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Erste Group Bank AG

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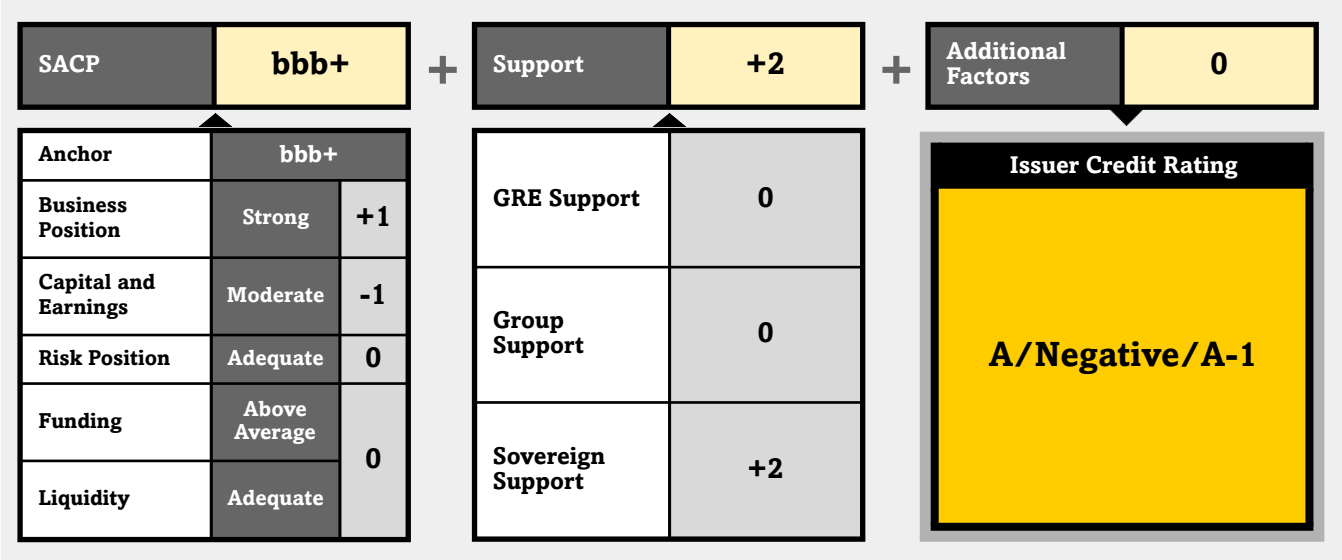
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Erste Group Bank AG



Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Strong market position in Austria and several Central and Eastern European (CEE) countries. • Stable operating revenues coming from traditional customer-driven retail and commercial banking operations. • Funding position dominated by granular retail deposits with only moderate reliance on wholesale funding. 	<ul style="list-style-type: none"> • Sensibility to negative developments in the CEE region. • High nonperforming loans and loan loss provisions, stemming from exposures to riskier CEE countries. • Only moderate capital position and limited capacity to strengthen capital internally.

Outlook: Negative

Standard & Poor's Ratings Services' outlook on Austrian bank Erste Group Bank AG (Erste) is negative. We see Erste as potentially vulnerable to the impact of rising economic risks in the eurozone (European Economic and Monetary Union) and Central and Eastern Europe (CEE). We consider that the current economic environment, including the persistence of low interest rates and slowing economic growth, would put pressure on Erste's financial performance. This would, in turn, impede the bank's ability to build up capital.

We could consider a negative rating action if we see significant deterioration of Erste's nonperforming loans or cost of risk.

An outlook revision to stable would follow a stabilization of Erste's asset quality metrics and a stable trend in the main macroeconomic indicators for the eurozone and Erste's CEE markets, mainly Romania and Hungary.

Rationale

The starting point for our ratings on Erste is its 'bbb+' anchor, which we base on our view of aggregated economic risks in the countries where the bank operates and our industry risk assessment for Austria.

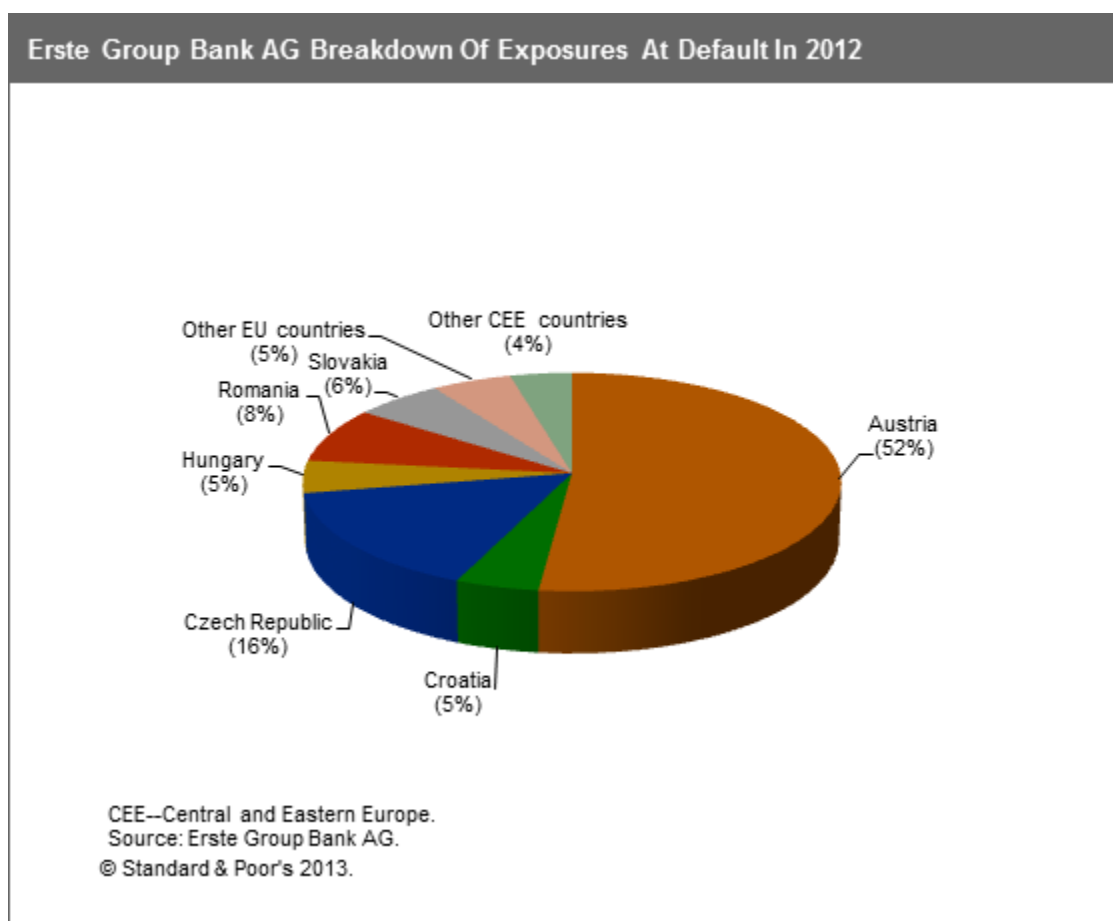
We assess Erste's stand-alone credit profile (SACP) at 'bbb+'. We consider Erste's business position as "strong," as defined by our criteria, reflecting primarily its franchise in its home market of Austria and several CEE countries and also its focus on stable retail and corporate banking operations. We view capital and earnings as "moderate," and the main weakness to the ratings, based on our expectation that our risk-adjusted capital (RAC) ratio will remain in the 6%-6.5% range in the coming 24 months. Our assessment of Erste's risk position is "adequate," mainly reflecting good diversification of exposure. We view the bank's funding as "above-average" and its liquidity as "adequate." These assessments are underpinned by a large, granular, and stable deposit base and sound liquidity buffer.

The ratings also reflect Erste's high systemic importance in Austria and our assessment of Austria as supportive to its banking sector. These factors result in a two-notch uplift above the bank's SACP, leading to the issuer credit rating of 'A' on Erste.

Anchor: 'bbb+', reflecting economic risks in all countries of operations and industry risk in Austria

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our economic risk score for Austria is '2' on a scale of 1-10 (1 is the lowest risk and 10 the highest). However, the weighted average of economic risks of countries in which Erste operates, based on the geographic distribution of its exposures at default, is close to '4' (see chart 1). We believe that Erste will retain its higher risk profile compared with purely domestic banks, because of its strong presence in CEE. We anticipate no material shift in the bank's geographical exposure split in the medium term.

Chart 1



The industry risk score we use for Erste is '3' and is based solely on its home market of Austria. Austrian banks, in our view, benefit from an increasing share of core customer deposits, both domestically and at their foreign operations. At the same time, we expect that strong competition from a relatively high number of banks will maintain pressure on risk-adjusted margins. We see a stable trend for our industry risk score for Austria in the coming two years.

Reflecting the average weighted economic risk score rounded to '4' and industry risk score of '3' for the Austrian banking system, we derive a 'bbb+' anchor for Erste.

Table 1

Erste Group Bank AG Key Figures					
	--Year end Dec. 31--				
(Mil. €)	2013*	2012	2011	2010	2009
Adjusted assets	210,132.0	210,930.1	206,474.4	201,263.0	196,843.7
Customer loans (gross)	130,335.0	131,926.5	134,750.0	132,729.0	129,133.7
Adjusted common equity	11,329.6	11,346.7	9,967.9	10,493.0	9,230.5
Operating revenues	1,816.7	7,840.9	7,495.5	7,741.3	7,448.6
Noninterest expenses	1,059.7	4,809.7	4,254.5	4,142.3	4,151.9
Core earnings	214.0	830.5	570.2	1,167.2	930.6

Table 1**Erste Group Bank AG Key Figures (cont.)**

*Data as of March 31, 2013.

Business position: Strong and stable franchise in Austria and CEE

We regard Erste's business position as "strong." This reflects the bank's strong and sustainable retail, small business, and corporate banking franchises in Austria, where Erste is among the top-three banks that dominate the market. Equally important is the bank's strong position across a number of CEE countries, including Czech Republic, Slovakia, and Romania, where Erste is the market leader. We expect its market shares to remain stable overall, except in Hungary and some smaller higher-risk regions, where the bank has slowed its expansion.

Erste's "savings bank" brand is a plus in terms of image and customer loyalty, notably in Austria, but also in the Czech Republic and Slovakia. Domestic retail operations are concentrated in 47 savings banks with 744 branches spread all over Austria. Domestic savings banks differ widely in terms of size, performance, and credit quality.

Due to its widespread operations, Erste benefits from good geographic diversification of revenues, although we acknowledge certain correlations among CEE countries and between CEE and Austria. We also take into consideration Erste's exposure to some economically riskier countries in CEE. Both margins and credit losses are typically higher in CEE than in Austria, which means that these countries tend to heavily influence the group's profitability. Although the bank's Austrian operations feature thin margins (2% for 2012), they provide stable returns and we expect this trend to continue.

In comparison with many large Western European banks, Erste has a stronger focus on retail and typically derives most of its revenues from retail, small businesses, and corporate lending, which we view as stable sources. We believe this will provide the business model with stability and compensate for Erste's lower business diversity than larger Western European banking groups.

Erste's management team is stable and has followed a generally consistent strategy. The bank's overall goal is to build a large retail bank covering Austria and CEE, with top positions in each market but not covering all markets. The group has largely aimed at balanced growth of activities to avoid an increase in wholesale funding needs.

For the coming years, Erste's management faces two main challenges at its Hungarian and Romanian activities. Erste's ability to find the appropriate balance between risk and reward is crucial to recover pre-crisis operating performance.

Table 2**Erste Group Bank AG Business Position**

(%)	--Year-ended Dec. 31--				
	2013*	2012	2011	2010	2009
Loan market share in country of domicile	19.0	19.0	19.0	19.0	19.0
Deposit market share in country of domicile	20.0	20.0	20.0	20.0	20.0
Total revenues from business line (currency in millions)	1,820.5	8,378.5	7,538.4	7,741.1	7,448.2
Commercial banking/total revenues from business line	7.5	5.8	6.4	9.1	8.9
Retail banking/total revenues from business line	77.4	68.8	79.7	79.6	80.1
Trading and sales income/total revenues from business line	6.7	6.1	6.5	7.3	9.4

Table 2

Erste Group Bank AG Business Position (cont.)					
Investment banking/total revenues from business line	6.7	6.1	6.5	7.3	9.4
Return on equity	5.1	3.2	(7.8)	7.7	8.0

*Data as of March 31, 2013.

Capital and earnings: Gradually rebuilding, but still a key weakness to the ratings

Erste's capital and earnings are, in our opinion, "moderate," and the main weakness for the ratings. We base our assessment mainly on our projection that the RAC ratio for Erste will remain in the 6%-6.5% range over the next 24 months.

Organic growth and acquisitions in CEE have increased the group's franchise over the past decade, but have also put pressure on capital. At year-end 2012, our RAC ratio for Erste was 6.3%. The improvement versus 5.6% one year earlier stems mainly from the exit from some non-core businesses and deleveraging in some higher risk countries, as well as from the bank's increase in capital through profit retention.

We do not anticipate that the RAC ratio will increase materially in the coming two years, owing to rising economic risks across the CEE region and the eurozone and only subdued internal capital generation. We expect the bank to be profitable in 2013/2014, but with profits largely below potential levels over the long term mainly due to still-elevated cost of risk.

The economic environment and operating conditions prevailing in the eurozone and certain CEE markets remain weak and prevent a rapid recovery in profitability. In Austria, economic growth is likely to be only marginally positive in 2013 and 2014. Therefore, we expect Erste to post low volume growth and, at best, stable interest margins. Erste has reassumed its active dividend policy, paying out 33% of 2012 profits, which we believe will further hinder the bank's internal capital generation.

We exclude participation capital provided to Erste by the Republic of Austria and other parties (€1.74 billion in total) from our RAC ratio calculation. As such, the upcoming repayment of these instruments in third-quarter 2013 will have no impact on our RAC ratio. However, in our view, the bank's loss absorption capacity will decrease following the repayment.

Erste's planned capital increase of approximately €660 million will not have a material impact on our capital assessment. Based on end-2012 Standard & Poor's estimates of Erste's risk-weighted assets (RWA), the increase would improve the RAC ratio by 36bps. However, capital increase of 36 bps will lead only to marginal growth of our projected RAC ratio, reflecting growing risks in Erste's foreign exposures and subdued internal capital generation. The planned capital increase will also only partially offset the bank's decreasing loss absorption capacity following the repayment of capital.

Table 3

Erste Group Bank AG Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2013*	2012	2011	2010	2009
Tier 1 capital ratio	11.6	11.6	10.4	10.2	9.2

Table 3

Erste Group Bank AG Capital And Earnings (cont.)					
S&P RAC ratio before diversification	N.M.	6.3	5.6	5.9	5.0
S&P RAC ratio after diversification	N.M.	7.3	6.4	6.5	5.8
Adjusted common equity/total adjusted capital	98.8	98.8	96.7	96.8	96.3
Net interest income/operating revenues	66.0	64.5	72.2	67.7	67.9
Fee income/operating revenues	24.7	21.9	23.8	25.0	23.8
Market-sensitive income/operating revenues	2.1	3.0	1.7	4.9	5.4
Noninterest expenses/operating revenues	58.3	61.3	56.8	53.5	55.7
Preprovision operating income/average assets	1.4	1.4	1.6	1.8	1.6
Core earnings/average managed assets	0.4	0.4	0.3	0.6	0.5

*Data as of March 31, 2013. N.M.--Not meaningful.

Risk position: RAC ratio appropriately captures riskier exposures

We assess Erste's risk position as "adequate." Risk exposure is widely diversified between countries and retail and corporate clientele. Single-name and sector concentrations in the loan book are low.

Our capital framework captures the risks of operating in more vulnerable countries or in higher-risk sectors, such as construction and real estate development, by applying higher risk weights in calculating our RAC ratio. We regard risks not fully covered by our capital framework, such as credit spread or interest rate risk in the banking book, as limited.

We believe that Erste's risk management is comprehensive and efficient, which is crucial in light of the bank's geographic reach. There are no particularly complex businesses or products, and the bank's governance does not present unusual risk. All the CEE operations are operationally run as stand-alone banks applying the bank's strategy locally and using its risk tools and framework.

The same rules also apply for the savings banks network in Austria. Although only three of 47 are majority owned by Erste, it exercises control over the members of the cross-guarantee system through its majority ownership in the steering company for the cross-guarantee system. The steering company is vested with the power to implement and monitor risk policies and has the mandate to intervene by policy breaches.

Erste's nonperforming loans and cost of risk have been on the high side compared with peers with similar economic risk in its exposure split. Erste's nonperforming loans reached 9.4% of customer loans at the end of March 2013. In our base-case scenario, we anticipate that the deleveraging in higher-risk countries will lead to slight improvement in exposure split toward countries with stronger economic environment. As such, we expect stabilization in asset quality metrics. Any further material increase in nonperforming loans or cost of risk would not be consistent with our current assessment of the bank's risk position as adequate.

Table 4

Erste Group Bank AG Risk Position					
	--Year-ended Dec. 31--				
(%)	2013*	2012	2011	2010	2009
Growth in customer loans	(4.8)	(2.1)	1.5	2.8	2.3
Total diversification adjustment / S&P RWA before diversification	N.M.	(14.0)	(12.5)	(9.1)	(12.5)

Table 4

Erste Group Bank AG Risk Position (cont.)					
Total managed assets/adjusted common equity (x)	18.8	18.8	21.1	19.6	21.9
New loan loss provisions/average customer loans	1.2	1.5	1.7	1.6	1.6
Gross nonperforming assets/customer loans + other real estate owned	9.4	9.2	8.5	7.6	6.9
Loan loss reserves/gross nonperforming assets	62.9	63.2	61.7	60.9	55.3

*Data as of March 31, 2013. N.M.--Not meaningful.

Table 5

Erste Group Bank AG Risk-Adjusted Capital Framework Data						
(Mil. €)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)	
Credit risk						
Government and central banks	47,225.8	2,729.2	5.8	10,680.4	22.6	
Institutions	20,135.1	2,834.8	14.1	3,977.8	19.8	
Corporate	74,106.9	51,945.0	70.1	76,060.9	102.6	
Retail	68,889.6	24,974.3	36.3	37,933.0	55.1	
Of which mortgage	39,760.4	11,366.0	28.6	12,664.3	31.9	
Securitization	1,586.3	1,291.3	81.4	1,253.7	79.0	
Other assets	10,170.1	5,100.0	50.1	14,086.5	138.5	
Total credit risk	222,113.8	88,874.5	40.0	143,992.3	64.8	
Market risk						
Equity in the banking book§	3,065.0	1,734.9	58.4	14,808.3	483.1	
Trading book market risk	--	3,714.0	--	5,571.0	--	
Total market risk	--	5,448.9	--	20,379.3	--	
Insurance risk						
Total insurance risk	--	--	--	2,050.0	--	
Operational risk						
Total operational risk	--	11,175.0	--	15,806.2	--	
(Mil. €)		Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA	
Diversification adjustments						
RWA before diversification		105,498.4		182,227.8	100.0	
Total adjustments to RWA		--		(25,532.8)	(14.0)	
RWA after diversification		105,498.4		156,695.0	86.0	
(Mil. €)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)	
Capital ratio						
Capital ratio before adjustments		12,223.0	11.6	11,485.8	6.3	
Capital ratio after adjustments†		12,223.0	11.6	11,485.8	7.3	

Table 5**Erste Group Bank AG Risk-Adjusted Capital Framework Data (cont.)**

*Exposure at default. €Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. §Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. †Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2012. Standard & Poor's.

Funding and liquidity: Stable and granular customer deposits

We consider Erste's funding to be "above average" and its liquidity "adequate." The stability of the retail funding base, especially in the bank's largest markets in Austria, Czech Republic, and Slovakia, as well as its only moderate reliance on wholesale funding drive the "above average" funding score.

Erste's large retail branch network in Austria and CEE, and its relationships with domestic corporate clients provide it with a stable and granular deposit base, with very low single-name concentrations. Customer deposits have been growing in Austria and CEE, even during the latest crisis, underlining the group's funding strength. In the event of market stress, we expect Erste's retail operations, particularly in Austria and in core subsidiaries in Czech Republic and Slovakia, to benefit from potential "flight to quality."

The ratio of loans to deposits was about 100% at the end of March 2013, and compares very well with peers', even though it masks discrepancies between very liquid subsidiaries (Czech Republic and Slovakia) and those that depend on parental funding (for example, Hungary and Croatia). We expect the loan-to-deposit ratio to gradually increase to a more adequate level throughout the group in the medium term, also reflecting more stringent regulatory requirements.

At the end of March 2013 wholesale funding (defined as interbank, unsecured, and secured issues) accounted for a moderate one third of total funding. Short-term funds accounted for about a half of total wholesale funding (interbank included). Erste is gradually lengthening the maturity profile of its debt, notably by increasing usage of secured funding. As of end-2012, covered bonds issues amounted to 7% of the total funding base.

Erste's "adequate" liquidity assessment primarily reflects the bank's prudent liquidity management and high liquidity reserves. We cannot assume full tangibility of liquidity within the bank's foreign branches and Austrian savings banks, which prevents a better liquidity assessment for the group. Erste's solid consolidated liquidity ratios do not reflect discrepancies at the single foreign subsidiaries, which continue to report disparate liquidity levels.

Table 6**Erste Group Bank AG Funding And Liquidity**

(%)	--Year-ended Dec. 31--				
	2013*	2012	2011	2010	2009
Core deposits/funding base	68.2	67.9	65.8	66.6	63.8
Customer loans (net)/customer deposits	99.6	101.0	107.4	108.2	110.8
Long term funding ratio	87.5	89.5	88.2	87.9	82.9
Broad liquid assets/short-term wholesale funding (x)	1.7	0.9	1.1	1.2	1.2
Net broad liquid assets/short-term customer deposits	22.3	(3.1)	2.6	5.6	6.0
Net short-term interbank funding/total wholesale funding	16.2	13.9	15.7	6.7	18.0
Short-term wholesale funding/total wholesale funding	52.2	35.3	36.9	38.6	50.3

*Data as of March 31.

External support: Two notches uplift for government support

The counterparty credit rating is two notches higher than the 'bbb+' stand-alone credit profile, owing to our view of a "moderately high" likelihood of support from the Austrian government. This assessment is based on our view of Erste's high systemic importance in Austria and our assessment of the Austrian government as supportive to its banking sector. The analyses incorporate our assumption that Erste will retain its important role in financing the local economy and its high share in customer deposits. As of year-end 2012, Erste had about 18% of customer deposits within the system.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of June 24, 2013)

Erste Group Bank AG

Counterparty Credit Rating

A/Negative/A-1

Commercial Paper

A-1

Senior Unsecured

A

Subordinated

BBB

Counterparty Credit Ratings History

25-Jan-2012

A/Negative/A-1

08-Dec-2011

A/Watch Neg/A-1

11-Oct-2011

A/Negative/A-1

Ratings Detail (As Of June 24, 2013) (cont.)

24-Nov-2010	A/Stable/A-1
16-Oct-2008	A/Negative/A-1
Sovereign Rating	
Austria (Republic of)	AA+/Stable/A-1+
Related Entities	
Ceska Sporitelna A.S.	
Issuer Credit Rating	A/Negative/A-1
Slovenska Sporitelna A.S. (Unsolicited Ratings)	
Issuer Credit Rating	
<i>Local Currency</i>	Api/--/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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