Austria
Credit Analysis

Erste Bank der oesterreichischen Sparkassen AG

Ratings

Erste Bank der oesterreichischen Sparkassen

Foreign Currency	
Long-Term IDR*	A
Short-Term IDR*	F1
Outlook	Positive
Individual	B/C
Support	1
Support Rating Floor	A-
Sovereign Risk	
Foreign Long-Term IDR*	AAA
Local Long-Term IDR*	AAA
Outlook	Stable

* IDR – Issuer Default Rating

Financial Data

Erste Bank der oesterreichischen Sparkassen

	30 June 2007	31 Dec 2006
Total Assets (USDm)	263,137.3	239,303.6
Total Assets (EURm)	197,353.0	181,703.2
Equity (EURm)	11,444.0	10,943.2
Operating Profit (EURm)	902.9	1,477.5
Published Net Income (EURm)	708.8	1,182.4
Comprehensive Income (EURm)	353.8	745.4
Operating ROAA (%)	0.95	0.88
Operating ROAE (%)	16.13	16.99
Internal Capital Generation (%)	6.32	6.21
Eligible Capital/ Weighted Risks (%)	9.20	8.21
Tier 1 Ratio (%)	6.40	6.60

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Rating Rationale

- The ratings of Erste Bank der oesterreichischen Sparkassen AG (Erste Bank) reflect its sustainable profitability and strong retail banking franchise at home and in some countries in Central and Eastern Europe (CEE). They also take into account the undistinguished asset quality of the domestic loan book and exposure to the untested economies in CEE.
- The overall performance of the Austrian business has improved partly due to a more favourable domestic economy. However, given the strong competition, the operating environment remains challenging. Revenue generation benefits from closer cooperation with the Austrian savings banks, more sales-orientated customer services and cross-selling. Cost control remains tight.
- The operations in CEE generate more than half of operating profit. In CEE, Erste Bank has a well-established franchise, and the restructuring at its largest subsidiaries, excluding Banca Comerciala Romana (BCR), acquired in Q406, is now complete. Scope for additional revenues in CEE through volume growth, despite narrowing interest spreads, and from selling more sophisticated, fee-based products is substantial.
- The bank's risk profile is improving on the back of growing CEE economies. With their entrance into the EU, these economies are expected to converge with the more mature EU economies, reducing their volatility. Controls over risks at the CEE subsidiaries are tight. Asset quality is satisfactory. However, accelerated loan growth in CEE bears additional risks, given that these markets remain largely untested.
- In Austria, non-performing loans (NPLs) are high, at 4.7% of end-2006 gross domestic loans; reserve coverage is reliant on collateral.
- Market risk is low, mostly structural and closely monitored. Funding benefits from a stable retail deposit base at home and in CEE.
- While the eligible capital base is adequate, Fitch considers the capital ratios to be somewhat tight in light of a possible change in the bank's rating level. A strengthened earnings base should enable the bank to focus on its internal capital generation.

Support

- Given Erste Bank's significance to Austria's banking system, there is, in Fitch Ratings' opinion, an extremely high probability of support from the authorities, should this ever become necessary.

Rating Outlook and Key Rating Drivers

- The Positive Outlook on the Long-Term IDR reflects the bank's franchise, size and ability to manage the execution risk of integrating BCR. Sustaining profitability, including a stronger performance in its domestic market, without compromising on risks and capitalisation, and improving domestic asset quality would support a positive rating action.

Profile

- Erste Bank, Austria's second-largest banking group by assets, is a savings bank in its own right. It acts as central institution for the savings banks and has a strong domestic retail franchise and close relationships with small and medium-sized enterprises (SMEs).
- The presence in CEE encompasses Ceska Sporitelna (CS, rated 'A') and Slovenska Sporitelna (SLSP, rated 'A'), among the largest retail banks in the Czech Republic and Slovakia respectively; BCR (rated 'A-'); Erste Bank Hungary (EBH), including Postabank; Erste Bank Croatia (EBC), including Rijecka Banka; and Erste Bank ad Novi Sad in Serbia (EBS), including Novosadska banka, acquired in 2005.

31 July 2007

Profile

- **Central institution of Austria's savings banking sector with strong retail banking franchise at home and in CEE**
- **A portfolio of investments in CEE banks at different stages in their development cycle should secure long-term growth**
- **Implementation of operating holding company structure by mid-2008**

At home, Erste Bank is a central and savings bank, consolidating around a third of Austria's domestic banking assets. As one of the key investors in CEE, it has considerably expanded its distribution network throughout the region, continuing to mainly serve its core client base: SMEs and private individuals in Austria and abroad. The group's strategy focuses on loan growth, the provision of asset management services as well as regional expansion. Profit growth should be facilitated by the fact that the markets in which the bank is operating are at different stages in their development cycle.

In Austria, Erste Bank acts as the central institution of the savings banks sector, comprising 53 savings banks, to which it provides products, services and back-office functions. The Austrian division (986 branches and 14,802 employees at end-March 2007 or 29% of total staff) consists of the following operations:

- **Savings Banks** includes the 43 savings banks that are part of the cross-guarantee system (see below). Erste Bank has improved coordination and cohesion within the sector, which has adopted a common corporate identity, joint marketing initiatives and a unified IT platform. The banks follow common risk management standards and have harmonised processes for asset and liability management (ALM), budgeting and planning.

- **Retail and Mortgage (R&M)** comprises retail and private banking, real estate finance (including lending to property developers) and the three savings banks majority-owned by Erste Bank. It also includes the country's second-largest asset manager, ERSTE-SPARINVEST KAG, with EUR31bn of assets under management at end-2006 and a domestic market share of 18%; a building and loans association; and a car leasing firm. Erste Bank also owns 62% in Sparkassen Versicherung AG, the sector's insurance company and one of Austria's largest life assurers (EUR1.1bn of premium written in 2006).

- **Large Corporates** services domestic and international companies with a turnover exceeding EUR70m. The bank has relationships with about 50% of Austria's top 500 companies and is servicing large corporates with operations across the group's key markets through a separate unit. In addition to commercial lending, the bank offers structured, trade, export and project finance, as well as leasing services and corporate finance advisory and capital market services.

- **Trading and Investment Banking (T&IB)** includes the treasury and trading activities in Vienna and abroad and also develops structured products. Erste Bank is one of Austria's main providers of investment banking services for SMEs.

Central and Eastern Europe: Since 1997, Erste Bank has invested in banks in CEE (see *Appendix 1*) as the potential for growth in its mature home market has been limited (although this has improved in recent years). Asset growth in the CEE region has been rapid, in particular driven by retail lending in fast growing economies. To date, acquisitions have mainly centred on retail banks in neighbouring countries, with the aim of capturing a 15%-20% share of the market. Erste Bank group enjoys strong local franchises in the Czech Republic, Romania and Slovakia, whereas the subsidiaries in Serbia, Hungary, and Croatia accounted for a market share in their respective countries of between 2%-12% at end-2006. Erste Bank has closely integrated its CEE businesses and restructured them post-acquisition. A group steering committee, in place since 2003, is dealing with cross-country topics and currently comprises the group's board of directors and the CEOs of the main CEE subsidiaries. Erste Bank now holds 69.2% in BCR after acquiring the stakes of the Romanian government, other shareholders and some BCR employees, with mainly local investment funds holding the remainder. The purchase of BCR has been the most substantial to date and was completed in Q406. Management centred the acquisition rationale for BCR on the above-average potential for growth in Romania (rated 'BBB') and on the country's likely convergence with EU countries. A comprehensive plan to integrate and develop BCR is in place. In July 2006, Erste Bank entered the Ukrainian banking market by purchasing Bank Prestige (now renamed Erste Bank Ukraine) for EUR80m and is planning to inject around EUR230m of fresh capital until 2010 to support growth.

International Business serves international large corporates, banks and public sector entities and operates from branches in London, New York and

Table 1: Key Performance Indicators

(%)	Erste Bank ('A', 'B/C') H107	2006	2005	BA-CA ('A', 'B/C')[a] H107	2006	2005	RZB (NR)[b] H107	2006	2005
Net interest margin	2.19	2.02	1.97	n.a.	1.73	1.71	n.a.	2.17	2.02
Costs/average assets	2.05	1.95	1.97	n.a.	1.80	1.87	n.a.	2.02	1.95
Cost/income ratio	63.27	62.91	64.17	n.a.	59.11	62.65	n.a.	58.38	60.46
Pre-imp. operating profit/ROAA	1.21	1.17	1.12	n.a.	1.31	1.17	n.a.	1.52	1.37
Operating ROAA	0.95	0.88	0.81	n.a.	0.86	0.82	n.a.	1.16	1.07
Operating ROAE	16.13	16.99	19.19	n.a.	15.28	17.42	n.a.	20.70	20.73
Core capital/total assets	3.77	3.66	2.83	n.a.	6.21	4.48	n.a.	5.10	4.66
Eligible capital ratio	9.20	8.21	6.89	n.a.	12.99	9.90	n.a.	10.58	9.70
Equity (EURm)	11,444	10,943	6,453	n.a.	10,140	7,520	n.a.	6,717	5,042

[a] Bank Austria Creditanstalt AG (BA-CA), Long-Term IDR driven by support and on Positive Outlook
[b] Raiffeisen Zentralbank AG (RZB)
Source: Banks' annual reports, data adapted by Fitch. Long-Term IDR and Individual rating shown in brackets where applicable

Hong Kong, as well as the international business unit in Vienna. Business focuses on trade, project and structured finance.

Erste Bank is in the process of transforming itself into an operating holding company. The change in organisational structure is planned to become legally effective in July 2008 and includes the transfer of all Austrian customer business to a newly created domestic bank. Capital markets, corporate finance and investment banking businesses will be bundled with the holding company as well as corporate functions.

Cross-Guarantee Mechanism (Haftungs-verbund): Effective from 1 January 2002, Erste Bank and the savings banks set up a cross-guarantee mechanism. A recent ruling by the Austrian Supreme Court approved this cooperation and ended some long-lasting legal cases. While the ruling restricted the exchange of client information between Erste Bank and the savings banks, the savings bank sector has now further intensified the cooperation. Some additional regulatory approvals are required, but are likely to be granted given the ruling. Currently, 43 of the 53 savings banks have agreed to the revised terms of the agreement of the Haftungsverbund (initially valid for 10 years), which should further strengthen cooperation in the sector and provide Erste Bank with some control over the appointment of board members at the savings banks, the annual budgeting process and price strategy. A steering company, at least 51%-owned by Erste Bank, implements and monitors common risk policies; the steering company is obliged to support member banks in financial difficulties through a limited fund. The domestic banking law allows full consolidation of the capital of all member savings banks, which together hold 95% of the savings bank sector's customer deposits. In Fitch's view, the capital of all member banks would be available to support any member within the Haftungsverbund.

Ownership: The main shareholder is Die Erste oesterreichische Privatstiftung, a foundation with limited resources, holding 30.6%, followed by the Austrian savings banks (around 7%) with the remainder being widely held.

Presentation of Accounts: The bank consolidates the Austrian savings banks of the Haftungsverbund and deducts minority interests for entities not wholly owned. Since Fitch bases part of its analysis on net income before deductions of minority interests, its ratios may differ from those published by the bank.

■ Performance

- **Results in CEE lift performance, with CS remaining key contributor. BCR should become the second driver of profitability once integrated and restructured**
- **Improving performance of Austrian retail business**

Erste Bank's profitability in recent years has largely reflected its string of acquisitions in CEE. In H107, the bank continued to benefit from the consolidation of BCR. As the restructuring at the largest entities in CEE, excluding BCR, has been completed, the CEE operations now generate more than half of group operating profit while they only accounted for 37% of credit exposure or assets at end-June 2007. The contribution from the region to operating profit should become even more pronounced on completion of BCR's integration and restructuring (scheduled for 2008). Erste Bank's management targets a ROE of 18%-20% and a cost/income ratio below 55% for 2009 (bank's calculation). It forecasts group net income to grow by 25% in 2007, and subsequently at 20% p.a. until 2009. Fitch considers these targets as achievable.

Fitch's comprehensive income includes net income and changes in reserves. The movement in H107 and 2006 resulted from the change in value of the available-for-sale investments with rising interest rates.

Austria: In Austria, competition remains fierce, but profits are gradually picking up through improved earnings, relatively favourable capital markets and stronger results from the R&M segment. Competition pressure on margins is unlikely to subside, constraining domestic profitability levels in the long-term. Cost control remains good, although the overall cost/income ratio – while improving – is influenced by the only moderate efficiency of the savings banks and R&M divisions. T&IB increased its net interest income due to a strong contribution from its money market operations while lively capital markets and securities sales drove net commission income. The distribution of structured products, including in CEE, is an important revenue driver. Both equity trading and fixed-income derivatives boosted the trading result. Although a large part of trading revenues is customer-driven, these revenues depend on market conditions and therefore tend to be more volatile. The savings banks have reported moderate growth in profit in recent years, but Fitch considers there to be some scope for further cross-selling, an area Erste Bank is continuously working on with the savings banks. The retail branch network in the R&M division has improved fee generation by selling more structured investment products. A moderately growing mortgage loan book has allowed Erste Bank to offset the margin pressure on deposits. The restructuring of the SME business is bearing fruit, and the bank has been able to report a modest but steady operating profit since Q106. Large corporates business benefited from intensified cooperation with the treasury department in terms of products and active capital markets transactions.

CEE: Erste Bank targets an ROE of 20% (bank's calculation based on local reporting) for its CEE subsidiaries. In H107, the larger subsidiaries reported sound ROEs around 21% (2006: CS 23%; SLSP 20.3%; and BCR 18.8%). Net interest income is likely to remain the key driver of revenues given the rapid asset growth, in particular in residential mortgage and consumer lending, rather than an increase in spreads. Erste Bank is also positioning its regional entities to enter the local markets for wealth management as and when demand picks up. Staff expenditure in CEE is gradually rising with a change in staff profile, the introduction of performance-related and more market-based compensation, and following branch expansion in several countries.

Underlying profitability at CS has improved, as a result of CS defending its leading market position in retail mortgage lending. CS contributed around a quarter of group operating profit in 2005 and 2006.

Table 2: Operating Profit by Segment

	H107 (EURm)	% of NOR	FY2006 (EURm)
Austria	**399.9**	**39**	**698.7**
Savings banks	117.9	12	246.1
R&M	105.9	10	178.3
Large corp.	72.6	7	115.4
T&IB	103.4	10	158.9
CEE	**552.4**	**54**	**808.5**
Czech Republic	222.9	22	451.7
Romania	178.6	18	67.9
Slovakia	69.3	7	134.3
Other	81.6	7	154.6
Int. business	**67.4**	**7**	**160.0**
Net operating revenues	**1,019,7**	**–**	**1,667.1**
Corp. Centre	**-116.8**	**–**	**-144.9**
Operating profit	**902.9**	**100**	**1,522.2**

Source: Interim and Annual reports

The current integration plan for BCR (expected restructuring expenses during 2007 of around EUR40m) includes an overhaul of the product offering to retail and corporate customers, the opening of 125 smaller branches and the bundling of back-office functions. Erste Bank intends to sharpen BCR's operating performance and to transform the bank into a driver of profits, similar to CS. The bank is also altering its product offering in order to halt the margin erosion in Romania where competition is increasing. Similar to its Czech sister company, SLSP has now fully compensated for a maturing high-yielding book of government bonds by strong loan growth. EBH's profitability has been improving thanks to stronger retail loan growth and a sound increase in net commission income from its securities business. Due to the somewhat volatile Hungarian operating environment, EBH is likely to face challenges during 2007, although net income should grow by 15% in part because of a cooperation agreement with the local post office. Good growth in payment, lending and transaction fees at EBC has enabled the bank to offset margin pressure and investments into branches and headcount. Both the Croatian and Serbian operations continue to be affected by the relatively strict minimum reserves established by the central banks on liabilities. At EBS, on-going investments in branch refurbishment and restructuring expenses affected the performance in 2006, resulting in a loss of around EUR28m. However, with the restructuring now largely completed, EBS should break even in 2007 and get closer to its ROE target in 2008, as indicated by a much-reduced operating loss in H107. Erste Bank anticipates an operating loss at Erste Bank Ukraine of up to EUR20m for 2007 because of investment in the branch network and restructuring; it expects a positive contribution to profit from 2009 onwards.

Given the relatively benign operating environment in the CEE region at present, Fitch would expect loan impairment charges (LICs) to rise in the medium term as the low level of credit costs is not sustainable. The increase in LICs largely reflects the increase in loan volume. In some countries, notably the Czech Republic, a gradual conversion to more normalised costs of risk is taking place as a steady seasoning of the loan book is being experienced, leading management to expect the overall standard costs of risk to range between around 50-55 basis points.

International Business: This business has delivered relatively stable revenues over the years, mainly generated from loan syndications and buying debt in the capital markets.

■ Risk Management

- **Tight control over subsidiaries in CEE – 37% of assets at end-March 2007**
- **Domestic provisioning levels reliant on collateral value**
- **Market risk is low and mainly structural**

Overall, Erste Bank's risk appetite is not aggressive; credit and operational risks are its main types of risk. Lending growth at some CEE subsidiaries has been substantial, but is being monitored by head office, and a substantial part of lending is secured by mortgages. Operational risk arises mainly from the group's extensive branch network in Austria and CEE. Erste Bank has put in place a well-established process of post-acquisition integration to mitigate the execution risk stemming from its acquisitions.

The risk committee undertakes risk oversight and control across the whole group and is chaired by the board member in charge of group risk management, the group chief risk officer. The management board allocates group risk limits to the operating divisions while the group risk control department monitors and aggregates all risks (market, credit and operational risks). Overall, controls over the CEE banks appear relatively tight.

Credit Risk: In January 2007, Erste Bank received regulatory approval for Basel II, which includes the savings banks in Austria. The bank has adopted the foundation internal ratings-based (IRB) approach for banks, sovereign, corporates and specialised lending. The retail business in Austria and the Czech Republic are on the advanced IRB approach while Erste Bank has agreed on a roll-out plan with the regulators for the Basel II implementation at the other subsidiaries.

Credit approval procedures follow strict guidelines. For retail customers, the bank uses a nine-grade rating system, based on a scoring model that includes behavioural scores. For corporates and SMEs, Erste Bank uses 14 rating categories, based on default probabilities. The bank operates a credit value at risk (VaR) approach, using the CreditMetrics methodology (based on a one-year horizon and a 99.95% confidence level), which is also applied to credit exposure on its securities portfolio. Centralised credit departments are responsible for credit approval within an existing loan approval hierarchy, dependent on size; larger loans must be approved centrally. In 2005, group risk control introduced a model for standard risk cost, taking into account Basel II parameters for credit pricing, using internal probabilities of default and transition probabilities.

The rapid growth in Erste Bank's assets since 2000 reflects the various acquisitions, while domestic loan volumes have been relatively stable. At end-March 2007, the aggregate credit risk exposure (including lending, interbank placements, securities portfolios, guarantees and the insurance division's investment portfolio) amounted to EUR176.5bn.

Domestic Exposure amounted to EUR65.4bn at end-March 2007. At end-2006, the breakdown was: 28% to private customers (including the savings banks' retail customers); 19% banks and insurance companies; 15% real estate sector; 8% public sector; 7% trade; 7% manufacturers; 5% construction sector; and 11% others. Erste Bank's exposure to the still difficult SME sector amounted to EUR1.5bn. Exposure to the 20 largest domestic corporate borrowers accounted for about 6% of the end-2006 domestic loan book, which is moderate and reflects the bank's granular loan portfolio.

CEE Exposure amounted to EUR61.9bn at end-March 2007 and was split as follows: 39% Czech Republic, 18% Romania, 15% Hungary, 13% Slovak Republic, 11% Croatia, 3% Slovenia, and 1% Serbia. Although corporates have been CEE banks' major borrowers, the focus has shifted to SMEs and private individuals. Loans to individuals have risen rapidly, although they still accounted for a relatively low 27% of CEE exposure at end-2006.

One of the prime areas for growth, both in Austria and CEE, has been mortgage lending and consumer financing. Total property exposure amounted to about EUR23bn at end-2006, of which EUR6.4bn was commercial real estate, EUR9.1bn Austrian residential mortgages and the remainder CEE mortgages. In residential mortgage lending, initial loan to value (LTV) ratios are typically 70%-75% on average, although one subsidiary has recently launched retail mortgages with LTV ratios of up to 100% of collateral value (which equates to 85%-90% of market value). Loans outstanding under this scheme still represent a small percentage of the subsidiary's loan book. The bank extends loans to private individuals (mainly mortgage loans) in foreign currency, primarily in Austria and Hungary (denominated in CHF) and in Croatia and Romania (denominated in euro). The bank faces credit risk in respect of these loan products when the borrower has no matching income in the foreign currency. However, Fitch has been informed that the bank's risk management processes closely monitors and addresses this risk. Repossession of collateral in some of Erste Bank's countries of operations is proving more difficult due to the legal systems, but over time standards are gradually catching up with those in more mature EU economies.

Other International Exposure: This amounted to EUR49.2bn at end-March 2007, including securities, interbank positions, credit derivatives, property financing, project finance and participations in the secondary market. EU countries and other industrialised countries accounted for 65% of this exposure while the remainder was spread over other industrialised countries (25%) and other emerging countries (10%).

Loan Loss Experience and Reserves: Overall, asset quality appears adequate. NPL coverage ratios (before collateral) for Austria are coming into line with international standards. After the EU enlargement in May 2004, the CE operating environment has become more stable, resulting in a gradually improving risk profile. At end-March 2007, total NPLs amounted to about EUR4.3bn, or 4.5% of gross loans excluding public sector lending, although the volume of loans 90 days past due amounted to only EUR2.3bn. NPLs were about 74% covered by specific loan impairment. In addition, the bank has classified a further EUR3.6bn as substandard at end-March 2007 (loans are serviced but full payment is doubtful).

Within the domestic portfolio, lending growth has been somewhat restricted due to the operating environment. Domestic NPLs typically represent a large share of group NPLs and were mainly held at the savings banks. They accounted for 4.7% of domestic loan book at end-2006 (excluding public sector) and were 67% covered by specific loan impairment. Asset quality at the CEE banks is satisfactory and benefited from the balance sheet clean-ups as part of the banks' privatisations. At end-2006, CEE NPLs amounted to 1.8% of CEE loans and were fully covered by reserves. However, loan portfolios in these regions are less seasoned given the long-term nature of mortgage lending and may develop problem loans depending on the economic cycle or as they mature. Erste Bank has indicated that it is expecting for a normalisation of coverage ratio in CEE so that the coverage ratio would come in line with the overall group ratio. Other international exposures classified as NPL were fully reserved.

Other Assets: The securities portfolio (EUR34bn at end-March 2007) consisted largely of fixed-income securities driven by treasury activities. Fitch is informed that around one-third relates to CE, more than half to Austria and other EU countries, and only a small portion to emerging markets. The insurance company's growing investment portfolio amounted to EUR7.5bn at end-March 2007. The structure of the balance sheet reflects Erste Bank's role as liquidity provider to its savings banks. Interbank assets (around 10% of assets) related mainly to foreign banks. The latter were of good credit quality, with nearly 97% investment-grade counterparties. The positive replacement value of Erste Bank's derivatives at end-2006 amounted to EUR6.4bn, which remains high relative to its equity base. The vast majority relates to interest rate products. A rating-based limit system is in place for the counterparty selection, and the vast majority of counterparties is investment grade. At end-March 2007, the bank had a portfolio of about EUR4.4bn of credit default swaps, used to sell protection on sovereigns and banks. The large majority of underlying entities are rated investment grade. This portfolio is subject to the existing limits monitored by the treasury department. Business involvement with hedge funds consists mostly of own investments. The bank started this activity in 1998; single exposures are small, and the portfolio is well diversified. Total exposure is presently not material.

Operational Risk: Erste Bank is planning to apply the advanced measurement approach (AMA) in 2008. During 2007, the bank is applying the basic indicator approach in order to compute the capital charge for operational risk, which amounts to EUR661m or 6.5% of regulatory capital at end-2006. The bank performs a quarterly VaR calculation at the parent bank, CS and SLSP. The model used has been developed in-house. The restructuring of subsidiaries and the harmonisation of the group's IT platform have improved the overall infrastructure, but the bank maintains a substantial branch network and presence in CEE. The bank has collected loss data since 1998 at parent bank level and since 2002 at group level. Erste Bank is participating in the ORX data consortium for external loss data.

Market Risk and ALM: The market risk committee allocates global risk limits, as determined by the risk committee, to the individual units. Compliance with the limits is verified by a local risk management unit and by the group risk control unit. Market risk is calculated using a VaR approach (99% confidence level and holding periods of one and 10 days) based on two years' historical data. Calculations are routinely back-tested and subjected to stress scenarios.

Market risk relating to the banking book is measured by the treasury and managed by the asset and liability committee. Monthly meetings of the committee, attended by the board, group treasury, the controlling and accounting departments, are held to monitor and manage the interest rate risk at group level. At end-March 2007, the aggregate VaR at Erste Bank group (banking and trading books) amounted to around EUR35m (based on a one-day holding period), mostly resulting from structural interest rate mismatch in the duration of banking assets and liabilities, as is typical for retail banks. Scaled up to a 10-day holding period, the VaR would amount to about EUR111m (equivalent to 1.4% of eligible capital at end-March 2007). The banking book VaR is dominated by the fixed-rate deposits of CS and the Austrian savings banks' investments in fixed-income bonds. FX risk is generally hedged.

The VaR within the trading book was relatively low at EUR4.9m at end-March 2007. The VaR limits for the trading book have been relatively low at EUR18m (equivalent to 0.2% of end-March 2007 eligible capital). Trading activities are primarily carried out in Austria, CE, New York and Hong Kong. Trading market risk is reported online by the separate units, and controlled daily by Vienna.

■ Funding and Capital

- **Large retail funding base**
- **The bank needs to maintain a level of capitalisation adequate for its current rating level**

Funding: The group has access to a broad and relatively stable retail deposit base, including the CEE banking operations. At end-March 2007, customer deposits represented just under half of total liabilities, with a large part in the form of savings accounts. Erste Bank's wholesale funding reflects its role as central institution and liquidity provider in the savings bank sector. Under the Haftungsverbund agreement, member savings banks are legally obliged to keep excess liquidity at Erste Bank (end-March 2007: EUR4.2bn). To lengthen its funding maturity profile, Erste Bank has a EUR15bn debt issuance programme in place. The bank has also established a USD7bn commercial paper programme through its New York branch. Under the Austrian mortgage banking law, Erste Bank is also issuing covered bonds backed by mortgages.

The bank's treasury unit monitors liquidity on a group basis and across currencies. There is currently an FX restriction on the deployment of excess funds in some of the CEE subsidiaries, but this should change in the long term with the introduction of the euro in the countries concerned. Erste Bank also provides ALM consultancy services to a large number of Austrian savings banks and has produced, in accordance with the requirements of Basel II, liquidity guidelines for managing liquidity at group level.

Capital: Through an ordinary share capital issue in early 2006, Erste Bank increased its Tier 1 capital by EUR2.7bn to finance the purchase of BCR. For end-2007, Erste Bank aims to be back inside its targeted range of 6.5%-7.0%. In Q107, Erste Bank adopted the Basel II regulations, resulting in a reduction of risk-weighted assets by 6% between Q107 and end-2006. Fitch considers capitalisation as satisfactory but not strong, particularly in relation to the bank's risk profile and its continued expansion into CEE. Despite some progress made, CEE still have different inherent risks than more mature European banking markets.

The differences of the bank's eligible capital and regulatory ratios is due to different consolidation requirements under Austrian banking law compared with IFRS. The latter also prescribes the capitalisation of certain intangible assets (other than goodwill, accounting for around 130bp) and different valuation of derivatives in the banking book. At end-March 2007, Tier 1 hybrid capital instruments amounted to about 15% of eligible capital, which is well within Fitch's tolerance level. The earnings base has been strengthened and should enable the bank to focus on its internal capital generation. Where possible, Erste Bank strives to achieve full ownership of its acquisitions in order to better allocate group capital. The fungibility of intra-group capital has yet to be tested, but capital management should be more efficient once the holding structure will be implemented. Fitch considers the equity allocated to the Austrian segment to be thin.

Balance Sheet Analysis

ERSTE BANK DER OESTERREICHISCHEN SPARKASSEN

	30 Jun 2007				31 Dec 2006		31 Dec 2005		31 Dec 2004	
	6 Months - Interim USDm Original	6 Months - Interim EURm Original	As % of Assets Original	Average EURm Original	Year End EURm Original	As % of Assets Original	Year End EURm Original	As % of Assets Original	Year End EURm Restated	As % of Assets Restated
A. LOANS										
1. Private	52,089.3	39,067.0	19.80	37,748.0	36,429.0	20.05	29,200.0	19.13	24,829.0	17.76
2. Corporate	78,721.3	59,041.0	29.92	56,661.0	54,281.0	29.87	45,126.0	29.56	41,346.0	29.57
3. Government	6,382.7	4,787.0	2.43	4,748.5	4,710.0	2.59	4,262.0	2.79	4,598.0	3.29
4. Other	1,992.0	1,494.0	0.76	1,590.4	1,686.7	0.93	1,831.0	1.20	2,070.0	1.48
5. Loan Impairment	4,318.7	3,239.0	1.64	3,185.9	3,132.8	1.72	2,816.7	1.85	2,804.1	2.01
6. Loan Impairment (memo)	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
7. Less: Loans from the Insurance Business	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
TOTAL A	**134,866.7**	**101,150.0**	**51.25**	**97,562.0**	**93,973.9**	**51.72**	**77,602.3**	**50.83**	**70,038.9**	**50.10**
B. OTHER EARNING ASSETS										
1. Loans and Advances to Banks	28,540.0	21,405.0	10.85	19,010.7	16,616.3	9.14	16,858.0	11.04	15,684.7	11.22
2. Government Securities	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
3. Trading Assets	6,886.7	5,165.0	2.62	4,529.5	3,894.0	2.14	3,971.0	2.60	3,414.0	2.44
4. Derivatives	2,022.7	1,517.0	0.77	1,549.2	1,581.3	0.87	1,985.0	1.30	1,779.0	1.27
5. Other Securities and Investments	47,365.3	35,524.0	18.00	34,644.0	33,763.9	18.58	38,600.0	25.28	37,562.0	26.87
6. Equity Investments	4,332.0	3,249.0	1.65	3,997.3	4,745.6	2.61	3,628.0	2.38	286.0	0.20
7. Insurance	10,074.7	7,556.0	3.83	7,442.6	7,329.2	4.03	n.a.	-	n.a.	-
TOTAL B	**99,221.3**	**74,416.0**	**37.71**	**71,173.2**	**67,930.3**	**37.39**	**65,042.0**	**42.61**	**58,725.7**	**42.00**
C. TOTAL EARNING ASSETS (A+B)	**234,088.0**	**175,566.0**	**88.96**	**168,735.1**	**161,904.2**	**89.10**	**142,644.3**	**93.44**	**128,764.6**	**92.10**
D. TANGIBLE FIXED ASSETS	**3,002.7**	**2,252.0**	**1.14**	**2,208.3**	**2,164.5**	**1.19**	**1,688.1**	**1.11**	**1,722.6**	**1.23**
E. NON-EARNING ASSETS										
1. Cash and Due from Banks	9,004.0	6,753.0	3.42	7,065.5	7,377.9	4.06	2,728.0	1.79	2,722.9	1.95
2. Other	17,042.7	12,782.0	6.48	11,519.3	10,256.6	5.64	5,599.9	3.67	6,601.8	4.72
F. TOTAL ASSETS	**263,137.3**	**197,353.0**	**100.00**	**189,528.1**	**181,703.2**	**100.00**	**152,660.3**	**100.00**	**139,811.9**	**100.00**
G. DEPOSITS & MONEY MARKET FUNDING										
1. Due to Customers - Current	67,500.0	50,625.0	25.65	49,483.7	48,342.4	26.61	33,969.9	22.25	30,253.5	21.64
2. Due to Customers - Savings	56,813.3	42,610.0	21.59	42,558.5	42,507.0	23.39	38,823.0	25.43	37,959.0	27.15
3. Due to Customers - Term	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
4. Deposits with Banks	54,652.0	40,989.0	20.77	39,338.4	37,687.8	20.74	33,911.5	22.21	28,551.4	20.42
5. Other Deposits and Short-term Borrowings	n.a.	n.a.	-	n.a.	3,690.0	2.03	4,194.0	2.75	2,866.0	2.05
TOTAL G	**178,965.3**	**134,224.0**	**68.01**	**133,225.6**	**132,227.2**	**72.77**	**110,898.4**	**72.64**	**99,629.9**	**71.26**
H. OTHER LIABILITIES										
1. Derivatives	n.a.	n.a.	-	n.a.	1,545.1	0.85	1,304.0	0.85	288.0	0.21
2. Trading Liabilities	2,272.0	1,704.0	0.86	n.a.	n.a.	-	n.a.	-	1,046.0	0.75
3. Fair Value Portion of Debt	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
4. Insurance	11,013.3	8,260.0	4.19	8,090.1	7,920.1	4.36	n.a.	-	n.a.	-
TOTAL H	**13,285.3**	**9,964.0**	**5.05**	**9,714.6**	**9,465.2**	**5.21**	**1,304.0**	**0.85**	**1,334.0**	**0.95**
I. OTHER FUNDING										
1. Long-term Borrowing	44,482.7	33,362.0	16.90	26,645.8	19,929.5	10.97	18,872.0	12.36	18,644.0	13.34
2. Subordinated Debt	n.a.	n.a.	-	n.a.	2,154.0	1.19	1,615.0	1.06	1,194.3	0.85
3. Other Funding	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
TOTAL I	**44,482.7**	**33,362.0**	**16.90**	**27,722.8**	**22,083.5**	**12.15**	**20,487.0**	**13.42**	**19,838.3**	**14.19**
J. NON-INTEREST BEARING	**9,478.7**	**7,109.0**	**3.60**	**6,421.6**	**5,734.1**	**3.16**	**12,617.7**	**8.27**	**12,399.4**	**8.87**
K. HYBRID CAPITAL										
1. Hybrid capital accounted for as equity	n.a.	n.a.	-	n.a.	n.a.	-	900.0	0.59	n.a.	-
2. Hybrid Capital accounted for as debt	1,666.7	1,250.0	0.63	1,250.0	1,250.0	0.69	n.a.	-	711.0	0.51
L. TOTAL LIABILITIES	**247,878.7**	**185,909.0**	**94.20**	**178,334.5**	**170,760.0**	**93.98**	**146,207.1**	**95.77**	**133,912.6**	**95.78**
M. EQUITY										
1. Common Equity	11,844.0	8,883.0	4.50	8,466.1	8,049.2	4.43	3,715.5	2.43	2,940.9	2.10
2. Minority Interest	3,846.7	2,885.0	1.46	2,905.0	2,925.0	1.61	2,331.7	1.53	2,529.4	1.81
3. Revaluation Reserves	-432.0	-324.0	-0.16	-177.5	-31.0	-0.02	406.0	0.27	429.0	0.31
TOTAL M	**15,258.7**	**11,444.0**	**5.80**	**11,193.6**	**10,943.2**	**6.02**	**6,453.2**	**4.23**	**5,899.3**	**4.22**
MEMO:CORE CAPITAL	**9,698.7**	**7,274.0**	**3.69**	**6,876.8**	**6,479.6**	**3.57**	**4,273.0**	**2.80**	**3,730.8**	**2.67**
MEMO: ELIGIBLE CAPITAL	**11,365.3**	**8,524.0**	**4.32**	**8,126.8**	**7,729.6**	**4.25**	**5,173.0**	**3.39**	**4,441.8**	**3.18**
N. TOTAL LIABILITIES & EQUITY	**263,137.3**	**197,353.0**	**100.00**	**189,528.1**	**181,703.2**	**100.00**	**152,660.3**	**100.00**	**139,811.9**	**100.00**
Exchange Rate		USD1 = EUR 0.7500			USD1 = EUR 0.7593		USD1 = EUR 0.8477		USD1 = EUR 0.7342	

Income Statement Analysis

ERSTE BANK DER OESTERREICHISCHEN SPARKASSEN

	30 Jun 2007		31 Dec 2006		31 Dec 2005		31 Dec 2004	
	Income Expenses EURm Original	As % of Total AV Earning Assts Original	Income Expenses EURm Original	As % of Total AV Earning Assts Original	Income Expenses EURm Original	As % of Total AV Earning Assts Original	Income Expenses EURm Restated	As % of Total AV Earning Assts Restated
1. Interest Income	4,748.6	5.63	6,998.7	4.60	5,691.6	4.19	5,163.3	4.20
2. Interest Expense	2,904.0	3.44	3,928.7	2.58	3,014.9	2.22	2,571.8	2.09
3. NET INTEREST REVENUE	**1,844.6**	**2.19**	**3,070.0**	**2.02**	**2,676.7**	**1.97**	**2,591.5**	**2.11**
4. Net Fees & Commissions	884.9	1.05	1,445.9	0.95	1,256.8	0.93	1,135.3	0.92
5. Net Insurance Revenue	29.5	0.03	35.8	0.02	36.7	0.03	36.8	0.03
6. Other Operating Income	328.1	0.39	668.4	0.44	551.8	0.41	519.5	0.42
7. Personnel Expenses	1,039.8	1.23	1,750.5	1.15	1,576.5	1.16	1,482.4	1.21
8. Other Operating Expenses	905.1	1.07	1,508.3	0.99	1,302.2	0.96	1,419.9	1.15
9. PRE-IMPAIRMENT OPERATING PROFIT	**1,142.2**	**1.35**	**1,961.3**	**1.29**	**1,643.3**	**1.21**	**1,380.8**	**1.12**
10. Loan Impairment Charge	239.3	0.28	483.8	0.32	458.2	0.34	421.5	0.34
11. Other Credit Impairment and Provisions	n.a.	-	n.a.	-	n.a.	-	n.a.	-
12. OPERATING PROFIT	**902.9**	**1.07**	**1,477.5**	**0.97**	**1,185.1**	**0.87**	**959.3**	**0.78**
13. Other Income and Expenses	n.a.	-	44.7	0.03	36.6	0.03	37.3	0.03
14. PUBLISHED PRE-TAX PROFIT	**902.9**	**1.07**	**1,522.2**	**1.00**	**1,221.7**	**0.90**	**996.6**	**0.81**
15. Taxes	194.1	0.23	339.8	0.22	301.7	0.22	277.9	0.23
16. Profit/(Loss) from Discontinued Operations	n.a.	-	n.a.	-	n.a.	-	n.a.	-
17. Change in Value of AFS investments	-355.0	-0.42	-437.0	-0.29	-23.0	-0.02	429.0	0.35
18. CurrencyTranslation Differences	n.a.	-	n.a.	-	n.a.	-	n.a.	-
19. Other Gains/(Losses) not in Published Net Income	n.a.	-	n.a.	-	n.a.	-	n.a.	-
20. FITCH COMPREHENSIVE INCOME	**353.8**	**0.42**	**745.4**	**0.49**	**897.0**	**0.66**	**1,147.7**	**0.93**
21. Total Gains/(Losses) not in Published Net Income	-355.0	-0.42	-437.0	-0.29	-23.0	-0.02	429.0	0.35
22. IFRS Dividends included in Fitch Interest Expense	n.a.	-	n.a.	-	n.a.	-	n.a.	-
23. PUBLISHED NET INCOME	**708.8**	**0.84**	**1,182.4**	**0.78**	**920.0**	**0.68**	**718.7**	**0.58**

Spread Sheet Annex

ERSTE BANK DER OESTERREICHISCHEN SPARKASSEN (C.)

EURm	30 Jun 2007 Original	31 Dec 2006 Original	31 Dec 2005 Original	31 Mar 2005 Original
TOTAL REPORTED EQUITY	**11,368.0**	**10,904.2**	**6,461.2**	**6,934.0**
Other reserves - cash flow hedge reserve	-76.0	-39.0	8.0	n.a.
M : EQUITY	**11,444.0**	**10,943.2**	**6,453.2**	**6,934.0**
Revaluation Reserves	-324.0	-31.0	406.0	0.0
Goodwill	4,429.0	4,429.2	1,530.2	n.a.
Deferred income tax assets - to be deducted from equity	65.0	65.4	244.0	n.a.
CORE CAPITAL	**7,274.0**	**6,479.6**	**4,273.0**	**6,934.0**
Eligible Weighted Hybrid Capital	1,250.0	1,250.0	900.0	-6,934.0
FITCH ELIGIBLE CAPITAL	**8,524.0**	**7,729.6**	**5,173.0**	**n.a.**
MEMO: Total Weighted Hybrid Capital	1,250.0	1,250.0	900.0	n.a.
MEMO: Eligible Hybrid Capital Limit	3,117.4	2,777.0	1,831.3	2,971.7
MEMO: Potential for Further Eligible Hybrid Issuance	1,867.4	1,527.0	931.3	9,905.7

Ratio Analysis

ERSTE BANK DER OESTERREICHISCHEN SPARKASSEN

		30 Jun 2007	31 Dec 2006	31 Dec 2005	31 Dec 2004
		6 Months - Interim	Year End	Year End	Year End
		EURm	EURm	EURm	EURm
		Original	Original	Original	Restated
I. PERFORMANCE					
1. Net Interest Margin	%	2.19	2.02	1.97	2.11
2. Loan Yield	%	9.24	7.59	7.09	7.02
3. Cost of Funds	%	3.58	2.73	2.39	2.21
4. Costs/Average Assets	%	2.05	1.95	1.97	2.16
5. Costs/Income	%	63.27	62.91	64.17	67.76
6. Pre-Impairment Operating ROAA	%	1.21	1.17	1.12	1.03
7. Operating ROAA	%	0.95	0.88	0.81	0.71
8. Pre-impairment Operating ROAE	%	20.41	22.55	26.61	25.17
9. Operating ROAE	%	16.13	16.99	19.19	17.49
II. CAPITAL ADEQUACY					
1. Internal Capital Generation	%	6.32	6.21	12.35	18.73
2. Core Capital/Total Assets	%	3.77	3.66	2.83	2.70
3. Eligible Capital/Regulatory Weighted Risks	%	9.20	8.21	6.89	6.79
4. Eligible Capital+Eligible Revaluation Reserves/Regulatory Weighted Risks	%	8.85	8.18	7.43	7.45
5. Tier 1 Regulatory Capital Ratio	%	6.40	6.60	6.80	6.70
6. Total Regulatory Capital Ratio	%	9.80	10.30	11.00	10.70
7. Free Capital/Equity	%	17.72	4.33	0.00	0.00
III. LIQUIDITY (year end)					
1. Liquid Assets/Deposits & Money Mkt Funding	%	17.68	24.92	24.07	17.84
2. Loans/Deposits	%	108.49	103.44	106.61	102.68
IV. ASSET QUALITY					
1. Loan Impairment Charge/Gross Loans (av.)	%	0.50	0.57	0.63	0.64
2. Total Credit Impairment/Pre-impairment Operating Profit	%	20.95	24.67	27.88	30.53
3. Loan Impairment/Gross Impaired Loans	%	77.30	73.77	73.49	72.29
4. Individual Loan Impairment/Gross Impaired Loans	%	77.30	73.80	73.50	72.30
5. Impaired Loans Gross / Loans Gross	%	4.21	4.60	5.03	5.68
6. Impaired Loans Net/Eligible Capital	%	11.16	14.41	19.65	24.20
7. Net Charge-offs/Gross Loans (av.)	%	n.a.	n.a.	n.a.	n.a.

Appendix 1

Major Central European Operations – End-2006

Name	Year of acquisition[a]	% Held	Total assets (EURm)	Equity (EURm)	Net income (EURm)	Staff	Branches	RWA/Erste Bank RWA (%)
CS	2000	98.0	26,501	1,814.1	372.8	10,856	637	14.1
SLSP	2001	100.0	8,651	592.3	104.1	4,797	271	4.1
EBH	2003/2004	99.9	7,069	456.3	88.4	2,881	182	4.8
EBC[b]	2002	64.65	4,854	386.9	56.0	1,759	112	3.6
EBS	2005	99.99	288	59.2	-28.3	871	60	0.2
BCR	2005	69.2	14,020	1,255.8	218.0	13,492	473	2.6
Erste Bank (c.)[c]	**–**	**–**	**181,703**	**10,904.2**	**1,182.4**	**50,164**	**2,721**	**–**

RWA: Average risk-weighted assets;
[a] Shows the year of acquisition or the most recent year in which Erste Bank increased its stake
[b] Directly and indirectly held
[c] In December 2006, Erste Bank increased its stake in the Ukraine-based Bank Prestige to 100% and completed the transaction in Q107 and has consolidated the entity since.
Source: Erste Bank's 2006 annual report and FY06 presentation