S&P Global Ratings

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Research Update:

Slovenia-Based Gorenjska Banka D.D. Assigned 'BB+' Rating; Outlook Stable

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Overview

- Gorenjska banka d.d. (GB) is a well-established, small, and regional universal bank operating in Slovenia with minimal exposures to neighboring countries. Key credit drivers are its strong capitalization and solid earnings generation capacity, in our view.
- Its small size, focus on small and midsize enterprises (SMEs), and its large consumer finance book through its market-leading car leasing franchise make it more vulnerable to economic swings than larger banks in Slovenia. That said, its current portfolio shows robust risk performance.
- The bank has a solid deposit franchise benefitting from high market shares of clients in its core region, Gorenjska. Like other banks in the country, its excess liquidity buffers make it resilient to adverse financial markets.
- We assigned our 'BB+' long-term issuer credit rating and our 'BBB' resolution counterparty rating to GB.
- The stable outlook reflects our expectation that GB will maintain a resilient balance sheet with strong risk-adjusted capitalization, and sound asset quality with solid profitability, over the next 12 months.

Rating Action

On Oct. 22, 2024, S&P Global Ratings assigned its 'BB+' long-term issuer credit rating to Slovenia-based Gorenjska banka d.d. (GB). The outlook is stable. At the same time, we assigned our 'BBB' resolution counterparty rating to the bank.

Rationale

GB is a well-established, small, regional universal bank in Slovenia. The bank mainly operates in Slovenia accounting for about 90% of its retail and corporate lending book, while the remainder is across Southeast Europe. Therefore, the anchor for GB is the same as that of a bank that operates exclusively in Slovenia, leading to a 'bbb' starting point for our rating.

GB's business position is constrained by concentrations related to its small size and narrow business focus. The bank is mainly active in Gorenjska, with a strong loan market share of 50%-60% and deposit market share of 60%-70%. While the region has seen strong economic growth recently, GB's lack of scale and geographical diversification remain key weaknesses, in our view. As is common among small banks, concentrations in loan portfolios are higher than larger and more diversified peers. GB's product range is also narrower compared to peers; NLB Group (BBB/Stable/--), for example, has sound asset management and insurance businesses in Slovenia, complementing its lending activities. Also, GB's focus on SME clients makes it vulnerable to regional economic shocks.

That said, GB is achieving sound profitability and is earning sufficient income to cover its cost of capital. Its return on average common equity of 18.2% compared well to peers at year-end 2023. The bank's management board consists of experienced members, while relevant committee positions on the supervisory board are occupied by independent members, ensuring good corporate governance practices. We also acknowledge that GB is investing in an upgrade of its digital infrastructure, with front-end improvements for its client base. We understand that it aims to generate synergies through group-wide efforts, considering that its Serbian sister bank, AIK Banka, is more advanced in terms of digital offerings. We believe the bank will catch up with currently stronger peers when it comes to digital solutions, although this may take a few years.

GB's capitalization and high profitability are rating strengths. GB maintains solid capital buffers above its minimum regulatory capital requirements. As of year-end 2023, the CET1 ratio stood at 14.4%. We forecast that GB's risk-adjusted capital (RAC) ratio, our key capital metric, will decline to 12.0%-12.5% in the next two years after reaching 13.4% at year-end 2023. Our projections are based on the following assumptions:

- Operating revenues declining by 9% in 2024 due to a net interest margin decrease, followed by a slight recovery by 2%-4% annually driven by loan growth;
- Cost base increasing by 5%-10% annually because of expenses related to the digitalization of the business model, renovation of branches, and higher wages coupled with additional hiring;
- Cost of risk normalizing toward 50 basis points (bps);
- Dividend payment of €25 million-€30 million annually to its parent, Agri Europe Cyprus Limited (AEC), between 2024 and 2026; and
- Annual loan growth of 7%-8% translating into equivalent growth of S&P Global Ratings risk-weighted assets (RWA).

GB's earnings capacity is better than peer banks, with a core earnings-to-S&P Global Ratings RWA ratio of 2.8% and an earnings buffer of 280 bps as of year-end 2023. Both metrics are higher than the average of European banks, indicating strong earnings quality, which we view as supporting our strong capital assessment. We project that GB's earnings buffer ratio, which measures the capacity for a bank's earnings to cover its normalized credit losses, will remain solid at close to 1.5% through to 2026. GB's cost-to-income ratio according to our definition was 46% at year-end 2023. We believe GB's cost efficiency will deteriorate toward 57% by year-end 2026 because of normalizing operating revenues and some cost pressures.

GB's local focus on SME clients and its large car leasing book are vulnerabilities. We think this exposes GB to regional economic trends. Its loan book split shows that consumer finance, particularly car leasing, makes up almost 60% of the retail book, while mortgage lending accounts for about 40%. While the consumer finance portfolio has remained resilient to date, we note generally higher default rates in this segment through the full economic cycle. Importantly, GB does not take on residual value risks within its car leasing business. GB's corporate portfolio is dominated by SME clients (70%), followed by larger corporates (20%) and government counterparties (10%). At the same time, apart from the concentration in corporate and SME lending (about 70% of total exposures, including project finance), we consider the bank's loan book to be well diversified across different sectors. GB's risk appetite framework is sound, with proper limits that also align with the risk policies of its parent, AEC. The bank has a positive track record in terms of nonperforming assets (NPAs) and loan loss management. The NPA ratio decreased from 6.0% in 2019 to 2.1% in 2023, while cost of risk was 36 bps at the same time. We expect a mild deterioration in GB's asset quality toward NPAs of 3.0% by 2026. Non-financial risks are adequately managed, in our view, considering that the bank has been prudently managing relevant risk areas to avoid money-laundering attempts and cyber-attacks. We understand that the bank is not exposed to sizable legal risks, while interest rate and currency risks are well managed within predefined in-house and regulatory limits.

GB's deposit-funded franchise and excess liquidity buffers are comparable to other Slovenian banks. Its funding consists mainly of deposits, with about 80% of its total funding from retail (74% as of June 30, 2024) and corporate deposits (26%). The remaining 11% comes from interbank loans (4%) and wholesale funding (7%), primarily through minimum requirement for own funds and eligible liabilities (MREL) bonds. The bank's equity makes up around 9% of its total funding. Most of the deposit base is concentrated in Gorenjska. While this regional concentration is a weakness compared to larger banks, GB has not experienced significant deposit outflows during periods of financial market turbulence. GB's core customer deposits are sight deposits (about 80%) that can be redeemed at any time. To mitigate risk, 70% of these are insured by the national deposit guarantee scheme, which contributes to stability in adverse scenarios, in our view.

GB has a well-defined liquidity strategy that aims to maintain a high level of liquid assets. The bank's loan-to-deposit ratio reached 76% at year-end 2023, while the stable funding ratio was solid at 138%. Although this ratio is stronger than many peer banks in Europe, we do not view GB as a positive outlier among Slovenian banks. Given its low proportion of wholesale funding, our main liquidity measure--broad liquid assets to short-term wholesale funding--has somewhat limited value for the assessment. It reached a strong 56x at year-end 2023. More importantly, GB's net broad liquid assets to short-term customer deposits ratio was 35% at the same date, which is solid in the European peer context. GB has a well-defined liquidity contingency plan that outlines procedures for addressing liquidity deficits during stress situations.

We expect neither extraordinary group support nor negative intervention from the owner. GB is a subsidiary of AEC, which is a financial holding company headquartered in Cyprus. AEC's goal is to develop a leading financial services group in southeastern Europe with a focus on Serbia, Slovenia, Croatia, and Montenegro. The group consists of three key banks that contribute substantially to AEC's balance sheet: Slovenia-based GB (about 25% of total assets at year-end 2023), Serbia-based AIK Banka (50%), and Eurobank Direktna (25%). We believe that GB is important to the long-term strategy of AEC considering its access to the euro area, which leads to funding benefits, and its high profitability. We therefore regard GB as a strategically important subsidiary of AEC. At the same time, we don't see any potential for extraordinary group support to GB to merit an uplift to the ratings. This is because we see GB as inherently stronger than the broader group--notably given the group's exposure to higher risk jurisdictions. We remain mindful that, to a degree, the group could have a negative influence on the bank given that banking is a confidence-sensitive business and the wide crossover of franchise and customers. Nevertheless, we view GB as likely to be resilient to stress in the broader group given features such as: minimal financial and operational interlinkages to its affiliates; no funding dependency, and; the authorities' apparent stance to apply a multiple-point-of-entry resolution approach to the group, implying that GB is readily severable from its affiliates.

We believe that GB would be subject to effective resolution in the unlikely event of non-viability. We consider GB to have moderate systemic importance in Slovenia owing to its domestic 5% market share in customer deposits, which is much higher in its core region Gorenjska. GB's preferred resolution approach assigned by the Single Resolution Board (SRB) is a "Sale-of-Business" in the unlikely event of non-viability. In our view, GB's moderate size and limited financial, funding, and operational interlinkages to AEC could support the execution of such a resolution transaction. GB must meet MREL requirements, which was set by the SRB at 19.99% (as a percentage of total risk exposure) in addition to a combined buffer requirement of 3.15% at year-end 2023. GB's MREL ratio was just above the minimum requirement, at 24.1% as of Dec. 31, 2023. We do not apply rating uplift for additional loss-absorbing capacity (ALAC) to GB. This is because of the bank's limited issuance of ALAC-eligible subordinated debt instruments. The bank has issued MREL bonds through senior preferred debt and eligible deposits to meet the MREL requirements (we do not include these in the bank's ALAC buffers). GB's ALAC ratio was 2.7% at year-end 2023. We project a deterioration of the ALAC ratio toward 2.1% by 2027, well below the relevant threshold of 4.0% for ALAC uplift because we do not expect further ALAC-eligible issuances. We adjust the threshold upward by 100 bps for the first ALAC notch to 4.0%, and 200 bps for the second ALAC notch to 8.0% because of limited numbers of ALAC-eligible instruments and GB's weaker market access than larger longer-established banks.

We assigned a long-term resolution counterparty rating (RCR) of 'BBB' to GB. An RCR is a forward-looking opinion of the relative default risk of certain liabilities, particularly those legally exempt from bail-in (such as insured deposits or secured liabilities), that may be better protected from default in an effective resolution scenario than other senior liabilities. For more details, see "Resolution Counterparty Ratings Jurisdiction Assessment For Slovenia Completed," published July 16, 2018.

Environmental, Social and Governance (ESG)

We believe GB is well positioned to face emerging environmental and social risks. We think ESG standards are in line with those of other banks. The bank is the ESG hub of AEC considering its advanced setup and ESG achievements compared to other group members. As part of the groupwide ESG strategy and governance model, GB is embedding such considerations into its product offerings and product pricing. We understand that data quality remains a concern for fully applying ESG standards. This is similar to other local banks.

Outlook

The stable outlook reflects our view that GB will maintain its sound earnings and asset quality performance, while safeguarding its internal capital generation, over the next 12 months. Our base case assumes that GB will preserves its solid balance sheet and financial performance thanks to benign credit conditions in its core operating regions and broader Europe. We believe that the bank's separate resolution approach will continue to provide protection against contagion within the group in adverse scenarios.

Downside scenario

We could downgrade GB if its capitalization deteriorates in the next 12 months, with the RAC ratio falling and remaining below 10%. Factors that could contribute to this include a significant increase in dividend payments to the parent company or weakening asset quality leading to higher credit losses eroding GB's capital base. A significant increase in NPAs because of increased vulnerabilities in its cyclical consumer and SME loan book could also lead to a negative rating action.

Upside scenario

We could upgrade GB if it issues higher-than-expected ALAC-eligible instruments on the capital markets, pushing the ALAC ratio sustainably above 4.0%. This would not only support ALAC uplift in the rating but would increase GB's likely ability to continue to service its senior obligations in a parental stress scenario.

Ratings Score Snapshot

Issuer Credit Rating	**BB+/Stable/--**
SACP	bb+
Anchor	bbb
Business position	Constrained (-2)
Capital and earnings	Strong (+1)
Risk position	Moderate (-1)
Funding and liquidity	Adequate and adequate (0)
Comparable rating analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

SACP--Stand-alone credit profile. ALAC--Additional loss absorbing capacity. GRE--Government-related entity.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Banking Industry Country Risk Assessment: Slovenia, June 17, 2024
- Slovenia, Full Analysis, June 10, 2024
- Resolution Counterparty Ratings Jurisdiction Assessment For Slovenia Completed, July 18, 2024

Ratings List

New Rating	
Gorenjska Banka d.d.	
Resolution Counterparty Rating	BBB/--/--
New Rating;Outlook Action	
Gorenjska Banka d.d.	
Issuer Credit Rating	
Foreign Currency	BB+/Stable/--
Local Currency	BB+/Stable/--