MOODY'S INVESTORS SERVICE

CREDIT OPINION

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Update

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JSC Development Finance Institution Altum

Update following confirmation of Baa1 and change of outlook to stable

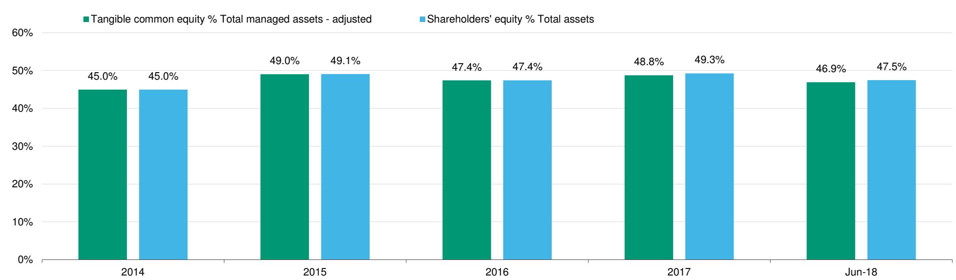
Summary

JSC Development Finance Institution Altum's (Altum) long- and short-term issuer ratings are positioned at Baa1/Prime-2, reflecting the combination of (1) a baseline credit assessment of baa3, and (2) a very high probability of support from the Latvian government (A3 stable). The support assumption is 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. However, without explicit government guarantees to Altum, or to its creditors, the government support does not lead to a rating at par with the sovereign rating.

Altum's stand-alone baseline credit assessment of baa3 reflects 1) the strong financial profile of the company with very strong capitalization (see Exhibit 1) and the large share of loss coverage incorporated in the funding programmes, whose characteristics also result in low refinancing risks, balanced against high levels of problem loans and low profitability, and 2) the unique standing of Altum in the industry reflecting its policy mandate to provide a distribution channel for state and EU program funds to both end-customers and other financial institutions.

Exhibit 1

Altum's capital metrics, as adjusted



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

Credit strengths

» Very high probability of government support

» High capitalization

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

Credit challenges

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

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

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: (1) the Latvian government ratings are upgraded, or the provision of government guarantees protecting creditors in case of failure: or (2) Altum improves its standalone credit fundamentals significantly, including demonstrating lower volumes of problem loans and losses arising from venture capital and guarantees, as well as managing non-EU and State funding prudently.

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 2

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

	6-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total managed assets (EUR thousand)	468,886	451,686	443,126	406,918	435,360	2.1[4]
Total managed assets (USD thousand)	547,451	542,383	467,388	442,033	526,809	1.1[4]
Pretax Preprovision profits / Average Managed Assets (%)	1.3	0.8	0.5	0.7	-0.1	0.7[5]
Net Income / Average Managed Assets (%)	1.1	0.8	0.0	0.2	-0.5	0.3[5]
ROE (%)	2.2	1.7	0.0	0.4	-1.1	0.7[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	46.9	48.8	47.4	49.0	45.0	47.4[5]
Effective Leverage (%)	104.2	94.8	99.9	91.4	111.8	100.4[5]
Problem Loans / Gross Loans (Finance) (%)	21.0	23.1	27.6	29.0	30.6	26.3[5]
Problem Loans / (Shareholders' Equity + Loan Loss Reserve) (Finance) (%)	18.1	20.1	26.6	29.2	33.4	25.5[5]
Net Charge-Offs / Gross Loans (%)	1.8	1.7	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 the Ministry of Finance (40%), the Ministry of Economy (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 five regional centers and 16 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 end-December 2018, Altum reported a total consolidated asset base of EUR502.0 million ($74.1 million).

Detailed credit considerations

Strong capitalization

We assign a capital score of A2, five notches below the initial score, which reflects the large portfolio of off-balance sheet guarantees and the view that these will continue increasing in the business mix.

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 a very strong 43.9% as of end-December 2018, although down from 48.8% as of end-December 2017, primarily due to a one-off increase of loan loss provisions in the amount of EUR1.65 million from the adoption of IFRS9 in January 2018. However, Altum's strategy to grow its guarantee portfolio increases its contingent liabilities.

Altum's profit is not 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

The assigned average weighted asset quality score of Ba3 is higher than the B3 initial score and incorporates the additional risk buffers that Altum benefits from under its EU and government sponsored funding programs.

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.

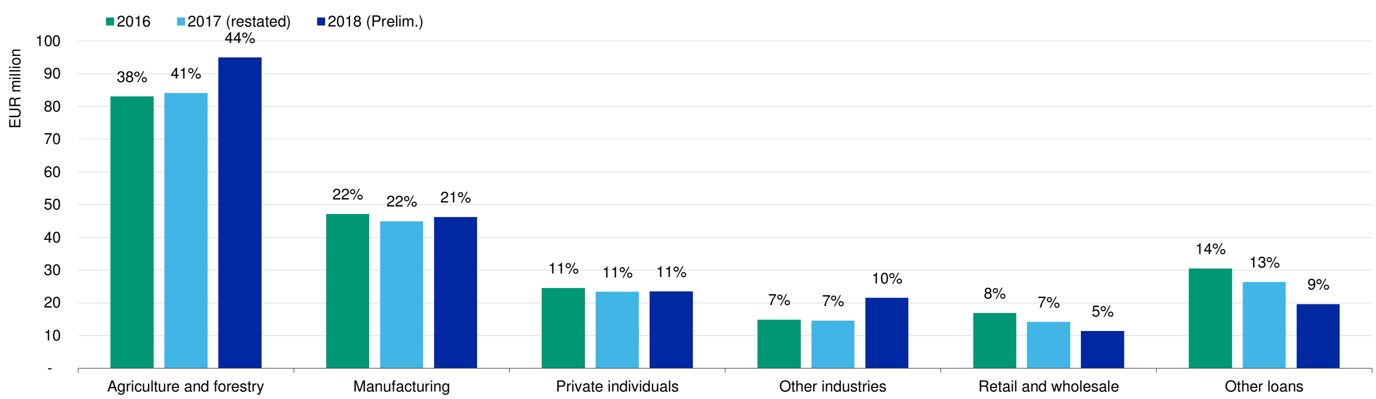
Altum's portfolio is diversified. As of end-December 2018, the Group's books and records held a portfolio of the financial instruments granted within the state aid programmes for the total value of EUR503.0 million (2017: EUR443.1 million), made up of 18,280 projects (2017: 14,402), including:

» loan portfolio of EUR217.1 million (2017: EUR207.6 million)

» investments in venture capital funds for the total value of EUR49.0 million (2017: EUR53.2 million)

» guarantee portfolio of EUR236.9 million (2017: EUR182.4 million).

Exhibit 3
Loan book breakdown by industry



Percentages show the share of the total loans for each period.
Source: Altum's financial reports, Moody's Investors Service

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.

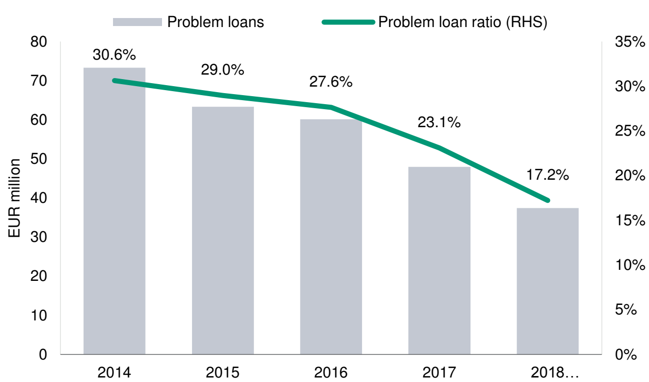
Altum expects a certain amount of loss on all its investments, depending on the programme structure and terms. The expected losses are estimated in advance and covered by the credit risk cover, a percentage of a programme's funding.

» 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 44% of the loan portfolio at end-December 2018. Manufacturing and processing industry makes up 21% and private individuals 11%.

» 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.

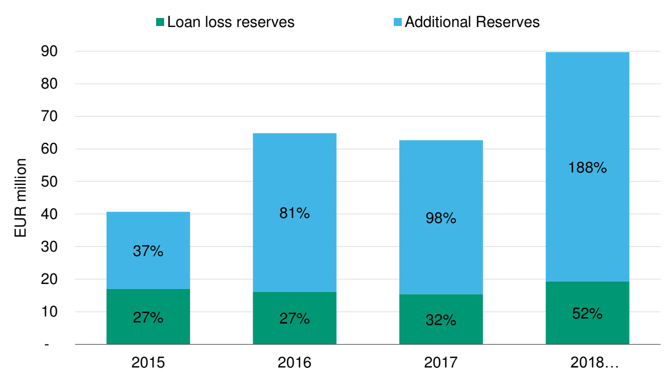
The problem loan-to-gross loan ratio[1] stood at 17.2% at end December 2018, falling from 23.1% at end-December 2017, which is commensurate with the entity's business model as it is targeting borrowers with weaker risk profiles. The loan loss reserves-to-problem loans ratio stood at a low 52% at end-December 2018 (end-2017: 32%). However, when including the programmes' credit risk cover for loans, coverage is high at 240% at end-December 2018 (end-2017: 131%).

Exhibit 4
Problem loans ratio



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

Exhibit 5
Provisioning coverage



Percentages show the ratio to problem loans
Source: Altum's financial reports, Moody's Investors Service

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

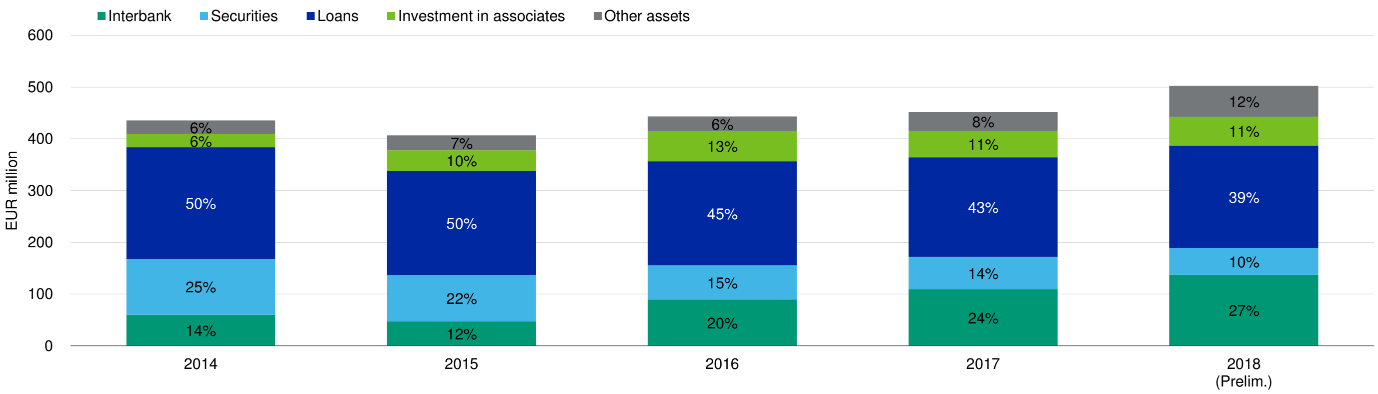
The weighted average cash flow and liquidity score of Ba1, two notches below the initial score reflects that most programmes that are used to fund the institution, have limited refinancing risks for Altum. This is balanced against weak funds from operations which is used to repay market funding, constraining the liquidity score.

Altum is funded by borrowings from Latvian state, the European institutions and bond issuances. As of end-December 2018, 47% of Altum's liabilities comes from support programme funding and state programmes, the amounts and maturity of which are defined by the Cabinet of Ministers before the implementation of each programme. The remaining liabilities include bond issuances (at 11% of total liabilities) and funding from general governments (at 17% of total liabilities). However, past 2020, some of the EU structural funds might gradually decrease while Altum plans on gradually increasing its funding with additional market funding.

Altum has a comfortable maturity profile, with 63% of funding (liabilities against credit institutions, general governments and support programme funding and state aid) having a maturity of more than one year, as of end-December 2018. Even though the support programme funding appear to have a given maturity, Altum can continue using the funds in accordance with the intentions of the program, limiting refinancing risks.

As of end-December 2018, Altum has a comfortable liquid resources cushion consisting mainly of demand deposits in other credit institutions and Latvian Treasury (EUR137 million), as well as Latvian government bonds (around EUR50 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.

Exhibit 6
Altum's assets breakdown



Note: The data labels refer to the percentages with respect to total assets.
Source: Altum's financial statements

Funds from operations were low at EUR8 million in 2018, whereas the outstanding senior debt was EUR30 million. With further issuances planned in the future, the funds generated by the operations might not be enough to repay upcoming maturities. This is largely mitigated by the large stock of liquid assets.

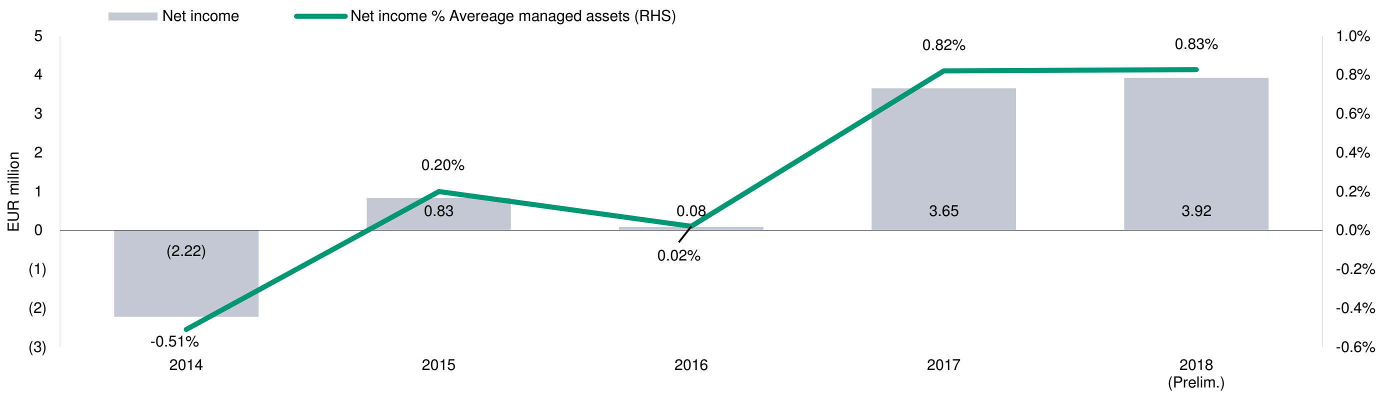
Moderate profitability as profit maximization is not a priority

We assign a Profitability score of B3, three notches below the initial score to reflect our expectation of softening profitability going forward.

Although Altum posted stronger profits in 2017 and 2018, we expect lower internal capital generation in the longer term due to its public mandate and lack of profit maximisation incentives. 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 in 2018, although decreasing by 2% from 2017. Fees and commission income increased by 68% in 2018 compared with 2017. After adjusting for non-recurring items, Altum's net profit stood at EUR3.92 million in 2018, up from EUR3.65 million in 2017, which translate into net income to average managed assets ratios of 0.83% and 0.82% respectively.

Exhibit 7
Profitability levels have strengthened



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

Over time, Moody's expects moderate profitability, with an assigned score of B3 on profitability.

Operating environment

A key component of our analysis is the extent to which external conditions can have a meaningful influence on Altum's credit profile. The operating environment score for Altum, Baa3, considers two factors: a Macro-Level Indicator and Industry Risk. The score for the Operating Environment is combined with the Financial Profile score to determine the Adjusted Financial Profile score.

With the macro-level indicator being higher than the industry risk indicator, it receives 0% weight in the Operating Environment score. Thus the industry risk score has a 100% weight in the Operating Environment score. The assigned Operating Environment Score of Baa3 takes into account the limited track record as a constraint, explaining the 1 notch difference from the Home country Operating Environment Score of Baa2.

Macro level indicator

The macro-level indicator of A3 for Latvia reflect the intrinsic strength of its economy, the capacity of the government to conduct sound economic policies, as well as political risk, government liquidity risk, financial sector risk and external vulnerability risk. The economic strength score of "Moderate +" reflects the small but diversified export sector with proven track record of managing economic shocks. The "High+" institutional strength score reflects its strong institutional capacity, as exemplified by Latvia's sizeable postcrisis macroeconomic adjustment and fiscal consolidation undertaken, with one of the largest deficit reductions in the EU. Susceptibility to event risk is assessed as "Moderate (-)", driven by our assessment of the geopolitical risk in the region.

Industry risk indicators

In assessing industry risk, we consider competitive position, exposure to cyclical economic forces and the track record of the product offering of a finance company's business line or business lines. The industry risk score for Altum is Baa, which reflects its stable position in the industry as a development institution with limited exposure to competition from commercial banks and with a specific government mandate regulated by law and within that scope, its ability to channel EU and State funding into the real economy. Therefore economic cycles are less important for Altum than other private finance companies. The track record of the company's business line is limited and therefore constrains the industry risk score. Altum was founded in December 2013, as a result of the merged three state owned organisations. The re-organisation was finished as recently as April 2015, and the company's future missions will depend not only on the Latvian state, but also future allocations of EU Structural funds to Latvia.

Support and structural considerations

The issuer ratings of Altum incorporate both the BCA and a support considerations. The very high dependence and very high probability of government support leads to a two notch uplift to Baa1. However, without explicit government guarantees to Altum, or to its creditors, the government support does not lead to a rating at par with the A3 sovereign rating.

Very high probability of government support

The Latvian government has a 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 assess 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.

Methodology

The principal methodologies we use in rating JSC Development Finance Institution Altum are our Finance Companies rating methodology, published in December 2018, and Government related Issuers, published in June 2018.

Exhibit 8

JSC Development Finance Institution Altum

Financial Profile	Historical			Assigned		
	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	0.56%	Ba3	**B3**	Expected trend	
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	43.91%	Aa1	**A2**	Other adjustments	Expected trend
Asset Quality						
Problem Loans / Gross Loans (%)	10%	22.63%	Ca	**B2**	Portfolio composition	
Net Charge-Offs / Average Gross Loans (%)	10%	3.40%	Ba1	**Baa3**	Portfolio composition	
Weighted Average Asset Risk Score			B3	**Ba3**		
Cash Flow and Liquidity						
Debt Maturities Coverage (%)	10%	100.00%	Ba1	**Baa3**	Other adjustments	
FFO / Total Debt (%)	15%	0.35%	Caa3	**Ba1**	Other adjustments	
Secured Debt / Gross Tangible Assets (%)	20%	0.00%	Aaa	**Ba1**	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			**Baa2**	**Ba1**		
Financial Profile Score	**1**		**Baa2**	**Baa3**		

Operating Environment			
Home Country			
	Factor Weights	Qualitative Scale	Score
Macro Level Indicator	0%		A3
Economic Strength	25%	Moderate +	
Institutional Strength	50%	High +	
Susceptibility to Event Risk	25%	Moderate -	
Industry Risk	100%		Baa
Home Country Operating Environment Score			Baa2

	Factor Weights	Score	Comment
Operating Environment Score	**0**	**Baa3**	

ADJUSTED FINANCIAL PROFILE		Score
Adjusted Financial Profile Score		**Baa3**
Financial Profile Weight	100%	
Operating Environment Weight	0%	

Business Profile and Financial Policy	Adjustment	Comment
Business Diversification, Concentration and Franchise Positioning	0	
Opacity and Complexity	0	
Corporate Behavior / Risk Management	0	
Liquidity Management	0	
Total Business Profile and Financial Policy Adjustments	**Baa3**	

		Comment
Sovereign or parent constraint	**A3**	
Standalone Assessment Range	baa2 - ba1	
Assigned Standalone Assessment	**baa3**	

Source: Moody's Investors Service

Exhibit 9

JSC Development Finance Institution Altum

Government Related Issuer Factors

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

Source: Moody's Investors Service

Ratings

Exhibit 10

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

Endnotes

1 Problem loans in 2018 consist of Stage 3 loans as per the IFRS9 reporting standards (introduced in January 2018), while for previous periods problem loans consist of the reported impaired loans and past due but not impaired loans.

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