PRESS RELEASE

SEPTEMBER 27, 2023

DBRS Morningstar Confirms Kommunalkredit Austria AG's BBB Long-Term Issuer Rating, Trend Changed to Positive from Stable

BANKING ORGANIZATIONS

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

KEY CREDIT RATING CONSIDERATIONS

The trend change to Positive reflects KA's improving profitability while maintaining strong asset quality metrics, high liquidity buffers and solid capital ratios. Management has consistently executed and outperformed its strategic targets in the past and DBRS Morningstar believes that KA's positive revenue momentum continues to benefit from factors such as balance sheet growth, margin improvement and one-off opportunities. In addition, new business initiatives should help further growth and also diversify revenue streams to some extent. The Positive trend also takes into account that Altor Funds signed an agreement to acquire an 80% stake in KA along with a capital increase. The deal is expected to close by year-end 2023 or early 2024. DBRS Morningstar does not expect a change in strategy from the ownership change and is of the opinion that it will support the Bank's strategy.

The BBB IA continues to incorporate KA's growing franchise in Infrastructure and Energy (I&E) finance as well as the Bank's public finance business. The I&E business (including exposure to utilities and corporates) now represents 60% of total assets. In DBRS Morningstar's opinion the Bank's credit risk management is sound and non-performing loans are negligible. Also, we generally consider infrastructure assets as more resilient during time of crises. However, given the concentration risk and the significant proportion of sub-investment grade assets, and assets in the construction and development phase, we will continue to closely monitor credit performance. Syndication risk remains a key risk for the Bank but continues to be well managed. Funding sources are balanced between the growing deposit base and other wholesale sources, and the Bank has consistently maintained high liquidity buffers. However, we also note the increased inflow of short-term deposits. Capital ratios remained robust and in order to take advantage of the current market opportunities, the Bank has announced new and ambitious growth plans, which entail some execution risk.

The current IA is positioned below the DBRS Morningstar Intrinsic Assessment range (IAR). The IAR incorporates the strong 2021 and 2022 results, which have partly benefitted from a number of factors that may not be recurring, such as gains from debt repurchases and valuation gains as a result of the increase in interest rates. Also, KA is a small, specialised Bank with a still short, albeit growing, operating track record and with limited revenue diversification. These factors are not fully reflected in the Scorecard and Grids. In order to take advantage of the current market opportunities, the Bank plans further growth, which is likely to lead to more diversified earnings streams and reduced balance sheet risk in the future, but entail some execution risk in the interim. We will be monitoring the progress made, with regards to recurring revenue growth, the strengthening of the Bank's capital base, and the Bank's funding activities in order to maintain a sound funding profile.

CREDIT RATING DRIVERS

A ratings upgrade is contingent on a successful ownership change along with the planned capital increase. In addition, a further well-executed expansion of the franchise, together with continuous track record of sustainable profitability, solid asset quality, and sound liquidity and capital management is required for a ratings upgrade.
Should the change in KA's ownership and the related capital increase not materialise, the trend would be changed back to Stable. A marked deterioration in asset quality, challenges in syndicating risk or other risks that could adversely affect the Bank's reputation or financial wellbeing could also result in a negative rating action.

CREDIT RATING RATIONALE

Franchise Combined Building Block (BB) Assessment: Weak

Kommunalkredit is a small bank with total assets of EUR 4.9 billion at H1 2023 specialised in infrastructure and energy (I&E) finance and public sector finance. In addition to net interest income from assets held on balance sheet, the Bank derives fee income from its subsidiary Kommunalkredit Public Consulting (KPC) gradually supplemented by ancillary businesses. The Bank is well established, ranking among the top 20 originators in the European I&E finance market. Its relatively small size makes the Bank less dependent on movements in the overall market and leaves ample room for growth. However, DBRS Morningstar also notes the high concentration in the I&E finance segment and the Bank's still limited operating track record. In February 2023, Altor Funds agreed to take a majority stake in the Bank and to inject EUR 100 million in capital to support KA's growth plans. This will allow KA to gradually increase its market share and participate in larger deals. KA also plans to expand in advisory, asset management, and structured export finance, largely capitalising on existing relationships. This should lead to a higher revenue diversification over time. KA targets a medium-term ROE in excess of 14% and a CET1 ratio of ca. 15%.

Earnings Combined Building Block (BB) Assessment: Good

In DBRS Morningstar's opinion KA's earnings capacity is sound and has continuously improved as the Bank has expanded its I&E platform and revenue growth outpaced expense growth. 2021, 2022 and H1 2023 results were particularly strong, benefitting mostly from balance sheet growth and margin expansion. While some of the revenue improvement was also due to developments that are less recurring in nature, it afforded KA the flexibility to invest in growth. We expect KA's positive revenue momentum to continue to benefit from factors such as balance sheet growth, strong new business margins, increasing underwriting volumes, one-off opportunities as well as new business initiatives, especially in advisory. At the same time we expect management to keep its focus on costs in order to achieve its medium-term return on equity (ROE) target in excess of 14% (as calculated by the Bank).

The Bank reported a 2022 net profit of EUR 78.2 million, up 59.9% YOY, mostly driven higher interest income, resulting in an ROE of 17.5% as calculated by DBRS Morningstar, up from 11.2% in 2021. Net interest income rose significantly, up 59% YOY to EUR 126 million at end-2022, driven by strong portfolio growth of 20%, a special financing opportunity and the high interest rate environment. In H1 2023 net profit was EUR 41.7 million, up from EUR 39.1 million in H1 2022, driven also by a strong increase in net interest income, but largely offset by the significantly lower valuation gains and higher expenses to facilitate growth. Due to a higher equity base the ROE slipped somewhat from 18.0% in H1 2022, but was still high at 16.8%.

Risk Combined Building Block (BB) Assessment: Strong / Good

Despite a slight increase in nonperforming loans, DBRS Morningstar considers KA's asset quality as strong, reflecting the sound underwriting standards and the general resilience of I&E lending. However, sector concentration risk has been increasing with the growth of the I&E portfolio and a significant proportion of these assets are sub-investment grade. In addition, single name concentration in the private sector lending portfolio is on the high side as well. In our view, syndication risk is relatively contained supported by the Bank's asset management platform, which absorbs a part of the assets originated, and high capital buffers. DBRS Morningstar notes that the management team has been growing, but still sees key man risk as a challenge for the Bank. The Bank has ambitious growth plans for the future and will be under new ownership, which could pose a variety of operational risks, as systems and management processes are likely to be subject to significant change and management attention could be diverted. However, we positively view a higher degree of revenue diversification without incurring incremental credit risk resulting from the Bank's strategic initiative.

Funding and Liquidity Combined Building Block (BB) Assessment: Good / Moderate

In DBRS Morningstar's view KA's funding profile is diverse and comprises a significant deposit base, covered bonds, unsecured debt, AT1 capital and central bank funding. KA has demonstrated access to unsecured wholesale markets, however, given its small size and infrequent issuance needs, wholesale funding conditions may not always be favorable and this option is likely to be used on a more opportunistic basis. Customer deposits have become the Bank's most important source of funding, representing 55% of the Bank's total non-equity funding compared to 43% a year earlier, and funded 85% of private sector loans (I&E projects, utilities and corporates). With the growth of retail deposits, the depositor base has become more granular over time. However, we note that retail deposits are gathered online, which tends to make them less sticky. We also note an increased inflow of short-term deposits, but understand that the Bank is looking to lengthen the term structure. At H1 2023, the Bank's Liquidity Coverage Ratio (LCR) was high, at 387%, and the Net Stable Funding Ratio (NSFR) was solid at 115%.

Capitalisation Combined Building Block (BB) Assessment: Strong / Good

At the Bank level, KA reported a CET1 ratio of 15.2% at end-H1 2023, down from 16.9% at year-end due to an increase in risk-weighted assets (RWA) to EUR 2.8 billion at end-H1 2023 from EUR 2.6 billion at end-2022, while H1 2023 retained earnings are not yet reflected in capital. The regulatory minimum requirement for the Bank's CET1 ratio is 9.3% and the Bank aim to maintain a ratio of 15%. DBRS Morningstar notes that KA's capital ratios can fluctuate due to its origination and syndication activities. In our view, it is essential for the Bank to maintain high cushions over minimum capital requirements, as a safeguard against the credit risk concentration and syndication risk as well as the relative illiquidity of the financed assets.

Further details on the Scorecard Indicators and Building Block Assessments can be found at https://www.dbrsmorningstar.com/research/421114

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

There were no Environmental, Social or Governance factors that had a significant or relevant effect on the credit analysis.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings (4 July 2023).

Notes:
All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations https://www.dbrsmorningstar.com/research/415978/global-methodology-for-rating-banks-and-banking-organisations (22 June 2023). In addition DBRS Morningstar uses the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings in its consideration of ESG factors.

The credit rating methodologies used in the analysis of this transaction can be found at: https://www.dbrsmorningstar.com/about/methodologies

The sources of information used for this credit rating include Morningstar Inc. and Company Documents, KA's Annual Reports 2018-2022, KA's Interim Report H1 2023, KA's Disclosure Report 2022. DBRS Morningstar considers the information available to it for the purposes of providing this credit rating to be of satisfactory quality.

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

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and credit ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: https://registers.esma.europa.eu/cerep-publication. For further information on DBRS Morningstar historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see https://data.fca.org.uk/#/ceres/craStats.

The sensitivity analysis of the relevant key credit rating assumptions can be found at: https://www.dbrsmorningstar.com/research/421112.

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Initial Rating Date: September 30, 2015
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For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

Ratings

Kommunalkredit Austria AG

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
27-Sep-23	Long-Term Issuer Rating	Trend Change	BBB	Pos	EU U
27-Sep-23	Short-Term Issuer Rating	Trend Change	R-2 (high)	Pos	EU U
27-Sep-23	Long-Term Senior Debt	Trend Change	BBB	Pos	EU U
27-Sep-23	Short-Term Debt	Trend Change	R-2 (high)	Pos	EU U
27-Sep-23	Short-Term Deposits	Trend Change	R-2 (high)	Pos	EU U
27-Sep-23	Long-Term Deposits	Trend Change	BBB	Pos	EU U

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