Moody's Investors Service

Global Credit Research
Credit Opinion
27 NOV 2007

Credit Opinion: Hypo Alpe-Adria-Bank International AG

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Klagenfurt, Austria

Ratings

Category	**Moody's Rating**
Outlook	Positive(m)
Bank Deposits	A2/P-1
Bkd Bank Deposits	Aa2/P-1
Bank Financial Strength	D-
Issuer Rating	A2
Public-sector Pfandbriefe -Dom Curr	Aaa
Senior Unsecured	A2
Subordinate MTN -Dom Curr	A3
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

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Key Indicators

Hypo Alpe-Adria-Bank International AG

	[1]**2007**	**2006**	**2005**	**2004**	**2003**	**Avg.**
Total assets (EUR billion)	**37.78**	**30.59**	**24.23**	**17.83**	**12.71**	[2]**32.13**
Total capital (EUR billion)	**2.68**	**2.15**	**1.59**	**1.01**	**0.88**	[2]**32.18**
Return on average assets	**0.72**	**0.37**	**0.78**	**-0.91**	**0.90**	**0.40**
Recurring earnings power [3]	**1.04**	**1.04**	**1.40**	**1.71**	**1.75**	**1.55**
Net interest margin	**1.97**	**1.89**	**2.38**	**2.74**	**3.02**	**2.63**
Cost/income ratio (%)	**56.08**	**62.24**	**55.64**	**55.53**	**57.03**	**57.35**
Problem loans % gross loans	**--**	**--**	**--**	**--**	**--**	**--**
Tier 1 ratio (%)	**5.93**	**5.40**	**5.30**	**2.90**	**--**	**4.53**

[1] As of June 30. [2] Compound annual growth rate. [3] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of D- to Hypo-Alpe-Adria-Bank International AG (HAA), which is equivalent to a baseline credit assessment of Ba3. While the bank's financial profile is satisfactory, the D- BFSR reflects our concern regarding HAA's corporate governance and risk management which, in Moody's view, has been well below industry best practice, as well as the heightened business and financial risks associated with the bank's rapid expansion in South-eastern Europe. The announcement in May 2007 that Bayerische Landesbank would purchase a 50% plus one share stake in HAA contributed to the positive outlook for HAA's BFSR and reflects the potential influence of Bayerische Landesbank on the risk management and corporate governance of the bank.

HAA's long term global local currency (GLC) deposit rating is at the A2 level. The rating is underpinned by (i) the baseline risk assessment of Ba3; (ii) our assessment of the high probability of support from the Austrian Federal State of Carinthia; and (iii) our expectation of systemic support in the event of a crisis.

HAA's debt rating is A2. The debt rating for grandfathered obligations which continue to benefit from deficiency guarantees from the Austrian Federal State of Carinthia is Aa2, reflecting the financial strength of the guarantor.

Credit Strengths

- Strong implicit support from the Austrian Federal State of Carinthia. The benefits of the explicit deficiency guarantee from the Austrian Federal State of Carinthia are not applicable to new senior obligations, but the bulk of HAA's debt is grandfathered

- Good regional retail and SME banking franchise in Carinthia with resilient market shares, and an important economic role in Carinthia

- Valuable South-eastern European banking network which spans much of the Balkan states, as well as northern Italy

- Satisfactory financial flexibility

- Positive influence of owner Bayerische Landesbank on HAA's risk management and corporate governance

Credit Challenges

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

- Corporate governance and risk management have been well below industry best practice

- 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 negative repercussions for the asset quality and earnings of the bank

- Deficiency guarantee is not available for future obligations

- Implicit support could diminish as the State of Carinthia has reduced its indirect stake in HAA to 20% in conjunction with the majority purchase by Bayerische Landesbank

Rating Outlook

The outlook for the D- BFSR is positive and reflects the positive impact of Bayerische Landesbank towards material improvements in corporate governance and risk management over the medium term. The outlooks for HAA's other ratings are stable. These include the A2 long-term rating for the bank's senior unsecured obligations, the Baa2 rating for junior subordinated securities, the Aa2 rating for obligations which qualify for grandfathering, as well as the short-term P-1 rating.

What Could Change the Rating - Up

Any upgrade of the D- BFSR would necessitate a track record of improved risk management framework and stronger corporate governance. These have been 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.

An upgrade of HAA's A2 rating, or the Baa2 rating for its junior securities, could be triggered by (i) a marked improvement in Hypo-Alpe-Adria-Bank's BFSR; (ii) strengthening in the credit quality of the State of Carinthia and its commitment to HAA; and/or (iii) a strengthening of parental support. Any change in the backed Aa2 rating for obligations which benefit from grandfathered deficiency guarantees would be directly linked to changes in the financial assessment of the Austrian Federal State of Carinthia.

What Could Change the Rating - Down

The current outlook for the BFSR is positive. However, failure to make further progress in corporate governance and risk management, or evidence of weakness with regard to implementing a stronger risk culture, could create downward pressure on the BFSR. Likewise, deterioration in any of the bank's current qualitative and quantitative factors - particularly asset quality, earnings or overall risk profile - could result in negative rating pressure. In this regard, we highlight the risks associated with HAA's rapid expansion in South-eastern Europe.

A downgrade of HAA's LT local currency deposit rating could be triggered by (i) a change in HAA's baseline rating; (ii) a weakening of implicit support expected from the Austrian Federal State of Carinthia or a deterioration in the state's creditworthiness; and/or (iii) a negative change in expected systemic support.

Recent Results and Developments

Moody's affirmed the A2 long-term rating for HAA in May 2007 following the announcement that Bayerische Landesbank would purchase 50% plus one share of the bank. Concurrently, the outlook for HAA's D- BFSR was changed to positive from stable reflecting the possible positive influence of Bayerische Landesbank with respect to risk management and corporate governance. The Austrian State of Carinthia reduced its indirect stake in HAA to 20% in conjunction with the sale to Bayerische Landesbank.

For the first six months of 2007, HAA reported net income of EUR 119 million and total assets as of 30 June of EUR 37.8 billion. For the full year 2006, HAA reported group net income of EUR 71.7million under Austrian GAAP (EUR 83.5 million as per IFRS). One-off charges and higher refinancing costs, partly linked to the amendment of financial statements, had negatively impacted full year 2006 results.

DETAILED RATING CONSIDERATIONS

Detailed rating considerations for HAA's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a D- BFSR to HAA, versus the D outcome generated by our bank financial strength rating scorecard. Moody's believes the D- rating is a more appropriate measure of the bank's financial strength given our concern regarding weaknesses in HAA's corporate governance and risk management practices, the satisfactory levels of the bank's financials and the ongoing risks associated with HAA's expansion in South-eastern Europe.

Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

Although based in Austria, HAA's franchise broadly spans the main banking markets of South-eastern Europe. Domestically, HAA has a good regional retail and SME banking franchise in Carinthia with resilient local market shares, including market leadership in institutional and public-sector related business. HAA has become a regional leader in terms of leasing activities and has established profitable banking operations across the region, including meaningful franchises in northern Italy, Slovenia, Croatia, Bosnia and Serbia.

The overall score for franchise value is C-.

Factor 2: Risk Positioning

Trend: Improving

Moody's remains concerned that HAA's corporate governance and risk management remain well below industry best practice. During 2006, HAA announced that its treasury activities from 2004 resulted in significant losses and an erosion of the bank's then capital to levels which breached capital adequacy requirements. These losses only came to light during 2006. This followed a decision by HAA's international auditor to revoke certification of the bank's 2004 accounts and to call into question the liberal accounting approach originally taken by the local auditors and the HAA boards, which had enabled the losses to be concealed.

During 2006, Moody's commented that these events revealed not only weaknesses in the bank's risk management framework, including risk culture, measurement and systems, but also a lack of transparency and rigour in the bank's handling of developments once the details of the transactions became known. HAA's strong expansion into countries with less developed legal and risk infrastructures than those in Austria further underscores the importance for HAA to have robust risk management practices, covering risk governance and culture, management, measurement and systems. In light of developments in 2006, HAA made significant changes to the composition of its management and supervisory boards, yet these fell short of a wholesale exit of all board members collectively responsible. Likewise, HAA has made some progress to date in introducing improved risk management systems and procedures. The impact of the improvement in risk infrastructure should be felt in the near term, however by its nature the establishment of a more robust risk culture is more time consuming and its outcome uncertain. A successful track record will need to be demonstrated for Moody's to factor in these changes in its assessment. Moody's views positively the possible future influence of Bayerische Landesbank towards strengthening risk measurement and corporate governance at HAA.

With regard to transparency, the publication of IFRS reporting by HAA for interim and year-end 2007 should result in improved financial disclosure and transparency. We note that credit concentrations in terms of both borrowers and industries may pose a threat to the bank's overall credit quality, particularly due to the significant level of leasing and real estate based lending outside of Austria. Up to end-March 2007, HAA took advantage of its backed Aa2 ratings in order to ensure strong liquidity via pre-funding. Reported market risk appetite has also been reduced materially.

The overall score for risk positioning is E.

Factor 3: Regulatory Environment

All Austrian banks are subject to the same score on the regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether or not regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control.

Factor 4: Operating Environment

Trend: Neutral

HAA's home market of Austria receives an A- score for its operating environment and benefits from the established Austrian legal and business practices. However, much of HAA's operations lie outside of Austria in the less developed markets of South-eastern Europe; these include Bosnia, Serbia and Croatia. We use a weighted average of the operating environment score of each country in which HAA operates, with the weights based on operating profit allocated to each respective country.

HAA's operating environment is scored as D.

Quantitative Rating Factors (50%)

Factor 5: Profitability

Trend: Neutral

Profits from growth markets such as Croatia and Serbia, combined with earnings from HAA's leading franchises in related financial activities such as leasing, continue to help to offset lacklustre profits in HAA's domestic market. Indeed, HAA's expanding franchise in South-eastern Europe offers the prospect of future earnings growth, though offset by ongoing investment in expansion and the potential for higher operational and credit risks than those in Austria. Nonetheless, we expect that profitability may well improve, and should benefit from the bank's further diversification of revenues to include a higher share of non-interest income. Overall, however, we expect a neutral view for the score, incorporating our concerns regarding potential business and operational costs in HAA's markets - particularly outside of Austria. Profitability has improved during the first half of 2007, yet full-year figures could be impacted negatively by higher risk provisioning levels.

The D score reflects Moody's view on the bank's profitability.

Factor 6: Liquidity

Trend: Neutral

HAA enjoys a solid liquidity position, which has benefited in part by prudent pre-funding under HAA's backed Aa2 rating. Although the deficiency guarantee which underpinned the higher rating is no longer available for obligations generated from 1 April 2007, HAA has maintained an ample liquidity profile. Liquidity management practices are appropriate, as underscored by both the qualitative assessment and the profile of the bank's financials. HAA is not among those institutions which have contingent liquidity risks with respect to ABCP and structured product conduits.

The C score reflects Moody's view on the bank's liquidity.

Factor 7: Capital Adequacy

Trend: Improving

Although HAA's capital base for year-end 2004 failed to meet regulatory requirements in the re-stated financial statements, HAA's profitability and subsequent capital increases have helped to rebuild adequate capitalisation. Further strengthening of capital adequacy was achieved via retained earnings from 2006 and interim 2007 results to levels which we expect will be more commensurate with the risk profile of the bank. As of 30 June 2007, Tier 1 capital was reported at 5.93% with a total capital ratio of 9.82%. A track record of maintaining significantly higher capital levels could result in upward pressure on this score and a meaningful additional capital increase is planned.

The D score reflects Moody's view on the bank's capital adequacy.

Factor 8: Efficiency

Trend: Neutral

HAA's efficiency scores are strong and reflect the bank's increasing share of non-interest income from services, as well as HAA's strength in leasing activities, and measures to keep its cost base under control. Although we expect future costs may well increase due to investment and expansion, the current cost-income ratio is very competitive relative to that of peers and lies at the extreme high end of the range for the C score.

The C score reflects Moody's view on the bank's efficiency.

Factor 9: Asset Quality

Trend: Neutral

The overall level of non-performing loans reflects HAA's business profile and the bank's strong expansion into markets in South-eastern Europe. This has contributed to a moderate level of problem lending. Our evaluation of asset quality also incorporates the bank's levels of available capital. As such, should HAA's capitalisation strengthen materially more than expected, there could be positive pressure on this metric. Moody's views HAA's exposure to structured credit products as manageable, yet given the current market conditions, the bank could be negatively impacted.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a global local currency deposit rating of A2 for HAA. The rating is supported by HAA's baseline risk assessment of Ba3 (which translates from the BFSR of D-), and high levels of implicit support from the State of Carinthia, as well as systemic support.

Notching Considerations

Ratings for HAA's junior obligations issued via Hypo Alpe Adria (Jersey) Ltd. are rated at Baa2 and reflect a three-notch rating differential, in line with Moody's refined notching methodology published in April 2007.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Hypo Alpe-Adria-Bank International AG

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**D+**	
Factor: Franchise Value						**C-**	**Neutral**
Market Share and Sustainability			**x**				
Geographical Diversification			**x**				
Earnings Stability				**x**			
Earnings Diversification [2]							
Factor: Risk Positioning						**E**	**Neutral**
Corporate Governance [2]					**x**		
- Ownership and Organizational Complexity	--	--	--	--	**--**		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management					**x**		
- Risk Management					x		

- Controls					x		
Financial Reporting Transparency			x				
- Global Comparability	x						
- Frequency and Timeliness				x			
- Quality of Financial Information				x			
Credit Risk Concentration	**--**	**--**	**--**	**--**	**--**		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management		**x**					
Market Risk Appetite		**x**					
Factor: Operating Environment						**A-**	**Neutral**
Economic Stability	**x**						
Integrity and Corruption		**x**					
Legal System	**x**						
Financial Factors (50%)						**D+**	
Factor: Profitability						**D**	**Neutral**
PPP % Avg RWA	--	--	--	--	--		
Net Income % Avg RWA	--	--	--	--	--		
Factor: Liquidity						**C**	**Neutral**
(Mkt funds-Liquid Assets) % Total Assets					48.16%		
Liquidity Management		x					
Factor: Capital Adequacy						**D**	**Improving**
Tier 1 ratio (%)				4.53%			
Tangible Common Equity % RWA	--	--	--	--	--		
Factor: Efficiency						**C**	**Neutral**
Cost/income ratio			57.80%				
Factor: Asset Quality						**D**	**Neutral**
Problem Loans % Gross Loans	--	--	--	--	--		
Problem Loans % (Equity + LLR)	--	--	--	--	--		
Lowest Combined Score (15%)						**D**	
Economic Insolvency Override						**D**	
Aggregate Score						**D**	
Assigned BFSR						**D-**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information
[2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral