

Research Update:

Kommunalkredit Austria AG Upgraded To 'BBB/A-2' On Strong Earnings And Better Performance Than Peers'; Outlook Stable

March 13, 2024

Overview

- Austria-based bank Kommunalkredit reported a record high net profit in 2023, thanks to its ability to boost interest income while keeping loan losses low.
- Most financial metrics that we track as part of our rating analysis indicate that Kommunalkredit is outperforming its peer group of banks.
- We therefore raised our ratings on Kommunalkredit to 'BBB/A-2' from 'BBB-/A-3', and our issue rating on the bank's senior preferred debt by one notch to 'BBB'.
- The stable outlook reflects our expectation that, over the next 12-24 months, the bank will continue to demonstrate sound earnings and asset quality, supported by a steady business and risk strategy under its new majority shareholder, Altor Funds.

Rating Action

On March 13, 2024, S&P Global Ratings raised its long- and short-term issuer credit ratings on Kommunalkredit Austria AG to 'BBB/A-2' from 'BBB-/A-3'. The outlook is stable.

We also raised our issue rating on Kommunalkredit's senior unsecured (senior preferred) debt instrument to 'BBB' from 'BBB-'.

Rationale

The upgrade stems from Kommunalkredit's strong earnings generation over 2023 and better performance than other European banks in its peer group in recent years. The bank reported a record high after-tax profit of €101 million at year-end 2023, translating into what we measure as a return on average common equity (ROCE) of 21.8% and a cost-to-income ratio of 41.3%. By contrast the median ROCE for the peer group was 8.8% and the cost to income figure was 55%.

PRIMARY CREDIT ANALYST

Cihan Duran, CFA
Frankfurt
+ 49 69 3399 9177
cihan.duran
@spglobal.com

SECONDARY CONTACTS

Harm Semder
Frankfurt
+ 49 693 399 9158
harm.semder
@spglobal.com

Karim Kroll
Frankfurt
6933999169
karim.kroll
@spglobal.com

ADDITIONAL CONTACT

Financial Institutions EMEA
Financial_Institutions_EMEA_Mailbox
@spglobal.com

Kommunalkredit's risk-adjusted profitability, measured as core earnings to S&P Global Ratings' risk-weighted assets metric, also reached 3.0%, far surpassing the median for the peer group of 1.1%. We believe Kommunalkredit has stronger earnings power and higher efficiency than banks with a 'bbb-' stand-alone credit profile (SACP).

Sweden-based Altor Funds plans to acquire an 80% majority stake in Kommunalkredit pending regulatory approval. The change in ownership will likely be completed during the next 12 months. We understand that Altor supports Kommunalkredit's current strategy and management. Therefore, we view execution risk stemming from the change in control as low. We include the €100 million equity injection that Altor plans to make in our calculation of Kommunalkredit's total adjusted capital for 2024. However, we believe this amount will be consumed by the bank's planned growth over the next few years. As such, we project that our risk-adjusted capital (RAC) ratio will be close to 14.5% by year-end 2026, the same as at year-end 2023, after increasing from 13.5% in 2022 due to earnings retention.

Kommunalkredit targets balance sheet growth on the back of Europe's green transition and digital transformation. Its project finance business with corporates in Europe's infrastructure and energy sector, as well as its public finance portfolio, have remained resilient to recent market turbulence and economic swings. This explains the bank's continuously low cost of risk, ranging between zero basis points (bps) and 10 bps over the past 10 years. We anticipate the bank will adhere to a prudent growth and risk strategy, despite loan growth, which we project at 7%-12% annually in 2024-2026. Kommunalkredit reported a nonperforming asset (NPA) ratio of only 1.3% as of Dec. 31, 2023 (based on S&P Global Ratings definition), after zero NPAs previously. We note that the largest default will likely be recovered over the next 12-18 months. Most of the remaining exposures are insured by export credit agencies. Nonetheless, we believe the bank will see inflows of new NPAs considering its growth plan and event risks in its concentrated loan portfolio, keeping its NPA ratio at close to 1.5% through 2026.

Our positive view of Kommunalkredit in our comparable rating analysis results in an upward adjustment to the SACP to 'bbb'. Our adjustment is informed by our analysis of the bank's peers and captures characteristics not fully covered by other rating factors. We expect Kommunalkredit's profits will dip over 2024 as net interest margins normalize and costs rise alongside its growth plans. Nevertheless, we believe the bank will maintain its solid earnings capacity in the future. The bank's earnings buffer was 3.6% at year-end 2023, indicating its strong capacity to absorb normalized credit losses with operating income through a full economic cycle. This is markedly better than the estimated median of 1.9% for rated European banks in 2023.

Outlook

The stable outlook reflects our expectation that, during the next 12-24 months, Kommunalkredit can maintain sound earnings and asset quality, strong capitalization, and prudent lending and underwriting standards. We believe the bank's current strategy and risk governance, including execution of the business pipeline, will remain unchanged under the incoming majority shareholder, Altor.

Downside scenario

We could lower our ratings on Kommunalkredit if the bank's loan portfolio deteriorated, with a

subsequent rise of nonperforming assets and credit losses. Similarly, we could lower our ratings if Kommunalkredit unexpectedly adopted a more aggressive growth strategy that stretched its resources, or if material risks arose from higher risk taking within its loan syndication portfolio. Weakening profitability could also put pressure on the ratings.

Upside scenario

An upgrade is unlikely over the next 12-24 months because we expect Kommunalkredit's business expansion and growth of risk-weighted assets will restrict further improvement of our RAC ratio. What's more, the amount of unseasoned loans in its portfolio since 2020 and concentrations on the loan book make the bank vulnerable to asset quality deterioration, in our view.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB/Stable/A-2	BBB-/Positive/A-3
SACP	bbb	bbb-
Anchor	bbb+	bbb+
Business position	Constrained (-2)	Constrained (-2)
Capital and earnings	Strong (+1)	Strong (+1)
Risk position	Adequate (0)	Adequate (0)
Funding and liquidity	Moderate and adequate (-1)	Moderate and adequate (-1)
Comparable ratings analysis	+1	0
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Eurozone Q1 2024: Headed For A Soft Landing, Nov. 27, 2023
- Banking Industry Country Risk Assessment: Austria, Aug. 1, 2023
- Full Analysis: Kommunalkredit Austria AG, July 21, 2023
- Kommunalkredit Austria Outlook Revised To Positive On Sound Performance And Asset Quality Trajectory; Affirmed At 'BBB-', March 10, 2023

Ratings List

Upgraded

	To	From
Kommunalkredit Austria AG		
Senior Unsecured	BBB	BBB-

Upgraded; Outlook Action

	To	From
Kommunalkredit Austria AG		
Issuer Credit Rating	BBB/Stable/A-2	BBB-/Positive/A-3

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.spglobal.com/ratings (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.spglobal.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.