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BAWAG P.S.K.'s Improving Profitability and Capital Ratios Are Credit Positive

International loan book expansion and pending litigation pose risks, however

RATINGS

BAWAG P.S.K.

Baseline Credit Assessment	baa3
Long-term issuer rating	Baa1, positive
Long-term bank deposit	Baa1, positive
Senior unsecured	Baa1, positive
Subordinated debt	Ba1
Short-term ratings	Prime-1
Counterparty Risk Assessment	A3(cr)/Prime-1 (cr)

KEY INDICATORS

	2014	2013	2012
Problem Loans/ Gross Loans	2.8%	3.5%	4.9%
TCE/RWA (1)	13.6%	11.1%	7.3%*
NI/TA (2)	1.0%	0.6%	0.3%
Efficiency (3)	54.2%	58.5%	63.0%
Market Funds/TA	23.0%	21.8%	29.5%
Liquid Assets/TA	19.4%	27.4%	31.3%

Source: Moody's Banking Financial Metrics, adjusted

(1) TCE: Tangible Common Equity, RWA: Risk-Weighted Assets; (2) NI: Net Income, TA: Tangible Banking Assets; (3) Cost-to-income ratio

* 2012 TCE ratio calculated under CRD III (Basel 2.5)

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Summary Opinion

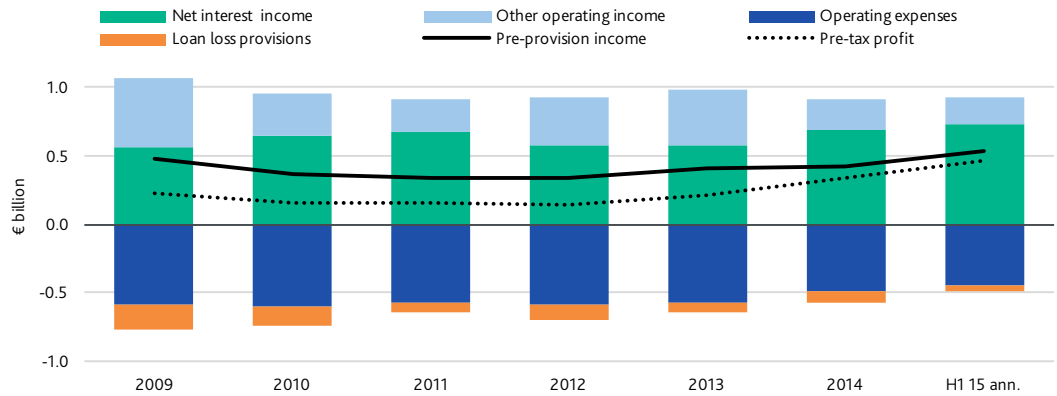
- » **Bank fuer Arbeit und Wirtschaft und Oesterreichische Postsparkasse AG's (BAWAG) improving financial strength drove our recent ratings upgrade.** The Austrian bank's stronger and higher-quality capital adequacy ratios as well as a recovery in its underlying profitability resulted in a ratings upgrade. We raised its baseline credit assessment (BCA), a measure of its standalone intrinsic strength, to baa3 and its long-term bank deposit and issuer ratings to Baa1, with a positive outlook. Solid H1 2015 results confirmed these developments.
- » **Further upward momentum in BAWAG's financial profile may emerge over the next 12-18 months.** We anticipate further improvement in the bank's financial profile, driven by (1) the further de-risking of its balance sheet; (2) the continuous build-up of the bank's capital buffers; and (3) a developing track record of sustainably higher earnings.
- » **Strong access to stable retail deposits supports the bank's funding and liquidity profile.** We expect that BAWAG will be able to maintain a balanced liquidity profile despite facing relatively high debt maturities in 2015. We anticipate that the debt repayments will be covered by existing cash, the continued, albeit slowing, reduction of BAWAG's balance sheet (and thus lower funding needs), as well as its large portfolio of on-balance-sheet liquid unencumbered assets.
- » **Asset-quality risks could pressure net profit in a less benign economic climate.** BAWAG's credit rating remains constrained by the bank's expansion into higher-risk asset classes, including loans to international corporate and commercial real estate. In our view, this adds concentration risks to BAWAG's balance sheet and may exert undue pressure on the bank's profitability and, potentially, capital in a highly adverse economic climate.
- » **While manageable, litigation risk may exert pressure on the bank's profitability.** A potentially unfavourable court ruling or settlement agreement in the City of Linz case¹ would hurt the bank's bottom line. It is our understanding, however, that any potential net charge for BAWAG resulting from an unfavourable court ruling would be substantially lower than the value of the claim brought against the bank (approximately EUR440 million). We therefore believe the risk of a more substantial loss, that may erode BAWAG's capital ratios, to be limited.

BAWAG's core earnings will continue to improve following its business re-alignment

- » Following a costly restructuring phase, the bank is now reaping the benefits of its business re-alignment
- » In addition, the full repayment of state aid (participation capital) provided by the Republic of Austria (Aaa, stable) reduced state aid costs to zero
- » We expect a continued trend of improving net profits in 2015 and potentially beyond

EXHIBIT 1

BAWAG has reduced costs in its core business...

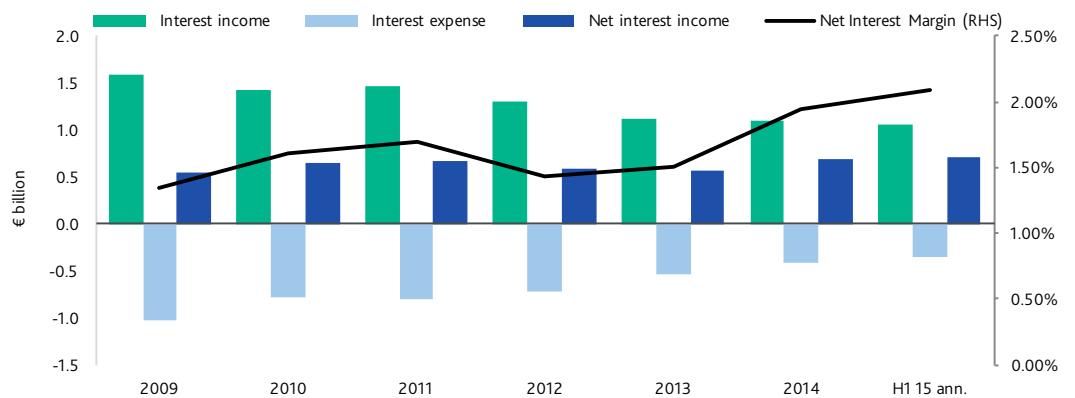


Source: BAWAG annual reports 2009-2014, H1 2015 report, Moody's Banking Financial Metrics

- » BAWAG's average deposit rate fell to 0.39% in H1 2015, down from 0.77% in 2013
- » The bank continued shifting maturing fixed-rate deposits into variable-rate products, thereby increasing the share of variable-rate deposits to 82% of total private client deposits (2013: 70%)
- » The bank's net interest margin thereby improved to 2.08% as of H1 2015, up from 1.43% in 2012 (Moody's calculation)

EXHIBIT 2

...and re-priced deposits...

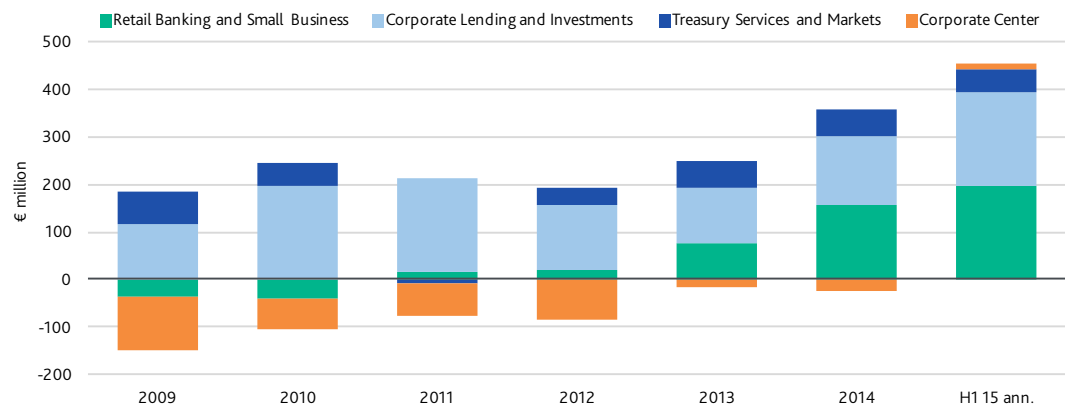


Source: BAWAG annual reports 2009-2014, H1 2015 report, Moody's Banking Financial Metrics

- » Following a strong 2014, BAWAG reported a record EUR226 million net profit in H1 2015, up 29% year-over-year, and driven by a 9% year-over-year increase of stable core revenues, strong cost control (-8% year-over-year) and declining risk charges
- » We believe that BAWAG will be able to maintain its solid profitability, thereby establishing a track record of sustainably higher earnings

EXHIBIT 3

...driving a strong recovery in its underlying profitability*



Note: Pre-tax profits by segment

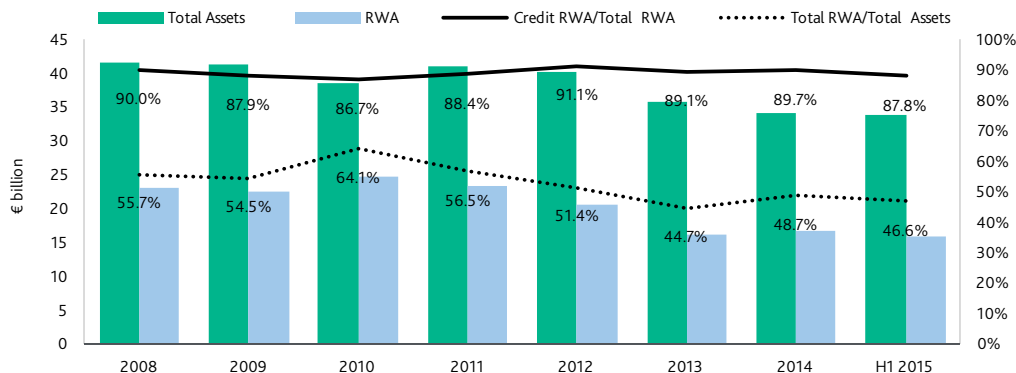
* BAWAG slightly changed the segment reporting in 2013. For the years 2009-12 we have therefore (1) grouped the former Corporate Client and International Business divisions under Corporate Lending and Investments; and (2) grouped the former Financial Markets segment under Treasury and Markets.

Source: BAWAG annual reports 2009-2014, H1 2015 report

Capital ratios have significantly improved, despite full redemption of state-aid

- » BAWAG's capital ratios have improved strongly following de-risking and pro-active management of risk-weighted assets (RWA)
- » This is demonstrated by the strong improvement in Basel III capital ratios, together with a leverage ratio of 7.0% under transitional Basel III requirements (see Exhibit 5)
- » We believe that the bank has annual capacity to grow its Common Equity Tier 1 (CET1) ratio by more than two percentage points per annum (H1 2015: +2.2%)

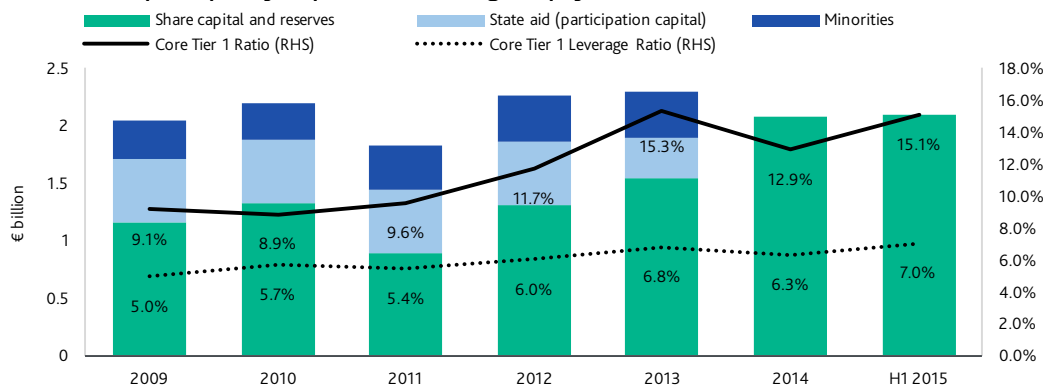
EXHIBIT 4
BAWAG's capital adequacy metrics were supported by pro-active risk reduction and the introduction of the internal ratings-based approach in 2013



Source: BAWAG annual reports 2008-2014, H1 2015 report, Moody's calculations

- » The redemption and optimisation of elements within the bank's capital structure prior to the full implementation of the Basel III capital framework led to a decline in BAWAG's loss absorbing capital by EUR319 million during 2014
- » This reduction was partly offset by strong net profits of EUR226 million in the first half of 2015
- » At the same time the capital adjustments led to a meaningful improvement in the quality of capital

EXHIBIT 5
BAWAG's capital quality improved following the payback of state aid



Source: BAWAG annual reports 2009-2014, H1 2015 report, Moody's calculations

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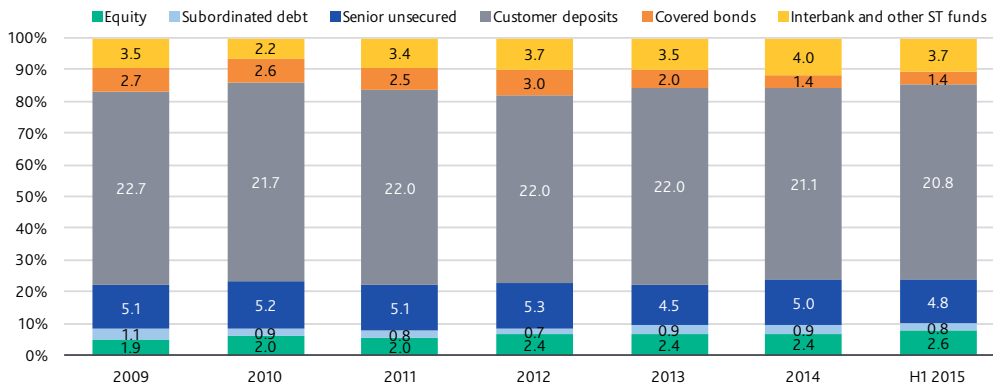
Strong access to stable retail deposits supports the bank's funding and liquidity profile

- » The slight decline in BAWAG's deposit base results from the bank's policy of favouring variable-rate deposits over fixed-rate products
- » This, together with a stable (gross) loan book, led to an increase in BAWAG's loan-to-deposit ratio to 105% as of 30 June 15, up from 95% at year-end 2013

EXHIBIT 6

BAWAG's funding profile is stable and sound

Note: All figures in EUR billion



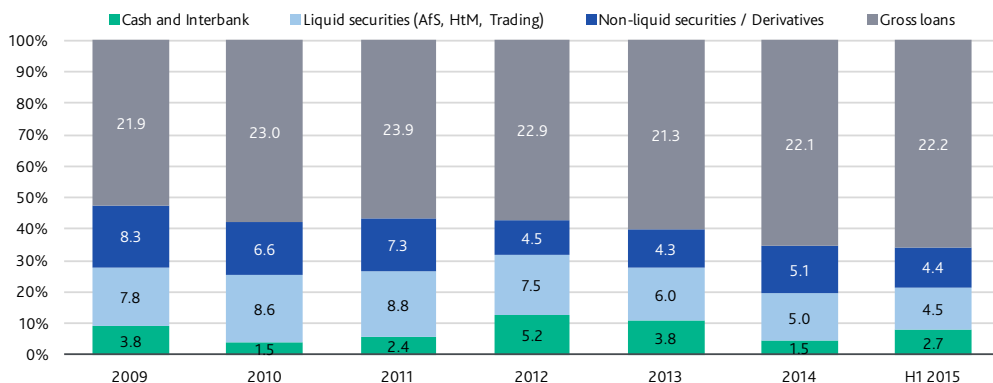
Source: Moody's Banking Financial Metrics

- » We expect that BAWAG will be able to maintain a balanced liquidity profile
- » Liquid assets declined during 2014 and H1 2015, owing largely to declining interbank exposures
- » Furthermore, BAWAG's liquid assets partly consist of corporate and peripheral euro area bonds, yet are mostly exposed to investment-grade issuers

EXHIBIT 7

Liquid assets are adequate for the bank's risk profile

Note: All figures in EUR billion

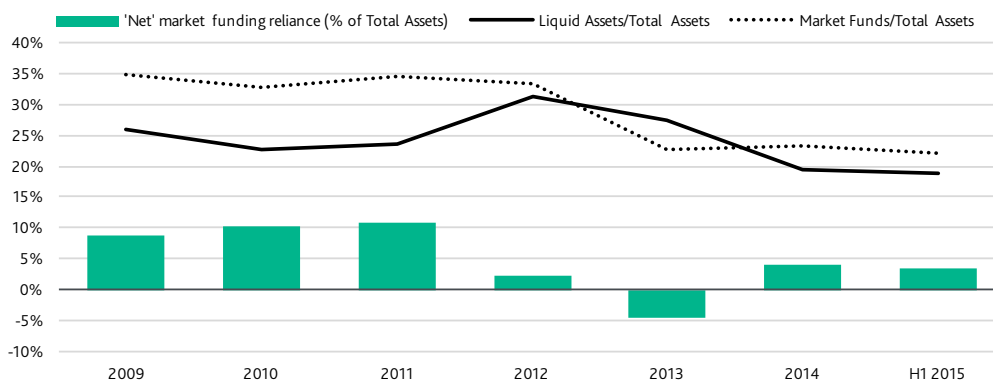


Source: Moody's Banking Financial Metrics

- » The bank's low reliance on confidence sensitive market funding sources supports its credit profile
- » In addition, BAWAG has strong and proven access to the covered bond market, potentially alleviating pressure on the bank's refinancing capabilities in times of stress

EXHIBIT 8

BAWAG displays low reliance on confidence-sensitive wholesale funding sources

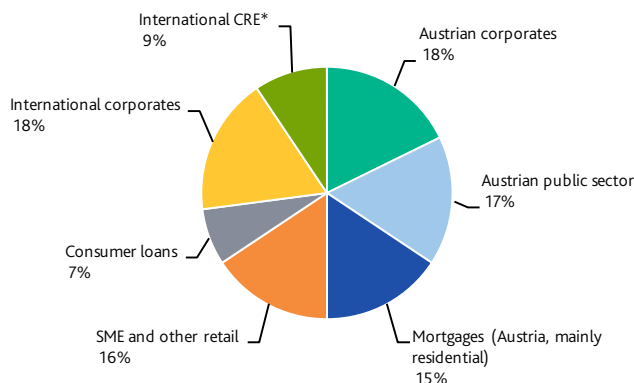


Source: Moody's Banking Financial Metrics

Asset-quality risks have decreased and are manageable, yet uncertainties remain around the future performance of BAWAG's international investment and loan portfolios

- » BAWAG has a sizeable corporate lending and investments book and other high sector concentrations, such as interbank and the public sector
- » BAWAG's exposure to the more diversified retail and small business sectors (EUR9.6 billion as of H1 2015) remain relatively modest in spite of a significant re-build of its nationwide presence

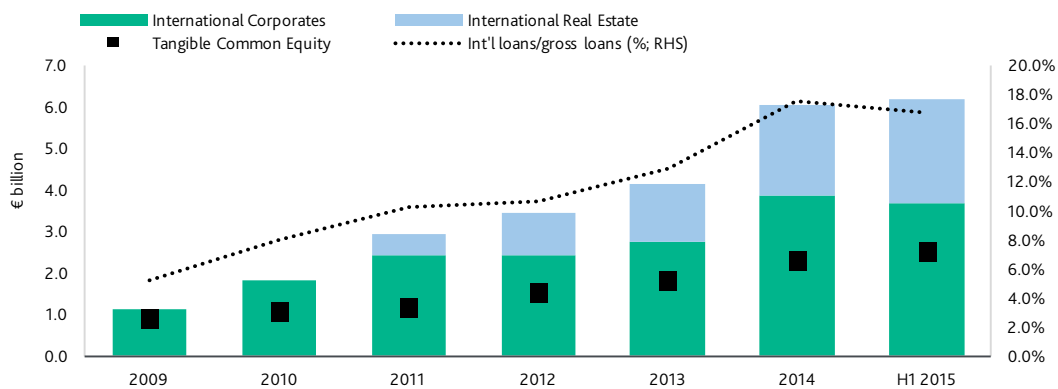
EXHIBIT 9
BAWAG's loan book remains Austrian-focused, but international loans add to risk profile



* Note: CRE = Commercial Real Estate
Source: BAWAG annual report 2014

- » The expansion of BAWAG's international corporate and CRE portfolios as well as the more recent investment in non-domestic collateralised loan obligations (CLOs) creates uncertainties and tail risks
- » These investments are incongruous with BAWAG's overall risk-reducing strategy, given that these exposures represent a significant proportion of the bank's Tier1 capital (249% as of H1 2015)

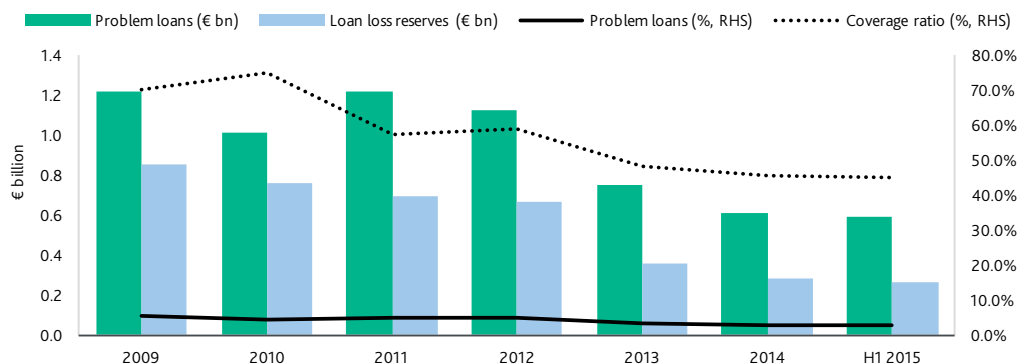
EXHIBIT 10
Strong growth in international loan portfolios adds concentration risks



Source: BAWAG annual reports 2009-2014, H1 2015 report, Moody's Banking Financial Metrics

- » BAWAG's impaired assets decreased to EUR597 million or 2.7% of customer receivables as of H1 2015 (2013: 3.5%), indicating further improvement in underlying core asset quality
- » However, the bank's newly acquired international assets, as well as exposures to peripheral euro-area countries and highly-rated CLOs in Europe may add to problem loans if the credit cycle turns

EXHIBIT 11
Favourable development of problem loans



Source: BAWAG annual reports 2009-2014, H1 2015 report, Moody's Banking Financial Metrics

BAWAG's ratings benefit from a two-notch uplift resulting from our Loss Given Failure (LGF) Analysis

- » Because BAWAG is subject to the [Austrian Bank Resolution and Recovery Directive \(BaSAG\)](#), we apply our Advanced LGF analysis, considering the risks faced by the different debt and deposit classes across the liability structure at failure
- » Our analysis of the bank's liability structure indicates a very low loss-given-failure for senior unsecured debt and deposits, leading to a two-notch rating uplift from BAWAG's baa3 adjusted BCA

EXHIBIT 12

BAWAG's liability structure supports its credit ratings*

DE JURE (75%)				DE FACTO (25%)			
1	43.7%	Preferred Deposits		1	43.7%	Preferred Deposits	
2	17.8%	Other Liabilities		2	17.8%	Other Liabilities	
3	23.2%	Junior Deposits (12.1%)	Senior Long-Term Debt (Bank 11.1%)	3	12.1%	Junior Deposits	
3				4	11.1%	Senior Long-Term Debt (Bank)	
5	0.0%	Senior Long-Term Debt (HoldCo)		5	0.0%	Senior Long-Term Debt (HoldCo)	
6	2.7%	Dated Sub Debt (Bank 2.7%)		6	2.7%	Dated Sub Debt (Bank 2.7%)	
6				6			
8	0.0%	Junior Sub Debt (Bank 0.0%)		8	0.0%	Junior Sub Debt (Bank 0.0%)	
8				8			
10	0.0%	Preference Shares (Bank 0.0%)		10	0.0%	Preference Shares (Bank 0.0%)	
10				10			
11	3.0%	Equity		11	3.0%	Equity	

* We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. These ratios are in line with our standard assumptions as set out in our Global Bank Rating Methodology.

Source: BAWAG annual report 2014, Moody's Investors Service

Moody's Related Research

Credit Opinion:

- » [BAWAG P.S.K.](#)

Company Profile:

- » [BAWAG P.S.K., April 2015 \(180546\)](#)

Credit Focus:

- » [Key Analytic Considerations in Our Rating Actions on Austrian banks, July 2015 \(1006111\)](#)
- » [Austrian Banks: Lower Support Assumptions Post Hypo Alpe Adria Law Are Credit Negative, July 2014 \(172915\)](#)

Banking System Outlook:

- » [Austria, July 2015 \(1006349\)](#)

Rating Actions:

- » [Moody's concludes reviews on 3 Austrian banking groups; takes action on another 2 institutions' ratings, July 2015](#)
- » [Moody's assigns Baa2 issuer ratings to BAWAG P.S.K. Bank fuer Arbeit und Wirtschaft und Oesterreichische Postsparkasse AG; outlook negative, December 2014](#)
- » [Moody's downgrades Austrian banks following change in systemic support assumptions, June 2014](#)
- » [Moody's affirms BAWAG P.S.K.'s Baa2 ratings; outlook changed to positive, April 2014](#)

Rating Methodology:

- » [Banks, March 2015 \(179038\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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Endnotes

1. The swap transaction with a nominal volume of CHF195 million (signed 12 February 2007) entitled the City of Linz (the City) to receive a variable interest rate in Swiss Francs (6M CHF-Libor) and obligated the City to pay to BAWAG a fixed interest rate in Swiss Francs plus a premium that depended on the exchange rate between the Euro and the Swiss Franc. Following the significant strengthening of the Swiss Franc against the Euro, the City was obligated to make payments to BAWAG. The Linz city council decided on 13 October 2011 that it would make no more payments in connection with the swap and BAWAG immediately exercised its right to close out the swap transaction. BAWAG sued Linz in November 2011 after the City had sued the bank, saying it didn't inform Austria's third-biggest city about the risks of the swap. The following mediation process failed and the matter (total claim value EUR443 million as of 8 May 2015; Source: [City of Linz website](#)) will continue to be handled in court.

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