

Global Credit Research - 07 May 2013

Ringkjøbing, Denmark

## Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Baa1/P-2
Bank Financial Strength	C-
Baseline Credit Assessment	(baa1)
Adjusted Baseline Credit Assessment	(baa1)

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## Key Indicators

### Ringkjøbing Landbobank A/s (Consolidated Financials)[1]

	[2]12-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (DKK million)	17,681.5	17,549.0	18,247.2	17,928.0	18,001.8	[3]-0.4
Total Assets (EUR million)	2,369.9	2,361.2	2,448.6	2,409.4	2,418.5	[3]-0.5
Total Assets (USD million)	3,124.4	3,065.1	3,284.9	3,456.8	3,361.9	[3]-1.8
Tangible Common Equity (DKK million)	2,775.9	2,582.9	2,487.2	2,105.6	1,834.6	[3]10.9
Tangible Common Equity (EUR million)	372.1	347.5	333.8	283.0	246.5	[3]10.8
Tangible Common Equity (USD million)	490.5	451.1	447.7	406.0	342.6	[3]9.4
Net Interest Margin (%)	3.5	3.4	3.3	3.4	3.0	[4]3.3
PPI / Average RWA (%)	4.5	3.8	3.8	3.7	2.6	[5]3.7
Net Income / Average RWA (%)	2.4	2.2	1.9	1.7	1.5	[5]2.0
(Market Funds - Liquid Assets) / Total Assets (%)	-17.9	-14.6	-5.7	-1.6	16.6	[4]-4.6
Core Deposits / Average Gross Loans (%)	96.5	93.2	86.2	82.3	62.8	[4]84.2
Tier 1 Ratio (%)	20.9	19.8	18.6	16.6	13.0	[5]17.8
Tangible Common Equity / RWA (%)	20.9	19.6	18.9	15.5	12.1	[5]17.4
Cost / Income Ratio (%)	30.5	33.5	35.6	36.2	38.3	[4]34.8
Problem Loans / Gross Loans (%)	6.9	6.2	6.2	5.0	3.8	[4]5.6
Problem Loans / (Equity + Loan Loss Reserves) (%)	25.8	25.9	28.1	26.1	24.7	[4]26.1

Source: Moody's

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

## Opinion

### SUMMARY RATING RATIONALE

Moody's rates Ringkjøbing Landbobank A/S Baa1/Prime-2/C-. The C- standalone bank financial strength rating

(BFSR), which is equivalent to a standalone baseline credit assessment (BCA) of baa1, reflects the bank's good intrinsic financial strength and, in particular, its solid capitalisation and high profitability, which has proven resilient in recent years relative to Danish peers. However, the rating is constrained by a continued weak domestic economy, the bank's limited national market share, low level of geographic diversification, high credit risk concentrations and concentrations in financing niche sectors.

Ringkjøbing's Baa1 long-term global local currency (GLC) deposit rating does not include systemic support uplift. The baa1 standalone credit assessment for Ringkjøbing Landbobank means we view the bank as the strongest rated Danish financial institution on a standalone basis. This assessment reflects Ringkjøbing's solid recent performance with high levels of profitability and capital.

### **Rating Drivers**

- Sound local brand in western Jutland region and moderate nationwide presence
- Good earnings from core operations and high operating efficiency resulting in high profitability
- Increased deposit funding has reduced dependence on wholesale funding; liquidity position has improved
- Somewhat concentrated loan book by geography and industry

### **Rating Outlook**

The outlook on all ratings is stable.

### **What Could Change the Rating - Up**

Rating upgrades are unlikely in the near future. A limited amount of upward rating momentum could develop if Ringkjøbing Landbobank demonstrates (1) continued strong earnings generation without an increase in its risk profile and/or (2) improved asset quality management especially in relation to more volatile segments such as agriculture and commercial real estate (3) good access to a diversified range of wholesale funding sources.

### **What Could Change the Rating - Down**

While the current rating levels incorporate a degree of expected further deterioration, ratings may decline further if (1) Ringkjøbing Landbobank's financing conditions become more difficult, (2) its asset quality deteriorates more than we anticipate and/or (3) its risk profile increases, for example as a result of increased exposures to more volatile sectors or increased involvement in more risky operations, such as capital market activities.

## **DETAILED RATING CONSIDERATIONS**

### **SOUND LOCAL BRAND IN WESTERN JUTLAND REGION AND MODERATE NATIONWIDE PRESENCE**

Ringkjøbing Landbobank is a regional bank and among the 15 largest banks in Denmark in terms of total assets. Headquartered in Ringkjøbing, its main region of operation is central and western Jutland. The bank reports a market share of about 50% for both corporate and retail lending in the western part of Jutland. Overall, the bank enjoys a well-established market position in its region, but lacks geographic diversification - we estimate Ringkjøbing Landbobank's country-wide market share in lending to be around 1%.

Ringkjøbing is a full-service bank, with a total of 12 branches including the headquarters and 244 full-time employees on average for the year 2012. The bank's core operations can be divided into following two business areas:

- (1) Banking in the local area of central and western Jutland, where it serves private and business customers, and banking in the central Jutland towns of Herning, Holstebro and Viborg, where it serves private customers and, to a lesser extent, business customers; and
- (2) Banking in niche areas concentrating on the financing of wind turbines, private banking/asset management, the financing of doctors in private practices and first-priority financing of lending properties, primarily in Germany.

Our view of the bank's regional presence, moderate nationwide position and satisfactory earnings stability may be undermined by pressures on asset quality and profitability coupled with a continued weak macroeconomic environment.

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

Ringkjøbing Landbobank reported a pre-provision profit of DKK 605 million in 2012 which is up 19% from 2011. The bank's risk adjusted profitability - measured by pre-provision income as a percentage of average risk-weighted assets - increased to 4.5% in 2012 compared to 3.8% in 2011 and a three year average of 4%; and Ringkjøbing Landbobank's risk adjusted profitability compares well with that of its peers.

Core earnings (earnings excluding income on the banks security portfolio, but including expenses paid for the Danish deposit insurance scheme and bank packages) increased 5% to DKK 399 million in 2012 compared to DKK 379 million in 2011. Before loan losses and provisions, core earnings increased 9% to DKK 556 million. The result from the security portfolio increased to DKK 49 million from DKK 1 million in 2011, resulting in pre-tax profit of DKK 448 million in 2012 up from DKK 380 million in 2011. Core earnings amounted to 89% of pre-tax profit in 2012.

Total operating expenses and depreciation (excluding the costs for the first Danish bank packages) amounted to DKK 265 million at year-end 2012, up 7% from last year. Expenses paid for the Danish bank packages amounted to DKK 2 million in 2012 compared to DKK 11 million in 2011. Ringkjøbing Landbobank's cost efficiency is one of the best in Denmark. Its cost-to-income ratio (operating income/operating expenses) was 30.5% in 2012 (after standard adjustments), down from 33.5% the year before. The cost income ratio is significantly lower than the peers and one of the key drivers behind the bank's higher risk adjusted profitability compared to regional peers.

Loan losses and provisions increased to DKK 157 million in 2012 from DKK 129 million in 2011. Loan loss provisions amounted to 26% of pre-provision income in 2012, largely unchanged year on year, but still elevated compared to pre-crisis levels.

Return on year end equity was 12% which is around double the level of regional peers and largely in line with global peers.

Given the already very high cost efficiency, any uplift in the bank's profitability will likely have to be driven by falling loan losses and provisions. However, in light of the current economic climate and the expected continued low economic growth in Denmark in the coming years, we expect loan losses to remain elevated.

The start to 2013 marks a continuation of the key trends in 2012. The bank reported Q1 2013 pre-tax profit of DKK 123 million, down from DKK 141 million in 1Q 2012. The reduction in pre-tax profit was a result of a fall in the return on the bank's security portfolio to DKK 6 million in Q1 2013 from DKK 27 million in Q1 2012. The core earnings were largely stable at DKK 118 million in the quarter.

At end-March 2013 lending fell 2% year on year, while deposits increased 1%. The bank attributes the falling lending to a general deleveraging among the banks customers, while the number of customers is increasing. Q1 2013 loan losses were DKK 21 million, largely unchanged from DKK 24 million in Q1 2012.

The group's Core Equity Tier 1 ratio was unchanged at 18.3% for Q1 2013 relative to Q1 2012. Due to a change in the way the individual solvency need is calculated from 2013 to the so called 8+ model, the group's individual solvency need increased to 8.7% at end-March 2013 vs. 8.0% at YE2012.

## INCREASED DEPOSIT FUNDING HAS REDUCED DEPENDENCE ON WHOLESAL FUNDING; LIQUIDITY POSITION HAS IMPROVED

At YE2012 the bank had liquid assets of 29% of total assets, up from around 26% in 2011. Around 87% of the bank's funding is in deposits, up from around 86% in 2011, and a pre-crisis level close to 50%. The share of interbank funding has similarly been reduced from close to 50% pre-crisis to 8% end 2012.

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 lender will not show on the bank's balance sheet as the mortgage loans are transferred to the mortgage lenders. Like a number of domestic peers, Ringkjøbing Landbobank has entered into an agreement with BRF Kredit, by which funding can be obtained by BRF Kredit issuing Danish SDO bonds against security in loans made by Ringkjøbing Landbobank to customers with security in real estate. The bank has not yet used this funding source.

Moody's will continue to monitor Ringkjøbing Landbobank's existing funding trends, especially the stability of the increased deposit funding.

## SOMEWHAT CONCENTRATED LOAN BOOK BY INDUSTRY AND GEOGRAPHY

Problem loans (defined as gross loans subject to individual impairment) increased modestly to 6.9% of gross loans at YE2012, up from 6.2% in 2011. Ringkjøbing reported a coverage ratio (loan loss reserves as a percentage of problem loans) of 82%, up from 77% in 2011, reflecting one of the highest coverage ratios of the rated Danish banks.

At YE2012 around half of the bank's lending was to customers within the core region of western and central Jutland, while 5% of lending was outside Denmark. Much of the lending outside the core region is within the bank's chosen niche areas. Approximately 26% of the bank's loan and guarantee portfolio reflects private customers, of which around 22% to wind turbines (15% outside of Denmark), almost 10% to agriculture and the remainder to other corporates. Moody's notes that the bank has allocated considerable provisions for write-downs on agriculture, in particular.

During the financial crisis the loan growth has slowed significantly and the loan book contracted a further 3% in 2012, and is now around 10% below the YE2008 level, however, Moody's remain cautious about the asset quality of loans granted during the peak of the economic cycle in 2006 and 2007 (the bank's loan book increased 26% in 2006 and 10% in 2007).

Ringkjøbing Landbobank operates in, and is supportive to, a small operating region, and has therefore relatively large customer exposures in comparison with its European peers. To assess borrower concentration Moody's compares the sum of the top 20 largest exposures with the Tier 1 capital or pre-provision income - whichever provides the highest ratio. Measured as the worse of the ratios in relation to earnings and Tier 1, the bank is in the worst concentration bucket, though a third of the Top 20 largest exposures is related to highly rated Danish mortgage bonds, as well as a big part related to wind turbine financing. 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. At YE2012 Ringkjøbing had total large exposures of 27.2% measured according to the Danish FSA's methodology compared with 11.8% in 2011.

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 Danish and German real estate market (12% of 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 during the economic slowdown in light of the generally high debt levels of Danish farmers.

## ABOUT MOODY'S BANK RATINGS

### Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

### Global Local Currency Deposit Rating

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

### National Scale Ratings

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. An Aaa rating on Moody's

National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

#### Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

#### Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

#### About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

### Rating Factors

#### Ringjobing Landbobank A/s

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
<b>Qualitative Factors (50%)</b>						<b>C-</b>	
<b>Factor: Franchise Value</b>						<b>D-</b>	<b>Neutral</b>
Market share and sustainability				x			
Geographical diversification					x		
Earnings stability				x			
Earnings Diversification [2]							
<b>Factor: Risk Positioning</b>						<b>C-</b>	<b>Neutral</b>
<b>Corporate Governance [2]</b>	--	--	--	--	--		
- Ownership and Organizational Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
<b>Controls and Risk Management</b>		x					
- Risk Management			x				
- Controls	x						
<b>Financial Reporting Transparency</b>		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
<b>Credit Risk Concentration</b>	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		

- Industry Concentration	--	--	--	--	--		
Liquidity Management			x				
Market Risk Appetite	x						
<b>Factor: Operating Environment</b>						<b>B</b>	<b>Neutral</b>
Economic Stability				x			
Integrity and Corruption	x						
Legal System	x						
<b>Financial Factors (50%)</b>						<b>B-</b>	
<b>Factor: Profitability</b>						<b>A</b>	<b>Neutral</b>
PPI % Average RWA (Basel II)	4.03%						
Net Income % Average RWA (Basel II)	2.18%						
<b>Factor: Liquidity</b>						<b>B-</b>	<b>Neutral</b>
(Market Funds - Liquid Assets) % Total Assets	-12.75%						
Liquidity Management			x				
<b>Factor: Capital Adequacy</b>						<b>A</b>	<b>Neutral</b>
Tier 1 Ratio (%) (Basel II)	19.77%						
Tangible Common Equity % RWA (Basel II)	19.79%						
<b>Factor: Efficiency</b>						<b>A</b>	<b>Neutral</b>
Cost / Income Ratio	33.20%						
<b>Factor: Asset Quality</b>						<b>D+</b>	<b>Weakening</b>
Problem Loans % Gross Loans				6.46%			
Problem Loans % (Equity + LLR)			26.59%				
<b>Lowest Combined Financial Factor Score (15%)</b>						<b>D+</b>	
<i>Economic Insolvency Override</i>						<b>Neutral</b>	
<b>Aggregate BFSR Score</b>						<b>C</b>	
<b>Aggregate BCA Score</b>						<b>a3</b>	
<b>Assigned BFSR</b>						<b>C-</b>	
<b>Assigned BCA</b>						<b>baa1</b>	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.  
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.



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