risk management practices and procedures are integrated with those of its parent AIB, although similarly to the parent it has a high level of exposure to the real estate segment. Higher provisioning costs and asset quality deterioration were most visible in loans for land purchase and residential development, of which 6.9% were non-performing at end-Q3 2009 compared with 5.4% for the total loan portfolio.

However, borrower concentration remains relatively high and scores D. This is common for the majority of those Polish banks whose corporate portfolios represent a large share of their business. The risk positioning score is weighed down by high credit concentration. The bank's borrower concentration is significant, as its top 20 exposures exceed 100% of its Tier 1 capital. However, we note that this is similar to the figures of its Polish peers due to the relatively small size of the market.

BZ WBK maintains sufficient liquidity, and its liquidity management practices remain good, which underpins the bank's liquidity management score of B. We also note that 75% of customer deposits is retail and SMEs with remainder in corporate which tend to be more price- and confidence-sensitive than more granular deposits.

The bank's market risk appetite, as measured by its VaR numbers and stress test results, is modest, since it does not have any significant proprietary trading positions. However, we note that there was a notable adverse effect on the bank's provisioning needs due to the write-down of customer FX option derivatives. On the other hand, the overall impact of FX-related write-downs was relatively limited on BZ WBK's profitability compared with some of its peers. Also, due to the fact that the maturity profile of such exposures is relatively short term, we expect this effect to diminish in 2010, helped by the stabilisation in the exchange rate.

The bank's risk positioning scores C- and we see the trend as weakening.

Factor: Regulatory Environment

Refer to Moody's latest Banking System Outlook on Poland, published in November 2009, to obtain a detailed discussion of the regulatory environment.

Factor: Operating Environment

Trend: Neutral

This factor is common to all Polish banks. Refer to the Moody's latest Banking System Outlook on Poland, published in November 2009, to obtain a detailed discussion of the operating environment.

Quantitative Rating Factors (30%)

Factor: Profitability

Trend: Weakening

BZ WBK's profitability deteriorated in H1 2009 due to margin compression and pressure from strong competition. The return on average assets was 1.40% in H1 2009 compared with almost 2% in 2008.

Net interest and fee and commissions income were the dominant sources of revenue. However, fee and commission income decreased by 6.5% in H1 2009, mainly due to lower fees from mutual funds. Net interest income was driven down by net interest margin, which decreased to 2.96% in H1 2009 from 3.78% in 2008 due to the so-called `war on deposits' and the higher cost of FX funding. However, this was partly offset by the repricing of new or existing loans.

In the near term, we expect the bank's profitability to weaken from the historically strong performance in 2007-08 and therefore we see a weakening trend for the direction of the bank's profitability score, which is a B based on historical averages.

Factor: Liquidity

Trend: Neutral

BZ WBK's liquidity score is underpinned by the bank's strong customer funding and its limited reliance on market and interbank funding (11% of total funding in H1 2009). The bank's deposit base shrank by 4.2% in H1 2009 due to price competition in the Polish market. However, since the average loan-to-deposit ratio remains strong, at around 86.5% in H1 2009, the bank's reliance on market funds is limited in the short to medium term. The loan-to-deposit ratio is better than the average of its rated Polish peers (95% in the same period).

The share of liquid assets in total assets remained comfortable at 34% at end-H1 2009 (36% at end-2008) and is better than the average of its Polish peers.

BZ WBK scores B+ for liquidity.

Factor: Capital Adequacy

Trend: Weakening

BZ WBK has adequate capital adequacy, as measured by its total capital ratio of 12.6% at end-Q3 2009, up from 10.74% at end-2008. The Tier 1 ratio stood at almost 11.3% at end-Q3 2009 compared with 9.56% at end-2008. We view positively that the bank did not pay out dividends for 2008, however we expect payments of dividends from 2009 profit.

The bank's reported capital ratios are relatively high compared with those of its Polish peer group. However, there is a chance that this could be impacted by high provisioning on its commercial real estate and leasing activities. This explains the weakening trend for this factor. However, we note that, based on three-year average ratios, BZ WBK scores a high B+ for this factor, which compares favourably with its peer group's ratios.

Factor: Efficiency

Trend: Neutral

BZ WBK's efficiency has been stable in recent years, despite the weakening economic environment. The bank's cost-to-income ratio was 51.34% in H1 2009, essentially unchanged from 2008. This compares favourably with the ratios of its regional peers. The bank has commenced a number of cost-cutting initiatives including reducing salaries and headcount; in Q3 2009, the bank lowered its staff numbers by 536 full-time employees (around 5% of total workforce) year-on-year.

We expect the bank's efficiency, which scores B, to remain in the current range in the near future.

Factor: Asset Quality

Trend: Weakening

In H1 2009, the loan portfolio grew by 3.4% from end-2008. BZ WBK's loan portfolio is dominated by corporate lending, with mortgages and other retail lending representing 27% of the total as of end-H1 2009. In addition, we note that there is a high concentration on commercial real estate (30% of the corporate portfolio). Commercial development and land acquisitions, which we consider to be high-risk segments, represented around 41.2% of the commercial real estate portfolio.

In retail mortgages, there is also a significant element of FX-denominated lending (41% of total mortgages). Mortgages are denominated in Swiss francs, which, in the event of currency volatility, can stretch the affordability of customers and result in high non-performing loans. However, the asset quality of mortgages denominated in FX and Polish zlotys remains good. The bank stopped providing FX lending in Q1 2009, although the volume of FX mortgages more than tripled in 2008.

Due to the fact that the bank's loan portfolio has a relatively high risk profile and there is likely to be an increase in the non-performing loans in its corporate portfolio, we assign a weakening trend to BZ WBK's asset quality score of C+.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a long-term GLC deposit rating of Baa2 to BZ WBK. The rating reflects the bank's BCA of Baa3 and is supported by Poland's government bond rating of A2 and AIB's BCA of Ba2, i.e. the ratings of the underlying support providers. In light of BZ WBK's good nationwide market share and importance to the Polish banking system, we assess the probability of systemic support for BZ WBK in the event of need as high. Further, we believe there is a low probability of parental support for the bank, due to (i) AIB's management involvement in BZ WBK; and (ii) the close association of the parent's and BZ WBK's brands, resulting in high reputational risk for AIB. However, due to AIB's low BFSR, the parental support assessment does not influence BZ WBK's long-term ratings.

Under Moody's Joint Default Analysis (JDA) methodology, these considerations result in one-notch uplift in the long-term GLC deposit rating to Baa2 from the Baa3 BCA.

Foreign Currency Deposit Rating

Moody's assigns a Baa2 long-term foreign currency deposit rating to BZ WBK.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Bank Zachodni WBK S.A.

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (70%)						**C-**	
Factor: Franchise Value						**C+**	**Neutral**
Market Share and Sustainability		**x**					
Geographical Diversification			**x**				
Earnings Stability			**x**				
Earnings Diversification [2]							
Factor: Risk Positioning						**C-**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management			**x**				
- Risk Management			x				
- Controls			x				
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management		**x**					
Market Risk Appetite			**x**				
Factor: Operating Environment						**D**	**Neutral**
Economic Stability					**x**		
Integrity and Corruption				**x**			
Legal System			**x**				
Financial Factors (30%)						**B**	
Factor: Profitability						**B**	**Weakening**
PPP % Avg RWA - Basel II		3.56%					
Net Income % Avg RWA - Basel II		1.93%					
Factor: Liquidity						**B+**	**Neutral**
(Mkt funds-Liquid Assets) % Total Assets	-25.23%						
Liquidity Management		x					
Factor: Capital Adequacy						**B+**	**Weakening**
Tier 1 ratio (%) - Basel II		10.00%					
Tangible Common Equity / RWA - Basel II	9.51%						

Factor: Efficiency						**B**	**Neutral**
Cost/income ratio		53.58%					
Factor: Asset Quality						**C+**	**Weakening**
Problem Loans % Gross Loans			3.53%				
Problem Loans % (Equity + LLR)		17.91%					
Lowest Combined Score (9%)						**C+**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**C**	
Assigned BFSR						**D+**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral