

Credit Opinion: Erste Bank der oest. Sparkassen AG

Erste Bank der oesterreichischen Sparkassen AG

Vienna, Austria

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A1/P-1
Bank Financial Strength	C+
Senior Unsecured	A1
Senior Subordinate -Dom Curr	A2
Jr Subordinate -Dom Curr	A2
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	P-1
Ceska Sporitelna, a.s.	
Outlook	Stable
Bank Deposits	A2/P-1
Bank Financial Strength	C
Erste Bank Hungary Rt	
Outlook	Rating(s) Under Review
Bank Deposits	A2/P-1
Bank Financial Strength	*D
Erste Finance (Delaware) LLC	
Outlook	Stable
Bkd Commercial Paper	P-1

* Placed under review for possible upgrade on July 4, 2006

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Key Indicators

Erste Bank der oest. Sparkassen AG

	[1]2005	2004	2003	2002	2001	5-Year Avg.
Total assets (EUR billion)	152.66	139.81	128.58	121.22	86.03	[2]16.48
Total capital (EUR billion)	10.75	9.71	9.21	8.59	6.12	[2]16.00
Return on average assets	0.63	0.54	0.43	0.50	0.41	0.50
Recurring earnings power [3]	1.12	1.05	1.06	1.09	0.94	1.05
Net interest margin	2.05	2.19	2.06	2.36	1.80	2.09
Cost/income ratio (%)	62.20	65.36	65.27	69.13	66.89	65.77
Problem loans % gross loans	4.77	5.33	--	--	--	5.05
Tier 1 ratio (%)	6.80	6.70	6.30	6.30	6.20	6.46

[1] As of December 31. [2] Compound annual growth rate. [3] Preprovision income % average assets.

Opinion

Credit Strengths

- Clear retail banking profile with solid market shares in Austria and neighbouring Central and Eastern Europe (CEE); successful integration of CEE acquisitions and strengthening of their commercial and financial profile
- Integration and cooperation among Austrian savings banks underpin important domestic position
- Well-diversified recurring earnings benefit from stable revenue sources domestically and abroad
- Strengthened risk management and control framework across the group
- Good liquidity and funding benefit from stable retail funding bases in Austria and abroad

Credit Challenges

- Difficult operating environment domestically with low margins and moderate, yet improving efficiency
- Maintain a robust risk-return profile in a downturn in the untested and still more volatile markets in CEE
- Significant degree of exposure to domestic corporates in a difficult economic environment
- Adequate capitalisation, mitigated partially by low risk profile and resilient revenue base
- Balance of revenues, earnings and capital (goodwill) increasingly skewed towards CEE, with Romania weighing heavily

Rating Rationale

The A1/P-1/C+ ratings reflect good financial fundamentals and a solid position in the Austrian retail/SME market; underpinned by the closer integration of the Austrian savings banks for which Erste Bank acts as the central service provider. These ties enhance Erste Bank's domestic franchise and financial strength, notably through the consolidation of the savings banks' results and solid capital in its own financial statements. Erste Bank has successfully integrated its CEE acquisitions and bolstered their commercial and financial profile. While investments may still be necessary, it increasingly benefits from growing earnings from its retail banking franchises, all this without unduly pressuring its risk profile. Ratings incorporate that for economic and political reasons, these contributions may still prove volatile at times but that these dynamically growing economies also provide good diversification from the mature Austrian market. The growing imbalance between mature and volatile, riskier markets may however constrain ratings over time.

Rating Outlook

In June 2006, the review for downgrade was concluded by confirming the A1 rating and downgrading the FSR from B- to C+. The rating action reflects Erste Bank's decision to buy a 61.9% in Banca Comerciala Romana (BCR) for about EUR 3.8 billion and the implications this has for the balance of revenues, earnings, allocated capital and goodwill. The P-1 short-term rating was affirmed. The outlook for all ratings is stable.

What Could Change the Rating - UP

A marked and sustainable improvement in risk-adjusted profitability in Austria, continued progress in CEE, a good regional and customer mix of earnings and allocated capital, and a materially stronger economic capitalisation are factors which could result in upward pressure on ratings.

What Could Change the Rating - DOWN

A significant deterioration in asset quality or profitability in its CEE operations, reflecting unlikely weaknesses in risk management, or a failure to further improve its domestic operations could have adverse implications for debt and financial strength ratings, as would unexpected signs of a weakening ability and willingness for support among the savings banks. A marked shift in the balance of revenues, earnings and economic capital between Austria, more mature CEE and still nascent CEE markets could also have adverse implications for credit quality.

Recent Results

Erste Bank reported for 2005 a rise in operating profits (+22%) to EUR1.2 billion and in net income (+37%) to EUR712 million, driven by rather moderate volume growth (+9.2% to EUR153 billion), solid revenue increases, well contained costs and modestly higher provisions. This progress continued in 1Q'06, with operating profits of EUR 380.4 million (+33.8% q-o-q) and net income of EUR 239.6 million (+49.5% q-o-q). Following a capital increase of EUR 2.9 billion in January 2006 to finance the acquisition of BCR, Erste Bank's Tier 1 ratio has increased sharply - and temporarily - to 10.2% at end of March 2006.

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