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CREDIT OPINION
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Update

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JSC Development Finance Institution Altum

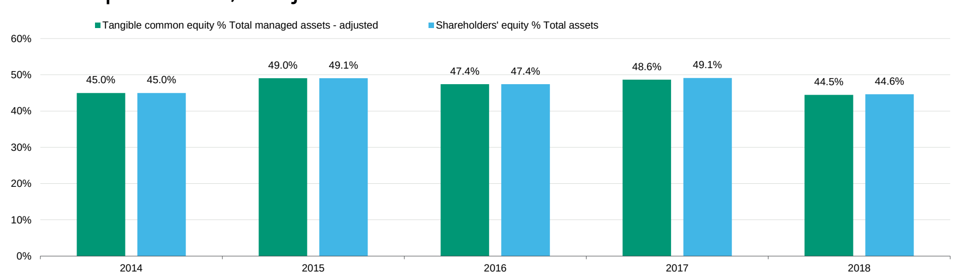
Update to credit analysis

Summary

JSC Development Finance Institution Altum's (Altum) long- and short-term issuer ratings are positioned at Baa1/Prime-2, reflecting the combination of (1) a Baseline Credit Assessment (BCA) of baa3, and (2) our assumption of a very high probability of support from the Government of Latvia (A3 stable). The support assumption is based on Altum's importance to 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 standalone BCA of baa3 reflects (1) the strong financial profile of the company, with very strong capitalization (see Exhibit 1), provisioning coverage incorporated into its funding programmes, and low refinancing risk, balanced against high problem loan levels 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 European Union (EU) programme funds to both end-customers and other financial institutions.

Exhibit 1
Altum's capital metrics, as adjusted



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

Credit strengths

» Very high probability of government support

» High capitalisation

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

Credit challenges

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

» Moderate profitability, resulting from its mandate as a development organisation

Rating outlook

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

Factors that could lead to an upgrade

An upgrade could follow if (1) the Latvian government's ratings are upgraded, or explicit government guarantees protecting creditors in case of failure are provided; or (2) Altum improves its standalone credit fundamentals significantly, including reducing its volume of problem loans and the 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's ratings are downgraded or if the probability of government support decreases. In addition, a downgrade could result from a combination of (1) Altum significantly changing its funding structure; (2) its risk-coverage reserves significantly deteriorating; and (3) capitalisation deteriorating significantly.

Key indicators

Exhibit 2

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

	12-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total managed assets (EUR Thousands)	495,939.0	453,668.0	443,126.0	406,918.0	435,360.0	3.3[4]
Total managed assets (USD Thousands)	566,930.0	544,763.3	467,388.1	442,033.1	526,808.7	1.9[4]
Net Income / Average Managed Assets (%)	0.9	1.2	0.0	0.2	-0.5	0.4[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	44.5	48.6	47.4	49.0	45.0	46.9[5]
Problem Loans / Gross Loans (Finance) (%)	8.3	10.9	27.6	29.0	30.6	21.3[5]
Net Charge-offs / Average Gross Loans and Leases (%)	3.4	1.7	1.7	4.6	5.5	3.4[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.

Sources: Moody's Investors Service, company filings

Profile

JSC Development Finance Institution Altum (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 for the delivery of the government's economic policy, and we believe 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 in venture capital funds. It also offers non-financial support in the form of consultations, education and mentoring. Altum's activity is restricted to programmes (financial instruments or grants) that are developed and then monitored at the ministry level.

Altum's activities are regulated by a 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 following the 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 licence. 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 the end of June 2019, Altum reported a total consolidated asset base of €517 million ($570 million).

Detailed credit considerations

Strong capitalization

We assign a Capital score of A2, four notches below the initial score, to reflect the large portfolio of off-balance-sheet guarantees and our view that the share of such guarantees in the business mix will continue to increase.

Altum has large capital buffers to withstand volatility in earnings and to support future growth. Its Moody's-adjusted tangible common equity/tangible managed assets stood at a very strong 44.5% as of the end of December 2018, although down from 48.6% a year earlier, primarily because of a one-off increase in loan-loss provisions in the amount of €1.65 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, the company accumulates reserves to ensure financial stability and sustainable operations, as well as 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 B2 initial score and incorporates the additional risk buffers that Altum benefits from under its EU- and government-sponsored funding programmes.

The problem loan ratio is high (16% at end-June 2019), but the risk is largely mitigated by 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 significant protection against asset risk. Because of 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 the end of June 2019, the group held a portfolio of financial instruments granted within the state aid programmes of a total value of €565 million (2018: €514 million), made up of 20,441 projects (2018: 18,280), including the following:

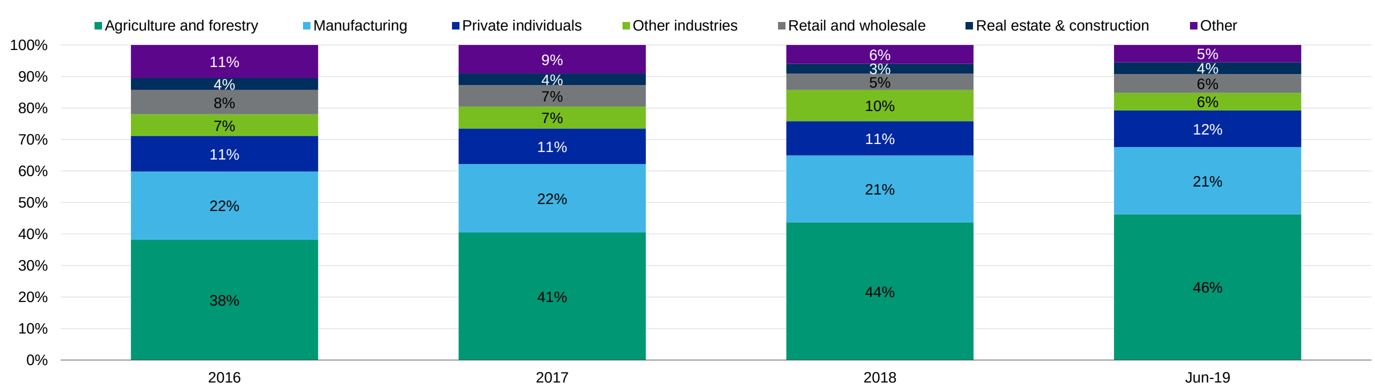
» a loan portfolio of €229 million (2018: €217 million)

» investments in venture capital funds for a total value of €63 million (2018: €60 million)

» a guarantee portfolio of €273 million (2018: €237 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, we expect 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 are covered by the credit risk cover, which is a percentage of a programme's funding.

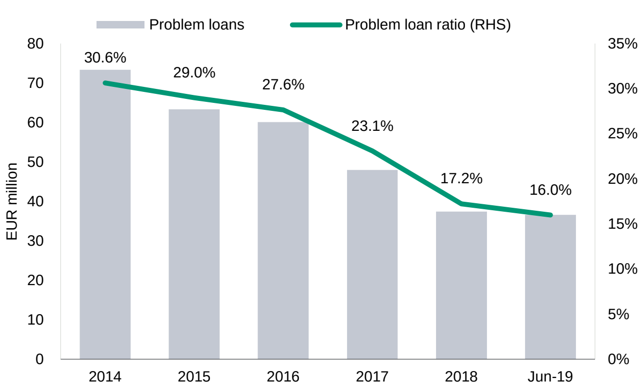
» Loans are given directly to companies and, to a lesser extent, to private individuals. The largest portion of loans are investment loans, aimed at helping smaller companies grow their businesses. Agriculture has traditionally been a large segment and constituted 46% of the loan portfolio as of the end of June 2019. Loans extended to the manufacturing industry and private individuals accounted for 21% and 12% of total loans, respectively.

» Funds aimed at venture capital/equity investments are managed by external funds, with partnership agreements and consultation committees in place to ensure that the programmes are followed. Fund managers typically also invest their own money in these funds. The programmes aimed at equity investments typically have larger expected loss and associated 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.

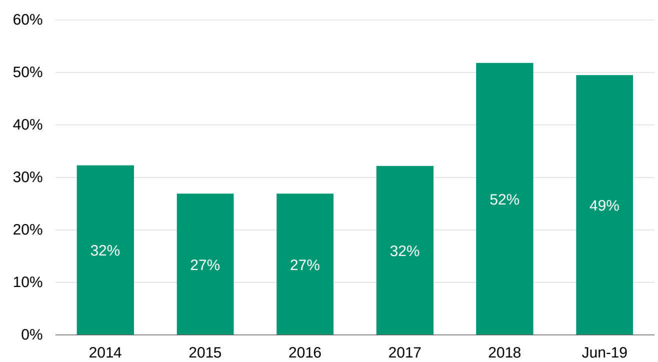
The problem loans-to-gross loans ratio[1] stood at 16.0% as of the end of June 2019, down from 17.2% as of the end of December 2018, which is commensurate with the entity's business model as it is targeting borrowers with weaker risk profiles. Loan-loss reserves/problem loans stood at a low 49% as of the end of June 2019 (2018: 52%). However, including the programmes' credit risk cover for loans, coverage was high at 240% as of the end of June 2019 (2018: 228%).

Exhibit 4
Problem loan ratio



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

Exhibit 5
Provisioning coverage
Loan loss reserves % Nonperforming loans



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

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

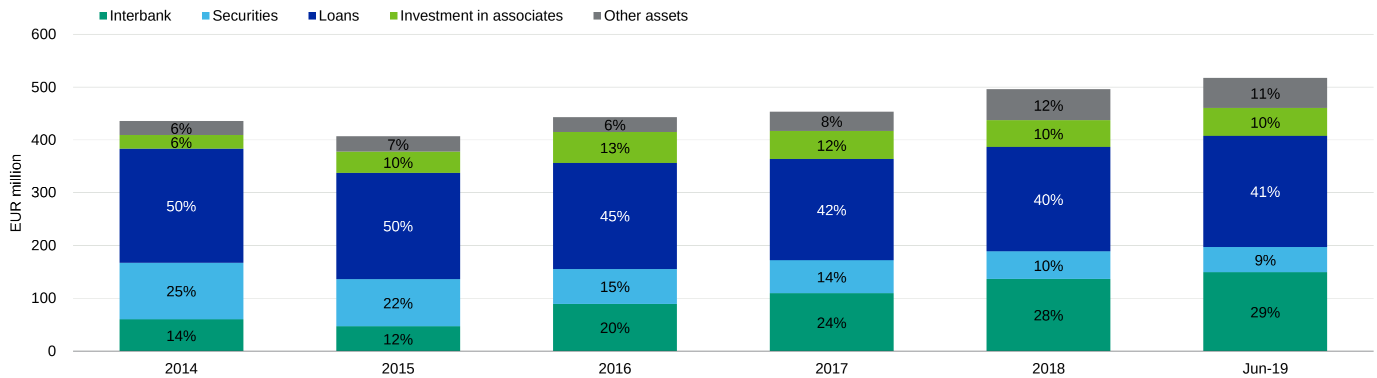
The Weighted Average Cash Flow and Liquidity score of Ba1, one notch below the initial score, reflects that most programmes that are used to fund the institution have limited refinancing risks for Altum. This is balanced against weak funds from operations, which is used to repay market funding, constraining the Liquidity score.

Altum is funded by borrowings from the Latvian state, European institutions and bond issuances. As of the end of June 2019, 41% of Altum's liabilities came from support programme funding and state programmes. The remaining liabilities include bond issuances (at 16% of total liabilities) and funding from general governments (at 21% of total liabilities). However, after 2020, some of the EU structural funds will gradually decrease as Altum gradually increases market funding.

Altum has a comfortable maturity profile, with 85% of funding (liabilities against credit institutions, general governments, issued debt, support programme funding and state aid) having a maturity of more than one year as of the end of June 2019.

As of the end of June 2019, Altum had a comfortable liquid resources buffer, consisting mainly of demand deposits in other credit institutions and the Latvian Treasury (€149 million), as well as Latvian government bonds (around €49 million).

Exhibit 6
Breakdown of Altum's assets



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

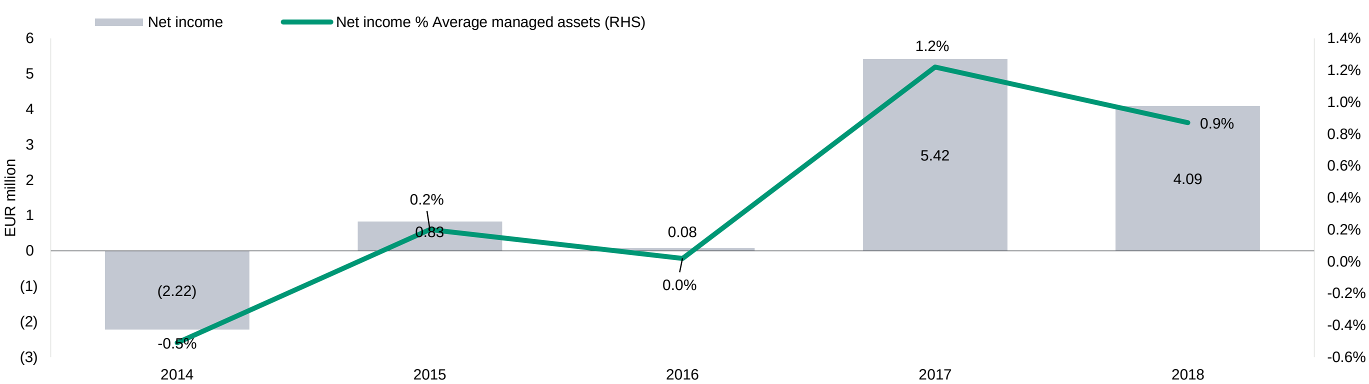
Moderate profitability because profit maximisation is not a priority

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

Although Altum posted strong profits in 2017, 2018 and the first six months of 2019, we expect lower internal capital generation in the longer term because of its public mandate and lack of profit maximisation incentives. Instead, the law sets out that Altum should be profitable over the long term, preserving the capital invested by the state. A positive return on equity is therefore incorporated into the business strategy.

Altum's top-line revenue mostly consists of net interest income, which declined by 5.6% during H1 2019 compared with the year-earlier period. Net income includes fee and commission income.

Exhibit 7
Profitability levels have strengthened



Sources: Altum's financial statements, Moody's Investors Service

Over time, we expect moderate profitability, with an assigned score of B3 for Profitability.

Operating environment

A key component of our analysis is the extent to which external conditions can have a significant influence on Altum's credit profile. The Operating Environment score for Altum, Baa3, takes into account 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.

As the Macro-Level Indicator is higher than the Industry Risk indicator, it receives 0% weight in calculating the Operating Environment score, which instead fully reflects the Industry Risk The assigned Operating Environment score of Baa3 takes into account Altum's limited track record as a constraint, explaining the one-notch difference from the Home Country Operating Environment score of Baa2.

Macro-Level Indicator

The Macro-Level Indicator of A3 for Latvia reflects the intrinsic strength of its economy, the capacity of the government to implement 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 a proven track record of managing economic shocks. The High(+) Institutional Strength score reflects the country's strong institutional capacity, as exemplified by the sizeable post-crisis macroeconomic adjustment and fiscal consolidation undertaken by Latvia, 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 take into account the 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 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 for 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 merger of three state-owned organisations. The reorganisation was completed as recently as April 2015, and the company's future missions will depend not only on the Latvian state, but also on future allocations of EU structural funds to Latvia.

Environmental, social and governance considerations

In line with our general view for the finance companies sector, Altum has a low exposure to Environmental risks, see our Environmental risk heat map for further information.

In terms of social considerations, Altum's role as the main development institution in Latvia makes it susceptible to politically and socially motivated decisions that could affect its financial profile. Given its public policy role, profit maximisation is not its primary goal, and its profitability has traditionally been modest compared with traditional finance companies. While public policy considerations could lead the institution to issue riskier loans, the credit risk cover scheme, whereby the sponsor (State of Latvia or the EU) takes the first losses, provides significant protection against asset risk. Other social risks in terms of customer relations or change in consumer preferences, which are generally relevant for the finance companies industry, are less important for Altum, given that the institution does not engage in retail activities.

Governance is highly relevant for Altum, as it is to all participants in the finance companies industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. We do not have any particular concern around Altum's corporate governance, which is regulated by law and influenced by its public ownership structure, with representatives of the Republic of Latvia's Ministry of Finance, Ministry of Economics and Ministry of Agriculture, its three shareholders, sitting on the supervisory board. Altum's corporate governance is organized in accordance with binding normative acts such as the Development Finance Institution Law, and its statutes are approved by the Cabinet of Ministers of the Republic of Latvia. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

The issuer ratings of Altum incorporate both the BCA and support considerations. The very high dependence on and very high probability of support from the government lead 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. Because of 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 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) the clear operational links with the government, whereby Altum has an explicit and well-recognised mandate to implement specific government policies; (2) the geographical focus of Altum's activities in Latvia; and (3) its high dependence on state funding.

Rating methodology and scorecard factors

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 rating methodology, published in June 2018.

Exhibit 8

JSC Development Finance Institution Altum

JSC Development Finance Institution Altum						
Financial Profile	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
Profitability						
Net Income / Average Managed Assets (%)	10%	0.70%	Ba2	B3	Expected trend	
Capital Adequacy and Leverage						
Tangible Common Equity / Tangible Managed Assets (%)	25%	44.48%	Aa1	A2	Other adjustments	Expected trend
Asset Quality						
Problem Loans / Gross Loans (%)	10%	15.62%	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%	101.45%	Ba1	Baa3	Other adjustments	
FFO / Total Debt (%)	15%	-3.12%	Ca	Ba1	Other adjustments	
Secured Debt / Gross Tangible Assets (%)	20%	0.00%	Aaa	Ba1	Other adjustments	
Weighted Average Cash Flow and Liquidity Score			**Baa3**	**Ba1**		
Financial Profile Score	**100%**		**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%**			**Baa2**		
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						

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 for 2018 onwards consist of Stage 3 loans as per the IFRS9 reporting standards, while for previous periods problem loans consist of the reported impaired loans and past due but not impaired loans.

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