FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Addiko 'BB'; Outlook Stable

Mon 07 Aug, 2023 - 3:15 AM ET

Fitch Ratings - Frankfurt am Main - 07 Aug 2023: Fitch Ratings has assigned Addiko Bank AG (Addiko) a Long-Term Issuer Default Rating (IDR) of 'BB' and Viability Rating (VR) of 'bb'. The Outlook on the Long-Term IDR is stable. A full list of rating actions is below.

KEY RATING DRIVERS

Addiko's Long-Term IDR and VR reflect the bank's company profile as a specialised lender focused on unsecured lending to retail clients and small businesses in the south eastern Europe (SEE) region, where its economies are more volatile. The VR also reflects the group's adequate risk profile, improving asset quality and earnings. Capitalisation, liquidity and funding are rating strengths.

The Stable Outlook on Addiko's Long-Term IDR reflects our view that labour market indicators in Addiko's largest markets should remain resilient in the next two years despite slower economic growth. However, high inflation is likely to lead to a moderate increase in impaired loans and loan impairment charges (LICs). The latter are likely to be offset by higher lending margins due to rising interest rates.

Focus on SEE: Addiko operates in SEE, including in countries with more volatile and less advanced economies as well as moderately developed banking sectors and capital markets. This is partly mitigated by limited geographic diversification across the region and a highly developed regulatory and legal framework in Austria, where the bank is headquartered and key corporate functions including liquidity management are centralised.

Niche Business Model: Our assessment of Addiko's business profile balances the group's small but growing franchise, which we believe has a critical mass in all markets. It also reflects Addiko's positioning as a challenger, with clear unique selling points (speed and modern digital offering), which affords the group some pricing power.

Execution of the bank's business plan and strategy benefit from management's knowledge of local markets and record in its key banking segments. Our assessment also reflects Addiko's small operations and a less diversified business model compared with larger peers'.

Unsecured Lending: Addiko's risk profile is driven by its exposure to unsecured consumer and SME lending in SEE. We view the bank's underwriting criteria in line with local industry practice. However, these have not yet been tested in a prolonged economic downturn.

At the same time, the bank's risk profile benefits from significantly reduced concentration risks due to the wind-down of non-core corporate exposures and impaired loans. Risk controls are adequate while market risk is low. Addiko's exposure to non-financial risks has significantly reduced in recent years and does not constrain its risk profile. Non-financial risks mainly result from legal claims related to Swiss-franc mortgages originated before 2009.

Improving Asset Quality: Addiko's asset quality reflects its positive performance in recent years. Addiko has reduced its impaired loans ratio to 4.6% at end-2022 from 25% at end-2015 through portfolio sales and settlements. We expect the four-years average impaired loan ratio to remain close to 5% over the next two years, as it writes off non-performing loans (NPLs) in Croatia and Slovenia.

We expect loan impairment charges (LICs)/gross loans to increase to about 100bp-130bp in 2024, which is adequately covered by pre-impairment profits. LICs have remained below that level in the past five years and benefited from loan loss allowance reversals in wind-down portfolios.

Weak but Improving Profitability: Addiko's profitability is weak but improving on the back of its successful restructuring, supported by a solid record of cost management, lower LICs and improving net interest margins, which we expect to continue in the next two years. Our assessment also reflects the bank's dependence on less diversified revenues from less stable operating environments and a potential, albeit limited, burden from additional provisions for legacy Swiss franc loans.

Solid Capitalisation: Addiko's capitalisation is a rating strength in light of its high risk-weight density, which translates into an above-average leverage ratio. Our assessment also reflects the bank's high and stable capital adequacy targets and improving pre-impairment profitability.

Stable Deposits Underpin Funding: Addiko is mainly funded by retail deposits sourced locally, which is positive for our assessment of funding and liquidity. Its 'bb+' score at the higher end of the implied range is supported by a healthy structural liquidity position. Addiko has no reliance on external wholesale funding. We view as credible the bank's intention not to access the wholesale market in the medium term given its liquidity buffer and established depositor base.

Addiko's 'B' Short-Term IDR is the only option that maps to a 'BB' Long-Term IDR on Fitch's rating scale.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

We would downgrade the ratings following a substantial capital erosion, which could be caused by a materialisation of legal risks, from aggressive dividend distribution or from asset-quality deterioration (including materially larger write-offs).

In addition, we could downgrade the ratings if strategic objectives shift, growth acceleration results in a negative deviation from current underwriting standards and investment policies, or due to failure to maintain operating profit at least at 1.25% of risk-weighted assets (RWAs).

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade would require a record of operating profit close to 2.5% of RWAs, indicating a sustained strengthening of Addikos's business profile, while maintaining an impaired loans ratio at or below about 5% and a common equity Tier 1 ratio of close to 20%.

An upgrade could also result from a material improvement in the operating environment, as a result of a shift in business expansion towards markets Fitch deems more stable, notably Croatia or Slovenia.

The Government Support Rating of 'no support' reflects our view that the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism provide a resolution framework that is likely to require senior creditors participating in losses instead of a bank receiving sovereign support. In addition, we do not factor in any support from Addiko's owners because Fitch generally views that support from financial investors, while possible, cannot be relied on.

An upgrade of Addiko's GSR would require a higher propensity of sovereign support. While not impossible, this is highly unlikely due to the prevailing regulatory framework and Addiko's low systemic importance in Austria.

VR ADJUSTMENTS

The operating environment score of 'bb+' has been assigned below the 'aa' category implied score, due to the following adjustment reason: international operations (negative).

The business profile score of 'bb' has been assigned above the 'b' category implied score, due to the following adjustment reason: strategy and execution (positive).

The asset quality score of 'bb-' has been assigned above the 'b and below' category implied score, due to the following adjustment reason: historical and future metrics (positive).

The earnings and profitability score of 'bb-' has been assigned above the 'b and below' category implied score, due to the following adjustment reason: historical and future metrics (positive).

The capitalisation and leverage score of 'bb' has been assigned below the 'bbb' category implied score, due to the following adjustment reason: risk profile and business model (negative).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

DATE OF RELEVANT COMMITTEE

20 July 2023

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		
Addiko Bank AG	LT IDR	BB Rating Outlook Stable	New Rating
	ST IDR	B	New Rating
	Viability	bb	New Rating
	Government Support	ns	New Rating

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Addiko Bank AG	-

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