

Research Update:

Austria-Based BKS Bank AG Assigned 'BBB+' Rating; Outlook Stable

August 26, 2024

Overview

- We consider BKS Bank AG (BKS), a well-established small universal bank operating in Austria and some neighboring countries, to have strong capitalization and solid additional loss-absorbing capacity (ALAC).
- We assigned our 'BBB+' long-term issuer credit rating on BKS, which includes one notch of ALAC support to the bank's stand-alone credit profile (SACP).
- The stable outlook reflects our expectation that BKS will maintain its market position and stable franchise in its core markets over the next 24 months.

Rating Action

On Aug. 26, 2024, S&P Global Ratings assigned its 'BBB+' long-term issuer credit rating on BKS Bank AG. The outlook is stable.

At the same time, we assigned our 'A-' resolution counterparty rating on the bank.

Rationale

BKS is a well-established small universal bank operating mainly in Austria. The core markets for BKS' activities are the Carinthia, Styria, and Vienna regions, complemented by smaller operations in Slovenia, Croatia, and Germany. Therefore, the anchor for BKS is one notch lower than that for a bank that operates only in Austria, giving a 'bbb+' starting point for our rating.

Our business position assessment balances BKS' solid franchise in its core markets with its concentrated business model. Given BKS' small size, it has significant revenue concentration in its corporate loan portfolio. We therefore view its business model as more vulnerable to adverse scenarios compared with larger and more-diversified peers in Austria or other countries with similar industry risk. The bank primarily focuses on lending to corporate and small and midsize enterprises (SMEs), which exposes BKS to local economic developments and volatility in the

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valuations of its large equity stakes in local corporates. However, risks are partly balanced by BKS' solid regional market share of about 20% in corporate lending in its home market of Carinthia, and its proven stability and franchise strength throughout the cycle.

BKS is part of the 3 Banken Group, a partnership-based cooperation with two other regional banks in Austria--Oberbank AG (A/Negative/A-1) and Bank für Tirol und Vorarlberg AG. BKS' financial performance is strongly affected by its sizable equity investments in its two sister banks, which contributed on average about half of net income over the past 10 years. However, we do not interpret this as a sign of weak stand-alone earnings quality because returns proved very resilient throughout the previous cycle, and it enhanced revenue diversification.

We view BKS' capitalization as a rating strength. We forecast that BKS' risk-adjusted capital (RAC) ratio of 11.5% at year-end 2023 will increase to about 14.0% in the next two years. The expectation of high retained earnings underpins our RAC forecast, which will likely offset contained growth in risk-weighted assets (RWA) and buffer potential increases in risk and operational costs. BKS' asset quality slightly deteriorated throughout 2023, reflecting the challenging economic environment, but we expect this trend to moderate after 2024. Overall, we anticipate the effect of economic slowdown to be manageable, in line with our view on the broader Austrian banking sector.

We expect margins to remain robust, which--together with the ongoing focus on cost control--will support BKS' profitability. Nevertheless, we think BKS' improvement in profits likely peaked in 2023, in line with our expectation for the local peers. As per S&P Global Ratings' calculation (different from BKS reporting), BKS return on equity constituted 9.8% as of June 30, 2024 (compared to 11.3% at year-end 2023) and cost-to-income ratio equaled 42.4% (compared to 41.5%). As BKS operates in a highly competitive banking market, the pressure on profitability and cost efficiency persists.

We consider BKS' risk position as moderate, which reflects credit risks from the bank's concentrated loan book on corporate and SME loans. We think that BKS is exposed to regional economic trends given its geographical concentration. At the same time, despite the generally high concentration on corporate lending, we consider BKS' loan book to be well diversified across different sectors. We consider asset quality in BKS' €7.4 billion loan book to be comparable to that of peers with a similar business focus. As per S&P Global Ratings' calculation (different from BKS reporting), the bank's nonperforming loan ratio has increased to about 3.1% as of March 2024 and will marginally increase up to 3.2% in the next two years. Risk costs will likely remain elevated over the next two years.

We view BKS's funding profile in line with that of its peers. In our assessment, BKS has a sound deposit franchise with low reliance on wholesale funding and adequate liquidity buffers. The bank's stable funding ratio of 111% and loan-to-deposit ratio of 112% as of June 2024 indicate a comparatively solid funding base. Simultaneously, we consider the diversification of BKS' funding instruments and the bank's access to public funding markets as weaker than that of larger domestic peers', which we expect to limit any improvement in our funding assessment. As of June 2024, BKS' core deposits (our measure of stable deposits) account for 77% of its funding base. We view the high proportion of corporate deposits, and, hence, some single-name concentration, as comparable with peers with a similar business mix. We see liquidity as a neutral factor to our rating on BKS. The net broad liquid assets to short-term customer deposits ratio, which was at 21% as of year-end 2023, is broadly in line with domestic peers' average.

We reflect BKS' subordinated bail-in-able debt in the bank's ALAC uplift. We understand that BKS is targeted for an open bank resolution by the Austrian resolution authority. We think that the authorities envisage a full recapitalization of the business if the bank failed. As of year-end 2023, BKS had an ALAC buffer of about 3.9% of S&P Global Ratings' RWA metric. Based on the bank's issuance plan for subordinated debt and our forecast of S&P Global Ratings' RWA growth, we estimate that this buffer will increase to about 4.1% through 2026, above our adjusted ALAC to S&P Global Ratings' RWA threshold of 2.75%. We therefore reflect the one uplift notch in the assigned resolution counterparty rating of 'A-'.

We consider BKS well-positioned to cope with emerging environmental and social issues. We believe that environmental, social, and governance factors for BKS are in line with its industry and domestic peers.

Outlook

The stable outlook relates to the next two years and reflects our expectation that BKS will be able to protect its internal capital generation. In our base case, we expect slow economic growth to have only a limited effect on the bank and think that the elevated level of interest rates is likely to support the bank and more than offset higher operational, funding, and risk costs. Our forecast relies on the assumption that continuous issuance of subordinated debt will support the bank's ALAC buffer above the adjusted ALAC to S&P Global Ratings' RWA threshold.

Downside scenario

We could take a negative rating action if we expected BKS' capitalization to deteriorate, with the RAC ratio falling and remaining below 10%. This could be the case if the bank's asset quality unexpectedly weakened, leading to higher credit losses than in our base-case scenario and mitigating the positive effects from high interest rates.

We could also downgrade the bank if we doubted that the ratio of ALAC to S&P Global Ratings' RWA would remain consistently above 2.75%.

Upside scenario

The possibility of an upgrade is very remote. We think that, given regional concentrations in revenue and risks, the bank will remain more vulnerable to economic swings than larger, more diversified, retail-oriented peers.

Ratings Score Snapshot

| Issuer Credit Rating | BBB+/Stable/-- |
|----------------------|----------------|
| SACP | bbb |
| Anchor | bbb+ |
| Business position | Moderate (-1) |
| Capital and earnings | Strong (+1) |
| Risk position | Moderate (-1) |

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| Issuer Credit Rating | BBB+/Stable/-- |
|-----------------------------|---------------------------|
| Funding and liquidity | Adequate and adequate (0) |
| Comparable ratings analysis | 0 |
| Support | 1 |
| ALAC support | 1 |
| GRE support | 0 |
| Group support | 0 |
| Sovereign support | 0 |
| Additional factors | 0 |

SACP--Stand-alone credit profile. ALAC--Additional loss absorbing capacity. GRE--Government-related entity.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Eurozone Q3 2024: Growth Returns, Rates Fall, June 24, 2024
- Austrian Banks In 2024: Downside Risks Are Contained, April 18, 2024
- Banking Industry Country Risk Assessment: Austria, Aug. 1, 2023

Ratings List

New Rating

BKS Bank AG

| | |
|--------------------------------|----------------|
| Resolution Counterparty Rating | A/--/-- |
| Issuer Credit Rating | BBB+/Stable/-- |

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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