

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	Aa3/P-1
Bank Financial Strength	C
Senior Unsecured	Aa3
Senior Subordinate -Dom Curr	A1
Jr Subordinate -Dom Curr	A1
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	P-1
Banca Comerciála Romana S.A.	
Outlook	Stable
Bank Deposits -Fgn Curr	Baa3/P-3
Bank Deposits -Dom Curr	Baa1/P-2
Bank Financial Strength	D
Ceska Sporitelna, a.s.	
Outlook	Stable(m)
Bank Deposits -Fgn Curr	A1/P-1
Bank Deposits -Dom Curr	Aa3/P-1
Bank Financial Strength	C

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Key Indicators

Erste Bank der oest. Sparkassen AG

	[1]2006	2005	2004	2003	2002	5-Year Avg.
Total assets (EUR billion)	181.70	152.66	139.81	128.58	121.22	[2]16.13
Total capital (EUR billion)	16.11	10.75	9.71	9.21	8.59	[2]21.37
Return on average assets	0.83	0.63	0.54	0.43	0.50	0.58
Recurring earnings power [3]	1.38	1.12	1.05	1.06	1.09	1.14
Net interest margin	2.50	2.05	2.19	2.06	2.37	2.23
Cost/income ratio (%)	60.03	62.20	65.36	65.27	69.13	64.40
Problem loans % gross loans	4.37	4.77	5.33	0.00	0.00	2.89
Tier 1 ratio (%)	6.60	6.80	6.70	6.30	6.30	6.54

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

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of C to Erste Bank der österreichischen Sparkassen AG (Erste Bank), which translates into a Baseline Risk Assessment of A3. The rating derives from the bank's strong retail franchises throughout Austria and the more mature economies in Central & Eastern Europe (CEE), as well as

its satisfactory financial fundamentals.

Moody's believes that the probability of both sector and systemic support for Erste Bank is very high, which results in a three-notch uplift in the debt and deposit ratings to Aa3/Prime-1 from its A3 Baseline Risk Assessment. Austria is a medium support country.

Prior to the implementation of BFSR/JDA methodology on 20 April 2007, the ratings of Erste Bank were A1/P-1/C+.

Credit Strengths

- Clear strategic focus on retail banking, with firmly entrenched franchises in Austria and, increasingly, neighbouring CEE countries
- Successful integration of CEE acquisitions and strengthening of their commercial and financial profile
- Integration of, and co-operation with, Austrian Sparkassen underpins domestic position
- Well-diversified recurring earnings benefit from stable, granular revenue sources domestically and internationally
- Ongoing strengthening of the risk management and control framework across the group
- Resilient retail deposit bases provide stable sources for funding and liquidity

Credit Challenges

- Challenging operating environment in Austria, with intense competition, persistently low margins and moderate but gradually improving efficiency and profitability. Returns on RWA are substantially lower than in CEE markets.
- Maintaining a robust risk-return profile in a downturn in the untested and still more volatile CEE markets
- Revenues, earnings and capital (goodwill) increasingly skewed towards CEE, with Romania weighing heavily
- Improving asset quality measures, in terms of both reported problem loans and reserve coverage
- Satisfactory regulatory and adequate economic capitalisation and high reliance on hybrid capital securities

Rating Outlook

The outlook for all ratings has been stable since June 2006 when Erste Bank's BFSR was downgraded to C+ from B- in the wake of the acquisition of Banca Comerciala Romana.

The stable outlook on all ratings was reconfirmed at the time of the application of Moody's BFSR/JDA methodology in April 2007.

What Could Change the Rating - Up

Positive implications for Erste Bank's BFSR could possibly result from (1) improvements in the quality of regulatory capital and a materially stronger economic capitalisation (TCE % RWA), (2) marked and sustainable improvements in risk-adjusted profitability in Austria, both in the Sparkassen segment and in Erste Bank's own Retail & Mortgage business, (3) overall stronger efficiency and bottom-line profitability (net income % RWA) at group level, or (4) a significant reduction in the stock of non-performing loan, notably in Austria, and a group-wide strengthening in reserve coverage levels.

The bank's debt and deposit ratings could possibly benefit from sustainable improvements in the bank's intrinsic strength, as well as from (1) the strength of the Sparkassen sector in Austria overall and the potential support this may imply for Erste Bank, and/or (2) changes in the systemic support currently factored into Erste Bank's local currency deposit ratings.

What Could Change the Rating - Down

Negative implications for Erste Bank's BFSR could possibly result from: (1) a widespread deterioration in the economic and political health and solidity of Erste Bank's core markets in CEE, (2) a significant deterioration in the asset quality or profitability of the CEE operations, (3) an unduly heavy reliance on hybrid capital securities in order to maintain satisfactory regulatory capital requirements, or (4) a marked shift in the balance of revenues, earnings

and economic capital between Austria, more mature CEE markets and still nascent CEE economies.

The bank's debt and deposit ratings could possibly suffer from a material, longer-term weakening in the bank's intrinsic strength, as well as from (1) a deterioration in the commercial and financial profile of the Sparkassen sector in Austria overall and the lower potential support this may imply for Erste Bank, or (2) adverse changes in the systemic support currently imputed in favour of Erste Bank's local currency deposit ratings.

Recent Results and Developments

On a consolidated basis, Erste Bank reported total assets of EUR 181.7 billion, risk-weighted assets (RWA) of EUR 94.1 billion and equity of EUR 10.9 billion (including minority interests of EUR 2.9 billion) at the end of 2006. In line with previous years, the dynamic year-on-year growth of 19.0% in total assets and 25.4% in RWA mainly resulted from the group's expansion in Central & Eastern Europe and from first-time acquisitions, notably of Banca Comerciala Romana SA (BCR).

In light of the goodwill generally associated with these acquisitions and despite a capital increase of EUR 2.65 billion in January 2006, Erste Bank's regulatory capitalisation remains virtually unchanged. Core capital of EUR 6.2 billion as at December 2006 included hybrid capital securities in the amount of EUR 1.3 billion and translated into a Tier 1 ratio of 6.6% (6.8% at year-end 2005). The total capital ratio softened moderately to 10.3% from 11.0%.

In 2006, Erste Bank's pre-provision income rose by 19.9% to almost EUR 2 billion, though growth in pre-tax profits (+25.3% to EUR 1.5 billion) and net income (+30.9% to EUR 932 million) was even higher. All major revenue lines and moderately higher operating expenses and loan loss provisions contributed to the improving operating performance. In terms of business segments (adjusted for Corporate Centre), Austria accounted for 41.4% of pre-tax profits, CEE for 48.5% and the International Business for 9.6%.

In April 2007, the Austrian Supreme Court ruled in favour of Erste Bank that the close co-operation between Erste Bank and the 47 Sparkassen in Austria complies with Austrian competition law. As a result, Erste Bank will continue to be able to fully consolidate the Sparkassen even though it may not own controlling stakes in these banks.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Erste Bank's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a C BFSR to Erste Bank, based upon the group's good and sustainable market shares in retail banking in Austria and various CEE markets, its broad geographical diversification of revenues, earnings, customer loans and customer deposits, and resilient, predictable and diversified earnings streams. Furthermore, the BFSR reflects the meaningful amount of related-party exposures and Moody's general opinion that such exposures reflect negatively on a bank's overall risk management capabilities, as well as Moody's conviction that credit risk concentrations, including those in the financial services sector, may pose a challenge for banks' credit quality. In financial terms, the BFSR takes into account the good liquidity and funding profile, satisfactory levels of efficiency and profitability and comparatively weak measures of asset quality and capitalisation. The C BFSR is in line with the outcome of Moody's bank financial strength scorecard.

Qualitative Factors (50%)

Factor 1: Franchise Value

Trend: Improving

The strength of Erste Bank's franchise is positive for the bank's credit quality and ratings. Erste Bank, in conjunction with the Austrian Sparkassen, is the second largest banking group in Austria and benefits from a deeply entrenched retail banking franchise. Throughout recent years, the bank has scaled back its large corporate business and does not appear overly reliant on capital-markets or treasury-related operations. Over the last decade, Erste Bank has successfully built its presence in CEE countries, initially in what are now more mature markets but more recently with a growing emphasis on economies that are still in the earlier stages of a long-term convergence process.

Domestically and internationally, the group benefits from its broad geographical spread, mainly in Austria, the Czech and Slovak Republics, Hungary and, with a rapidly growing weight, Romania, and the granular nature of its activities. The well-diversified revenues, earnings, customer loans and deposits provide for a high degree of earnings stability. Overall, Erste Bank scores a B on franchise value.

In December 2006, Erste Bank announced plans to transfer its Austrian retail and SME businesses, as well as related subsidiaries, into a separate legal entity, Erste Bank in Osterreich. These changes in the group structure

are expected to become effective in mid-2008. Moody's does not believe this will affect the credit quality of Erste Bank der österreichischen Sparkassen AG. Rather, managing the Austrian business in the same way as the group's other regional operations should over time lead to more meaningful progress on efficiency and risk-adjusted bottom-line profitability, thus addressing one of the group's major current weaknesses.

Factor 2: Risk Positioning

Trend: Improving

In Moody's view, Erste Bank's current risk positioning weighs on its intrinsic credit quality. The group reports a meaningful amount of related-party exposures and it is Moody's general opinion that such exposures reflect negatively on a bank's overall risk management capabilities. While further progress in banks' risk management capabilities is often desirable and generally possible, Erste Bank appears sufficiently well equipped to properly gauge, monitor and steer the business, market, credit, liquidity, reputation and operational risks inherent in its business. In particular, we note that Erste Bank AG is the main risk taker within the group and that, at the level of regional offices and subsidiaries, market and liquidity risks are generally managed within tight parameters. We also see positively that, in light of the group's dynamic growth in CEE, equal attention has been given to building group-wide risk management standards and practices, and that credit, market and liquidity risks are all monitored centrally for the group.

It is also Moody's conviction that credit risk concentrations, including those in the financial services sector, may pose a challenge for banks' credit quality. Following the decision to focus primarily on retail banking and to de-emphasise the large corporate and capital-markets businesses, borrower and industry concentrations to truly risk-bearing borrowers generally appear manageable when adjusted for Erste Bank's exposure to the financial services sector. Erste Bank's good liquidity management and profile benefit from the group's retail focus and meaningful volumes of sticky retail deposits to which the bank and its subsidiaries have access domestically and in the respective local currencies. Overall, Erste Bank's risk profile is predominantly determined by business and credit risks; the appetite for market risks seems moderate and primarily relates to the structural risks characteristic for most retail-oriented financial institutions.

From 2007 onwards, the group will use the Advanced IRB approach to manage the regulatory capital requirement for the credit risks in its retail portfolios and the Foundation IRB approach for the remaining credit risks. With the consent of the Austrian banking supervisor, the group uses an internal model for its market risks. Operational risks will be covered by the basic-indicator approach.

We expect Erste Bank to continue to develop its good risk management capabilities in line with business and regulatory requirements and conform to its financial loss-absorption capacity.

The score for Erste Bank's risk positioning is D in Moody's bank financial strength ratings scorecard.

Factor 3: Regulatory Environment

All Austrian banks are subject to the same score on the regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. Refer to Moody's latest Banking System Outlook for Austria to obtain a detailed discussion on the regulatory environment.

Factor 4: Operating Environment

Trend: Improving

This factor is a weighted average of the major markets in which Erste Bank has meaningful operations, rather than the A- score that relates solely to the Austrian operating environment. Moody's takes into account the still marginally higher risk of political or economic setbacks in the maturing CEE economies in which Erste Bank currently generates the bulk of its revenues and earnings. However, minor delays in the economic development of any of these markets should not by themselves put pressure on the group.

To the extent that economies in which Erste Bank has undertaken substantial investments more recently continue to prosper and to create opportunities for both liability- and asset-driven business, Moody's assessment of the group's overall operating environment should develop positively.

Quantitative Factors (50%)

Factor 5: Profitability

Trend: Improving

Erste Bank's profitability measures are by and large in line with levels which Moody's typically associates with C

rated banks. Better returns on risk-weighted assets in Austria, albeit from a moderate level, coincide - unsurprisingly - with slightly lower returns in CEE and the International Business, which nonetheless remain clearly superior to domestic performance measures. The Sparkassen that Erste Bank consolidates as part of the sector-wide support arrangements appear as the most significant drag on group performance and account for roughly a third of consolidated RWA. In light of their local autonomy and preference for stable earnings and conservatively structured balance sheets, any progress in this segment is likely to take time. Erste Bank scores C+ for profitability.

We expect the bank to continue to achieve further progress in bolstering its operational efficiency and profitability, as well as its capacity to generate capital internally. Such advances should be expected for the medium term and to a fair degree depend on stronger risk-adjusted returns in Austria. The newly acquired banks should also begin to contribute more positively to overall profits.

Factor 6: Liquidity

Trend: Neutral

Both the Austrian operations and the CEE subsidiaries benefit from a base of attractive, stable retail deposits. Furthermore, the group has diversified its funding sources significantly across instruments, investors, tenors and currencies. Based upon its robust liquidity profile and good liquidity management capabilities, Erste Bank scores B on liquidity. We do not expect the bank to deviate from current practices and believe that the dynamic loan growth in CEE will be accompanied by a corresponding increase in long-term funding.

Factor 7: Capital Adequacy

Trend: Neutral

In relation to global banking peers, Erste Bank compares unfavourably in terms of its regulatory and economic capitalisation. Despite positive trends in profitability, internally generated capital has been insufficient to support the cash- and capital-intensive expansion in CEE and the substantial goodwill related with it. Positively, we note that, as a matter of general business conduct, Erste Bank has typically raised fresh equity to (partly) pay for its acquisitions. Nevertheless, capital metrics are closer to the lower end of the respective ranges and Erste Bank scores D+ on capital adequacy.

Substantially stronger capital ratios, notably with respect to tangible common equity (TCE), and a better quality of core capital are indispensable prerequisites for future improvements in the BFSR. Given the already extensive use of hybrid capital and the important volume of minority interests, Erste Bank's priority should be to strengthen its retained earnings (group share).

Factor 8: Efficiency

Trend: Improving

Efficiency indicators are somewhat weak, reflecting the relative weight of the group's Austrian operations and their inherently less favourable cost structures. The group scores a C on efficiency.

Some improvement over time is expected from changes in the bank's domestic remuneration standards which have been agreed upon by management and employees. Given the group's balance sheet structure and retail profile, a rise in interest rates or a meaningful steepening of the yield curve could also have a positive impact on revenues in the medium term.

Factor 9: Asset Quality

Trend: Neutral

Both asset quality metrics appear rather weak as Erste Bank reports a relatively high stock of substandard and non-performing loans. At year-end 2006, these amounted to EUR 1.9 billion and EUR 3.4 billion, respectively, accounting for 65% and 79% of group volumes classified in these categories. Reserve coverage levels of about two thirds in Austria appear satisfactory, taking into account available mortgage collateral on many retail and SME exposures. Coverage for CEE exposures still exceeds 100% of non-performing loans. It is, however, worth bearing in mind the supportive market environment that has prevailed in Austria and CEE so far, with positive implications for the credit cycle and the cost of credit risk.

In addition, we continue to take into account that loan growth in many CEE markets has only begun to accelerate and that many of these CEE economies have been following upward trends and have not been exposed to material stress recently, which could lead to rising personal and corporate indebtedness, shrinking debt service capacity and falling collateral values. Furthermore, in many countries the liquidation of collateral may still prove demanding for legal procedures and practices. Erste Bank scores a D+ on asset quality.

It appears reasonable to assume that a certain progress in Austria will be offset by growing lending volumes and non-performing exposures in CEE.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns global local currency (GLC) deposit ratings of Aa3 / Prime-1 to Erste Bank der österreichischen Sparkassen AG.

The GLC deposit rating is supported by Erste Bank's Baseline Risk Assessment of A3, as well as the positive contributions from the Austrian Sparkassen to the consolidated earnings and capital of Erste Bank, which are fully included in the consolidated financial statements and shown in the "savings banks" segment. Furthermore, the GLC rating reflects Moody's assessment of a very high probability of systemic support for Erste Bank AG and its creditors should a crisis occur. Backed by Austria's Aaa local-currency deposit ceiling (LCDC), the bank receives a three-notch uplift from its Baseline Risk Assessment, bringing the GLC rating to Aa3. The systemic support assessment is based upon Erste Bank's sizeable national market share, its critical role for the country's payment system and the Sparkassen sector's relative importance to the country's banking system.

Notching Considerations

Ratings for Erste Bank's junior obligations should be notched off the fully supported deposit rating because Moody's is of the opinion that there is no legal authority in place in Austria's bank regulators to impose losses on subordinated creditors outside of a liquidation scenario.

Foreign Currency Deposit Rating

The Foreign Currency Deposit Ratings of Erste Bank are unconstrained given that Austria, in common with other EU members, has a country ceiling of Aaa.

Moody's foreign currency deposit ratings for Erste Bank are Aa3 / Prime-1.

Foreign Currency Debt Rating

The Foreign Currency Debt Ratings of Erste Bank are unconstrained given that Austria, in common with other EU members, has a country ceiling of Aaa.

Moody's foreign currency debt ratings for Erste Bank are Aa3 / Prime-1.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Erste Bank der oesterreichischen Sparkassen AG

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C	
Factor 1: Franchise Value (20%)						B	Improving
Market Share and Sustainability		x					
Geographical Diversification			x				
Earnings Stability	x						
Earnings Diversification [2]							
Factor 2: Risk Positioning (20%)						D	Improving
Corporate Governance [2]				x			
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks				x			
Controls and Risk Management			x				
- Risk Management				x			
- Controls	x						
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information		x					

Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management		x					
Market Risk Appetite		x					
Factor 3: Regulatory Environment (5%)						--	--
Factor 4: Operating Environment (5%)						A-	Improving
Economic Stability	x						
Integrity and Corruption		x					
Legal System	x						
Financial Factors (50%)						C	
Factor 5: Profitability (7.9%)						C+	Improving
PPP % Avg RWA		2.56%					
Net Income % Avg RWA			1.44%				
Factor 6: Liquidity (7.9%)						B	Neutral
(Mkt funds-Liquid Assets) % Total Assets		-5.38%					
Liquidity Management		x					
Factor 7: Capital Adequacy (7.9%)						D+	Neutral
Tier 1 ratio (%)			6.70%				
Tangible Common Equity % RWA				2.74%			
Factor 8: Efficiency (3.5%)						C	Improving
Cost/income ratio			62.53%				
Factor 9: Asset Quality (7.9%)						D+	Neutral
Problem Loans % Gross Loans			4.82%				
Problem Loans % (Equity + LLR)				47.66%			
Lowest Combined Score (15%)						D+	
Economic Insolvency Override						Neutral	
Total Scorecard Implied BFSR						C	
Assigned BFSR						C	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information

[2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral

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