



Moody's Investors Service

## Credit Opinion: Ringkjøbing Landbobank A/s

Global Credit Research - 15 Mar 2010

Ringkøbing, Denmark

### Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	A1/P-1
Bank Financial Strength	C+

### Contacts

Analyst	Phone
Oscar Heemsker/London	44.20.7772.5454
Janne Thomsen/London	
Simon Harris/London	
Tom Petersson/London	

### Key Indicators

#### Ringkjøbing Landbobank A/s

	[1]2009	2008	[2]2007	2006	2005	[3]Avg.
Total assets (DKK billion)	17.93	18.00	19.63	17.27	13.36	[4]13.64
Total assets (EUR billion)	2.41	2.42	2.63	2.32	1.79	--
Total capital (DKK billion)	2.75	2.48	2.25	2.19	1.72	[4]14.92
Return on average assets	1.29	1.30	1.93	2.82	2.32	1.93
Recurring earnings power [5]	2.85	2.21	2.46	3.29	3.12	2.79
Net interest margin	3.67	3.32	2.76	2.91	3.17	3.17
Cost/income ratio (%)	36.34	38.45	34.54	29.25	34.77	34.67
Problem loans % gross loans	3.14	2.36	1.89	2.14	3.29	2.57
Tier 1 ratio (%)	16.60	13.00	11.20	10.40	11.60	12.56

[1] As of December 31. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate. [5] Preprovision income % average assets.

### Opinion

#### SUMMARY RATING RATIONALE

Moody's rates Ringkjøbing Landbobank A/S A1/C+/P-1. The C+ bank financial strength rating (BFSR), which translates into Baseline Credit Assessment (BCA) of A2, reflect the Danish bank's good intrinsic financial strength and, in particular, its solid capitalisation. However, the rating is constrained by the bank's limited national market share, low level of geographic diversification, high credit risk concentrations and concentrations in financing niche sectors.

Ringkjøbing's long-term global local currency (GLC) deposit rating of A1 receives a one-notch uplift from the A2 BCA

on the basis of a moderate probability of systemic support in the event of a financial crisis.

### **Credit Strengths**

- Sound local brand in western Jutland region
- Good earnings from core operations
- High operating efficiency
- Solid capitalisation

### **Credit Challenges**

- Maintaining profitability levels
- High borrower concentration
- Concentrated credit exposure to electricity production by wind turbines, agriculture and also to other niche sectors
- Limited geographical diversification
- Further integration and upgrade of risk management practices
- Preserving asset quality across the economic cycle

### **Rating Outlook**

The outlook on the BFSR and long-term deposit rating is negative.

Moody's cautions that if credit-risk-related costs were to exceed its current expectations, coupled with less sustainable core earnings, this could lead to a reassessment of the BFSR and deposit rating. Therefore, both ratings carry a negative outlook.

We described the assumptions behind our scenario analysis in a Special Comment entitled "Moody's Approach to Estimating Nordic Banks' Credit Losses", published on 16 July 2009.

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

At present, we do not view the bank's BFSR or long-term GLC deposit rating as enjoying upside pressure, as reflected by the negative outlook.

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

The BFSR could be adversely affected if credit quality weakens to a greater extent than we assume in our base case, which would exert pressure on the bank's earnings and capitalisation. Also any weakening in the bank's market position or weakening earnings generation could have negative implications on the BFSR.

GLC deposit ratings could be downgraded if the bank's BFSR was downgraded, or if Moody's assessment of probability of systemic support was lowered, which is however viewed unlikely at the moment.

### **Recent Results and Company Events**

Ringkjøbing Landbobank reported pre-tax income of DKK305 million for 2009, slightly below the DKK 318 million reported in 2008. A sharp increase of loan loss provisions was offset by an increase in net interest income and positive securities valuation adjustments.

Tier 1 and total capital ratios, as calculated under Basel II's standardised approach, were at 16.6% and 20.2%, respectively and showed an improvement from 13.0% and 16.3% at YE2008.

### **DETAILED RATING CONSIDERATIONS**

Detailed considerations for Ringkjøbing Landbobank's currently assigned ratings are as follows:

#### **Bank Financial Strength Rating**

The BFSR is in line with the outcome of Moody's bank financial strength scorecard.

#### Qualitative Factors (50%)

##### Factor 1: Franchise Value

Trend: Neutral

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 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 below 1%.

Ringkjøbing is a full-service bank, with a total of 12 branches including the headquarters and 262 full-time employees on average for the year 2009. The bank's core operations can be divided into following two business areas:

(i) 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

(ii) Banking in niche areas concentrating on the financing of wind turbines, private banking/asset management, the financing of doctors in private practices, first-priority financing of lending properties, primarily in Germany, and the financing of purchases of vacation homes, outside Denmark.

A franchise value score of D+ reflects our view of the bank's regional presence, moderate nationwide position and satisfactory earnings stability.

##### Factor 2: Risk Positioning

Trend: Neutral

Ringkjøbing Landbobank operates in accordance with the general guidelines set forth by the NASDAQ OMX Copenhagen. The bank is owned by approximately 18,600 shareholders (most of which are customers), with Denmark's largest pension fund, ATP, being its largest shareholder, with a stake of over 5%.

The bank reports according to the Danish Financial Business Act and the accounts are audited by PricewaterhouseCoopers. We view the information in the annual and quarterly accounts as satisfactory.

The bank has an independent Chief Risk Manager, and risk management practices are adequate for the level and type of risk in the bank; however, the risk systems and procedures lack the sophistication of many other regional players in the Nordic region.

The bank started developing and using a Value at Risk (VaR) model in 2007. Its total VaR, a statistical measurement of market risk, with a 10-day holding period and 99% confidence interval, varied from possible losses of DKK5.5 million to DKK26.9 million in 2009 (0.2%-1.2% of Tier 1 capital). Although according to the bank's own calculations, the market risk is low, in Moody's opinion the bank's VaR measure lacks a track record and we therefore take a conservative view with regard to this measure. We also note that the diversification gain due to spreading the risk across various asset classes is relatively high, which considerably reduces the bank's VaR.

The bank's total interest rate risk in relation to 100 bps change in interest rates was around 0.6% of core capital in 2009. The share holdings are mainly related to a number of sector companies, which are considered strategic investments (around 10% of Tier 1 capital). The portfolio of listed shares amounted to DKK25 million in 2009, which is around 1% of Tier 1 capital. The bank's currency risk is limited.

The score for risk positioning is C and is constrained by high credit risk concentration.

##### Factor 3: Regulatory Environment

This factor does not address bank-specific issues; instead, it evaluates whether regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. Refer to Moody's current Banking System Outlook on Denmark for an analysis of the country's regulatory environment.

##### Factor 4: Operating Environment

Trend: Neutral

This factor is common to all Danish banks. Moody's assigns an A score for the overall operating environment, which includes economic stability, integrity and corruption, and the legal system. Refer to Moody's current Banking System Outlook on Denmark for an analysis of the country's operating environment.

Quantitative Factors (50%)

Factor 5: Profitability

Trend: Weakening

Ringkjøbing Landbobank reported pre-tax income of DKK 305 million in 2009, relatively unchanged year-on-year. The bank's risk-adjusted profitability - measured by pre-provision income as a percentage of average risk-weighted assets - improved to 3.7% in 2009, compared with 2.6% in 2008 and 2.9% in 2007 and compares well with that of its peers.

Net interest income is the most important component of earnings, representing around 75% of operating income in 2009. In 2009 the bank reduced the gross loan book as well as funds with the central bank, while doubling exposure to banks and further increasing its bond portfolio. Funding from credit institutions fell sharply while the bank grew its deposit base. This increased the net interest margin to 3.7% in 2009 compared with 3.3% in 2008 and 2.8% in 2007.

In recent years, Ringkjøbing Landbobank's profitability has also been supported by the sale of niche products, which have relatively low overhead costs. In the near future, we expect competition to remain sluggish, which is likely to support margin levels, although we believe that the room for margin increases is decreasing. In the longer run, sluggish or even negative loan growth is likely to exert pressure on net interest income.

Operating income was further boosted by positive market valuation adjustments of DKK 58 million compared to a loss of DKK 44 million in 2008.

Loan loss provisions for the year 2009 stood at DKK 159 million (excluding the provisions for the Danish guarantee scheme), more than double the amount in 2008 and accounting for approximately 30% of pre-provision income.

The bank scores C+ for profitability based on three-year average ratios, which are calculated by using Basel II risk-weighted assets. We continue to see a weakening trend given the challenging economic outlook, which is likely to increase loan loss provisions. We also note the costs related to the Danish banking package, which will last to the 3rd quarter of 2010, and slower growth in core operations.

Factor 6: Liquidity

Trend: Neutral

At end 2009, 25% of the bank's total assets are in liquid assets. In addition, 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.

The bank's funding structure in 2009 was divided between customer deposits (66% of average total funding), interbank funding (28% of average total funding, of which 77% with a maturity over one year) and other market funding (6%).

Customer deposits increased by 23% in 2009 whereas gross loans decreased by 5%. As at year end, the ratio of deposits to gross loans stood at approx. 80%.

In December 2009, the bank gained approval to issue up to DKK 5 billion 3 year government guaranteed debt under the Act on Financial Stability.

Moody's will continue to monitor Ringkjøbing Landbobank's existing funding trends, especially considering the volatility of interbank funds. We also recognise that the government's measures to support the banking sector have been helpful in terms of liquidity.

Moody's views a score of C as appropriate for the bank's liquidity.

Factor 7: Capital Adequacy

Trend: Neutral

Ringkjøbing Landbobank's capital adequacy ratios are solid and improved in 2009 as a result of a decrease in risk-weighted assets, mainly reflecting a decrease in the loan portfolio and guarantees as well as satisfactory earnings which are retained during the term of bank package I. Under Moody's anticipated stress scenario, the current capital level provides the bank with a satisfactory buffer against potential credit losses.

The total capital and Tier 1 ratios were 20.2% and 16.6%, respectively, at end-2009, compared with 16.3% and 13.0% at YE2008. The Tier 1 ratio without hybrid capital was 15.1% at end-2009.

The bank scores A for capital adequacy.

#### Factor 8: Efficiency

Trend: Weakening

Ringkjøbing Landbobank's cost efficiency is one of the best in Denmark. Its cost-to-income ratio (operating income/operating expenses) was 36% in 2009, down from 38% in 2008. The improvement in efficiency results from higher operating income and stable operating costs.

Ringkjøbing, similar to other Danish banks, has had to bear the costs of participating in the Danish government guarantee scheme and support mechanism. For 2009, the total cost including monthly guarantee commission and provision for the guarantee amounted to DKK107 million.

The bank scores A for efficiency.

#### Factor 9: Asset Quality

Trend: Weakening

Ringkjøbing Landbobank's problem loan ratio (measured as accumulated individual writedowns) reached a low 1.9% at YE2007, but increased to 3.1% by end 2009. The ratio is somewhat higher than the average for banks in the Nordic region, but we note that the bank has a rather conservative approach to impairments. However, we also note that the level of loans with suspended calculation of interest increased to DKK63 million at end- 2009 from DKK22 million at YE2008, corresponding to 0.5% of gross loans.

Approximately 34% of the bank's loan and guarantee portfolio is to private customers, around 14% to wind turbines, almost 12% to agriculture and the remainder to corporates. Moody's views earnings driven by corporate and specialised lending as less predictable in the long term than earnings from retail-based lending. Nonetheless, we consider that the overall stability of Ringkjøbing Landbobank's core earnings is satisfactory and is in line with that of its domestic peers. However, we note that compared with regional banks in many other countries, Danish banks have a lower proportion of retail loans on their balance sheets, reflecting the fact that retail mortgages are largely transferred to mortgage credit institutions.

The bank's loan growth has slowed significantly (-5% in 2009, -1% in 2008, +10% in 2007 and +26% in 2006). However, Moody's will continue to monitor the effect of rapid loan growth of previous years on the bank's asset quality, since many of the loans are unseasoned.

Ringkjøbing operates in - and is supportive to - its small operating region, therefore it has relatively large customer exposures in comparison with its European peers. The 20 largest limits represented about 99% of Tier 1 capital in 2009 - the ratio has decreased slightly from the previous year.

Moody's notes that concentrations are mitigated by collateral, but cautions that collateral values have been affected by the economic downturn. There is also some industry concentration in the loan portfolio (as described under profitability), but we note that several of these exposures would not be deemed corporate exposures under the Basel II framework.

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 real estate market is more limited than that of many other Danish regional banks. However, it does have 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 as well as the weak prices of many agricultural products.

The score of C is appropriate for the bank's current asset quality, but the weakening trend reflects uncertainty in the Danish economy as well as the unseasoned loan portfolio and some concentration risks.

#### **Global Local Currency Deposit Rating (Joint Default Analysis)**

Ringkjøbing Landbobank's long-term GLC deposit rating is A1, with negative outlook. The rating incorporates the following main elements: (i) its A2 BCA; and (ii) Moody's assessment of a moderate probability of systemic support for this bank in the event of a financial crisis. The support assessment results in a one-notch uplift for the long-term GLC deposit rating from the BCA

### **Foreign Currency Deposit Rating**

Ringkjøbing Landbobank's A1 foreign currency deposit ratings are unconstrained given that Denmark, in common with other EU members, has a country ceiling of Aaa.

### **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

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

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. AAaa 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>
<b>Market Share and Sustainability</b>			<b>x</b>				
<b>Geographical Diversification</b>					<b>x</b>		
<b>Earnings Stability</b>			<b>x</b>				
<b>Earnings Diversification [2]</b>							
<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>		<b>x</b>					
- Risk Management			<b>x</b>				
- Controls	<b>x</b>						
<b>Financial Reporting Transparency</b>		<b>x</b>					
- Global Comparability	<b>x</b>						
- Frequency and Timeliness	<b>x</b>						
- Quality of Financial Information			<b>x</b>				
<b>Credit Risk Concentration</b>	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
<b>Liquidity Management</b>			<b>x</b>				
<b>Market Risk Appetite</b>		<b>x</b>					
<b>Factor: Operating Environment</b>						<b>A</b>	<b>Neutral</b>
<b>Economic Stability</b>	<b>x</b>						
<b>Integrity and Corruption</b>	<b>x</b>						
<b>Legal System</b>	<b>x</b>						
<b>Financial Factors (50%)</b>						<b>B-</b>	
<b>Factor: Profitability</b>						<b>C+</b>	<b>Weakening</b>
<b>PPP % Avg RWA- Basel II</b>		3.13%					
<b>Net Income % Avg RWA- Basel II</b>			1.59%				
<b>Factor: Liquidity</b>						<b>C</b>	<b>Neutral</b>
<b>(Mkt funds-Liquid Assets) % Total Assets</b>			9.09%				
<b>Liquidity Management</b>			<b>x</b>				

<b>Factor: Capital Adequacy</b>						<b>A</b>	<b>Neutral</b>
Tier 1 ratio (%) - Basel II	13.60%						
Tangible Common Equity / RWA- Basel II	12.56%						
<b>Factor: Efficiency</b>						<b>A</b>	<b>Weakening</b>
Cost/income ratio	36.44%						
<b>Factor: Asset Quality</b>						<b>C</b>	<b>Weakening</b>
Problem Loans % Gross Loans			3.76%				
Problem Loans % (Equity + LLR)			21.83%				
Lowest Combined Score (15%)						<b>C</b>	
<i>Economic Insolvency Override</i>						<b>Neutral</b>	
<b>Aggregate Score</b>						<b>C+</b>	
<b>Assigned BFSR</b>						<b>C+</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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