Moody's affirms State of Carinthia's A2 rating with stable outlook

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Moody's Investors Service Press Release
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Moody's Investors Service has today affirmed the State of Carinthia's A2 issuer and debt ratings following the Austrian government's decision to introduce a law to bail-in subordinated debt holders of recently nationalised Hypo Alpe-Adria-Bank International AG and declare the state's deficiency guarantees on this type of debt invalid. The outlook on the rating remains stable.

RATINGS RATIONALE

The affirmation follows the publication of the Austrian government's (Aaa stable) draft law to wind down nationalised Hypo Alpe-Adria-Bank International AG (HAA; unrated). In addition to the bail-in of subordinated debt investors and former owner BayernLB (A3 negative), the draft law also declares invalid Carinthia's deficiency guarantees on HAA's subordinated debt (worth nearly EUR 0.9 billion). Moody's notes that the draft law requires parliament's approval before coming into effect.

Although the elimination of guarantees on subordinated debt is a credit positive, Moody's cautions that Carinthia still provides a statutory deficiency guarantee on a very high portion of HAA's senior debt maturing over the next three years; the total guarantees are equivalent to nearly EUR12 billion or nearly six times the state's 2014 budgeted operating revenue. The law's successful implementation would only marginally reduce the guarantee amount to around EUR11 billion, or around 5.2 times operating revenues.

Although negotiations between the Austrian government and the State of Carinthia to determine the latter's financial contribution to the resolution of HAA are ongoing, Moody's expects its contribution to be manageable and the rating agency has already factored this into the current A2 rating.

Carinthia's A2 ratings benefit from a three notches of uplift from its baseline credit assessment of baa2, in order to reflect Moody's view of a high probability of extraordinary federal government support in the event of acute liquidity stress.

RATIONALE FOR AFFIRMATION OF STABLE OUTLOOK

Notwithstanding the positive aspects of recent developments, the stable outlook continues to reflect (1) the Austrian government's decision to pursue a bad bank solution, which should be set up by November 2014 via special legislation and (2) Moody's expectation that the ongoing negotiation with the federal government will result in a manageable financial contribution for Carinthia. Moody's is closely following the process which is not exempt from some degree of uncertainty and implementation risks.

The stable outlook also takes into account the State of Carinthia's robust operating and financial performances over the last few years, moderate direct debt and its sound liquidity position.

WHAT COULD MOVE THE RATINGS UP / DOWN

Upward pressure could develop on the rating only after the implementation of the bad bank and the evidence of a positive track record. The progressive reduction of guaranteed debt in the next few years will also exert upward pressure.

Downward pressure could develop from further uncertainty about the wind-down entity and greater than expected financial support from Carinthia to address the wind-down entity's future capital needs.

The publication of this rating action deviates from the previously scheduled release date in the sovereign release calendar published on www.moodys.com. The reason for the deviation is Moody's view that Austrian Goverenment's proposed law on **Hypo Alpe**-**Adria**-Bank resolution is credit neutral for the State of Carinthia.

Specific economic indicators as required by EU regulation are not applicable for this entity.

On 16 June 2014, a rating committee was called to discuss the rating of the State of Carinthia. The main points raised during the discussion were: The issuer's susceptibility to event risks has not materially changed.

The principal methodology used in this rating was Regional and Local Governments published in January 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this rating action, if applicable.

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