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CREDIT OPINION
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Update

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JSC Development Finance Institution Altum

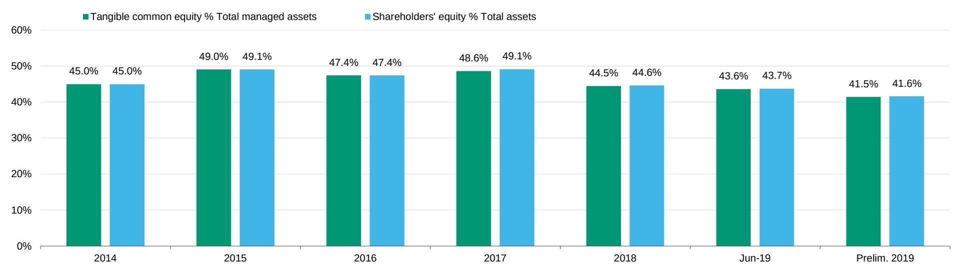
Update to credit analysis

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 capitalisation (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 Moody's-adjusted capital metrics



Sources: Altum's financial reports and 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

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]

	06-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total managed assets (EUR Thousands)	517,234.0	495,939.0	453,668.0	443,126.0	406,918.0	7.1[4]
Total managed assets (USD Thousands)	589,024.3	566,930.0	544,763.3	467,388.1	442,033.1	8.5[4]
Net Income / Average Managed Assets (%)	2.0	0.9	1.2	0.0	0.2	0.9[5]
Tangible Common Equity (Finance) / Tangible Managed Assets (%)	43.6	44.5	48.6	47.4	49.0	46.6[5]
Problem Loans / Gross Loans (Finance) (%)	16.0	17.2	23.1	27.6	29.0	22.6[5]
Net Charge-offs / Average Gross Loans and Leases (%)	1.1	3.4	1.7	1.7	4.6	2.5[5]
Debt Maturities Coverage (%)	20157.3	281.9	470.3	634.9	--	5386.1[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] IFRS [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime.

Sources: Moody's Investors Service and 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 funded through the state budget, EU structural funding and a bond issued in 2019. 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. As such, 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, guarantees and investment in seed and venture capital funds. It also offers non-financial support in the form of consultations, education and mentoring. Altum's activity is mainly 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 December 2019, Altum reported a total consolidated net asset base of €559 million ($626 million).

Recent developments

We have revised our 2020 growth forecast for all G-20 economies because of the coronavirus outbreak. The full extent of the economic costs will be unclear for some time but global recession risks have risen. In Europe, the coronavirus outbreak adds to late-cycle risks for European financial institutions. Under our downside scenario of an extensive and prolonged slump, the direct negative credit impact on the European broader banking sector would have a more severe outcome, weighing on loan quality and profitability. We expect fiscal policy measures, as already announced by a variety of euro-area nations, to mitigate the economic contraction caused by the outbreak.

Furthermore, given the close financial links with and oversight by the sovereign, government-related issuers (GRIs) will face the same credit risks from macroeconomic factors and government policy decisions — and therefore also the same deterioration in credit quality as their respective sovereigns. GRIs will also be hurt by broad sovereign credit pressures stemming from the coronavirus outbreak. However, these pressures are likely to vary among sectors: they will be very limited for the social housing sector given its strategic role and likelihood of government support, but more pronounced for the higher education and healthcare sectors.

On 20 March 2020, Altum announced the offering of new instruments in an effort to curb the impact from the coronavirus outbreak on the Latvian economy, acting in its capacity as the country's main development institution. Thus, part of the authorities' financial support package will be offered through Altum in two forms: (1) loan guarantees for stakeholders that will face difficulties in meeting their obligations for loans up to a total of €715, thereby allowing commercial credit institutions to reschedule such obligations; and (2) working capital loans under relaxed terms for companies that will operate in suboptimal conditions during this time. To provide these guarantees and loans, Altum will receive €100 million of state funding and €150 million from institutional investors. Overall, the package aims to help the banks continue to finance corporates and small and medium-sized businesses suffering from the effects of the coronavirus outbreak.

Detailed credit considerations

Strong capitalisation

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 was a very strong 41.5% as of the end of December 2019, although down from 44.5% a year earlier, primarily because of a 13% increase in tangible managed assets over the period. 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 Weighted Average 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 (15% as of the end of December 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. The new instruments offered as a response to the coronavirus outbreak will benefit from the same asset protection cover. 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 (see Exhibit 3). As of the end of December 2019, the group held a portfolio of financial instruments granted within the state aid programmes of a total value of €592 million (2018: €514 million), made up of 22,022 projects (2018: 18,280), consisting of the following:

» a loan portfolio of €240 million (2018: €217 million),

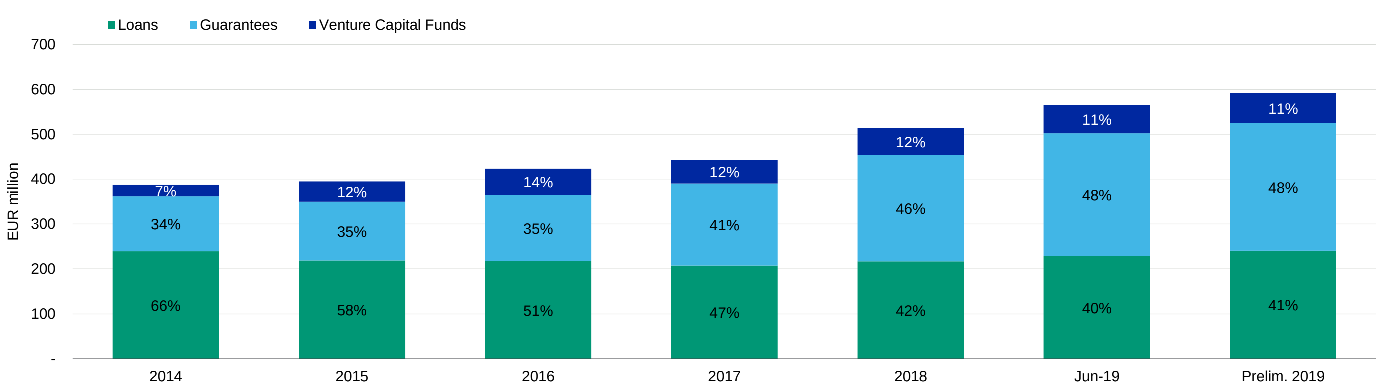
» investments in venture capital funds for a total value of €67 million (2018: €60 million), and

» a guarantee portfolio of €284 million (2018: €237 million).

Based on the measures announced on 20 March to curb the coronavirus outbreak, we expect the volume of guarantees and loans to grow rapidly in 2020.

Exhibit 3

Financial instruments outstanding



Ratios show the share of total financial instruments outstanding.
Source: Altum's financial reports

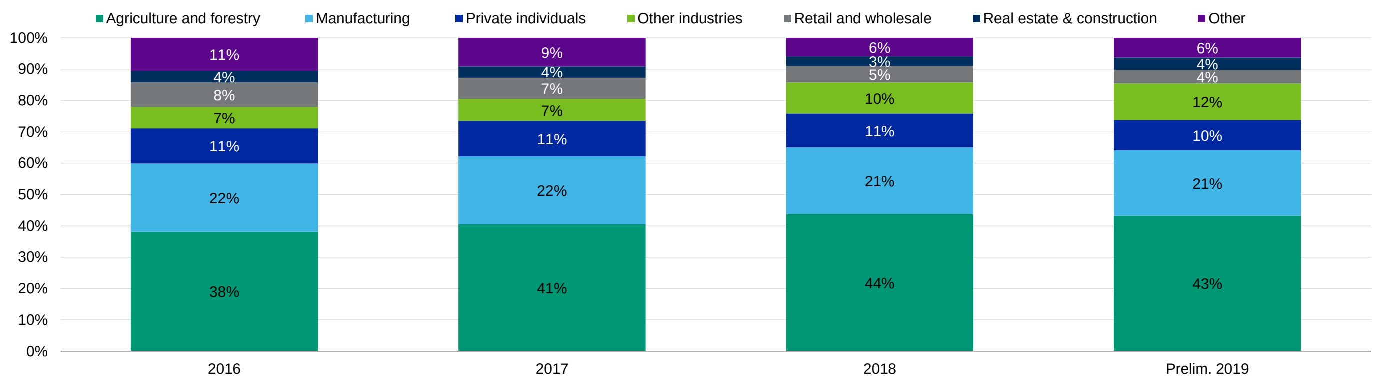
Altum expects a certain amount of loss on all its investments, depending on the programme structure and terms. The expected losses are estimated in advance and are covered by the credit risk cover, which is a percentage of a programme's funding.

» 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 43% of the loan portfolio as of the end of December 2019. Loans extended to the manufacturing industry and private individuals accounted for 21% and 10% of total loans, respectively (see Exhibit 4).

» 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. Such products will be extended as part of the State support package to the Latvian economy.

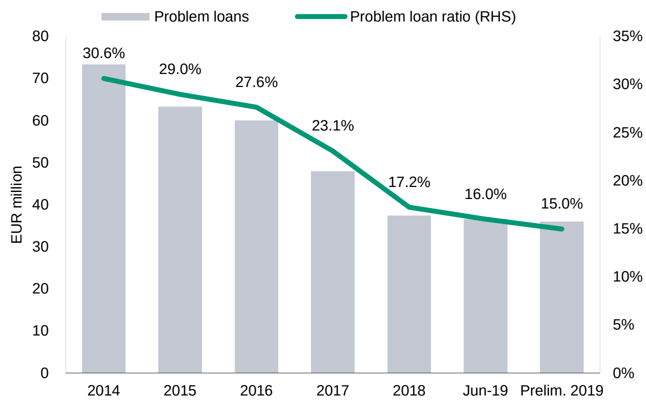
Exhibit 4
Loan book breakdown by industry



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

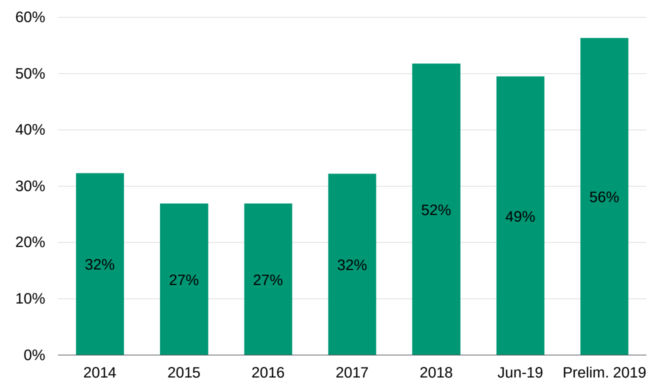
Altum's nonperforming loans (NPLs)/gross loans[1] was 15.0% as of the end of December 2019, which is commensurate with the entity's business model because it is targeting borrowers with weaker risk profiles (see Exhibit 5). The NPL ratio decreased from 17.2% as of year-end 2018 and 29.0% as of year-end 2015, while the company's loan-loss reserves/problem loans was a low 56% as of the end of December 2019 (2018: 52%) (see Exhibit 6). However, including the programmes' credit risk cover for guarantees, coverage was high at 274% as of the end of December 2019 (2018: 228%).

Exhibit 5
Problem loan ratio



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

Exhibit 6
Provisioning coverage
Loan-loss reserves as a percentage of nonperforming loans



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

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

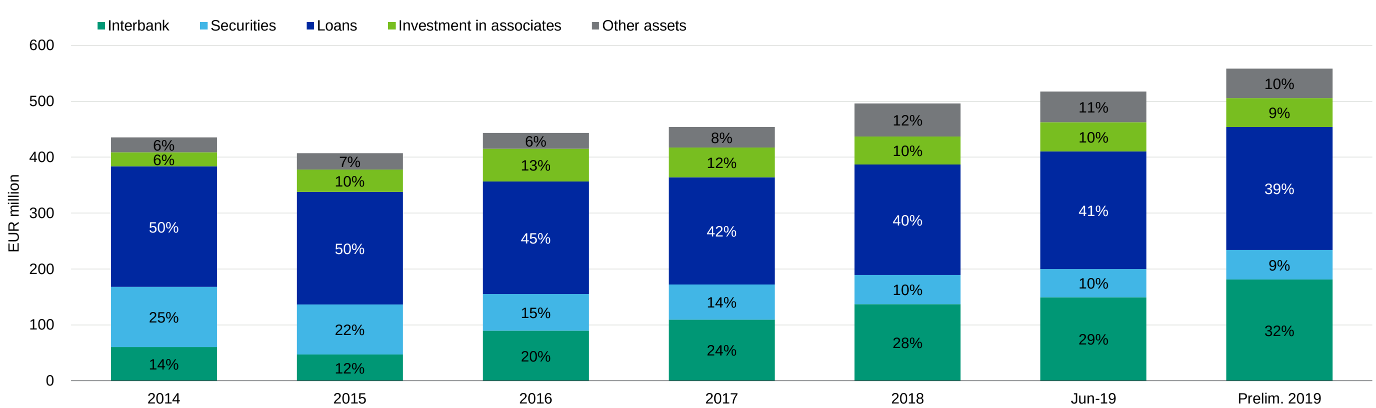
The Weighted Average Cash Flow and Liquidity score of Ba1, one notch below the initial score, reflects that most programmes that are used to fund the institution have limited refinancing risks for Altum. This is balanced against its weak funds from operations, which are used to repay market funding,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

Altum is funded by borrowings from the Latvian state, European institutions and bond issuances. As of the end of December 2019, 39% of Altum's liabilities came from support programme funding and state programmes. The remaining liabilities include bond issuances (at 14% of total liabilities) and funding from general governments (at 26% of total liabilities). We expect the share of state and institutional funding to increase as part of the coronavirus state support package.

Altum has a comfortable maturity profile, with 96% 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 December 2019.

As of the end of December 2019, Altum had a comfortable liquid resources buffer, consisting mainly of demand deposits in other credit institutions and the Latvian Treasury (€181 million), as well as Latvian government bonds (around €48 million) (see Exhibit 7).

Exhibit 7
Breakdown of Altum's assets



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

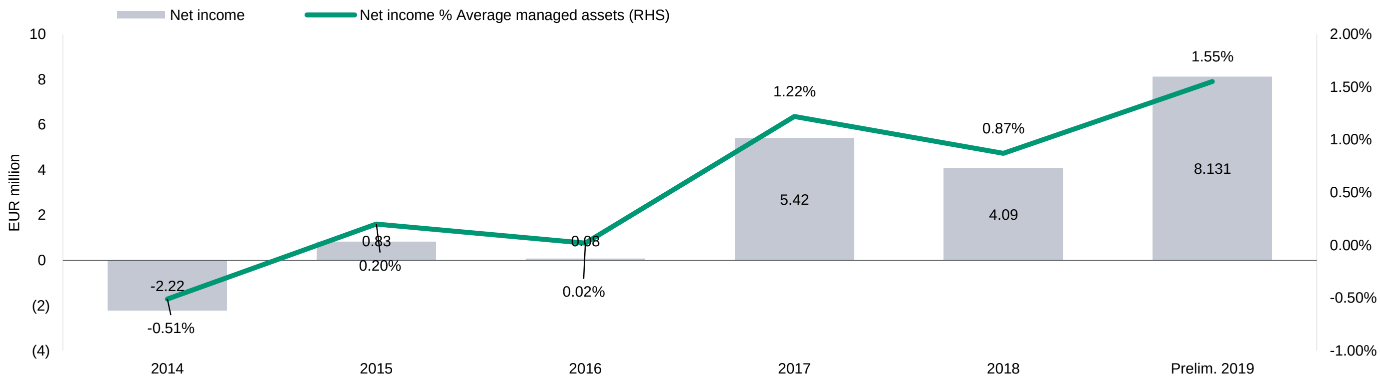
Moderate profitability because profit maximisation is not a priority

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

Altum's reported moderate net income levels throughout 2017-19, thereby meeting its obligation under the law to remain profitable over the long term, preserving the capital invested by the state. A positive return on equity is therefore incorporated into the business strategy. However, because of its public mandate and lack of profit maximisation incentives, we expect internal capital generation to be constrained.

Altum's top-line revenue mostly consists of net interest income, which increased by 4% during 2019 from a year earlier, despite the increase in interest paid against the bond issued during the year. Net income includes fee and commission income.

Exhibit 8
Profitability levels have strengthened



The net income for 2017 excludes the one-off income from the sale of a building.
Source: Altum's financial statements and 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 an Industry Risk score. 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 baa2 reflects the small but diversified export sector, with a proven track record of managing economic shocks. The a2 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 at baa, 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.

ESG considerations

In line with our general view for the finance companies sector, Altum has a low exposure to Environmental risks. Please refer to 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, for example as a response to the rapid and widening spread of the coronavirus outbreak, the credit risk cover scheme, whereby the sponsor (the State of Latvia or the EU) takes the first losses, provides significant protection against asset risk. Please refer to our Social risk heat map for further information.

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 organised 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 the very high probability of support from the government lead to a two-notch uplift to a Baa1 rating. 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 November 2019, and Government Related Issuers rating methodology, published in February 2020.

Exhibit 9
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%	43.60%	Aa2	A2	Other adjustments	Expected trend
Asset Quality						
Problem Loans / Gross Loans (%)	10%	22.65%	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%	281.88%	A1	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			Baa1	Ba1		
Financial Profile Score	100%		Baa2	Baa3		
Operating Environment						
Home Country	Factor Weights	Sub-factor Score	Score			
Macro Level Indicator	0%		A3			
Economic Strength	25%	baa2				
Institutions and Governance Strength	50%	a2				
Susceptibility to Event Risk	25%	baa				
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 Scorecard-indicated Range				baa2 - ba1		
Assigned Standalone Assessment				baa3		

Source: Moody's Investors Service

Exhibit 10
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 11

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

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