

Rating Action: Moody's affirms BAWAG's long-term ratings at A2; changes outlook to stable from positive

Global Credit Research - 18 Oct 2017

Frankfurt am Main, October 18, 2017 -- Moody's Investors Service has today affirmed BAWAG P.S.K.'s (BAWAG) A2 long-term senior unsecured debt, issuer and deposit ratings. At the same time, the rating agency changed the outlook on these long-term ratings to stable from positive. Concurrently, Moody's affirmed BAWAG's Baa2 subordinated debt ratings as well as the bank's P-1 short-term issuer and deposit ratings.

The rating agency further affirmed the bank's baa1 Baseline Credit Assessment (BCA) and Adjusted BCA, as well as the bank's A1(cr)/P-1(cr) Counterparty Risk Assessments.

The change in outlook reflects Moody's expectation that BAWAG's credit metrics will remain commensurate with the bank's baa1 BCA during the 12 to 18 months outlook horizon, following a decline in capital ratios towards the bank management's minimum target level once the acquisition of Suedwestbank AG (Suedwestbank) closes.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

-- AFFIRMATION OF THE BCA AND THE LONG-TERM RATINGS

The affirmation of BAWAG's ratings reflects Moody's assessment that the bank's currently pursued steps towards an expansion into Germany and the proposed listing of holding company BAWAG Group at the Vienna stock exchange represent expected steps within the bank's growth strategy that are reflected in the assigned rating levels.

Moody's believes BAWAG's continued strong earnings capacity gives the bank degrees of freedom to strengthen its capitalisation if and when needed. At the same time, the bank's intention to grow organically and through bolt-on acquisitions, particularly in Germany, as well as the holding company's commitment to a 50% dividend payout ratio to its future shareholders following the initial public offering (IPO) of its shares, will leave the bank's core capital ratios bound to a range only moderately above the bank management's declared target of a sustained 12% fully-loaded common equity tier 1 (CET1) ratio.

In its IPO prospect, BAWAG restated the amount of regulatory risk-weighted assets and consequently, its fully-loaded CET1 ratio as of 30 June 2017 by a full percentage point to 15.5%. The restatement is specific to BAWAG's acquired French mortgage portfolio where the presence of a special purpose vehicle resulted in additional regulatory scrutiny and requirements. The rating agency expects these to be less pronounced in the case of the integration of other already announced acquisitions, including of German regional bank Suedwestbank.

Following the restatement of its CET1 ratio and the expected further decline in capital ratios by an additional three percentage points upon the closing of the Suedwestbank transaction, BAWAG's regulatory capital ratios will be close to management's target range. At the same time, management expects regulatory minimum requirements, including higher add-ons resulting from the Supervisory Review and Evaluation Process (SREP), will reduce the capital cushion to regulatory requirements embedded within management targets.

The baa1 BCA also takes into account that Moody's expects BAWAG's future net income growth to be constrained by the industry-wide interest margin pressures driven by the low interest rate environment and an intense competitive landscape in many banking business areas in the Austrian and German target markets of BAWAG. In addition, the beneficial effects of the booking and usage of tax loss carry-forwards experienced up to 2016 will gradually diminish for BAWAG and result in higher effective tax rates and therefore lower capital retention capabilities over the medium-term.

Moody's affirmed BAWAG's long- and short-term ratings based on the affirmation of the BCA and because all other rating factors have remained unchanged.

-- CHANGE OF OUTLOOK ON BAWAG'S LONG-TERM RATINGS TO STABLE FROM POSITIVE

Moody's today changed the outlook for BAWAG's long-term ratings to stable to reflect a decline in the probability of BAWAG sustainably improving further its standalone credit profile over the course of the 12 to 18 months outlook horizon.

-- WHAT COULD MOVE THE RATINGS UP/DOWN

Upward pressure on BAWAG's BCA and long-term ratings could result from: (1) an improvement in solvency metrics, in particular an improvement in earnings retention beyond Moody's current expectations; (2) improved execution in terms of risk measurement and controls in relation to BAWAG's portfolio acquisition-driven diversification and international expansion strategy; and (3) the absence of unduly aggressive or transformative M&A activity.

BAWAG's ratings could be downgraded if the bank's financial strength significantly deteriorates following: (1) large acquisitive activities that would significantly reduce BAWAG's capital ratios and result in material execution risks; (2) execution challenges related to the integration of already acquired portfolios or banks, including Suedwestbank; and (3) currently unexpected losses from acquired international portfolios driving up significantly the risk costs of BAWAG.

A downgrade of the long-term issuer and senior unsecured debt ratings could develop if BAWAG's volume of debt instruments decreases relative to the bank's tangible banking assets, which could result in fewer notches of rating uplift resulting from our Advanced LGF analysis.

LIST OF AFFECTED RATINGS

Issuer: BAWAG P.S.K.

Affirmations:

...LT Issuer Rating (Local & Foreign Currency), Affirmed at A2, Outlook Changed to Stable from Positive

...ST Issuer Rating (Local & Foreign Currency), Affirmed at P-1

...LT Bank Deposits (Local & Foreign Currency), Affirmed at A2, Outlook Changed to Stable from Positive

...ST Bank Deposits (Local & Foreign Currency), Affirmed at P-1

...LT Senior Unsecured (Local & Foreign Currency), Affirmed at A2, Outlook Changed to Stable from Positive

...Subordinate (Local Currency), Affirmed at Baa2

...Senior Unsecured MTN (Local Currency), Affirmed at (P)A2

...Subordinate MTN (Local Currency), Affirmed at (P)Baa2

...Adjusted Baseline Credit Assessment, Affirmed at baa1

...Baseline Credit Assessment, Affirmed at baa1

...LT Counterparty Risk Assessment, Affirmed at A1(cr)

...ST Counterparty Risk Assessment, Affirmed P-1(cr)

Outlook Action:

...Outlook, Changed to Stable from Positive

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in September 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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