Moody's Investors Service

Global Credit Research
Credit Opinion
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Credit Opinion: Home Credit Slovakia, a.s.

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Piestany, Slovak Republic

Ratings

Category	Moody's Rating
Outlook	Stable
NSR Issuer Rating -Dom Curr	A3.sk

Contacts

Analyst	Phone
Gabriel Kadasi/London	44.20.7772.5454
Antonella Pisani/London	
Reynold R. Leegerstee/London	

Key Indicators

Home Credit Slovakia, a.s.

	[1]2007	2006	2005	Avg.
Total assets (SKK billion)	4.34	4.05	3.74	--
Total assets (EUR billion)	0.13	0.12	0.10	--
Total capital (SKK billion)	0.20	0.18	0.11	--
Return on average assets	0.54	1.68	--	1.11
Recurring earnings power [2]	7.67	5.31	--	6.49
Net interest margin	16.19	15.06	--	15.62
Cost/income ratio (%)	53.33	62.79	47.36	54.49
Problem loans % gross loans	13.44	14.04	--	13.74
Tier 1 ratio (%)	--	--	--	--

[1] As of December 31. [2] Preprovision income % average assets

Opinion

SUMMARY RATING RATIONALE

The A3.sk national scale rating of Home Credit Slovakia (HCS) is based on: (i) the expectation of support and commitment from the Home Credit Group and HCS's operational integration with Home Credit, a.s., (Czech Republic, rated A3.cz); (ii) the company's leading position in the consumer finance market in Slovakia, being the second largest player in terms of principal granted with a market share of approximately 25%; (iii) the extensive distributional network of its products based on partnership retailers covering the whole of the Slovak Republic; and (iv) strong risk management systems (both on the scoring and recovery sides) shared with Home Credit.

However, the rating also reflects: (i) HCS's heavy reliance on wholesale funding sources, limited funding-mix diversification and refinancing risk; (ii) the unregulated nature of consumer finance business in Slovakia; (iii) strong competition from other consumer finance companies, as well as retail banks focused on consumer finance; (iv) its relatively weak financial fundamentals, especially in terms of capitalization and profitability; (v) and relatively high volumes of impaired loans due to the nature of the company's business.

Credit Strengths

- One of the leading consumer finance companies in Slovakia

- Operational integration with its Czech sister company Home Credit, rated A3.cz

- Good spread of distribution channels

- Expected support from the Home Credit Group, which is ultimately owned by the PPF Group, the biggest Czech financial group

Credit Challenges

- Reliance on wholesale funding sources

- Increasingly competitive market, potentially leading to more pressure on margins and market position

- The consumer finance sector does not benefit from the same degree of regulation as banking

- High risk profile given the predominantly non-prime nature of the customer base

- Low capitalization

- Maintaining asset quality at acceptable levels

Rating Outlook

The outlook on HCS's rating is stable.

What Could Change the Rating - Up

The A3.sk rating is dependent on expected support from the Home Credit Group and integration with Czech Home Credit. Any rating upgrade would only follow sustained and significant increases in profitability and further franchise expansion, together with improved asset quality and diversification of the funding profile.

What Could Change the Rating - Down

A reduction in integration with the Home Credit Group or in the likelihood of support would have negative rating implications, as would a significant deterioration in asset quality, an inability to maintain sufficient funding sources or material erosion in market position.

Recent Results and Developments

HCS reported IFRS net income of SKK23 million (EUR0.683 million) in 2007, down from SKK66 million. The sharp decline in the company's profitability was a result mainly of the company's decision to increase provisioning following the implementation of new group risk policies (the company did not report any deterioration in asset quality in 2007 compared with 2006). On the other hand, HCS managed to increase its operating income, which was supported by 20% year-on-year increase in net interest income. Total assets of the company increased to SKK4.344 billion (EUR129 million) at the end of 2007 from SKK4.051 billion at the end of the previous year.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Home Credit Slovakia's currently assigned rating are as follows:

HCS is a consumer finance company operating in the Slovak Republic. The company is integrated with its Czech sister Home Credit and it has the same structure of product portfolio, as it provides consumer loans, revolving loans, cash loans and credit cards. HCS's business is, in Moody's view, a mono-line activity on the single market segment of non-prime customers, which are not typically a target segment for retail banks. However, strong competition in the Slovak banking market and some overlap in clients' segmentation of banks and consumer finance companies makes HCS's business very competitive. HCS's key net revenues are generated from revolving loans and consumer loans, but cash loans that were launched in 2006 were the main driver of the company's growth in revenues during 2007. Credit cards, which HCS began selling in 2007, still represent an insignificant part of the company's product portfolio.

HCS ranked second among Slovak consumer finance companies as of end-June 2007 with 25% market share (excluding used car financing, which is not provided by the company). At the same time, Consumer Finance Holding, a.s., (unrated) a subsidiary of Vseobecna Uverova Banka (rated Aa3/P-1/C-), had the leading position in the relevant market with a 37% share of new principal granted. Other leading players in the Slovak consumer market were, as of the middle of 2007, Cetelem (18% market share) and GE Multiservis (15%). HCS has a good track record in terms of protecting its existing market share.

HCS benefits from an extensive point of sale network covering the whole of the Slovak market. Sophisticated management of the distribution network was developed and tested in the Czech Republic before it was implemented in Slovakia. HCS cooperates with around 3,500 retailers and it does not plan to extend this network going forward. HCS's retailers' network is focused mainly on the acquisition of new customers via consumer loans. However, compared to its Czech sister entity, HCS is limited in leveraging synergies within the PPF Group (which owns 49% of the largest Czech insurance company Ceska pojistovna), which is partially due to its weaker position in Slovakia. HCS shares with Home Credit a call centre, the key element in the distribution of cash loans. HCS's operations are concentrated solely in the Slovak market, while the company's parent, Home Credit B.V. (ultimately owned by the PPF Group), is currently actively present in six CEE and CIS national consumer finance markets.

HCS's risk management tools and guidelines are integrated with its Czech sister, which has established data track records from its domestic market. Also, HCS's collection process is united with that of Home Credit. HCS's loan portfolio is characterised by a lack of concentration whereby the average size of its loans is below EUR1,000. Furthermore, HCS does not finance used or new cars. HCS's loan portfolio is denominated in Slovak koruna, and funding liabilities provided in a different currency have to be hedged, hence HCS has not been exposed to FX risk.

The business activities of consumer finance companies in Slovakia are not licensed by the Slovak National Bank (NBS); therefore, HCS is not allowed to use the credit register in which banks share data on their customers. HCS is also not required to comply with the prudential ratios that apply to banks; for example, in terms of capitalisation or liquidity, which implies additional risks in comparison with local banking peers.

HCS started to be profitable at end-2004, however, return on average assets is relatively low (0.54% as of end 2007 and 1.7% as of end-2006). However, recurring earning power recovered to 7.67% in 2007 from 5.3% in 2006. Compared to its sister company HC, HCS's profitability currently suffers from a lower level of revolving loans in its product portfolio, which bring relatively high yields with low levels of risk. Point of sale loans help the company to acquire new clients, but because the high competitiveness on the market their profitability is weak. The growing share of cash loans in the company's portfolio is expected to support its profitability in the short to medium term.

The overall liquidity of HCS is relatively good with sufficient headroom under current credit facilities. HCS's funding mix consists solely of bilateral and syndicated loans provided by local banks. HCS also uses one credit facility from PPF Bank, owned by the company's parental group, which is contractually subordinated to major funding sources. The company has met its 2008 funding needs by signing a three-year SKK2 billion syndicated loan facility in Q1 2008. The facility is secured by HCS's loan receivables and the company was also provided with an overdraft in the total amount of up to SKK100 million for the purposes of short-term liquidity management.

HCS's capitalisation remains weak, with shareholders' equity to total assets at 4.65% at end 2007 (2006: 4.43%). Nevertheless, HCS's aims to strengthen its capitalization by retaining its profits. HCS's low capital level is compensated by funds provided to the company from the parental group, which is based on the covenants of existing syndicated facility - HCS's total equity and funds provided by the PPF Group cannot decline below 20% of total assets (actual: 34.7% as of end 2007).

HCS reduced cost-to-income ratio to 53.3% in 2007 from over 60% in 2006, which was driven by growth in HCS's operating income. Despite the increase in volume of HCS's business, operating synergies between HC and HCS enable the effective management of personnel expenses. Moody's therefore expects that HCS's cost-to-income ratio will move in line with the evolution of its operating income.

The asset quality of two key products in HCS's portfolio - consumer and revolving loans - is stable, while the asset quality of cash loans (36% of the portfolio at end 2007) improved after poor start in 2006 that generated a high level of bad loans, especially among the new acquisitions. The share of non-performing loans slightly improved in 2007 to 13.4%, but this is partly a result to higher sale of non-performing loans (2007: SKK112 million and 2006: SKK64 million).

Other Considerations

The rating reflects the expectation of support from the Home Credit Group and the high level of integration with Czech Republic's Home Credit in the areas of consumer-credit approval processes, risk management, human resources and IT development. HCS is 100% owned by Home Credit B.V., a Dutch holding company that is 53.82% owned by PPF Group N.V. and 46.18% owned by Home Credit S.E. (resulting from merger between Home Credit Grand Holding a.s. and HC Holding, a.s., in December 2007). Czech Republic's Home Credit and Russia's Home Credit & Finance Bank (rated Ba3) are HCS's sister companies and constitute the most important parts of the Home Credit Group at this time. The ultimate controlling entity is PPF Group N.V.