

# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Ringkjobing Landbobank A/s

Global Credit Research - 05 Aug 2014

Ringkjobing, 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
Kim Bergoe/London	44.20.7772.5454
Jessica Svantesson/London	
Simon Harris/London	

#### Key Indicators

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

	[2]3-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (DKK million)	19,712.6	19,582.8	17,681.5	17,549.0	18,247.2	[3]1.9
Total Assets (EUR million)	2,640.3	2,624.9	2,369.9	2,361.2	2,448.6	[3]1.9
Total Assets (USD million)	3,639.0	3,617.0	3,124.4	3,065.1	3,284.9	[3]2.6
Tangible Common Equity (DKK million)	2,975.1	2,986.3	2,767.5	2,590.2	2,488.9	[3]4.6
Tangible Common Equity (EUR million)	398.5	400.3	370.9	348.5	334.0	[3]4.5
Tangible Common Equity (USD million)	549.2	551.6	489.0	452.4	448.1	[3]5.2
Net Interest Margin (%)	3.3	3.4	3.5	3.4	3.3	[4]3.4
PPI / Average RWA (%)	5.3	4.1	4.5	3.8	3.8	[5]4.3
Net Income / Average RWA (%)	3.8	2.5	2.4	2.2	1.9	[5]2.6
(Market Funds - Liquid Assets) / Total Assets (%)	-13.3	-16.2	-17.8	-14.7	-5.7	[4]-13.5
Core Deposits / Average Gross Loans (%)	93.3	103.3	96.5	93.2	86.2	[4]94.5
Tier 1 Ratio (%)	18.1	19.2	20.9	19.8	18.6	[5]19.3
Tangible Common Equity / RWA (%)	20.1	20.1	20.8	19.6	18.9	[5]19.9
Cost / Income Ratio (%)	25.7	31.6	30.4	33.6	35.6	[4]31.4
Problem Loans / Gross Loans (%)	-	8.1	7.3	6.8	6.2	[4]7.1
Problem Loans / (Equity + Loan Loss Reserves) (%)	-	30.9	27.2	28.3	28.0	[4]28.6

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 challenged, but stabilising, 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 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**

Upward ratings 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 funding sources.

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

Downward ratings momentum could develop if (1) Ringkjøbing Landbobank's financing conditions become more difficult, (2) its operating environment deteriorates 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 as of April 2014 including the headquarters and 251 full-time employees on average for the year 2013. In April 2014, a private banking branch was opened in Aarhus, Denmark's second most populated city. 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 Aarhus, 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 rental 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 coupled with a still challenging macroeconomic environment.

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

Ringkjøbing Landbobank reported a pre-provision profit of DKK 592 million in 2013 which is down 2% from 2012. Although the bank's risk adjusted profitability (measured by pre-provision income as a percentage of average risk-weighted assets) decreased slightly to 4.1% in 2013 compared to 4.5% in 2012, the bank's risk adjusted profitability continues to compare well with that of its peers. Ringkjøbing Landbobank has maintained an average risk-adjusted profitability of 4% between 2009 and 2013.

Core earnings (earnings excluding income on the bank's security portfolio, but including expenses paid for the Danish deposit insurance scheme and bank packages) increased 12% to DKK 448 million in 2013 compared to DKK 400 million in 2012. Before loan losses and provisions, core earnings increased 2% to DKK 571 million. The result from the security portfolio (including dividends on capital shares) decreased to DKK 36 million from DKK 48 million in 2012, resulting in pre-tax profit of DKK 472 million in 2013 up from DKK 448 million in 2012. Core earnings amounted to 95% of pre-tax profit in 2013.

Total operating expenses and depreciation (excluding the costs for the first Danish bank packages) amounted to DKK 273 million in 2013, up 3% from last year. Expenses paid for the Danish bank packages in the last three years amounted to DKK 2 million in 2013 and 2012 and 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 31.6% in 2013 (after standard adjustments), up from 30.4% 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 120 million in 2013 from DKK 157 million in 2012. Loan loss provisions amounted to 20% of pre-provision income in 2013, down from 26% in 2012, but still elevated compared to pre-crisis levels.

Return on year-end equity was 13% in 2013 which is around double the level of regional peers and largely in line with global peers. Ringkjøbing Landbobank has consistently recorded a return on equity in excess of 10% between 2009 and 2013 with a very strong leverage ratio (defined as shareholders' equity-to-total assets) averaging 14% over the same period (end-2013: 15%).

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, albeit with an improving trend.

For the three months ending March 2014, the bank reported a pre-tax profit of DKK 176 million, up DKK 53 million compared to the corresponding period the year before and primarily driven by a DKK 33 million increase in trading profit (excluding dividends on capital shares) and a DKK 14 million increase in net fees and commissions. Net interest income was up 1% to 161 million due to a lower interest margin - although this was somewhat offset by a higher volume of new loans. Core costs increased by DKK 5 million year-on-year to DKK 67 million and loan impairment charges were down by 31%, overall contributing to a net profit of DKK 136 million (Q1 2013: 91.9 million). At end-March 2014 the bank's Tier 1 capital and total capital ratios were 18.1% and 18.1%, respectively, still well above the bank's individual solvency requirement of 8.8%.

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

At end-2013 the bank had liquid assets of 28% of total assets, stable relative to end-2012. Just over 85% of the bank's funding has been in deposits over the last three years, a much higher share than the pre-crisis level of close to 50%. The share of interbank funding has similarly been reduced from close to 50% pre-crisis to 11% at end-2013.

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 so far only used this source of

funding to a limited extent.

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 8.1% of gross loans at end-2013, up from 7.3% in 2012. Ringkjøbing reported a coverage ratio (loan loss reserves as a percentage of problem loans) of 72%, down from 78% in 2012, but still reflecting one of the highest coverage ratios of the rated Danish banks.

At end-2013 around half of the bank's lending was to customers within the core region of western and central Jutland, while 4% 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 24% of lending to the wind turbine sector, 24% to private customers, 11% to real estate, 10% 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 has shrunk its loan book; the loan book contracted an average of 2% per year between 2009 and 2012. In 2013, the loan book turned around, recording 12% growth and is now above the end-2008 level. Just over half of the loan growth came from the wind turbine industry and the vast majority of the increased wind turbine lending was domestic-oriented.

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 end-2013 Ringkjøbing had total large exposures of 35.0% measured according to the Danish FSA's methodology compared with 27.2% in 2012 and 11.8% in 2011. One of the large exposures has been redeemed in 2014.

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 (11.4% 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 during the economic slowdown in light of the generally high debt levels of Danish farmers.

#### **NOTE ON DATA**

Unless noted otherwise, all figures shown in this report are sourced from the bank's latest annual and interim financial reports and our Banking Financial Metrics. These metrics are based on our own chart of account, and are adjusted for analytical purposes. Please refer to the documents entitled "Financial Statement Adjustments in the Analysis of Financial Institutions" published on 19 December 2013.

#### **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

#### Ringkjøbing 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			
<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			x				
- Controls	x						
<b>Financial Reporting Transparency</b>		<b>x</b>					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
<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>B</b>	<b>Neutral</b>
<b>Economic Stability</b>				x			
<b>Integrity and Corruption</b>	x						
<b>Legal System</b>	x						
<b>Financial Factors (50%)</b>						<b>B-</b>	
<b>Factor: Profitability</b>						<b>A</b>	<b>Neutral</b>
PPI % Average RWA (Basel II)	4.14%						
Net Income % Average RWA (Basel II)	2.37%						
<b>Factor: Liquidity</b>						<b>B-</b>	<b>Neutral</b>
(Market Funds - Liquid Assets) % Total Assets	-16.19%						
<b>Liquidity Management</b>			x				
<b>Factor: Capital Adequacy</b>						<b>A</b>	<b>Neutral</b>
Tier 1 Ratio (%) (Basel II)	19.97%						
Tangible Common Equity % RWA (Basel II)	20.17%						
<b>Factor: Efficiency</b>						<b>A</b>	<b>Neutral</b>
Cost / Income Ratio	31.86%						
<b>Factor: Asset Quality</b>						<b>D+</b>	<b>Weakening</b>
Problem Loans % Gross Loans				7.43%			
Problem Loans % (Equity + LLR)			28.91%				
<b>Lowest Combined Financial Factor Score (15%)</b>						<b>D+</b>	
<b>Economic Insolvency Override</b>						<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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