Press Release

DBRS Confirms Kommunalkredit Austria AG at BBB (low), Trend Revised to Positive

Banks & Trusts

October 03, 2019

DBRS Ratings Limited (DBRS) has confirmed the ratings of Kommunalkredit Austria AG (KA or the Bank), including its Long-Term Issuer Rating at BBB (low) and Short-Term Issuer Rating at R-2 (middle). The trend for all ratings has been revised to Positive, from Stable. The Intrinsic Assessment (IA) for the Bank is BBB (low), while its Support Assessment remains at SA3.

KEY RATING CONSIDERATIONS

The change in the trend to Positive, from Stable, reflects the continued progress the Bank has made in developing its franchise in infrastructure lending, the maintenance of solid capital levels as a result of both retained earnings and a further capital injection, and the solid core profitability.

The BBB (low) IA incorporates the "originate to collaborate" model for infrastructure project finance assets, whereby the Bank works closely with project sponsors and institutional investors to structure long term investments. In 2018 and the 1H19 KA has continued to build its franchise across a diverse range of deals, originating new business volumes of EUR 495.6 million in 1H19, and the new lending will continue to replace the legacy public sector portfolio as it runs off over the coming years. The Bank continues to have no non-performing loans reflecting the high quality of the public sector portfolio and the good quality of the more newly originated lending, however DBRS will continue to monitor asset quality closely given the lumpy nature of some of the infrastructure lending before syndication. Funding continues to be well balanced between the growing deposit base and other wholesale sources while liquidity remains robust, and capital ratios remain strong, albeit DBRS notes that the nominal capital base, while strengthened recently, is relatively small.

RATING DRIVERS

Further positive rating pressure would require (i) further evidence of a sustained positive track record of growth in infrastructure debt lending with well contained risks over the longer term, (ii) further improvement in core profitability resulting from the new business activity, and (iii) maintenance of good capitalisation levels.

Downward pressure on the ratings would be likely in the event of (i) evidence of the bank facing significant challenges in syndicating risk, or originating new business, (ii) any deterioration or variance in the Bank's progress in achieving its targeted levels of new business, profitability and/or capital levels, or (iii) deterioration in asset quality or earnings from new business or the legacy portfolio.

RATING RATIONALE

KA has established an "originate to collaborate" model for infrastructure and project finance assets, whereby the Bank places strong emphasis on its distribution capabilities, and works closely with project sponsors and institutional investors in order to structure long term investments. The originate to collaborate model is balance sheet-light and is based on sourcing, underwriting and then syndicating project risk. In 2018 the Bank's growth strategy, entitled "50 | 50 | 10", was clearly laid out in its 2022 financial targets. These include the aim to increase the operating result to EUR 50 million, reduce the cost/income ratio to 50% and to generate a return on equity of 10%. These targets are all set under local GAAP. New infrastructure lending continued to be strong in 1H19, reaching EUR 495.6 million, down slightly on the EUR 532.5 million in 1H18, although DBRS understands that the margins on new business have improved in 2019, and that the new business pipeline is strong.

The Bank reported net profit of EUR 11.3 million in 1H19, up from EUR 9.2 million in 1H18, primarily reflecting the increased revenues from the infrastructure and energy business. DBRS also notes that this increase incorporates the termination of the service agreement with KA Finanz AG (KF) at end-March 2019 and the related loss of revenues in the second quarter of 2019. The Bank's new business is more profitable than the legacy public finance business and as a result of the growth in the new business the gross revenue contribution from this increased to 54.2% in 1H19. DBRS expects this trend to continue as the legacy portfolio is expected to reduce by 40-50% by 2021 (from the YE16 level), however the legacy portfolio will continue to provide a crucial contribution to KA's earnings generation. As a result of the lower income from KF the Bank's reported cost-income ratio weakened slightly to 65.0% in 1H19 from 64.5% in 1H18.

KA's asset quality continues to be extremely strong with zero impaired loans as of 1H19. The Bank continues to benefit from the high quality of the legacy portfolio, but also from the strong performance of the more newly originated lending. DBRS notes that the Bank's total loan portfolio has high credit concentrations, however these concentrations are substantially mitigated by the high quality of the assets, which mostly relate to provinces or public entities and many additionally benefit from guarantees. Additionally, DBRS notes the still relatively unseasoned nature of KA's newly originated loan book and the greater risks during the portfolio build-up phase. DBRS will also continue to closely monitor the success of the Bank in syndicating exposures in a conservative manner to ensure it is appropriately positioned at times of market stress.

KA's customer deposits continue to grow, increasing by 28% over the last year to reach EUR 1.166 billion at 1H19, and at 1H19, represented 39% of the Bank's total funding, up from 30% at YE18.

DBRS considers the deposit base as relatively stable given the term of these deposits. The growing deposit base supports the already diversified funding base which also includes covered bonds, senior debt issuance and TLTRO funding. Covered bonds remain a significant funding source for KA with these funding the bulk of the legacy loan book. The legacy funding will decline in tandem with the run-off and maturity of the assets they finance. KA has a robust liquidity profile with a free liquidity reserve of EUR 294.6 million at 1H19, including EUR 284.5 million of HQLA (high quality liquid assets), and EUR 272.8 million of cash and balances with central banks. Together these are well in excess of total debt maturities to the end of 2020. At 1H19 the Bank's Liquidity Coverage Ratio (LCR) was very high at 733% and the Net Stable Funding Ratio (NSFR) was also solid at 101.8%.

The Bank's fully-loaded Basel III Common Equity Tier 1 (CET1) ratio was at a high level of 17.5% at 1H19, albeit DBRS notes this has reduced from 19.9% at FY18 as the proportion of new business with higher risk weightings continues to increase. As of 1H19, the Bank reported a total capital ratio of 20.9% and a leverage ratio of 7.7%. The relatively low level of nominal capital, however, highlights the importance of managing concentration risk and the ability of the Bank to syndicate exposures. KA is targeting to maintain a CET1 ratio exceeding 15% over the long term, as the new business increases and higher risk weightings for future new business impact the capital ratios. Maintaining both capital levels and ratios will be important to balance the risks arising from the credit risk concentrations inherent to the business model, the potential cash flow uncertainty of some infrastructure projects at times of market stress, as well as the relative illiquidity of the financed assets. DBRS views the Bank's internal capital generation ability as improving. As such DBRS notes positively that the FY18 earnings were retained within the Bank, and that in June 2019 a further EUR 20 million of capital was injected into the bank.

The Grid Summary Grades for Kommunalkredit Austria AG are as follows: Franchise Strength – Moderate; Earnings – Moderate; Risk Profile – Good/Moderate; Funding & Liquidity – Good; Capitalisation – Moderate.

Notes:
All figures are in EUR unless otherwise noted.

The principal applicable methodology is the Global Methodology for Rating Banks and Banking Organisations (June 2019). This can be found can be found at: http://www.dbrs.com/about/methodologies

The sources of information used for this rating include Company Documents, and S&P Global Market Intelligence. DBRS considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

DBRS does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

Generally, the conditions that lead to the assignment of a Negative or Positive Trend are resolved within a twelve month period. DBRS's outlooks and ratings are under regular surveillance

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Ratings

Kommunalkredit Austria AG

Date Issued	Debt Rated	Action	Rating	Trend	Issued
03-Oct-19	Long-Term Issuer Rating	Trend Change	BBB (low)	Pos	EU
03-Oct-19	Short-Term Issuer Rating	Trend Change	R-2 (middle)	Pos	EU
03-Oct-19	Long-Term Senior Debt	Trend Change	BBB (low)	Pos	EU
03-Oct-19	Short-Term Debt	Trend Change	R-2 (middle)	Pos	EU

Date Issued	Debt Rated	Action	Rating	Trend	Issued
03-Oct-19	Short-Term Deposits	Trend Change	R-2 (middle)	Pos	EU
03-Oct-19	Long-Term Deposits	Trend Change	BBB (low)	Pos	EU

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