Moody's Investors Service

Rating Action: **Moody's downgrades Hypo Alpe-Adria to E/Baa2**

Global Credit Research - 04 Dec 2009

Short- and long-term ratings on review for possible further downgrade

Frankfurt, December 04, 2009 -- Moody's Investors Service today downgraded the bank financial strength rating (BFSR) of Hypo Alpe-Adria-Bank International AG (Hypo Alpe-Adria) to E from E+, its senior long-term debt and deposit ratings to Baa2 from Baa1 and its ratings for subordinated liabilities to Baa3 from Baa2. The BFSR carries a stable outlook while the long-term ratings and the Prime-2 short-term ratings were placed on review for possible further downgrade.

At the same time, Moody's downgraded Hypo Alpe-Adria's hybrid ratings as detailed below.

The Aa2/Aa3/Prime-1 ratings for debt backed by the Austrian federal state of Carinthia and the Aaa rating for debt backed by the Republic of Austria are not affected by the rating action.

The rating actions follow Hypo Alpe-Adria's announcement that it expects a net loss for the financial year 2009 in excess of EUR1 billion. Moody's expects the bank to require a capital injection in excess of EUR1.5 billion before year-end to cover its current losses and provide an additional loss absorption cushion. Based on the statements of Hypo Alpe-Adria's shareholders and the Republic of Austria, Moody's is concerned that the support assumptions incorporated into Hypo Alpe-Adria's previous ratings are no longer valid, leaving the bank's future unclear.

BFSR DOWNGRADE PROMPTED BY LOSSES IN EXCESS OF MOODY'S EXPECTATIONS

The downgrade of the BFSR to E from E+ reflects (i) the fact that the severity of the net losses projected by Hypo Alpe-Adria for 2009 significantly exceeds Moody's earlier loss expectations and (ii) the increased likelihood that the bank may be subject to a transformative event, such as a significant restructuring or break up.

Moody's downgraded the bank's BFSR on 9 June 2009 to E+ from D- based on the expectation that it will not be able to generate profits until 2011 as a consequence of its historically weak risk management, the ongoing downturn of the global economy and the impact that these factors will have on its already very low profitability, asset quality and capital ratios.

Recent events, especially the severe losses and depletion of capital that we expect for year-end 2009 and the absence of a clear support commitment from either the shareholders or the Austrian government, mean that Moody's is concerned that the bank could be subject to transformation in the near future.

Overall, Moody's believes that the E BFSR better captures the profile of Hypo Alpe-Adria: a bank that will continue to depend on significant outside support for the foreseeable future or be subject to transformation.

REVIEW OF DEBT RATINGS WILL FOCUS ON SUPPORT PROBABILITY

The downgrade of the senior debt and deposit ratings to Baa2 from Baa1 was triggered by the downgrade of the BFSR. At the same time, Moody's placed the debt and deposit ratings on review for further downgrade. The rating agency's review will focus on parental, regional government and systemic support assumptions.

The Baa2 debt and deposit ratings benefit from Moody's assessment of a high probability of parental, regional government and systemic support in light of earlier support measures: i.e. BayernLB's EUR700 million capital injection and the Republic of Austria's EUR900 million participation capital injection in December 2008.

However, given current developments, the bank's need for fresh capital and the reluctance of the various stakeholders to provide the required funds, Moody's will review its support assessment, in respect of the willingness and ability of the stakeholders to support Hypo Alpe-Adria. More specifically, Moody's is concerned about whether BayernLB's shareholder, the Free State of Bavaria will agree to a further capital injection into a foreign subsidiary, given (i) the magnitude of Hypo Alpe-Adria's losses and capital needs and the (ii) the medium-term disposal plans for Hypo Alpe-Adria in the context of BayernLB's restructuring plans, which are currently being reviewed by the European Commission.

Moody's also believes that the bank's role in the national banking system and therefore its systemic importance may decrease in the event of a transformative event and, as a consequence, the probability of systemic support may be lowered. Furthermore, Moody's will assess the role the regional government could play under a bail-out scenario, given the magnitude of the required capital on the one hand and the financial flexibility of the local government on the other. However, Moody's recognises that Hypo Alpe-Adria has roughly EUR20 billion of debt guaranteed by the State of Carinthia outstanding, which leaves Carinthia and the Austrian government with a strong interest in preventing the bank's default, particularly given the related damage that would be caused to the Austrian banking system.

DOWNGRADE OF HYBRID INSTRUMENTS

Moody's downgraded the ratings of the hybrid securities (Tier 1 instruments) issued by HGAA's subsidiaries, Hypo Alpe Adria (Jersey) Ltd and Hypo Alpe Adria (Jersey) II Ltd, to Ca from Caa2 and the ratings of Hypo Alpe-Adria's Ergänzungskapital Notes (subordinated hybrid notes, ISINs: AT0000345202, XS0178449467) to C from Aa3. The Ca ratings of the Tier 1 instruments remain on review for further downgrade while the outlook on the C ratings of the Ergänzungskapital Notes is stable.

The Tier 1 instruments have a non-distributable profit trigger and are non-cumulative. The Ca ratings reflect Moody's expectation of at least four coupon losses and the risk that Hypo Alpe-Adria will be restructured. The Ca ratings also take into account that the perpetual instruments could have some prospect of recovery in the long term. The review is triggered by the fact that Hypo Alpe-Adria's future as a going concern is currently uncertain. The likelihood of a break up of the bank has increased, which would most likely trigger a downgrade of the Ca ratings.

The Ergänzungskapital Notes have a net loss trigger and are cumulative and loss participating. The C rating reflects Moody's expectation of at least four coupon losses and the notes' participation in the bank's losses in 2009 and the coming years. As the instruments mature in 2014 (ISIN AT0000345202) and 2015 (ISIN XS0178449467) Moody's believes that the recovery potential of those instruments is very limited.

The Ergänzungskapital Notes also benefit from a guarantee from the State of Carinthia. However, Moody's understands that the guarantee only becomes effective if existing claims are not served by the bank. The guarantee does not protect the investors in the event of a trigger breach.

PREVIOUS RATING ACTION AND METHODOLOGIES

Moody's previous rating action on Hypo Alpe-Adria was on 9 June 2009, when Moody's downgraded the bank's BFSR to E+ from D- and confirmed the Baa1 long-term debt and deposit ratings and the Baa2 rating on the bank's subordinated liabilities. The ratings carried a negative outlook.

The principal methodologies used in rating Hypo Alpe-Adria were "Moody's Bank Financial Strength Ratings: Global Methodology", published in February 2007, "Incorporation of Joint-Default Analysis into Moody's Bank Ratings", published in March 2007, and " Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt", published in November 2009, which are available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

Based in Klagenfurt, Austria, Hypo Alpe-Adria reported consolidated assets of EUR41.7 billion at the end of June 2009 and an after-tax loss of EUR162 million in H1 2009.

Frankfurt
Dominique Nutolo
Asst Vice President - Analyst
Financial Institutions Group
Moody's Deutschland GmbH
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Frankfurt
Carola Schuler
Managing Director
Financial Institutions Group
Moody's Deutschland GmbH
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Moody's Investors Service

CREDIT RATINGS ARE MIS'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MIS DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

Director and Shareholder Affiliation Policy."