

Credit Opinion: Ringjobing Landbobank A/s

Global Credit Research - 01 Jun 2012

Ringkobing, 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)

Contacts

Analyst	Phone
Oscar Heemskerk/London	44.20.7772.5454
Richard (Blake) B. Foster/London	
Simon Harris/London	
Jessica Svantesson/London	

Key Indicators

Ringjobing Landbobank A/s (Consolidated Financials)[1]

	[2]3-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (DKK million)	17,674.6	17,549.0	18,247.2	17,928.0	18,001.8	[3]-0.5
Total Assets (EUR million)	2,375.7	2,361.2	2,448.6	2,409.4	2,418.5	[3]-0.4
Total Assets (USD million)	3,163.8	3,065.1	3,284.9	3,456.8	3,361.9	[3]-1.5
Tangible Common Equity (DKK million)	2,618.6	2,582.9	2,487.2	2,105.6	1,834.6	[3]9.3
Tangible Common Equity (EUR million)	352.0	347.5	333.8	283.0	246.5	[3]9.3
Tangible Common Equity (USD million)	468.7	451.1	447.7	406.0	342.6	[3]8.2
Net Interest Margin (%)	3.6	3.4	3.3	3.4	3.0	[4]3.3
PPI / Avg RWA (%)	5.0	3.8	3.8	3.7	2.6	[5]3.8
Net Income / Avg RWA (%)	3.2	2.2	1.9	1.7	1.5	[5]2.1
(Market Funds - Liquid Assets) / Total Assets (%)	-14.4	-14.6	-5.7	-1.6	16.6	[4]-3.9
Core Deposits / Average Gross Loans (%)	94.9	93.2	86.2	82.3	62.8	[4]83.9
Tier 1 Ratio (%)	19.8	19.8	18.6	16.6	13.0	[5]17.6
Tangible Common Equity / RWA (%)	19.0	19.6	18.9	15.5	12.1	[5]17.0
Cost / Income Ratio (%)	28.4	33.5	35.6	36.2	38.3	[4]34.4
Problem Loans / Gross Loans (%)	--	6.2	6.2	5.0	3.8	[4]5.3
Problem Loans / (Equity + Loan Loss Reserves) (%)	--	25.9	28.1	26.1	24.7	[4]26.2

Source: Moody's

[1] All 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

RECENT CREDIT DEVELOPMENTS

On 30 May 2012, Moody's downgraded Ringkjøbing Landbobank's standalone rating to C- from C and its debt and deposit ratings to Baa1 from A3. The bank's Prime-2 short term ratings were affirmed.

This concluded the review initiated on 15 February 2012, and reflects our view that the challenges Ringkjøbing Landbobank faces have increased, notably regarding the operating environment and asset quality concerns.

The downgrade reflects the difficult operating environment for Danish banks, as well as the bank's relatively limited regional franchise in the West of Jutland, which makes the bank more vulnerable to region-specific developments. The bank is characterised by relatively high exposure to agricultural lending, which has led to elevated provisioning needs, and wind turbine financing. Moreover, the bank relies on second and sequential lien mortgages in household lending, whereas the corporate lending comprises a mix of first and second lien financing. In particular the wind turbines financing benefits from first lien mortgages. This results from the stronger funding position of mortgage credit institutions that generally fund Danish households' and corporates' first lien mortgage loans, but compared to the bank's international peers we view this position as credit negative, particularly in the current environment of weakening asset quality. The rating action captures Moody's view that exposures to more volatile sectors may give rise to increased need for provisions. We also caution that low interest-rate levels have thus far supported borrowers' ability to repay their debts but loans with variable rates are vulnerable to interest-rate hikes.

The one-notch downgrade of the standalone credit assessment for Ringkjøbing Landbobank to baa1 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.

SUMMARY RATING RATIONALE

Moody's rates Ringkjøbing Landbobank A/S Baa1/Prime-2/C-. The C- standalone bank financial strength rating (BFSR), which maps to baa1 on the long-term scale, reflects the bank's good intrinsic financial strength and, in particular, its solid capitalisation and good profitability. 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 Baa1 long-term global local currency (GLC) deposit rating does not include systemic support uplift.

Rating Drivers

- Sound local brand in western Jutland region
- Good earnings from core operations and high operating efficiency
- Improved deposit funding though generally adverse funding environment following Bank Package III
- Somewhat concentrated loan book by geography and industry, but further integration and upgrade of risk management practices, systems and procedures

Rating Outlook

The outlook on all ratings is stable.

What Could Change the Rating - Up

Rating upgrades are unlikely in the near future, for the reasons described in "Recent Credit Developments". A limited amount of upward rating momentum could develop if Ringkjøbing Landbobank demonstrates (i) continued good access to capital markets, (ii) stronger and more stable earnings generation without an increase in its risk profile and/or (iii) improved asset quality management especially in relation to more volatile segments such as agriculture and commercial real estate.

What Could Change the Rating - Down

While the current rating levels incorporate a degree of expected further deterioration, ratings may decline further if (i) Ringkjøbing Landbobank's financing conditions become more difficult, (ii) its asset quality deteriorates more than we anticipate and/or (iii) 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

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

Bank Financial Strength Rating

Moody's assigns a C- standalone BFSR to Ringkjøbing Landbobank. The assigned rating is one notch lower than the outcome of Moody's bank financial strength scorecard for Ringkjøbing Landbobank. This primarily reflects the bank's exposures to more volatile industries such as agriculture and wind energy, which we deem more vulnerable to a less favourable operating environment and more likely to lead to larger provisioning needs if credit quality deteriorates.

Sound Local Brand In Jutland, Moderate Nationwide Presence

Ringkjøbing Landbobank is a regional bank and among the 15 largest banks in Denmark in terms of total assets. Headquartered in Ringkøbing, 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 252 full-time employees on average for the year 2011. 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 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 deteriorating macroeconomic environment as explained above.

Good Earnings From Core Operations And High Operating Efficiency

Ringkjøbing Landbobank reported at end-December 2011 a pre-provision profit of DKK 517 million (after standard adjustments) which is largely unchanged from last year. The bank's risk adjusted profitability - measured by pre-provision income as a percentage of average risk-weighted assets - remained largely unchanged year-on-year at 3.9%, compared with 2.6% in 2008 and 2.8% in 2009 and compares well with that of its peers.

Core earnings (as represented by net interest and fee income) accounted for over 90% of operating income in 2011 and was largely unchanged year-on-year. Net income from interest amounted to DKK 613 million, up 3% year-on-year, mainly as a result of increased interest margin and increase in deposit figures. Fee and commission income was down 7% to DKK 158 million compared to last year due to fewer transactions within trading and asset management.

Total operating expenses and depreciation (excluding the costs for the first Danish government support package) amounted to DKK 248 million at year-end 2011, up 4% from last year, but overall profitability was boosted by a 7% decrease in loan impairment provisions (excluding provisions under the Danish support package) to DKK 129 million. Loan loss impairments accounts for 25% of pre-provision income.

Ringkjøbing Landbobank's cost efficiency is one of the best in Denmark. Its cost-to-income ratio (operating income/operating expenses) was 34% in 2011 (after standard adjustments), down from 36% the year before.

Given that the economic environment remains challenging and its potential impact on asset quality, we also expect that the need for loan loss provisions will remain elevated in the near future and thereby maintain pressure on the bank's net earnings.

At end-March 2012, Ringkjøbing Landbobank reported a pre-tax income of DKK 141 million, up from DKK 90 million in Q1 2011, corresponding to a 57% increase. This was mainly due to an increase in net income from interest and fees due to larger volumes within asset management and pension segments, as well as higher

remortgaging activity during the first quarter of 2012.

Improved Deposit Funding Though Generally Adverse Funding Environment Following Bank Package III.

At YE2011 the bank has 25% of assets 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.

Over the past 5 years customer deposits have increased almost 40%, while after a period of high growth in 2006-2007, lending declined and over the 5 year period has only increased 7%. As a result the ratio of deposits to gross loans has steadily grown from around 55% in 2006 to 93% in 2011. 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, also known as 'Bank Package II', but the bank did not exercise this option.

At YE 2011, the breakdown of the bank's funding structure was 73% deposit and 20% market funded, mostly through short and medium term inter-bank funds.

Moody's will continue to monitor Ringkjøbing Landbobank's existing funding trends, especially considering the volatility of interbank funds, and taking the expected deterioration of Danish funding markets post Bank Package III in consideration.

Loan Book Concentration and Risk Management

Problem loans (defined as gross loans subject to individual impairment) accounted for 6.2% of gross loans at YE2011, unchanged from last year. Ringkjøbing reported a coverage ratio (loan loss reserves % problem loans) of 77%, up from 66% in 2010, reflecting one of the highest coverage ratios of the rated Danish banks.

Approximately 28% of the bank's loan and guarantee portfolio reflects private customers, around 22% to wind turbines (of which 14% is outside of Denmark), almost 11% 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.

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, which also leads to many bank exposures only benefiting from second priority claims on collateral.

During the financial crisis the loan growth has slowed significantly (3.1% in 2011, +0.8% in 2010, -6.1% in 2009, -1.7% in 2008), but 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 - its small operating region, therefore it has 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. At year-end 2011 Ringkjøbing had total large exposures of 11.8% when excluding two large exposures to financials being terminated in 2012, compared with 10.2% in 2010.

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 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.

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 (Joint Default Analysis)

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 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

Ringkjøbing Landbobank A/s

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C-	
Factor: Franchise Value						D-	Neutral
Market Share and Sustainability				x			
Geographical Diversification					x		
Earnings Stability				x			
Earnings Diversification [2]							
Factor: Risk Positioning						C-	Neutral
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management		x					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration					x		
- Borrower Concentration					x		
- Industry Concentration		x					
Liquidity Management			x				
Market Risk Appetite	x						
Factor: Operating Environment						B	Neutral
Economic Stability				x			
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						B-	
Factor: Profitability						B+	Weakening
PPI / Average RWA- Basel II	3.78%						
Net Income / Average RWA- Basel II		1.93%					
Factor: Liquidity						C+	Weakening
(Mkt funds-Liquid Assets) / Total Assets		-7.31%					
Liquidity Management			x				
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio - Basel II	18.33%						
Tangible Common Equity / RWA- Basel II	17.99%						
Factor: Efficiency						A	Weakening
Cost / Income Ratio	35.11%						
Factor: Asset Quality						D+	Weakening
Problem Loans / Gross Loans				5.82%			
Problem Loans / (Equity + LLR)			26.70%				
Lowest Combined Score (15%)						D+	
Economic Insolvency Override						Neutral	
Aggregate Score						C	
Assigned BFSR						C-	

[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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