S&P Global Ratings

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Research Update:

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

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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%.

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