

# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Ringkjobing Landbobank A/S

Global Credit Research - 21 Dec 2015

Ringkjobing, Denmark

#### Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A1/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)

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#### Key Indicators

##### Ringkjobing Landbobank A/S (Consolidated Financials)[1]

	[2]9-15	[2]12-14	[3]12-13	[3]12-12	[3]12-11	Avg.
Total Assets (DKK million)	20,822.9	21,237.9	19,582.8	17,681.5	17,549.0	[4]4.4
Total Assets (EUR million)	2,791.2	2,852.1	2,624.9	2,369.9	2,361.2	[4]4.3
Total Assets (USD million)	3,115.7	3,451.2	3,617.0	3,124.4	3,065.1	[4]0.4
Tangible Common Equity (DKK million)	3,222.3	3,098.4	2,900.9	2,675.9	2,482.9	[4]6.7
Tangible Common Equity (EUR million)	431.9	416.1	388.8	358.7	334.1	[4]6.6
Tangible Common Equity (USD million)	482.1	503.5	535.8	472.9	433.7	[4]2.7
Problem Loans / Gross Loans (%)	–	6.7	8.1	7.3	6.8	[5]7.2
Tangible Common Equity / Risk Weighted Assets (%)	19.4	19.5	19.5	20.1	18.8	[6]19.4
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	–	27.3	31.6	27.9	29.2	[5]29.0
Net Interest Margin (%)	2.9	3.1	3.4	3.5	3.4	[5]3.3
PPI / Average RWA (%)	4.0	4.4	4.1	4.4	3.8	[6]4.2
Net Income / Tangible Assets (%)	2.2	2.1	1.8	1.9	1.6	[5]1.9
Cost / Income Ratio (%)	31.1	30.7	31.7	30.6	33.8	[5]31.6
Market Funds / Tangible Banking Assets (%)	8.7	10.3	10.4	9.0	9.9	[5]9.7
Liquid Banking Assets / Tangible Banking Assets (%)	22.3	25.0	27.4	27.4	24.8	[5]25.4
Gross loans / Due to customers (%)	109.7	106.4	104.1	102.4	105.0	[5]105.5

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP [3] Basel II; LOCAL GAAP [4] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [5] LOCAL GAAP reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & LOCAL GAAP reporting periods have been used for average calculation

#### Opinion

## SUMMARY RATING RATIONALE

We assign an A1 / Prime-1 deposit rating to Ringkjøbing Landbobank on the back of an a3 baseline credit assessment (BCA). We also assign a long-term and short-term Counterparty Risk Assessment (CR Assessment) of Aa3(cr) / P-1(cr) to Ringkjøbing Landbobank.

Ringkjøbing Landbobank's standalone a3 BCA reflects primarily our expectation that the bank's high and resilient profitability, as demonstrated throughout the financial crisis, and strong capitalisation, position it well to cope with any deterioration in the operating environment or the challenges arising from the low interest rate environment and the still elevated level of problem loans.

The bank's A1 deposit ratings takes into account the Advanced Loss Given Failure (LGF) analysis of the bank's own volume of debt and deposits and securities subordinated to them in our creditor hierarchy. Our Advanced LGF analysis of Ringkjøbing Landbobank's own volume of debt and deposits and securities subordinated to them indicates a very low loss given failure for depositors, resulting in a two-notch uplift to the deposit ratings from the bank's BCA. We continue to believe the probability of government support for Ringkjøbing Landbobank's long-term deposits is low and therefore do not add further support uplift.

### Rating Drivers

- Elevated problem loan level and somewhat concentrated loan book by geography and industry
- Solid capital base and leverage ratio
- Good earnings from core operations and high operating efficiency resulting in high profitability
- Primarily deposit-funded, with good liquidity
- Ringkjøbing Landbobank's bca is supported by its "Strong+" macro profile
- Deposit ratings are likely to benefit from a very low loss-given-failure rate stemming from a large volume of deposits and a large back-to-back development bank loan, which we view as bail-in-able
- Low probability of government support resulting in no uplift from BCA for deposits

### Rating Outlook

The outlook on all ratings is stable

### What Could Change the Rating - Up

Upward pressure on the ratings could develop from improved asset quality metrics, especially in relation to more volatile segments such as agriculture.

### What Could Change the Rating - Down

Downward pressure on the ratings could emerge if asset quality or capital metrics deteriorate, profitability reduces or the bank's reliance on market funding increases from the current low level.

## DETAILED RATING CONSIDERATIONS

### ELEVATED PROBLEM LOAN LEVEL AND SOMEWHAT CONCENTRATED LOAN BOOK BY INDUSTRY AND GEOGRAPHY

Our assigned ba2 Asset Risk score indicates that overall, asset risk remains a relative weakness for Ringkjøbing Landbobank.

Ringkjøbing Landbobank's continued elevated level of problem loans both relative to pre-crisis levels and to similarly highly rated peers across Europe remains a key weakness for the bank. We note, however, that more recently, the trend has been positive with problem loans (defined as gross loans subject to individual impairment) decreasing to 6.7% of gross loans at end-2014 from 8.1% in 2013. The bank reported a coverage ratio (loan loss reserves as a percentage of problem loans) of 85% at end-December 2014, up from 72% in 2013, the highest coverage ratio of the rated Danish banks. The end-September 2015 results showed a stable level of non-performing loans (a narrower definition than problem loans including only loans with suspended calculation of

interest) at 0.3% of total lending, same level as year-end 2014 figure.

At end-2014, around 40% of the bank's lending was to customers within the core region of western and central Jutland, while 7% of lending was outside Denmark. Much of the lending outside the core region is within the bank's chosen niche areas. The bank's loan and guarantee portfolio consists 21% of lending to the wind turbine sector, 24% to private customers, 12% to real estate, 15% to finance companies, almost 9% to agriculture, and the remainder to other corporates. We note that the bank has allocated considerable provisions for write-downs on agriculture, in particular.

During the 2007-09 financial crisis and the three years that followed, Ringkjøbing Landbobank shrunk its loan book; the loan book contracted an average of 2% per year between 2010 and 2012. In 2013 and 2014, loan growth turned around, recording 12% growth in 2014 so that the loan book is now above the end-2008 level. The loans figure for 2014 includes reverse transactions to a total of DKK583 million, and the increase in the bank's loans excluding these transactions was 8% for the year.

Ringkjøbing Landbobank operates in, and is supportive to, a small operating region, and therefore has relatively large customer concentration in comparison with its European peers measured as the top 20 largest exposures relative to Tier 1 capital. We note that a majority of the 20 largest exposures are outside the core area of central and western Jutland and therefore not concentrated locally and that a significant share of the large exposures are to highly rated Danish mortgage bonds. At end-2014, Ringkjøbing had total large exposures of 47.8% of the bank's capital measured, according to the Danish FSA's methodology, compared with 35.0% in 2013 and 27.2% in 2012.

Going forward, we view Ringkjøbing Landbobank's ability to control sector- and single-name concentration as an important rating driver. We note that Ringkjøbing Landbobank's exposure to the real estate market (11.6% of the loan book) is more limited than that of many other Danish regional banks. However, it does have some exposures to the real estate market in Germany, and its exposure to the agricultural sector could prove problematic in light of the generally high debt levels of Danish farmers.

#### SOLID CAPITAL BASE AND LEVERAGE RATIO

Our assigned Capital score reflects the bank's high capital level, making capital a relative strength for the bank. Ringkjøbing Landbobank applies the Basel III/CRDIV standardised method in calculating risk-weighted assets.

Ringkjøbing Landbobank reports strong capital metrics: Its Common Equity Tier 1 (CET1) capital ratio was 17.4 % at end-September 2015 (17.5% at end-2014). The bank's ratio of tangible common equity to total assets stood at 15.5 % at end-September 2015, which is significantly higher than the levels recorded by most of the bank's Nordic peers.

The bank's individual solvency need as calculated according to the Danish 8+ model was 8.9% at end-September 2015. We note that the bank's high profitability and strong track record point to a high capacity to generate capital internally. Accordingly, we expect that the bank will sustain strong capital buffers over the foreseeable future.

Ringkjøbing Landbobank has one of the highest leverage ratios among Nordic and international banks. The vast majority of the bank's capital consists of common shares. The bank had a ratio of tangible common equity to total assets of 15.5% at end-September 2015 and 14.6% at end-December 2014, which is significantly higher than the 4%-10% level recorded by most of the bank's Nordic peers.

#### GOOD EARNINGS FROM CORE OPERATIONS AND HIGH OPERATING EFFICIENCY RESULTING IN HIGH PROFITABILITY

Our assigned Profitability score reflects the bank's high profitability levels and strong track record of delivering bottom-line results.

We note that the bank's high profitability and strong track record point to a strong capacity to absorb losses through earnings and internal capital generation. Ringkjøbing Landbobank reported a return on assets of 1.7 % and a return on equity of 14.1% for the first nine months 2015. Although the very low interest rates in Denmark create some uncertainty regarding the bank's future earnings, we note that the bank's very high cost efficiency, with a cost-to-income ratio of 31% for the first nine months 2015, adds resilience to profitability.

Ringkjøbing Landbobank reported a pre-provision profit of DKK674 million in 2014, which is up 14% from 2013. The bank's risk-adjusted profitability (measured by pre-provision income as a percentage of average risk-weighted assets) increased slightly to 4.4% in 2014 from 4.1% in 2013 and continues to compare well with those of its peers. Ringkjøbing Landbobank maintained an average risk-adjusted profitability of 4% between 2009 and 2014.

Core earnings (earnings excluding income on the banks security portfolio and expenses paid for the Danish deposit insurance scheme and bank packages) increased 16% to DKK522 million in 2014 from DKK451 million in 2013. Before loan losses and provisions, core earnings increased 7% to DKK609 million. The result from the security portfolio (including dividends on capital shares) increased to DKK65 million in 2014 from DKK24 million in 2013, resulting in pre-tax profit of DKK587 million in 2014, up from DKK472 million in 2013. Core earnings amounted to 89% of pre-tax profit in 2014.

Total operating expenses and depreciation (excluding the costs for the first Danish bank support packages) amounted to DKK298 million in 2014, up 9 % from last year. Expenses paid for the Danish bank packages amounted to DKK0.132 million in 2014 compared with DKK2.300 million in 2013. Ringkjøbing Landbobank's cost efficiency is one of the best in Denmark. Its cost-to-income ratio (operating income/operating expenses) was 30.7% in 2014 (after standard adjustments), down from 31.8% the year before. The bank's cost-to-income ratio is significantly lower than those of peers and one of the key drivers behind the bank's high risk-adjusted profitability compared with that of regional peers.

Loan losses and provisions decreased to DKK87 million in 2014 from DKK120 million in 2013. Loan loss provisions amounted to 13% of pre-provision income in 2014, down from 20% in 2013, but remain somewhat elevated compared with pre-crisis levels.

Return on year-end equity was 14.4% in 2014, which is around double the level of regional peers and compares favourably with that of global peers. Ringkjøbing Landbobank consistently recorded a return on equity in excess of 11% between 2010 and 2014 with a very strong leverage ratio (defined as shareholders' equity to total assets) averaging 14% over the same period.

#### PRIMARILY DEPOSIT-FUNDED, WITH GOOD LIQUIDITY

Market funding accounted for just over 8% of the bank's tangible banking assets at end-June 2015 (just over 10% at end of December 2014) and has been relatively stable since 2011. Just over 85% of the bank's funding was in deposits in 2014 (compared with a the pre-crisis level of close to 50%) and has been relatively stable in recent years. The share of interbank funding has similarly been reduced from close to 50% pre-crisis to 12% at end-2014. As with most Danish regional and local banks, Ringkjøbing Landbobank can secure its mortgage loan financing via the specialised mortgage lenders Nykredit/Totalkredit and DLR. The loan funding by the specialised mortgage lenders will not show on the bank's balance sheet as the mortgage loans are transferred in full.

Our Funding Structure score indicates that the overall funding profile remains a modest fundamental strength for Ringkjøbing Landbobank, owing to the relatively low dependence on more confidence-sensitive wholesale funding.

At end-June 2015, liquid assets accounted for just under 30% of total assets (around 25% at December 2014), which has been relatively stable in recent years. At end-September 2015, Ringkjøbing Landbobank reported a liquidity coverage ratio of 150% and thereby meets the requirement of 100% to be met by 1 October 2015 by Danish systemically important financial institution banks (although Ringkjøbing Landbobank is not a systemically important financial institution bank).

#### RINGKJØBING LANDBOBANK'S BCA IS SUPPORTED BY ITS "STRONG+" MACRO PROFILE

Ringkjøbing Landbobank is almost purely active in Denmark, meaning that the bank's operating environment is heavily influenced by Denmark and its macro profile is thus aligned with that of Denmark at "Strong+". Danish banks and mortgage credit institutions benefit from an improving operating environment and a strong institutional and legal framework. Our assessment, however, also factors in the banks' large stock of problem loans that date back to the financial crisis in Denmark, and high household debt. The financial sector has considerable wholesale funding needs, which - though reducing - create some susceptibility to adverse events, while the relatively fragmented structure of the banking industry and strong competition constrain profitability.

#### **Notching Considerations**

##### LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

Ringkjøbing Landbobank is subject to the EU Bank Resolution and Recovery Directive, which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. We assume 26% of deposits are junior, in line with our standard assumption for European banks with mainly retail depositors. These are in line with

our standard assumptions.

The bank's A1 deposit ratings take into account the LGF analysis of the bank's own volume of debt and deposits and securities subordinated to them in our creditor hierarchy. Our Advanced LGF analysis of Ringkjøbing Landbobank's own volume of debt and deposits and securities subordinated to them indicates a very low loss-given-failure for depositors, resulting in a two-notch uplift to the deposit ratings from the bank's BCA.

## GOVERNMENT SUPPORT

The implementation of the Bank Resolution and Recovery Directive has caused us to reconsider the potential for government support to benefit certain creditors. We continue to consider the probability of government support to Ringkjøbing Landbobank to be low and hence do not assign any systemic support to the bank's rating.

## COUNTERPARTY RISK (CR) ASSESSMENT

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Ringkjøbing Landbobank's CR Assessment is positioned at Aa3(cr)/Prime-1(cr). The CR Assessment is positioned three notches above the adjusted BCA of a3, based on the substantial cushion against default provided to the senior obligations represented by the CR Assessment by subordinated instruments. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, thereby focusing purely on subordination and taking no account of the volume of the instrument class.

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## Rating Factors

### Ringkjøbing Landbobank A/S

<b>Macro Factors</b>	
<b>Weighted Macro Profile</b>	<b>Strong +</b>

<b>Financial Profile</b>						
<b>Factor</b>	<b>Historic Ratio</b>	<b>Macro Adjusted Score</b>	<b>Credit Trend</b>	<b>Assigned Score</b>	<b>Key driver #1</b>	<b>Key driver #2</b>
<b>Solvency</b>						
<b>Asset Risk</b>						
<i>Problem Loans / Gross Loans</i>	7.3%	ba1	← →	ba2	Sector concentration	Geographical concentration
<b>Capital</b>						
<i>TCE / RWA</i>	19.4%	aa2	← →	aa2	Risk-weighted capitalisation	
<b>Profitability</b>						
<i>Net Income / Tangible Assets</i>	2.0%	aa2	← →	aa3	Return on assets	

<b>Combined Solvency Score</b>		a2		a3		
<b>Liquidity Funding Structure</b>						
<i>Market Funds / Tangible Banking Assets</i>	10.3%	a2	← →	a2	Extent of market funding reliance	
<b>Liquid Resources</b>						
<i>Liquid Banking Assets / Tangible Banking Assets</i>	25.0%	a3	← →	a3	Stock of liquid assets	
<b>Combined Liquidity Score</b>		a2		a2		

<b>Financial Profile</b>	a3
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<b>Qualitative Adjustments</b>	<b>Adjustment</b>
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
<b>Total Qualitative Adjustments</b>	<b>0</b>

Sovereign or Affiliate constraint	Aaa
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Scorecard Calculated BCA range	a2 - baa1
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<b>Assigned BCA</b>	a3
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Affiliate Support notching	0
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<b>Adjusted BCA</b>	a3
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Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	2	0	a1	0	A1	A1

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