

BAWAG P.S.K. 2008
Strong Momentum in Core Austrian Business
despite Turbulent Market Conditions

Good performance demonstrates the Bank's key role in the Austrian market

- **Profitability of the core domestic business significantly improved**
- **Strong liquidity position**
- **Solid capital ratios**
- **CEE businesses successfully sold**
- **Conservative valuation methods for financial assets**

2008 was one of the most challenging years for Austrian and international banks in recent history. Despite the turbulent environment, the underlying business of BAWAG P.S.K. demonstrated strong momentum.

The financial results for 2008 were heavily influenced by two factors: the progress made in improving profitability in the core Austrian business; and the combined net adverse impact arising from the re-structuring of the Balance Sheet and the reduction in the fair value of the Bank's financial assets as a consequence of the global financial crisis.

Underlying pro-forma profits, excluding one-off factors due to the financial crisis and on-going balance sheet re-structuring, grew by 82%. Net interest income grew strongly, up 13% to EUR 675mn. Operating income grew by 4% to EUR 836 million.

Aggressive actions were taken throughout the year to reduce risk. However, the bankruptcy of Lehman Brothers Inc. on 15th September caused market conditions to worsen dramatically in the fourth quarter leading to significant mark-to-market valuation losses arising in the legacy Structured Credit Portfolio (which was mainly built up in the period 2003 – 2005). In the period September – December, following the dramatic change in market conditions after the bankruptcy of Lehman Brothers, the Bank recorded a consolidated loss after tax of EUR 452 million. This resulted in a full year loss of EUR 548 million. This loss is in direct contrast to the strong performance of the core Austrian business.

Strong Momentum in the Core Austrian Business

The Bank's core focus, and the centre of its business strategy is on the domestic Austrian retail and commercial business. As such, significant investments were made in modernising the underlying business and improving customer service. In 2008 BAWAG P.S.K. managed successfully to:

- Relaunch to positive effect the "BAWAG" and "PSK BANK" brands
- Focus employees in the branch networks on sales and service
- Centralizing administration and risk management activities
- Create a range of new, innovative products for retail customers
- Realign the commercial business by strengthening the organisation with regional and sectoral expertise

The results of this investment were very encouraging.

Underlying Pre-tax Operating Profit up 82%

Underlying pre-tax profit, excluding the impact of the global financial crisis, grew by 82%. Total underlying income grew 4%, with particularly strong gains recorded in net interest income, up 13%.

Performance was particularly strong in the core retail franchise:

- Customer numbers increased by 10%,
110,000 new retail current accounts were opened
- Retail savings balances across the Group increased by EUR 1.1 billion or +8%
- Retail customer loans grew by over EUR 300 million (+5%)
- 50,000 new building society contracts were signed (+12%)
- Premium income from new insurance contracts rose by EUR 320 million or +19%
- Gains were recorded in market share, client satisfaction and willingness to recommend
- easybank: sales, balances and income were all at record levels

Progress was also evident in the commercial business: lending increased by 13% (EUR 1.1 billion), notwithstanding higher margins and a difficult environment. This customer segment offers significant potential for future profit growth.

The Bank took a very defensive stance to deploying liquidity in the second half of 2008. This strategy, whilst prudent given the economic environment, was a drag on earnings in the period as investments were made of very short-term duration in a time when market interest rates were falling rapidly.

Underlying expenses fell by 3%, after accounting for higher investment in the on-going business. Significant changes were made to the business model, with implementation of a clear separation between front-office sales and service activities, back-office operations and risk management. These changes lay the foundation for future operational, productivity and service improvements.

Sale of Non-core Business Activities Largely Complete

A central part of the Bank's new strategy announced in 2007 was the sale of all non-core businesses. Implementation of the strategy was largely completed in 2008 with the sale of the Bank's subsidiaries in Slovakia and the Czech Republic, as well as the sale of real estate assets. The decision to dispose of the Bank subsidiaries operating in Central and Eastern Europe reflected the desire to concentrate important resources on the core Austrian market, as well as a focus on building liquidity and capital. The sale process proved to be both well-timed and highly successful. As a consequence, the Bank has reduced its exposure to Central and Eastern Europe to less than 5 % of total assets.

Strong Liquidity Position

The turmoil in the global financial markets emphasized the crucial importance of liquidity management. During 2008, BAWAG P.S.K. took further steps to maximize its available liquidity. Total cash and unutilized collateral resources as at 31 December 2008 amounted to EUR 6.2 billion. This strong liquidity position, driven by the Bank's sound business model of refinancing all customer loans by customer deposits (Deposit – Loan ratio 109%) represents a source of competitive advantage for the Bank, offering the opportunity to support private as well as commercial banking customers independent of the developments in the international money markets.

Financial Crisis Impacted Overall Results Significantly

| Income statement according IFRS in millions of Euros | 2008 | 2007 | Change | |
|---|---------------|---------------|--------------|---------------|
| | | | | |
| Net interest income | 652.5 | 602.9 | +49.6 | +8.2% |
| Net fee and commission income | 143.9 | 145.5 | -1.6 | -1.1% |
| Gains and losses on financial assets and liabilities | -595.8 | -0.5 | -595.3 | >-100% |
| Other operating income (expenses) | 14.1 | 101.3 | -87.2 | -86.1% |
| Administrative expenses | -617.4 | -549.5 | -67.9 | -12.4% |
| Depreciation and amortization on tangible and intangible non-current assets | -87.5 | -106.8 | +19.3 | +18.1% |
| Provisions and impairment losses | -281.4 | -758.0 | +476.6 | +62.9% |
| Share of the profit or loss of associates accounted for using the equity method | -32.5 | -0.9 | -31.6 | >-100% |
| Income taxes | 89.3 | 101.3 | -12.0 | -11.8% |
| Minority interests | 167.3 | 12.2 | +155.1 | >+100% |
| Consolidated loss | -547.5 | -452.5 | -95.0 | -21.0% |

Net interest income rose to - due to increased margins - by EUR 50 million or 8% to EUR 653 million in the reporting period. This reflects the Bank's successful strategy of focusing on BAWAG P.S.K.'s core banking business. Net fee and commission income (EUR 144 million) was in line with the results of 2007 in spite of the adverse market environment for the securities business.

The item **gains and losses on financial assets and liabilities** includes the result of the valuation and sale of financial assets: It **mainly consists of non-realised losses**. Within 2003-2005, BAWAG, like other banks, gradually built up a sizeable investment in products - known as "Structured Credit". Unlike other banks, BAWAG P.S.K. accounts the vast majority of these assets by "**Fair Value through Profit and Loss**" standards. This is a conservative valuation method, where all valuation changes are charged - irrespective of the quality of the underlying assets - through the profit and loss account.

Additionally, significant hedging-measures for the entire structure credit book and some other securities were implemented to mitigate risk throughout the year. The overall costs of the risk-reducing measures are directly reflected in the income statement. These factors led to a negative result of the valuation of securities and could partly be compensated by the **net gain from the sale of business activities** (especially foreign subsidiaries) and changes in the fair value of the Bank's issued securities because of wider spreads and the value of the associated derivatives. In total this item contributed a negative effect on the overall results. The realised losses deriving from the structured credit book are EUR 50 million.

Other operating income and expenses totalled EUR 14 million in the 2008 financial year. These items are substantially down on 2007, due to one-off gains in the prior reporting period (in particular the sale of real estate).

Administrative expenses grew by EUR 69 million. This increase is mainly due to restructuring substantial investments in the domestic business e.g. relaunch of the brands, marketing expenses, investments in processing facilities and operation systems as well as by increased provisions for social capital.

Depreciation and amortization fell by EUR 19 million to EUR 88 million because of the sale of properties and the elimination of the expenses arising from the subsidiary banks that were sold.

Expenses for **provisions and impairment losses** amounted to EUR 281 million in 2008. These include - amongst others - impairments for the small exposures to American and Icelandic banks, which were fully provisioned.

Despite the overall good result of the underlying business, the group reports a consolidated loss of EUR 548 million (2007 loss: EUR 453 million) for 2008 - due to valuation methods of the structured credit book.

ASSETS

Receivables from customers grew by EUR 674 million or 3.4% to EUR 20.7 billion in the reporting period. The development of business in the individual customer segments shows different trajectories. Receivables from public-sector borrowers fell, contrasting a nearly EUR 1 billion (+10.8 per cent) increase in loans to corporate (including financial institutions). The majority of these new loans were granted to Austrian customers, thereby improving the flow of credit in the domestic economy. Retail lending also grew significantly by more than EUR 300 million (+4.9 per cent).

The elimination of **items held for sale** correlates on both sides of the balance sheet with the sale of non-Austrian subsidiary banks.

| ASSETS in millions of Euros | 2008 | 2007 | Change | |
|---------------------------------------|---------------|---------------|---------------|--------------|
| Cash reserves | 717 | 945 | -228 | -24.1% |
| Financial assets | 14,367 | 13,624 | +743 | +5.5% |
| Loans and receivables | 25,246 | 26,552 | -1,306 | -4.9% |
| <i>thereof: Customers</i> | 20,697 | 20,023 | +674 | +3.4% |
| <i>Credit institutions</i> | 4,549 | 6,529 | -1,980 | -30.3% |
| Tangible non-current assets | 379 | 170 | +209 | >+100% |
| Intangible non-current assets | 295 | 340 | -45 | -13.2% |
| Other assets | 547 | 680 | -133 | -19.6% |
| Assets held for sale | - | 2,536 | -2,536 | -100.0% |
| Total assets | 41,578 | 44,847 | -3,269 | -7.3% |

LIABILITIES

Payables to customers came in at EUR 22.6 billion EUR 505 million or 2.3% higher than at the end of the prior year. Encouraging increases were seen in savings deposits (EUR + 666 million or 4.5%). Total saving deposits amounted to EUR 15,4 billion on 31 December 2008. This encouraging growth reflects the positive impacts of innovative saving products and the trust of customers in the bank.

| LIABILITIES | 2008 | 2007 | Change | |
|--|---------------|---------------|---------------|--------------|
| n millions of Euros | | | | |
| Financial liabilities | 39,336 | 40,289 | -953 | -2.4% |
| At amortised cost | 29,956 | 29,811 | +145 | +0.5% |
| <i>thereof: Customers</i> | 22,585 | 22,080 | +505 | +2.3% |
| <i>Credit institutions</i> | 3,668 | 4,048 | -380 | -9.4% |
| <i>Issued securities</i> | 3,703 | 3,683 | +20 | +0.5% |
| Provisions | 462 | 518 | -56 | -10.8% |
| Other obligations | 404 | 371 | +33 | +8.9% |
| Obligations in disposal groups held for sale | - | 1,539 | -1,539 | -100.0% |
| Equity | 1,138 | 1,752 | -614 | -35.0% |
| Minorities | 188 | 378 | -190 | -50.3% |
| Total liabilities | 41,578 | 44,847 | -3,269 | -7.3% |

Sound Capital Position

As at 31.12.08, the Tier 1 capital ratio (based on credit risk) amounted to 6.9%. This capital base provides a sound platform to further develop our business.

Outlook

The global financial crisis has not changed the Bank's strategy. BAWAG P.S.K. remains committed to building a powerful banking business centered in Austria.

The core of our strategy is a deep commitment to our customers and our employees. We will continue to modernize the Bank and ensure we remain an attractive place to bank and work. The combination of a relentless focus on operational improvements, new products, improved marketing and investment in our people has led to increases in volumes, market share, image and customer satisfaction. This allied with the financial benefits of strong liquidity and sound capital means the Bank is well-placed to execute its strategy and deliver long-term value for our customers and shareholders.

2009 has started satisfactorily. The Bank is profitable in the first quarter. Because of the Bank's financial strength, the development of its core business and the strong liquidity position, BAWAG P.S.K. is prepared to manage the challenging market conditions in 2009 and in the years to come.

Our focus and priorities for 2009 include:

- **Pro-active risk management** in response to a challenging market environment
- **Continue to improve productivity and stringent cost optimisation** with focus on non-personnel costs
- **Continue to invest and develop our core Austrian retail and commercial customer business** to build further sustainable profitability over the medium term
- **Redeploy our liquidity** to support households, small and medium enterprises and commercial customers and companies

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