

Credit Opinion: Hypo Alpe-Adria-Bank International AG

Hypo Alpe-Adria-Bank International AG

Klagenfurt, Austria

Ratings

Category	Moody's Rating
Outlook	Stable
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

Contacts

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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	3.02	3.11	2.82	2.81
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	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 include:

The benefits of the explicit deficiency guarantee by, and strong implicit support from, the Austrian Federal State of Carinthia (Kaernten)

Good regional retail and SME banking franchise in Carinthia with resilient market shares, and valuable South-eastern European banking network

Satisfactory financial flexibility

Credit Challenges

Credit challenges for the bank include:

Tarnished reputation following substantial treasury losses in 2004 which came to light belatedly during 2006

Further progress towards an improved risk management framework and stronger corporate governance

Rapid growth in South-eastern Europe requires ongoing improvements in operating and monitoring infrastructure

Revenues and earnings increasingly dependent on South-eastern European operations which entail materially higher business, financial and political risks, as well as possible detrimental repercussions for the asset quality and earnings of the bank

Deficiency guarantee will not be available for future obligations beginning in April 2007 (grandfathering of qualifying obligations existing as of end March 2007)

State of Carinthia is likely to reduce its 49.4% indirect stake in the bank in conjunction with planned EUR 250 million capital increase and the public listing envisaged for 2007/2008

Rating Rationale

The Aa2/Prime-1 deposit ratings for Hypo Alpe-Adria-Bank International AG (HAA) are based upon the statutory deficiency guarantee (Ausfallbürgschaft) granted by HAA's indirect majority owner, the Austrian Federal State of Carinthia. Currently, HAA is 49.4% owned by Kaerntner Landes- und Hypothekenbank Holding (owned by Carinthia), 45.6% by Grazer Wechselseitige Versicherung and 5% by HAA employees.

While the bank's financial profile is satisfactory, the D- financial strength rating (FSR) reflects Moody's concern regarding weaknesses in HAA's corporate governance and risk management practices and the heightened business and financial risks associated with the bank's rapid expansion in South-eastern Europe. The FSR was downgraded to D- from C+ and placed on review for possible further downgrade in June 2006 following belated disclosure of substantial treasury losses incurred by the bank during 2004. The D- FSR and the Baa2 preference share ratings were confirmed in December 2006.

Rating Outlook

The rating outlook for the Aa2/Prime-1 ratings is stable and remains linked to Moody's credit assessment of the Austrian State of Carinthia and the explicit support granted to HAA via the deficiency guarantee. The deficiency guarantee will cease to be available for new obligations incurred following end-March 2007 and the future non-guaranteed ratings for HAA will consider future implicit support from the state. The D- FSR and Baa2 ratings both carry stable outlooks.

What Could Change the Rating - Up

Further progress towards an improved risk management framework and stronger corporate governance are a necessary pre-requisite for any future upside potential in the D- FSR. At present, corporate governance at HAA remains well short of market best practices. Further considerations include better alignment of risk appetite and improvements in quality of earnings and capital, as well as improvements in asset quality and reserve coverage. Any upside in the Aa2/P-1 ratings would be linked to strengthening in the credit quality of the State of Carinthia and its commitment to HAA.

What Could Change the Rating - Down

Failure to make further progress in corporate governance and risk management could lead to downward rating pressure on HAA's FSR and the rating of its preference shares. Concerns regarding asset quality and earnings could also contribute to a more negative view. A weaker relationship with Carinthia or a deterioration in the State's creditworthiness could affect the bank's deposit ratings.

Recent Developments

For the full year 2005, HAA reported net income of EUR 142 million (2004 loss of EUR 154 million) on year-end total assets of EUR 24.2 billion (year-end 2004 EUR 17.8 billion).

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