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CREDIT OPINION
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Update

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JSC Development Finance Institution Altum

Update to credit analysis

Summary

JSC Development Finance Institution Altum's (Altum) long- and short-term issuer ratings of Baa1(stable) and Prime-2, respectively, reflect the combination of (1) a standalone credit profile of ba2, and (2) very high probability of support from the Latvian government (LT Issuer Rating A3 stable). The support assumptions are based on the importance of Altum for the growth strategies of the Latvian government, as well as the government's strong track record of providing support to strategic companies.

Altum's standalone credit profile of ba2 reflects the institution's mandate as a development institution, with high capitalisation, funding sourced from state and European Union (EU) government levels and including asset risk protection mechanisms. These strengths are balanced against high level of problem loans and weak profitability.

Credit strengths

» Very high probability of government support

» High capitalization

» Stable funding although state-backed funding is expected to decline in the long run

» Although weak, all profits are retained in the company

Credit challenges

» High volumes of problem loans, although coverage is very high

» Due to its mandate as a development organization, profitability is very low

Rating outlook

The stable outlook on Altum's long-term issuer rating reflects Moody's expectations that the company's standalone credit profile and the government support and dependence will remain broadly in line with their current standing over the next 12 to 18 months. .

Factors that could lead to an upgrade

An upgrade could follow if the Latvian government ratings are upgraded, or if Altum demonstrates improving profitability while maintaining its high asset risk coverage, and/or demonstrates lower volumes of problem loans and losses arising from venture capital and guarantees.

Factors that could lead to a downgrade

A downgrade could follow if the Latvian government ratings are downgraded, or if the probability of government support decreases, or a combination of (1) Altum significantly changing its funding structure and; (2) its risk coverage reserves significantly deteriorating; or (3) capitalisation deteriorating significantly.

Key indicators

Exhibit 1

JSC Development Finance Institution Altum (Consolidated Financials) [1]

	6-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total managed assets (EUR thousand)	438,889	443,126	406,918	435,360	0.3[4]
Total managed assets (USD thousand)	500,575	467,388	442,033	526,809	-2.0[4]
Pretax Preprovision profits / Average Managed Assets (%)	0.4	0.6	0.3	-0.2	0.3[5]
Net Income / Average Managed Assets (%)	0.5	0.0	0.2	-0.5	0.0[5]
ROE (%)	1.0	0.0	0.4	-1.1	0.1[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	49.3	47.4	49.0	45.0	47.7[5]
Effective Leverage (%)	90.9	98.5	89.8	111.1	97.6[5]
Problem Loans / Gross Loans (Finance) (%)	19.2	21.5	21.3	20.7	20.7[5]
Problem Loans / (Shareholders' Equity + Loan Loss Reserve) (Finance) (%)	17.3	20.7	21.5	22.6	20.5[5]
Net Charge-Offs / Gross Loans (%)	0.4	1.7	4.8	5.5	3.1[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime.
Source: Moody's Financial Metrics

Profile

Altum has a strong mandate by law to promote the advancement of the Latvian economy through the development, approval, implementation and monitoring of aid programmes. These programmes are currently funded through the state budget and through EU structural funding. Although not a systemically important institution by size, Altum is the main development institution in Latvia and is of considerable importance to the delivery of the government's economic policy and we expect that the probability of support from the Latvian government is very high. Altum's shareholders comprise of the Ministry of Finance (40%), the Ministry of Economics (30%) and the Ministry of Agriculture (30%).

Altum's main areas of activity relate to providing loans, credit guarantees and insurance for business export deals, as well as investment to venture capital funds. It also offers non-financial support in the form of consultations, education, mentoring, etc. Currently, Altum's activity is restricted to so-called programmes (financial instruments or grants) which are developed and then monitored at the ministry level. Therefore, all the investments made by Altum comply with government-defined development programme criteria. Altum implements support programmes and offers financial instruments, providing service to customers directly, as well as in cooperation with financial intermediaries and commercial banks. Altum has seven regional centers and 14 consulting offices in different parts of Latvia.

Altum's activities are regulated by special law, the Development Finance Institution Law, passed by the Latvian Parliament in October 2014 and in force since March 2015. Altum's creation was supported by the European Commission's decision "Latvia MLB development segment and creation of the Latvian Single Development Institution". The other laws applicable to the institution are the Law on Governance of Capital Shares of a Public Person and Capital Companies, the Commercial Law and other binding regulatory enactments. Altum was established in December 2013 as a merger of the following three enterprises:

» Latvian Development Finance Institution Altum SJSC, (previously the Mortgage and Land Bank of Latvia), specialised in credit activities;

» Latvian Guarantee Agency LLC (LGA), specialised in guarantees and investments in venture capital;

» Rural Development Fund SJSC (RDF), specialised in credit activities for farmers.

Altum is not a deposit-taking institution and does not have a banking license. While it is obliged to prepare annual audited accounts in accordance with IFRS, the entity is not required to comply with minimum capital requirements.

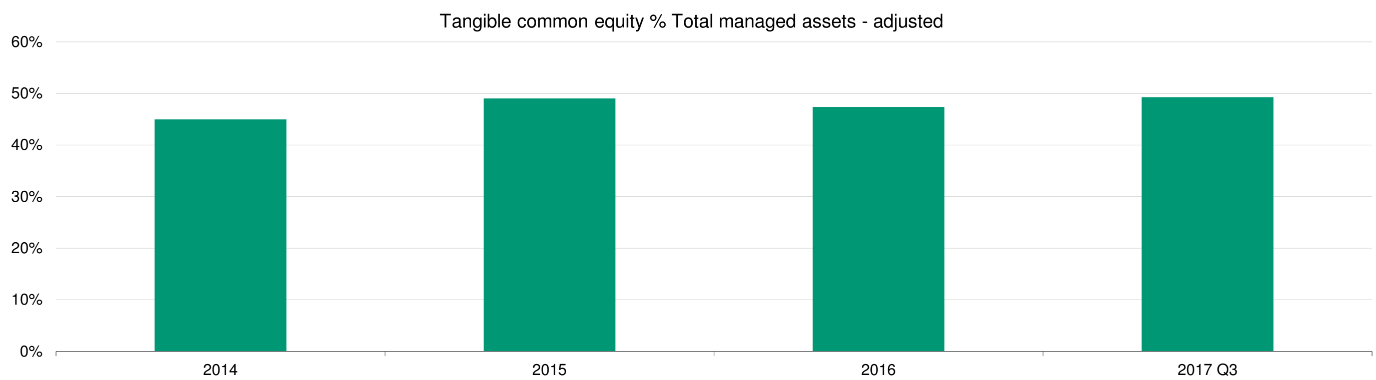
As of 30 September 2017, it reported a total consolidated asset base of EUR432.7 million (USD511 million).

Detailed credit considerations

Strong capitalization

Altum has large capital buffers to withstand volatility in earnings, and to support future growth. The Moody's adjusted tangible common equity to tangible managed assets ratio stood at 49.5% as of end-September 2017 (end-2016: 47.4%), which we expect to fall in the next twelve months mostly due to the growth in business volumes.

Exhibit 2
Altum's capital metrics



Source: Altum's financial reports, Moody's Investors Service

Altum's profit cannot be paid out in dividends. Instead it accumulates as reserves to ensure financial stability and sustainable operations, and to mitigate programme risks.

Weak asset risk mitigated by substantial risk coverage reserves

A high number of problem loans is credit negative but the risk is largely mitigated by a sizeable government- and EU-backed asset risk protection (reported as credit risk cover by public funding). Under this credit risk cover scheme, the sponsor (the state of Latvia or the EU) takes the first losses within the portfolios of loans, venture fund investments or guarantees (the percentage varies from one programme to another), providing meaningful protection against asset risk. Due to the nature of Altum's mandate and the risk cover, the institution has a larger risk appetite than would be the case for a commercial bank.

Altum's portfolio is diversified, with 20 exposures (including both loans and guarantees) accounting for around 20% of TCE and the single biggest exposure accounting for less than 2% of TCE. Based on Altum's business development strategy, Moody's expects moderate growth in the entity's loan book and venture capital funds while the volume of guarantees should grow more rapidly.

As of end-September 2017, the Group's books and records held a portfolio of the financial instruments granted within the state aid programmes for the total value of EUR443.2 million (2016: EUR430.9 million), made up of 13,787 projects (2016: 11,449), including:

» loan portfolio of EUR211.5 million (2016: EUR217.4 million), with 6,331 transactions (2016: 6,327);

» investments in venture capital funds for the total value of EUR55.2 million (2016: EUR58.5 million), with 192 total number of projects financed by funds (2016: 185);

» guarantee portfolio of EUR176.5 million (2016: 147.2 million), with 7,264 transactions (2016: 4,937).

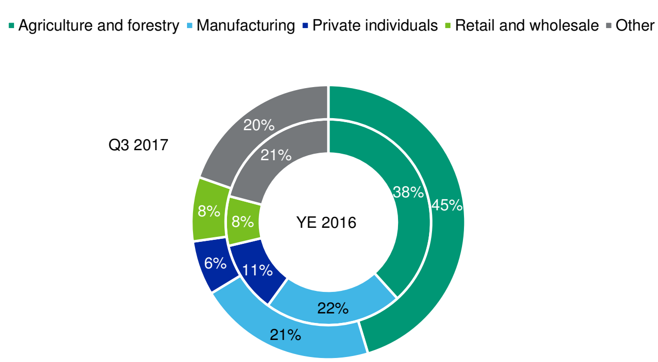
Altum expects a certain amount of loss on all its investments, depending on the programme structure and terms. The expected losses are estimated in advance and covered by the credit risk cover, a percentage of a programme's funding.

» Loans are given directly to companies and to a lesser degree, private individuals. The largest portion of loans are investment loans, aimed at helping smaller companies grow their businesses. Agriculture has traditionally been a large segment and constituted 45% of the loan portfolio at end-September 2017. Manufacturing and processing industry makes up 21% and private individuals 6% (see Exhibit 3).

» Funds aimed at venture capital/equity investments are managed by external funds, with partnership agreements and consultation committees in place to safeguard that programmes are followed. Fund managers typically also invest own money in these funds. The programmes aimed at equity investments have a large expected loss and therefore there are larger risk coverage reserves.

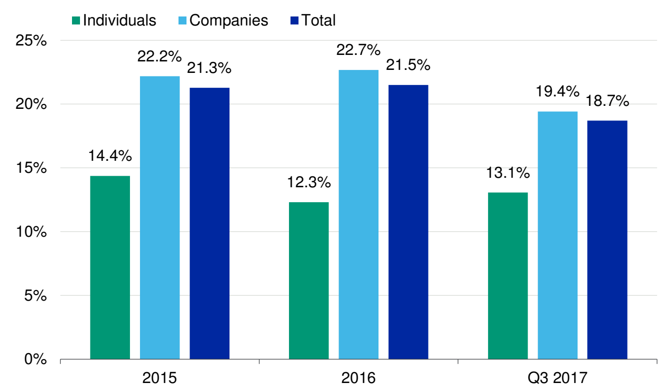
» Guarantees are given to banks to stimulate lending to borrowers who have viable business strategies but might lack enough own funds or enough collateral. Altum aims to grow primarily through guarantees going forward.

Exhibit 3
Loanbook breakdown



Source: Altum's financial reports; Moody's Investors Service

Exhibit 4
Segmental and total non-performing loans ratios

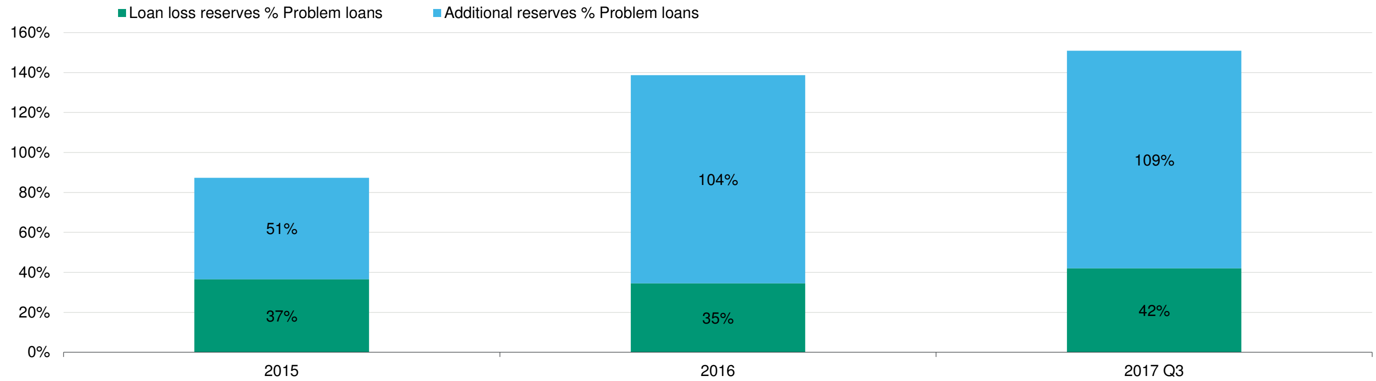


Source: Altum's financial reports; Moody's Investors Service

The problem loan over gross loan ratio remained relatively stable over the period 2014-2016, while it declined slightly to 18.7% at end-September 2017 (21.5% at end-2016), which is commensurate with the entity's business model as it is targeting borrowers with weaker risk profiles (see Exhibit 4). According to the management's forecast, they expect this ratio to remain stable in the midterm.

Loan loss reserves to problem loans ratio stood at a low 42% at end-September 2017 (end-2016: 35%). However, when including the programmes' credit risk cover for loans, coverage is high at 151% at end-September 2017(Exhibit 5).

Exhibit 5
Altum's coverage ratio



Source: Altum's annual report 2016, Altum, Moody's calculations

Altum-issued guarantees benefit from government backing

According to the Law on Development Finance Institution, the state is responsible for the guarantees issued by Altum (in case of Altum's failure to pay) to the amount specified in the Law On the State Budget for the Current Year. As of end-September 2017, a portfolio of outstanding guarantees (EUR176 million) is oversecured by state funding to amount of EUR200 million according to the Law on State Budget 2017 (2016: amount of EUR131 million and state funding of EUR100 million). Although this does not affect the standalone credit profile of Altum, it contributes to our view that the state is committed to Altum and its mandate.

We expect asset risk to remain stable and that the provisions and risk coverage will be sufficient to cover most losses incurred on loans, venture funds or guarantees.

Strong liquidity profile, with funding coming from Latvian state and European institutions

Funding and liquidity management is a credit strength because most aid programmes, which are used to fund the institution, are replaced with new ones at maturity and thus funds are in practice not repaid.

Altum is funded by borrowings from Latvian state, the European institutions and a green bond (issued in October 2017). As of end-September 2017, around half of Altum's liabilities comes from support programme funding and state aid, the amounts and maturity of which are defined by the Cabinet of Ministers before the implementation of each programme. The other 50% of liabilities is divided between loans from the European Investment Bank, Rural Support Service and Latvian Treasury. The recently issued bond will be included in the year-end financial results, and we estimate that it will fund around 4% of Altum's assets. However, past 2020, some of the EU structural funds might gradually decrease and Altum will want to replace this funding with additional market funding.

Altum has a comfortable maturity profile, with 94% of funding (liabilities against credit insitutions, general governments and support programme funding and state aid) having a maturity of more than one year, as of end-September 2017. Even though the support programme funding appears to have a given maturity, in reality it is transferred into a new programme after termination of the old one, so in practice these funds do not get repaid.

As of end-September 2017, Altum has a comfortable liquid resources cushion consisting mainly of demand deposits in other credit institutions and Latvian Treasury (EUR86 million), as well as Latvian government bonds (around EUR63 million). Over the longer term, we expect the increasing share of market funding might increase funding risks, as there will be a higher dependency on confidence-sensitive investors and higher refinancing risks.

Weak profitability as profit maximization is not a priority

Profitability is a credit weakness for Altum, with expected low internal capital generation. Although profit maximization is not Altum's goal due to its specific business model, according to the Law the entity should operate with profit in the long-term, preserving the capital invested by the state. A positive return on equity is incorporated into the business strategy.

Altum's top-line revenues mostly consist of net interest income, which makes up around 80% of total revenues (adjusted for non-recurring items such as proceeds from the sale of properties in H1 2017). Other items include compensation for management expenses related to state aid programmes, proceeds from sales of office building and income from property privatisation, which have been at around EUR5.5 million during H1 2017. Fees and commission income accounted for around 1% of total revenues both in H1 2017.

After reporting a net loss of EUR2.2 million in 2014, Altum showed a positive bottom-line result over the next two years, although it was very close to break-even in 2016. After adjusting for non-recurring items, its net profit stood at EUR2.1 million in H1 2017 up from EUR85 thousand in YE 2016, which translate into net income to average managed assets ratios of 0.48% and 0.02% respectively. Reported net profit stood at EUR5.4 million in H1 2017 and EUR2.2 million in YE 2016.

Over time, Moody's expects slight improvement in profitability, with efficiency gains coming from increased business volumes on one side and reduced operating expenses on the other, mostly due to reorganization efforts, and implementation of new IT systems.

Very high probability of government support

The Latvian government has a strong track record of providing support to strategic companies, including the electricity, postal services, airlines, railways, and telecom sectors, as well as development institutions. The Latvian government has previously supported its development institutions by means of recapitalisation, liquidity support and guarantees. Due to the importance of Altum for planning and implementing growth strategies in the national economy, we expect that the probability of government support is very high.

Altum has a very high dependence on the Latvian state.

The very high default dependence reflects the strong probability that, in the event of a sovereign credit default, the risk of a potential financial crisis affecting Altum would be quite high, given (1) clear operational linkages to the government, whereby Altum has an explicit and well-recognised mandate to implement specific government policies; (2) the geographic focus of Altum's activities in Latvia; and (3) its high dependence on state funding.

Rating methodology and scorecard factors

Exhibit 6
JSC Development Finance Institution Altum

Rating Factors	Aa/A	Baa	Ba	B	Caa	Historical View	Forward View
Non-Financial Factors						Ba	Ba
Factor: Franchise Positioning						Ba	Ba
- Market Position and Sustainability	x						
- Operational Diversification				x			
Factor: Risk Positioning						Baa	Baa
- Potential Volatility of Assets/Cashflows		x					
- Governance and Management Quality			x				
- Risk Management		x					
- Key Relationship Concentrations	x						
- Liquidity Management	x						
Factor: Operating Environment						Ba	Ba
- Economic Strength			x				
- Institutional Strength	x						
- Susceptibility to Event Risk			x				
Financial Factors						B	B
Factor: Profitability						Caa	B
- PPI / AMA					0.40%		
- Net Income / AMA					-0.10%		
- Pre-tax Income Coefficient of Variation					-156.73%		
Factor: Liquidity						Aa/A	Aa/A
- 24 Month Coverage Ratio	437.00%						
- Secured Debt / Gross Tangible Assets	0.00%						
Factor: Capital Adequacy						Aa/A	Aa/A
Capital Bucket: Traditional Finance Company							
- TCE / TMA	47.39%						
Factor: Asset Quality						Caa	Caa
- Problem Loans / Gross Loans					21.16%		
- Problem Loans / (Shareholders Equity + LLR)				21.57%			
Scorecard estimated stand-alone credit assessment:						Ba3	Ba2
Assigned stand-alone credit profile:						Ba2	

Government-Related Issuer	Factor
a) Standalone Credit Pofile	ba2
b) Government Local Currency Rating	A3
c) Default Dependence	Very High
d) Support	Very High
e) Final Rating Outcome	Baa1

[1] Capped at Baa; The risk management sub factor score will not exceed the weighted average of scores assigned to a firm's other risk positioning sub factor scores.

Ratings

Exhibit 7

Category	Moody's Rating
JSC DEVELOPMENT FINANCE INSTITUTION ALTUM	
Outlook	Stable
Issuer Rating -Dom Curr	Baa1
ST Issuer Rating -Dom Curr	P-2

Source: Moody's Investors Service

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