

**Credit Opinion: Ringkjobing Landbobank A/s**

Global Credit Research - 02 Apr 2015

Ringkjobing, Denmark

**Ratings**

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits	*Baa1/*P-2
Baseline Credit Assessment	**baa1
Adjusted Baseline Credit Assessment	**baa1

\* Rating(s) within this class was/were placed on review on March 17, 2015

\*\* Placed under review for possible upgrade on March 17, 2015

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**Key Indicators**

**RINGKJOBING LANDBOBANK A/S (Consolidated Financials)[1]**

	[2]12-14	[3]12-13	[3]12-12	[3]12-11	[3]12-10	Avg.
Total Assets (DKK million)	21,237.9	19,582.8	17,681.5	17,549.0	18,247.2	[4]3.9
Total Assets (EUR million)	2,852.1	2,624.9	2,369.9	2,361.2	2,448.6	[4]3.9
Total Assets (USD million)	3,451.2	3,617.0	3,124.4	3,065.1	3,284.9	[4]1.2
Tangible Common Equity (DKK million)	3,098.4	2,900.9	2,675.9	2,482.9	2,312.2	[4]7.6
Tangible Common Equity (EUR million)	416.1	388.8	358.7	334.1	310.3	[4]7.6
Tangible Common Equity (USD million)	503.5	535.8	472.9	433.7	416.2	[4]4.9
Problem Loans / Gross Loans (%)	6.7	8.1	7.3	6.8	6.2	[5]7.0
Tangible Common Equity / Risk Weighted Assets (%)	19.5	19.5	20.1	18.8	17.6	[6]19.5
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	27.3	31.6	27.9	29.2	29.8	[5]29.2
Net Interest Margin (%)	3.2	3.4	3.5	3.4	3.3	[5]3.3
PPI / Average RWA (%)	4.4	4.1	4.5	3.8	3.8	[6]4.4
Net Income / Tangible Assets (%)	2.1	1.8	1.9	1.7	1.5	[5]1.8
Cost / Income Ratio (%)	30.5	31.6	30.4	33.6	35.6	[5]32.3
Market Funds / Tangible Banking Assets (%)	10.3	10.4	9.0	9.9	18.3	[5]11.6
Liquid Banking Assets / Tangible Banking Assets (%)	25.0	27.4	27.4	24.8	24.8	[5]25.9
Gross Loans / Total Deposits (%)	94.7	92.6	93.6	95.7	95.9	[5]94.5

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

On 17 March 2015 we placed the following ratings for Ringkjobing Landbobank under review for possible upgrade: baa1 standalone credit assessment (BCA), baa1 adjusted BCA, Baa1 long term deposit rating and Prime-2 short-term deposit rating.

The review was prompted by the implementation of our new methodology, which suggests upward pressure on the bank's standalone credit strength. Specifically, the review reflects Ringkjobing Landbobank's consistently strong earnings generation, high capital buffers and improved funding profile, which help offset elevated, albeit easing, asset quality pressures. The review on deposit ratings also reflects the introduction of Loss Given Failure (LGF) in the new methodology, which takes into account the risks faced by the different debt and deposit classes across the liability structure should the bank enter resolution, and our reassessment of systemic support assumptions.

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

Ringkjobing 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, 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.

#### 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
- 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 likely resulting in no uplift from BCA for deposits

#### Rating Outlook

Ringkjobing Landbobank's ratings are under review. After the review process, Ringkjobing Landbobank's ratings may have a stable outlook underpinned by the banks strong fundamentals and the current liability structure, which is likely to result in two notches of uplift reflecting very low loss-given-failure for deposits.

The review on Ringkjobing Landbobank's BCA and long term deposits was triggered by the introduction of our new methodology, and specifically our advanced LGF analysis, which applies to institutions subject to an operational resolution regime under the Bank Recovery and resolution Directive (BRRD). Our advanced LGF analysis on Ringkjobing Landbobank's long term and short term deposits led us to place the ratings on review for upgrade. The review will focus on the liability structure, in particular the amount of deposits, senior long-term debt outstanding and the amount of debt subordinated to it. At the end of the review period, we expect long term deposits rating to be upgraded by up to three notches.

We continue to believe the probability of government support for Ringkjobing Landbobank's long term deposits to be low and there is thus no uplift from its unsupported level.

#### What Could Change the Rating - Up

Ringkjøbing Landbobank's BCA and long-term deposits are on review for upgrade, as indicated under "Rating Outlook".

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

Given the review for upgrade on Ringkjøbing Landbobank's BCA and deposit ratings, we believe there is a very low likelihood for a downward change in deposit ratings.

### **DETAILED RATING CONSIDERATIONS**

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

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

Problem loans (defined as gross loans subject to individual impairment) decreased to 6.7% of gross loans at end-2014, down from 8.1% in 2013. Ringkjøbing 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 ratios of the rated Danish banks.

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 and almost 9% 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 2007-2009 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 DKK 583 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 Danish and German 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 reported a Common Equity Tier 1 (CET1) capital ratio of 17.5% at end-2014. The bank's individual solvency need as calculated according to the Danish 8+ model was 8.9% at end-December 2014. 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.

We find that 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 Tangible Common Equity to Total Assets, an indicator of leverage where this is not reported, of 14.6% at end-2014, which is significantly higher than the 4% to 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 reflect the bank's high profitability levels and strong track record of delivering bottom line results.

Ringkjøbing Landbobank reported a pre-provision profit of DKK 674 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 compared to 4.1% in 2013 and continues to compare well with that of its peers. Ringkjøbing Landbobank has 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 compared to DKK 451 million in 2013. Before loan losses and provisions, core earnings increased 7% to DKK 609 million. The result from the security portfolio (including dividends on capital shares) increased to DKK 65 million in 2014 from DKK 24 million in 2013, while expenses relating to bank packages fell to DKK 0.132 million in 2014 from DKK 2.3 million in 2013, resulting in pre-tax profit of DKK 587 million in 2014, up from DKK 472 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 DKK 298 million in 2014, up 9 % from last year. Expenses paid for the Danish bank packages amounted to DKK 0.132 million in 2014 against DKK 2.3 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 30.5 % in 2014(after standard adjustments), down from 31.6 % the year before. The bank's 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 decreased to DKK 87 million in 2014 from DKK 120 million in 2013. Loan loss provisions amounted to 13% of pre-provision income in 2014, down from 20% in 2013, but remains somewhat elevated compared to 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 global peers. Ringkjøbing Landbobank has 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 10% of the bank's tangible banking assets at the end of December 2014 and has been relatively stable since 2011. Our funding structure score indicates that the overall funding profile remains a modest fundamental strength for Ringkjøbing Landbobank due to the relative low dependence on more confidence sensitive wholesale funding. At end-December 2014 liquid assets accounted for around 25% of total assets which has been relatively stable in recent years. Ringkjøbing Landbobank expects to be able to report a liquidity coverage ratio (LCR) of 100% by 1 October 2015, in line with the requirements for Danish SIFI banks (although Ringkjøbing Landbobank is not a SIFI bank). Compared to the liquidity position at end-December 2014, this will require a reinvestment of liquid resources currently held in Danish covered bonds into government bonds. The bank expect this will negatively impact earnings by DKK1 million due to the lower yield on government bonds.

Just over 85% of the bank's funding was in deposits in 2014 (compared to 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.

## Notching Considerations

### AFFILIATE SUPPORT

Ringkjøbing Landbobank does not have an affiliate.

### LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

Ringkjøbing Landbobank is subject to the EU Bank Resolution and Recovery Directive (BRRD), 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 10% 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.

For Ringkjøbing Landbobank's long-term deposit ratings, our review will consider the likely impact on loss-given-failure of the combination of their own volume and the amount of debt subordinated to them. We expect this will result in Preliminary Rating Assessment (PRA) of two notches above the BCA for long term deposits, reflecting very low loss-given-failure. Our advanced LGF analysis identifies junior deposits account for 5.5% of tangible banking assets at failure. Our expectation assumes the DKK1,081 million (at end-2014) back-to-back project finance loan from KfW Bankengruppe can be bailed-in. This loan accounts for around 6% of Ringkjøbing Landbobank's tangible banking assets at failure. Junior instruments account for just over 1% of tangible banking assets at failure.

#### GOVERNMENT SUPPORT

The implementation of the BRRD 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.

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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>	19.5%	aa2	← →	aa2	Risk-weighted capitalisation	
<b>Profitability</b>						
<i>Net Income / Tangible Assets</i>	2.0%	aa3	← →	aa3	Return on assets	
<b>Combined Solvency Score</b>		a2		a3		
<b>Liquidity</b>						
<b>Funding Structure</b>						
<i>Market Funds / Tangible Banking</i>	10.3%	a2	← →	a2	Extent of market funding	

<b>Assets</b>					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>	<b>a3</b>
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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	<b>a2 - baa1</b>
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<b>Assigned BCA</b>	<b>baa1 Possible Upgrade</b>
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Affiliate Support notching	--
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<b>Adjusted BCA</b>	<b>baa1 Possible Upgrade</b>
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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	--	--	--	--	Baa1 RUR Possible Upgrade	Baa1 RUR Possible Upgrade

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