FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Addiko Bank at 'BB'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 18 Nov 2024: Fitch Ratings has affirmed Addiko Bank AG's (Addiko) Long-Term Issuer Default Rating (IDR) at 'BB'. The Outlook is Stable. Fitch has also affirmed Addiko's Viability Rating (VR) at 'bb'. A full list of rating actions is below.

KEY RATING DRIVERS

Addiko's Long-Term IDR and VR reflect its company profile as a specialised lender focused on unsecured lending to retail clients and small businesses in south-eastern Europe (SEE). The VR also reflects the group's improved risk profile and asset quality, modest profitability and solid capitalisation. Liquidity and funding are rating strengths. The Stable Outlook reflects our view that economic conditions, including labour market indicators, in Addiko's largest markets should remain resilient in the next two years.

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

Niche Business Model: Our assessment of Addiko's business profile balances the group's small but growing franchise, which we believe has a critical mass in all markets. It also reflects Addiko's positioning as a challenger, with clear unique selling points (speed and modern digital offering), which affords the group some pricing power. Execution of the bank's business plan and strategy benefit from management's knowledge of local markets and record in its key banking segments. Our assessment also reflects Addiko's smaller scale and a less diversified business model compared with larger peers.

Unsecured Lending: Addiko's risk profile assessment is driven by its exposure to unsecured consumer and SME lending in SEE and is supported by improving operating conditions in most of its core markets. Addiko's risk profile benefits from significantly reduced concentration risks due to the wind-down of non-core corporate exposures and impaired loans. Risk controls are adequate while market risk is low. Addiko's exposure to non-financial risks has significantly reduced in recent years and does not constrain its risk profile. Non-financial risks mainly result from legal claims related to Swiss-franc mortgages originated before 2009.

Improved Asset Quality: Addiko's impaired loan ratio stabilised at about 4% at end-September 2024, driven by low new inflows, continued recoveries and loan growth. Reserve coverage was stable and sound at 121% at end-1H24. We expect the four-years average impaired loan ratio to remain below 5% over the next two years, as it writes off non-performing loans in Croatia and Slovenia.

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

Modest but Improving Profitability: Addiko's profitability is only modest but improving on the back of its successful restructuring, supported by a solid record of cost management, lower LICs and robust net interest margins, which we expect to continue in the next two years. Our assessment also reflects the bank's dependence on less diversified revenues from less stable operating environments.

Capitalisation Adequate for Risk Profile: Addiko's common equity Tier 1 (CET1) ratio was 21.1% at end-September 2024, providing an adequate buffer to absorb moderate shocks considering the bank's risk profile and improving pre-impairment profitability. Addiko's leverage ratio was a high 11.9%, resulting from the use of the standardised approach. We expect earnings retention to remain sufficient to support growth and maintain comfortable buffer over its regulatory capital requirements.

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

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

RATING SENSITIVITIES

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

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

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

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

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

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

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

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

VR ADJUSTMENTS

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

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

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

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

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

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

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

ESG CONSIDERATIONS

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

RATING ACTIONS

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

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Addiko Bank AG	EU Issued, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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