



## Fitch Affirms BAWAG P.S.K. at 'A-'; Outlook Stable

Fitch Ratings-London-06 February 2019: Fitch Ratings has affirmed BAWAG P.S.K.'s (BAWAG) 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 PREFERRED DEBT

The ratings of BAWAG reflect its healthy financial profile and management's successful record in implementing the bank's post-restructuring stabilisation and expansion strategy, as well as its fairly conservative risk appetite, which combined above-average external growth with effective risk management.

The bank intends to remain acquisitive, and so far heightened operational and execution risks from multiple acquisitions have been mitigated by its extensive due diligence processes, its owners' expertise in M&A and the smooth integration of several acquisitions in the last three years. These acquisitions add to the bank's geographical (recently in Germany) and product diversification but an increase of the number of acquisition targets or their size could consume considerable management attention. Corporate governance is sound, despite the presence of a dominant shareholder, with whom the bank jointly invests in selected projects or portfolios when an opportunity arises.

BAWAG's domestic franchise is adequate, and it has been increasing its retail market shares, especially in consumer lending. We expect this trend to continue, also due to new partnerships with leading Austrian retailers.

Sound asset quality benefits from overall conservative risk appetite in Austria and Germany, its core markets, where favourable economic and credit conditions translated into a group-wide non-performing exposure ratio of 1.7% at end-3Q18, which we believe is close to the bank's cyclical low.

BAWAG's international business accounts for almost one fifth of the bank's loan exposure and combines the bank's international real estate and corporate loan books, with manageable exposures to higher-risk leveraged finance and non-performing loan financing. In addition, recently BAWAG showed an appetite for highly rated collateralised loan obligations (CLOs), although the exposure remains moderate and subject to limits. We believe these investments reflect the bank's opportunistic behaviour in the hunt for higher yields, but also contribute to higher diversification by country and industry and risk management appears effective.

BAWAG's performance compares well with domestic peers' and is supported by a strong focus on cost control, efficient processes and pricing discipline. Persistent low interest rates are a challenge for BAWAG although the higher-risk portfolios in the bank's international business, and continued growth in higher-yielding segments such as consumer lending, should support the net interest margin. Profitability benefits from the termination of the bank's co-operation with the Austrian Post through lower fee payments and the transformation of its branch network.

Healthy earnings support BAWAG's solid reported capital ratios. The common equity Tier 1 (CET1) ratio, including interim profits, at 15.3% at end-3Q18 comfortably meets regulatory requirements. Fitch expects BAWAG to maintain its fully loaded CET 1 ratio above the management target of 12%. Part of the excess capital above this target is to be used to fund organic growth and acquisitions, as well as profit distribution

through dividends and share buybacks. The bank is also working to reduce the density of risk-weighted assets, which will further strengthen regulatory capital ratios.

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

BAWAG's senior preferred notes' rating is equalised with the bank's Long-Term IDR because the bank's available buffer of qualifying junior and senior non-preferred (SNP) debt is not large enough to warrant a one-notch uplift of the senior preferred debt rating.

We expect future issuance of subordinated capital to be at BAWAG Group level, the holding company, although BAWAG P.S.K. should remain the main issuing entity for senior secured and senior unsecured debt. BAWAG plans a EUR500 million senior non-preferred issue this year to comply with minimum requirement for own funds and eligible liabilities.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating and Support Rating Floor (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. In addition, we do not factor in any support from BAWAG's owners because Fitch generally believes that support from financial investors, while possible, cannot be relied upon.

#### SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

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 PREFERRED DEBT

An upgrade of the ratings 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 BAWAG's asset base, particularly the establishment of a solid franchise in the bank's targeted international markets, while maintaining a conservative risk appetite and a focus on retail banking.

Future acquisitions could put negative pressure on the ratings if they erode capitalisation and profitability significantly for a longer period or result in unexpectedly high operational or integration risks, or if we believe that future acquisitions are no longer well-controlled or are beyond current risk appetite and management expertise.

More generally, a downgrade of the ratings could arise from excessive growth significantly undermining internal capital generation and putting pressure on the bank's currently robust capital ratios, or deterioration in the bank's risk profile or material increase in risk appetite. This could include significant growth in asset classes that we view as inherently higher-risk such as investments in CLOs and performing and non-performing loans via asset-backed structures.

A downgrade of the Short-Term IDR could be triggered by a downgrade of BAWAG's Long-Term IDR or a weakening of the bank's funding and liquidity.

The senior preferred notes' rating is sensitive to a change in the Long-Term IDR. Fitch could also notch up the rating of BAWAG's senior preferred notes by one notch above the Long-Term IDR once a sufficiently large buffer of qualifying junior debt and senior non-preferred notes exists to protect senior preferred debt

from default in case of failure.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

An 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 regulatory regime in place since the implementation of BRRD.

#### SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The subordinated notes' rating is sensitive to changes in BAWAG's VR. It is also sensitive to a wider notching from the VR, which could arise if Fitch sees an increase in the probability of non-performance of the subordinated debt relative to the probability of failure of the bank, or if our view of the subordinated notes' recovery prospects changes negatively.

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 preferred notes: affirmed at 'A-'

Tier 2 subordinated debt: affirmed at 'BBB+'

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Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

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