

Credit Opinion: Hypo Alpe-Adria-Bank International AG

Hypo Alpe-Adria-Bank International AG

Klagenfurt, Austria

Ratings

Category	Moody's Rating
Outlook	Stable(m)
Bank Deposits	Aa2/P-1
Bank Financial Strength	*D-
Issuer Rating	Aa2
Public-sector Pfandbriefe -Dom Curr	Aaa
Senior Unsecured	Aa2
Subordinate -Dom Curr	Aa3
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	P-1
Hypo Alpe-Adria (Jersey) II Limited	
Outlook	Stable
Bkd Preferred Stock	*Baa2
Hypo Alpe-Adria (Jersey) Limited	
Outlook	Stable
Bkd Preferred Stock	*Baa2

* Placed under review for possible downgrade on June 9, 2006

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Key Indicators

Hypo Alpe-Adria-Bank International AG

	[1]2005	2004	2003	2002	2001	5-Year Avg.
Total assets (EUR billion)	24.23	17.83	12.71	9.82	7.60	[2]34.88
Total capital (EUR billion)	1.59	1.01	0.88	0.69	0.53	[2]36.23
Return on average assets	0.78	--	0.90	0.89	0.67	0.81
Recurring earnings power [3]	1.43	1.74	1.75	1.83	1.59	1.67
Net interest margin	2.38	2.74	3.01	3.09	2.80	2.80
Cost/income ratio (%)	54.77	54.77	57.03	56.34	58.60	56.30
Problem loans % gross loans	0.00	0.00	--	--	--	0.00
Tier 1 ratio (%)	--	--	--	--	--	--

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

Opinion

Credit Strengths

Credit strengths of Hypo Alpe-Adria-Bank International AG are:

-Strong state support- the bank benefits from the implicit and explicit support of the Austrian State of Carinthia

(Kaernten)

- Strong market penetration in some key markets and products
- Profitability indicators in core products have shown improvements in recent years

Credit Challenges

Credit challenges for the bank are:

- Successfully restore and maintain the confidence of the bank's business partners in light of the revelations of substantial treasury losses in 2004 which have not been properly communicated by the bank
- Successfully develop and implement stringent and transparent risk management procedures and guidelines
- A thorough review of the bank's assets particularly in some markets of former Yugoslavia might lead to increase in provisioning
- Profit growth is becoming increasingly attributable to the group's foreign operations, which are potentially more volatile, which in turn places additional pressure on HAAB to continuously upgrade its risk management tools
- Increasing risk component due to the bank's exposure in Croatia (particularly due to the concentration of non-performing loans) and other countries of former Yugoslavia, whilst the relatively untried credit quality of the Central and East European (CEE) market - from the bank's perspective - could pose problems in the event of a significant economic downturn in this region
- Significant orientation towards domestic retail/corporate customers could also expose the group to asset quality concerns in view of the difficult economic environment in Austria

Rating Rationale

The Aa2/Prime-1 deposit ratings for Hypo Alpe-Adria Bank International AG (HAAB) are based on the legal support obligation in the form of an Ausfallbürgschaft (deficiency guarantee) from the bank's majority owner - the Austrian State of Carinthia - whilst also taking into consideration the state's firm implicit support. In assessing the explicit support provided by Ausfallbürgschaft, we note the well-established banking relationship between Carinthia and HAAB as well as Carinthia's intention to retain its majority shareholding in the bank. In addition to its public sector role, HAAB has a modest but growing retail and commercial franchise within a highly competitive domestic market. The D- financial strength rating (FSR) for Hypo Alpe-Adria Bank International AG reflect the concerns about weaknesses in the bank's risk management systems and its risk culture as well as a lack of transparency which have become apparent in the aftermath of the unveiling this year of substantial losses in the bank's treasury activities in 2004.

On 1 April 2003, the European Commission announced the phasing-out of State guarantees (Ausfallbürgschaft - deficiency guarantee), which currently benefit Austrian public banks. Moody's rating approach for the unguaranteed debt and deposits of the Austrian Landeshypothekenbanken will be announced in due time before the stated phase-out date.

Rating Outlook

The rating outlook of the Aa2/Prime-1 ratings is stable and the support mechanism, in the form of Ausfallbürgschaft, is the dominant factor currently underpinning HAAB's rating stability. The D- FSR and the Baa2 rating on the bank's preference shares are on review for possible downgrade. The review will focus on the repercussions that the losses in 2004 and the surrounding circumstances will have on the bank's franchise and standing in the financial markets, as well as risk management related issues and corporate governance practices That HAA needs to address appropriately to exclude any further critical events.

What Could Change the Rating - UP

Successful implementation of prudent risk management principles and a diminished risk appetite as well as improved corporate governance could exert upward pressure on its D- financial strength rating. The bank's Aa2 debt and deposit ratings reflect the legal support obligation in the form of an Ausfallbürgschaft (deficiency guarantee) from its majority shareholder - the Austrian State of Carinthia. Following the upgrade in September 2002 of the long-term debt and deposit ratings to Aa2 from Aa3, we see little upside pressure on these ratings for the time being.

What Could Change the Rating - DOWN

Further negative control and/or governance issues could place downward pressure on the bank's FSR and the rating of the bank's preference shares. A potential deterioration in asset quality as a result of increasing CEE exposure and more particularly if the latter should expose weaknesses in risk management could be a further factor.

Recent Results

Recent Results

For FY 2005 HAA reported total assets to EUR 15.6 billion (EUR 11.6 in FY 2004) and an operating result of EUR 49.1 million (FY 2004: EUR 325.3 million).

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