

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

Global Credit Research - 17 Feb 2012

*Ringkobing, Denmark*

**Ratings**

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits	*A3/*P-2
Bank Financial Strength	*C

\* Placed under review for possible downgrade on February 15, 2012

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**Key Indicators**

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

	[2]12-11	[2]12-10	[2]12-09	[2]12-08	[2]12-07	Avg.
Total Assets (DKK million)	17,549.0	18,247.2	17,928.0	18,001.8	19,633.7	[3]-2.8
Total Assets (EUR million)	2,361.2	2,448.6	2,409.4	2,418.5	2,633.1	[3]-2.7
Total Assets (USD million)	3,065.1	3,284.9	3,456.8	3,361.9	3,849.7	[3]-5.5
Tangible Common Equity (DKK million)	2,582.9	2,487.2	2,105.6	1,834.6	1,828.4	[3]9.0
Tangible Common Equity (EUR million)	347.5	333.8	283.0	246.5	245.2	[3]9.1
Tangible Common Equity (USD million)	451.1	447.7	406.0	342.6	358.5	[3]5.9
Net Interest Margin (%)	3.4	3.3	3.4	3.0	2.5	[4]3.1
PPI / Avg RWA (%)	3.8	3.8	3.7	2.6	2.8	[5]3.3
Net Income / Avg RWA (%)	2.2	1.9	1.7	1.5	2.2	[5]1.9
(Market Funds - Liquid Assets) / Total Assets (%)	-14.6	-5.7	-1.6	16.6	15.7	[4]2.1
Core Deposits / Average Gross Loans (%)	93.2	86.2	82.3	62.8	66.7	[4]78.2
Tier 1 Ratio (%)	19.8	18.6	16.6	13.0	11.2	[5]15.8
Tangible Common Equity / RWA (%)	19.6	18.9	15.5	12.1	11.3	[5]15.5
Cost / Income Ratio (%)	33.5	35.6	36.2	38.3	34.4	[4]35.6
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 15 February 2012, Moody's placed on review for downgrade Ringkjøbing Landbobank's C/A3 Financial Strength Rating and its A3 and Prime-2 long-term and short-term ratings. This follows Moody's announcement on the same day to place a number of European banks on review for downgrade, reflecting the multiple challenges we consider these banks face, notably (1) a weakening macroeconomic environment; (2) costly and constrained market funding; and (3) pressure on profits. These challenges may lead us to reduce our assessment of several important rating factors, notably economic stability, franchise value, risk positioning, liquidity, profitability and capital. Our current expectation is that the bank's senior debt rating may be lowered by up to three notches.

In particular, we expect that Danish sector performance will continue to be negatively affected by the country's operating environment through sluggish economic activity, stagnating credit growth and falling property prices. Danish financial institutions are also subject to funding pressure as a result of needing to refinance their government-guaranteed debt maturing in 2012-13 and weakened asset quality, which continues to lead to elevated loan impairments and depressed net profits. Given this operating environment, we remain concerned about asset quality in the coming year, specifically in real estate, lending to small- and medium-sized enterprises, agriculture, and potentially household lending. Sector efficiency has weakened, and profitability has been hit by the lack of credit turnover and higher provisioning.

As a consequence, like other European banks, Danish face immediate pressures centered on their ability to retain the confidence of investors. For more details please see our reports "Why Global Bank Ratings Are Likely To Decline In 2012", "Euro Area Debt Crisis Weakens Bank Credit Profiles" and "European Banks: How Moody's Approach Reflects Evolving Challenges", published on January 19, 2012.

### SUMMARY RATING RATIONALE

Moody's rates Ringkjøbing Landbobank A/S A3/Prime-2/C (on review for downgrade). The C bank financial strength rating (BFSR), which maps to A3 on the long-term scale, reflects the 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 A3 long-term global local currency (GLC) deposit rating does not include systemic support uplift.

#### Credit Strengths

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

#### Credit Challenges

- High borrower concentration
- Concentrated credit exposure by geography and by sector, including agriculture which has performed worse in recent years
- Increased pressure on funding following the implementation of Bank Package III
- Further integration and upgrade of risk management practices, systems and procedures
- Preserving asset quality across the economic cycle

### **Rating Outlook**

The BFSR, long-term and short-term deposit ratings are on review for downgrade. During the review we will consider the impact on the bank's standalone creditworthiness of weakening fundamentals, notably economic stability, franchise value, risk positioning, liquidity, profitability and capital, in the context of the current environment.

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

The bank's BFSR and long-term ratings are on review for downgrade. At present and over the immediate rating horizon, we therefore do not see any meaningful upwards rating pressure on the bank's standalone rating, and also on the bank's deposit ratings.

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

The BFSR and deposit rating could be downgraded following our review which will re-assess the impact of a further deteriorating of the Danish operating environment on profits, as well as considering the bank's economic stability, franchise value and risk positioning in the current environment.

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

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. Total assets amounted to DKK 17.5 billion (DKK 18.2 billion in 2010). The Group's Tier 1 and total capital ratios were 19.8% and 21.4% respectively at end-December 2011, compared with an individual solvency requirement of 8.0%.

### **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, supported by stronger capitalisation and efficiency, but restricted by our assessment of asset quality deterioration. During the review period Moody's will reassess the bank's strengths and weaknesses under the BFSR scorecard, in line with the recently published reports referenced under "Recent Credit Developments".

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 around 1%.

Ringkjøbing is a full-service bank, with a total of 13 branches including the headquarters and 254 full-time employees on average for the year 2010. 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.

A franchise value score of D+ reflects our view of the bank's regional presence, moderate nationwide position and satisfactory earnings stability. Ringkjøbing Landbobank's franchise value score of D+ may be undermined by pressures on asset quality and profitability coupled with a deteriorating macroeconomic environment as explained above. Franchise value will be one of the factors on which we will focus over the review period, particularly with a view to the longer-term sustainability of the franchise and of core 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 18 000 shareholders, 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 established risk management which, while they reflect the smaller size of the bank and relatively lower complexity of exposures, lack the sophistication of other regional players in the Nordic region.

The bank's total Value at Risk (VaR), with a 10-day holding period and 99% confidence interval, varied from possible losses of DKK2.5 million to DKK16.8 million in 2010 (0.1%-0.7% of Tier 1 capital). The bank's total interest rate risk in relation to 100 bps change in interest rates was around 0.1% of core capital in 2010. The share holdings are mainly related to a number of sector companies, which are considered strategic investments (around 9% of Tier 1 capital). The portfolio of listed shares amounted to DKK25 million in 2010, 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 which will also be re-assessed during the review period.

## 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 Profile 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 Profile on Denmark for an analysis of the country's operating environment. However, we consider that the operating environment has worsened for many European banks and during the review we will reassess the implications of the projected deterioration of the macroeconomic environment for banks operating in the Danish market.

Quantitative Factors (50%)

Factor 5: Profitability

Trend: Weakening

Ringkjøbing Landbobank reported pre-tax profit of DKK 338 million in 2010, an 11% increase from 2009 as a result of higher fee and commission income and lower loan impairment charges. The bank's riskadjusted profitability - measured by pre-provision income as a percentage of average risk-weighted assets - remained unchanged year-on-year at 3.7%, compared with 2.6% in 2008 and 2.9% in 2007 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 2010 and was largely unchanged year-on-year. Net interest income decreased 4% on the year to DKK 594 million, following a reduction in net interest margin to 3.2% (3.4% in 2009), as a result of the low interest environment and a 7% decrease in the bond portfolio. However, this was offset by a 19% surge in net fee and commission income, reflecting increased securities transaction activity and volume of assets under management. Although fee & commission income was a source of growth in 2010, this still only represented around 20% of net revenue in 2010 (16% in 2009).

Operating expenses (excluding the costs for the first Danish government support package) remained unchanged on the year, but overall profitability was boosted by a 13% decrease in loan impairment provisions (excluding provisions under the Danish support package) to DKK 138 million. Loan loss impairments accounts for 27% 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. Moody's applies a weakening trend to profitability, reflecting upward pressure on funding costs, albeit somewhat mitigated by the expiry of costs associated with banking package I (costing the bank DKK80 million in 2010). 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. In addition, we believe, there will be further pressure on the bank's profitability, given our expectation of a continued weak macro-economic environment in Denmark in the short to medium term.

Factor 6: Liquidity

Trend: Weakening

At YE2010 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 lending after a period of high growth in 2006-2007 declined since and over the 5 year period has only increased 5%. As a result the ratio of deposits to gross loans has steadily grown from around 55% in 2006 to 85% in 2010. 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 2010, the breakdown of the bank's funding structure was 75% deposit & 25% 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. This is reflected in the weakening trend that Moody's adds to the bank's C score on liquidity. The review will assess the impact of the additional pressures that the bank may face as a result of the persistent fragility of investor confidence.

#### Factor 7: Capital Adequacy

Trend: Neutral

Ringkjøbing Landbobank's capital adequacy ratios are solid and improved in 2010 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.

Ringkjøbing's Tier 1 ratio and total capital were 18.6% and 22.4% respectively at YE 2010, up from 16.6% and 20.2% from YE 2009 and substantially higher than the 8% individual solvency requirement. The bank had a capital cushion exceeding its individual requirement of DKK 1.9 billion (equivalent to 9.8% of total credit exposures). The Tier 1 ratio without hybrid capital was 17.1% at YE 2010.

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 2010, unchanged year-on-year. Although both net revenue decreased, operating expenses fell as well, effectively cancelling each other out.

Ringkjøbing, similar to other Danish banks, has had to bear the costs of participating in the Danish government guarantee scheme and support mechanism. For 2010, the total cost including monthly guarantee commission and provision for the guarantee amounted to DKK80 million.

The bank scores A for efficiency, but adds a weakening trend in the expectation of increasing costs over time related to IT and management information systems.

#### Factor 9: Asset Quality

Trend: Weakening

Problem loans (defined as gross loans subject to individual impairment) accounted for 6.2% of gross loans at YE2010, up from 5.0% at YE2009. Ringkjøbing reported a coverage ratio (loan loss reserves % problem loans) of 66% which is down from 69% in 2009, but still remains one of the highest coverage ratios of the rated Danish banks. Approximately 32% of the bank's loan and guarantee portfolio reflects private customers, around 19% to wind turbines, almost 11% to agriculture and the remainder to other corporates. Moody's views earnings driven by corporate and specialised lending as less predictable in the long term than earnings from retailbased 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.

Moody's notes that historically rapid loan growth can increasingly pose a challenge for the bank's asset quality going forward; the bank's loan book increased 26% in 2006 and 10% in 2007. During the financial crisis the loan growth has slowed significantly (+1% in 2010, -5% in 2009, -1% in 2008), but Moody's remain cautious about the asset quality of loans granted during the peak of the economic cycle in 2007 and 2006.

Ringkjøbing 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, Ringkjøbing is in the "E" concentration bucket.

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.

The score of D+ 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 A3 (on review for downgrade), with stable outlook. The rating is equal to the bank's A3 BCA and does not include systemic support uplift.

### **Foreign Currency Deposit Rating**

Ringkjøbing Landbobank's A3 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. A 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>
<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>C+</b>	
<b>Factor: Profitability</b>						<b>C+</b>	<b>Weakening</b>
<b>PPI / Average RWA - Basel II</b>		3.34%					
<b>Net Income / Average RWA - Basel II</b>			1.70%				
<b>Factor: Liquidity</b>						<b>C</b>	<b>Weakening</b>
<b>(Mkt funds-Liquid Assets) / Total Assets</b>			4.53%				
<b>Liquidity Management</b>			<b>x</b>				
<b>Factor: Capital Adequacy</b>						<b>A</b>	<b>Neutral</b>
<b>Tier 1 Ratio - Basel II</b>	16.07%						
<b>Tangible Common Equity / RWA - Basel II</b>	15.51%						
<b>Factor: Efficiency</b>						<b>A</b>	<b>Weakening</b>
<b>Cost / Income Ratio</b>	36.84%						
<b>Factor: Asset Quality</b>						<b>D+</b>	<b>Weakening</b>

<b>Problem Loans / Gross Loans</b>				5.01%			
<b>Problem Loans / (Equity + LLR)</b>			26.31%				
<b>Lowest Combined Score (15%)</b>						<b>D+</b>	
<b>Economic Insolvency Override</b>						<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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