

## FITCH AFFIRMS BAWAG P.S.K. AT 'A-'; OUTLOOK STABLE

Fitch Ratings-London-24 August 2017: Fitch Ratings has affirmed BAWAG P.S.K. Bank fuer Arbeit und Wirtschaft und Oesterreichische Postsparkasse Aktiengesellschaft's Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook, Short-Term IDR at 'F1' and Viability Rating (VR) at 'a-'. A full list of rating actions is at the end of this rating action commentary.

### KEY RATING DRIVERS

#### IDRS, VR AND SENIOR UNSECURED DEBT

The IDRs and senior unsecured debt rating of BAWAG are driven by its VR, which reflects our view of the bank's strong financial profile and the successful record of its management in implementing the bank's post-restructuring strategy. The ratings also reflect the bank's effective risk management and generally conservative risk appetite, which includes a focus on high-quality assets in highly developed markets.

The ratings also factor in BAWAG's significant medium-term growth plans driven, mainly by the acquisition in the past two years of loan portfolios or other banks. We expect future growth to remain well-controlled, but we believe that BAWAG will remain acquisitive. This carries heightened execution risk and may negatively affect the bank's profitability and capitalisation.

The recently signed acquisition of Suedwestbank AG, a small German regional bank active in retail, corporate and private banking in southwestern Germany, is consistent with BAWAG's growth strategy and intention to establish a significant German franchise. BAWAG's balance sheet will grow by 18% through the acquisition, which will be the bank's largest in recent years.

The affirmation of the ratings reflects our belief that BAWAG's strong risk control framework and experience with bolt-on acquisitions in the last two years adequately mitigate the operational and execution risks resulting from Suedwestbank's acquisition. Integrating a full bank is more challenging than BAWAG's recent asset deals, but we view Suedwestbank's moderate complexity and size as significant mitigating factors.

BAWAG's asset quality is strong, with a stable non-performing loan (NPL) ratio at around 2% in the last two years. The bank's risk appetite for exposures to cyclical industries, particularly international commercial real estate, is mitigated by the bank's robust underwriting standards and risk controls.

BAWAG's performance compares well with those of its domestic peers and is supported by a strong focus on cost control, efficient processes and pricing discipline. Together with the bank's growing international presence, this mitigates the high competitive pressure in the bank's small home market of Austria.

The ratings take into account a likely material but manageable dilution of BAWAG's strong capital ratios as a result of the Suedwestbank acquisition, as well as possible medium-term pressure from future acquisitions. However, we expect BAWAG to be able to rapidly restore levels of capitalisation post-acquisitions that compare favourably with domestic peers', through healthy internal capital generation and a continuing flexible approach to profit distribution, which the bank resumed in 2016. At end-1H17 (ie without Suedwestbank, which we expect to be consolidated from end-2017), BAWAG's transitional common equity Tier 1 Capital ratio and fully-loaded regulatory leverage ratio remained strong at 15.4% and 7%, respectively.

The 'F1' Short-Term IDR is the higher of the two Short-Term IDRs possible for an 'A-' Long-Term IDR, which reflects Fitch's view of BAWAG's solid liquidity and funding. Its solid funding structure is underpinned by a large and stable customer deposit base - which accounts for 70% of total liabilities - and increasingly diversified wholesale market access. The bank also benefits from its established brand and strong retail franchise in Austria.

#### SUPPORT RATING AND SUPPORT RATING FLOOR (SRF)

The Support Rating and SRF reflect our view that the EU's Bank Recovery and Resolution Directive (BRRD) and Single Resolution Mechanism provide a resolution framework that is likely to require senior creditors participating in losses, if necessary, instead, or ahead, of a bank receiving sovereign support. The BRRD includes minimum loss absorption requirements before resolution financing or alternative financing (eg, government stabilisation funds) can be used. In addition, we do not factor in any support from BAWAG's owners because Fitch generally views that support from financial investors, while possible, cannot be relied upon.

#### SUBORDINATED DEBT

BAWAG's Tier 2 subordinated debt is rated one notch below the VR to reflect below-average recovery prospects. These securities are subordinated to all senior unsecured creditors. No notching is applied for incremental non-performance risk because there is no coupon flexibility prior to non-viability and the notes would only be written down once the point of non-viability is reached.

#### RATING SENSITIVITIES

##### IDRS, VR AND SENIOR UNSECURED DEBT

The Long-Term IDR is sensitive to changes to the VR.

An upgrade of the VR would require a longer record of resilient earnings and sound asset quality through the economic cycle including amid more adverse market conditions. An upgrade would also require a successful expansion and diversification of the bank's asset base, particularly the establishment of a solid franchise in the bank's targeted international markets, while maintaining a conservative risk appetite.

The VR is also sensitive to BAWAG's ability to successfully integrate Suedwestbank. Over the longer term, future acquisitions could put negative pressure on the VR if they erode capitalisation and profitability significantly for a longer period or result in unexpectedly high operational or integration risks. More generally, a downgrade of the VR could arise from excessive growth significantly undermining internal capital generation and putting pressure on the bank's currently high capital ratios, or deterioration in the bank's risk profile or material increase in risk appetite.

The Short-Term IDR is sensitive to changes to BAWAG's Long-Term IDR, or a worsening of the bank's funding and liquidity.

#### SUPPORT RATING AND SRF

Any upgrade of the Support Rating and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to provide support. This is highly unlikely, in our view, in light of the new regulatory regime.

#### SUBORDINATED DEBT

The subordinated notes' rating is sensitive to changes in BAWAG's VR. It is also sensitive to a wider notching from the VR if Fitch's view of the probability of non-performance of the subordinated debt relative to the probability of the bank failing, as measured by its VR, increases, or if Fitch's view of recovery prospects changes adversely.

The rating actions are as follows:

BAWAG P.S.K.

Long-Term IDR: affirmed at 'A-'; Outlook Stable

Short-Term IDR: affirmed at 'F1'

Viability Rating: affirmed at 'a-'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'No Floor'

Senior unsecured notes: affirmed at 'A-'

Tier 2 subordinated debt: affirmed at 'BBB+'

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Applicable Criteria

Global Bank Rating Criteria (pub. 25 Nov 2016)

<https://www.fitchratings.com/site/re/891051>

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