

## CREDIT OPINION

16 December 2016

Update

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### RATINGS

#### Ringkjøbing Landbobank A/S

|                   |                                |
|-------------------|--------------------------------|
| Domicile          | Ringkøbing, Denmark            |
| Long Term Deposit | A1                             |
| Type              | LT Bank Deposits - Fgn<br>Curr |
| Outlook           | Stable                         |

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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# Ringkjøbing Landbobank A/S

## Update to Discussion of Key Credit Factors

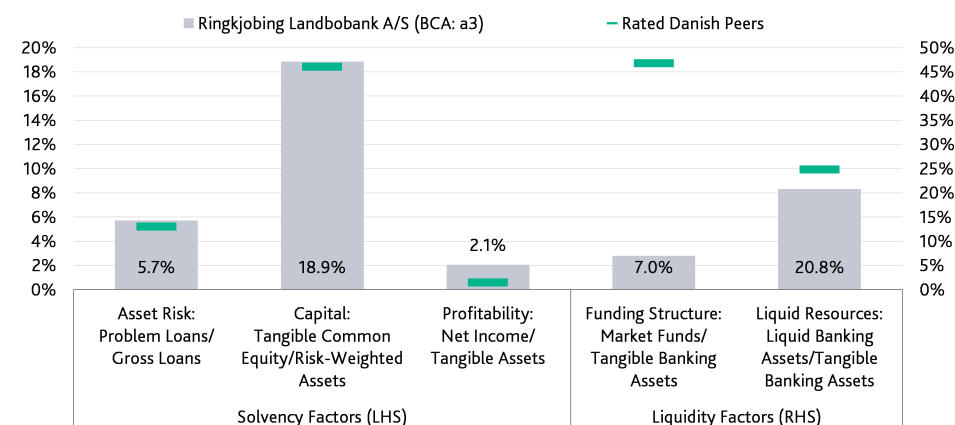
### Summary Rating Rationale

We assign an A1 / Prime-1 deposit rating to Ringkjøbing Landbobank on the back of an a3 baseline credit assessment (BCA). We also assign a long-term and short-term Counterparty Risk Assessment (CR Assessment) of Aa3(cr) / P-1(cr) to Ringkjøbing Landbobank. Ringkjøbing Landbobank's standalone a3 BCA reflects primarily our expectation that the bank's high and resilient profitability, as demonstrated throughout the financial crisis, and strong capitalisation, position it well to cope with any deterioration in the operating environment or the challenges arising from the low interest rate environment and the still elevated level of problem loans.

The bank's A1 deposit ratings takes into account the Advanced Loss Given Failure (LGF) analysis of the bank's own volume of debt and deposits and securities subordinated to them in our creditor hierarchy. Our Advanced LGF analysis of Ringkjøbing Landbobank's own volume of debt and deposits and securities subordinated to them indicates a very low loss given failure for depositors, resulting in a two-notch uplift to the deposit ratings from the bank's BCA. We continue to believe the probability of government support for Ringkjøbing Landbobank's long-term deposits is low and therefore do not add further support uplift.

Exhibit 1

### Financial Profile Key Indicators as of Dec 2015



Source: Moody's Banking Financial Metrics

## Credit Strengths

- » Ringkjøbing Landbobank's BCA is supported by its "Strong+" macro profile
- » 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

## Credit Challenges

- » Elevated problem loan level and somewhat concentrated loan book by geography and industry
- » Low probability of government support resulting in no uplift from BCA for deposits

## Rating Outlook

The outlook on all ratings is stable.

## Factors that Could Lead to an Upgrade

- » Upward pressure on the ratings could develop from improved asset quality metrics, especially in relation to more volatile segments such as agriculture.

## Factors that Could Lead to a Downgrade

- » Downward pressure on the ratings could emerge if asset quality or capital metrics deteriorate, profitability reduces or the bank's reliance on market funding increases from the current low level.

## Key Indicators

Exhibit 2

### Ringkjøbing Landbobank A/S (Consolidated Financials) [1]

|  | 9-16 <sup>2</sup> | 12-15 <sup>2</sup> | 12-14 <sup>2</sup> | 12-13 <sup>3</sup> | 12-12 <sup>3</sup> | Avg.              |
|--|-------------------|--------------------|--------------------|--------------------|--------------------|-------------------|
| Total Assets (DKK million)                                       | 23,882.0          | 22,317.4           | 21,237.9           | 19,582.8           | 17,681.5           | 7.8 <sup>4</sup>  |
| Total Assets (EUR million)                                       | 3,207.3           | 2,990.6            | 2,852.1            | 2,624.9            | 2,369.9            | 7.9 <sup>4</sup>  |
| Total Assets (USD million)                                       | 3,604.3           | 3,248.6            | 3,451.2            | 3,617.0            | 3,124.4            | 3.6 <sup>4</sup>  |
| Tangible Common Equity (DKK million)                             | 3,458.9           | 3,293.8            | 3,098.4            | 2,900.9            | 2,675.9            | 6.6 <sup>4</sup>  |
| Tangible Common Equity (EUR million)                             | 464.5             | 441.4              | 416.1              | 388.8              | 358.7              | 6.7 <sup>4</sup>  |
| Tangible Common Equity (USD million)                             | 522.0             | 479.5              | 503.5              | 535.8              | 472.9              | 2.5 <sup>4</sup>  |
| Problem Loans / Gross Loans (%)                                  | -                 | 5.7                | 6.7                | 8.1                | 7.3                | 6.9 <sup>5</sup>  |
| Tangible Common Equity / Risk Weighted Assets (%)                | 19.1              | 18.9               | 19.5               | 19.5               | 20.1               | 19.1 <sup>6</sup> |
| Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%) | -                 | 24.5               | 27.3               | 31.6               | 27.9               | 27.8 <sup>5</sup> |
| Net Interest Margin (%)  | 2.9               | 2.9                | 3.1                | 3.4                | 3.5                | 3.2 <sup>5</sup>  |
| PPI / Average RWA (%)  | 4.0               | 3.9                | 4.4                | 4.1                | 4.4                | 4.1 <sup>6</sup>  |
| Net Income / Tangible Assets (%)                                 | 2.3               | 2.1                | 2.1                | 1.8                | 1.9                | 2.0 <sup>5</sup>  |
| Cost / Income Ratio (%)  | 29.7              | 32.1               | 30.7               | 31.7               | 30.6               | 31.0 <sup>5</sup> |
| Market Funds / Tangible Banking Assets (%)                       | 5.8               | 7.0                | 10.3               | 10.4               | 9.0                | 8.5 <sup>5</sup>  |
| Liquid Banking Assets / Tangible Banking Assets (%)              | 24.5              | 20.8               | 25.0               | 27.4               | 27.4               | 25.0 <sup>5</sup> |

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

|                                    |       |       |       |       |       |                    |
|------------------------------------|-------|-------|-------|-------|-------|--------------------|
| Gross loans / Due to customers (%) | 101.3 | 107.4 | 106.4 | 104.1 | 102.4 | 104.3 <sup>5</sup> |
|------------------------------------|-------|-------|-------|-------|-------|--------------------|

[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

Source: Moody's Financial Metrics

## Detailed Rating Considerations

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

Ringkjøbing 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 in Denmark, 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.

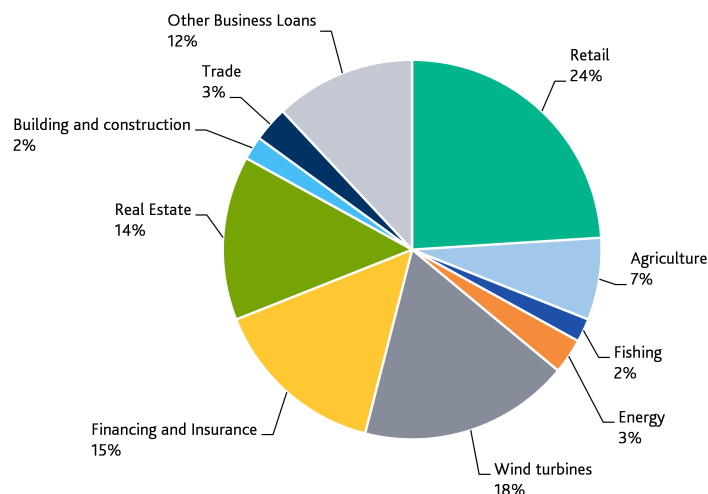
### ELEVATED PROBLEM LOAN LEVEL AND SOMEWHAT CONCENTRATED LOAN BOOK BY INDUSTRY AND GEOGRAPHY

Our assigned ba2 Asset Risk score indicates that overall, asset risk remains a relative weakness for Ringkjøbing Landbobank. Ringkjøbing Landbobank's continued elevated level of problem loans both relative to pre-crisis levels and to similarly highly rated peers across Europe remains a key weakness for the bank. We note, however, that more recently, the trend has been positive with problem loans (defined as gross loans subject to individual impairment) decreasing to 5.6% at the end of September 2016 from 5.7% of gross loans at end-2015 (6.7% in 2014). The bank reported a coverage ratio (loan loss reserves as a percentage of problem loans) of 90% at end-December 2015, up from 85% at end-December 2014, the highest coverage ratio of the rated Danish banks. At the end of September 2016 results showed a stable level of non-performing loans (a narrower definition than problem loans including only loans with suspended calculation of interest) at 0.4% of total lending (unchanged from end-2015).

At end-2015, around 40% of the bank's lending was to customers within the core region of western and central Jutland, while 9% 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 18% of lending to the wind turbine sector, 24% to private customers, 14% to real estate, 15% to finance companies, almost 7% to agriculture, and the remainder to other corporates. We note that the bank has allocated considerable provisions for write-downs on agriculture, in particular.

Between 2010 and 2012, Ringkjøbing Landbobank's loan book decreased by on average 2% per year. In 2013, 2014 and 2015 loan growth turned around, recording 12% growth in 2015 so that the loan book is now above the end-2008 level. When excluding DKK283 million in reverse transactions, the increase in the bank's loan book was 14% for 2015. Although at a lower rate compared to 2015, during the first nine months of 2016 the bank's loan book portfolio maintained its growing trend increasing by 1.6% (from December 2015).

Exhibit 3

**Breakdown of Ringkjøbing Landbobank's loan portfolio by sector at end-2015**

Source: Moody's, company reports

Ringkjøbing Landbobank operates in, and is supportive to, a small 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 the end of September 2016, Ringkjøbing Landbobank had total large exposures of 33.5% of the bank's capital measured, according to the Danish FSA's methodology, compared with 63.4% at end- 2015.

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 real estate market (14.3% of the loan book at the end of September 2016) is more limited than that of many other Danish regional banks. However, the bank does have some exposures to the real estate market in Germany, and its exposure to the agricultural sector could continue to 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/CRD IV standardised method in calculating risk-weighted assets.

Ringkjøbing Landbobank reports strong capital metrics: Its Common Equity Tier 1 (CET1) capital ratio was 17.0% at the end of September 2016 and 17.1% in December 2015 (17.5% at end-2014). The bank's ratio of tangible common equity to risk-weighted assets stood at 19.1% (18.9% at end-December 2015), which is significantly higher than the levels recorded by most of the bank's Nordic peers.

The bank's individual solvency need as calculated according to the Danish 8+ model was 9.1% at the end of September 2016 (9.0% at end-2015). 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.

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 a ratio of tangible common equity to total assets of 14.5% at end-September 2016 and 14.8% at end-December 2015 (14.6% at end-December 2014), which is significantly higher than the 4%-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 reflects the bank's high profitability levels and strong track record of delivering bottom-line results. We note that the bank's high profitability and strong track record point to a strong capacity to absorb losses through earnings and internal capital generation. During the first nine months of 2016 Ringkjøbing Landbobank reported a return on assets of 2.3% and a return on equity of 16.2% (2.1% and a return on equity of 14.5% at the end of 2015). Although the very low interest rates in Denmark create some uncertainty regarding the bank's future earnings, we note that the bank's very high cost efficiency, with a cost-to-income ratio of 29.7% for the first nine months of 2016 and 32% at the end of 2015, adds resilience to profitability.

For the first nine months of 2016, Ringkjøbing Landbobank's pre-tax profits of DKK497 million, increased by 11% (compared to the same period last year), mostly as a result of the reduction in impairment charges. The bank's risk-adjusted profitability (measured as pre-provision income as a percentage of average risk-weighted assets) was 4% in September 2016 and 3.9% in 2015 (4.4% in 2014) but still compares well with its Danish peers.

Further, Ringkjøbing Landbobank's remains one of Denmark's most efficient banks, with a 29.7% cost-to-income ratio in the first nine months of 2016 (measured as operating income divided by operating expenses) in 2015 (2015: 32%). In our view, the bank's lean and low-cost business model remains a key driver for its high risk-adjusted profitability compared with that of regional peers.

Loan losses and provisions decreased to DKK36 million in the first nine months of 2016 from the reported DKK44 million in September 2015 (DKK60 million in 2015). Loan loss provisions amounted to 7% of pre-provision income in September 2016 down from 9% in September and December 2015, but remain somewhat elevated compared with pre-crisis levels.

Return on year-end equity increased to 16.2% in September 2016 (from 14.5% in December 2015), which is around double the level of regional peers and compares favourably with that of global peers. Ringkjøbing Landbobank consistently recorded a return on equity in excess of 11% between 2010 and 2015 with a very strong leverage ratio (defined as tangible common equity to total assets) averaging 14% over the same period. At the end of September 2016, the leverage ratio was 14.5%.

## PRIMARILY DEPOSIT-FUNDED, WITH GOOD LIQUIDITY

Our Funding Structure score indicates that the overall funding profile remains a modest fundamental strength for Ringkjøbing Landbobank, owing to the relatively low dependence on more confidence-sensitive wholesale funding.

Market funding accounted for 5.8% of the bank's tangible banking assets at end-September 2016 and 7% at the end of December 2015 (just over 10% at end of December 2014) and has been relatively stable since 2011. Over 90% of the bank's funding was in deposits in the first nine months of 2016 (compared with a the pre-crisis level of close to 50%) and has been relatively stable in recent years. The share of interbank funding has been reduced from close to 50% pre-crisis to 7% at the end of September 2016. 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.

At end-September 2016, liquid assets accounted for 24.5% of total assets and 20.8% at December 2015 (around 25% at December 2014), which has been relatively stable in recent years. At the end of September 2016, Ringkjøbing Landbobank reported a liquidity coverage ratio of 200% and thereby met the requirement of 100% to be met by 1 October 2015 by Danish systemically important financial institution banks (although Ringkjøbing Landbobank is not a systemically important financial institution bank).

## Notching Considerations

### Affiliate Support

### Loss Given Failure

Ringkjøbing Landbobank is subject to the EU Bank Recovery and Resolution Directive, 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 26% 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.

The bank's A1 deposit ratings take into account the LGF analysis of the bank's own volume of debt and deposits and securities subordinated to them in our creditor hierarchy. Our Advanced LGF analysis of Ringkjøbing Landbobank's own volume of debt and deposits and securities subordinated to them indicates a very low loss-given-failure for depositors, resulting in a two-notch uplift to the deposit ratings from the bank's BCA.

### Government Support

The implementation of the EU Bank Recovery and Resolution Directive 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.

### COUNTERPARTY RISK (CR) ASSESSMENT

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Ringkjøbing Landbobank's CR Assessment is positioned at Aa3(cr)/Prime-1(cr). The CR Assessment is positioned three notches above the adjusted BCA of a3, based on the substantial cushion against default provided to the senior obligations represented by the CR Assessment by subordinated instruments. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, thereby focusing purely on subordination and taking no account of the volume of the instrument class.

### OUTPUT OF THE BASELINE CREDIT ASSESSMENT SCORECARD

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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 Methodology and Scorecard Factors

Exhibit 4

### Ringkjøbing Landbobank A/S

#### Macro Factors

|                               |                 |             |
|-------------------------------|-----------------|-------------|
| <b>Weighted Macro Profile</b> | <b>Strong +</b> | <b>100%</b> |
|-------------------------------|-----------------|-------------|

#### Financial Profile

| Factor  | Historic Ratio | Macro Adjusted Score | Credit Trend | Assigned Score | Key driver #1                     | Key driver #2              |
|---|----------------|----------------------|--------------|----------------|-----------------------------------|----------------------------|
| Solvency  |                |                      |              |                |                                   |                            |
| Asset Risk                                      |                |                      |              |                |                                   |                            |
| Problem Loans / Gross Loans                     | 6.8%           | ba1                  | ↓            | ba2            | Sector concentration              | Geographical concentration |
| Capital   |                |                      |              |                |                                   |                            |
| TCE / RWA                                       | 19.1%          | aa2                  | ← →          | aa2            | Risk-weighted capitalisation      |                            |
| Profitability                                   |                |                      |              |                |                                   |                            |
| Net Income / Tangible Assets                    | 2.1%           | aa2                  | ↓            | aa3            | Return on assets                  |                            |
| Combined Solvency Score                         |                | a2                   |              | a3             |                                   |                            |
| Liquidity                                       |                |                      |              |                |                                   |                            |
| Funding Structure                               |                |                      |              |                |                                   |                            |
| Market Funds / Tangible Banking Assets          | 7.0%           | aa3                  | ← →          | aa3            | Extent of market funding reliance |                            |
| Liquid Resources                                |                |                      |              |                |                                   |                            |
| Liquid Banking Assets / Tangible Banking Assets | 20.8%          | baa1                 | ← →          | baa1           | Stock of liquid assets            |                            |
| Combined Liquidity Score                        |                | a2                   |              | a2             |                                   |                            |
| Financial Profile                               |                |                      |              | a3             |                                   |                            |
| Business Diversification                        |                |                      |              | 0              |                                   |                            |
| Opacity and Complexity                          |                |                      |              | 0              |                                   |                            |
| Corporate Behavior                              |                |                      |              | 0              |                                   |                            |
| Total Qualitative Adjustments                   |                |                      |              | 0              |                                   |                            |
| Sovereign or Affiliate constraint:              |                |                      |              | Aaa            |                                   |                            |
| Scorecard Calculated BCA range                  |                |                      |              | a2-baa1        |                                   |                            |
| Assigned BCA                                    |                |                      |              | a3             |                                   |                            |
| Affiliate Support notching                      |                |                      |              | 0              |                                   |                            |
| Adjusted BCA                                    |                |                      |              | a3             |                                   |                            |

| Balance Sheet                            | in-scope (DKK million) | % in-scope | at-failure (DKK million) | % at-failure |
|--|------------------------|------------|--------------------------|--------------|
| Other liabilities                        | 4,468                  | 18.7%      | 6,337                    | 26.5%        |
| Deposits                                 | 18,326                 | 76.7%      | 16,457                   | 68.9%        |
| Preferred deposits                       | 13,561                 | 56.8%      | 12,883                   | 53.9%        |
| Junior Deposits                          | 4,765                  | 20.0%      | 3,574                    | 15.0%        |
| Senior unsecured bank debt               |                        |            |                          |              |
| Dated subordinated bank debt             | 372                    | 1.6%       | 372                      | 1.6%         |
| Junior subordinated bank debt            |                        |            |                          |              |
| Preference shares (bank)                 |                        |            |                          |              |
| Senior unsecured holding company debt    |                        |            |                          |              |
| Dated subordinated holding company debt  |                        |            |                          |              |
| Junior subordinated holding company debt |                        |            |                          |              |
| Preference shares (holding company)      |                        |            |                          |              |
| Equity                                   | 717                    | 3.0%       | 717                      | 3.0%         |
| Total Tangible Banking Assets            | 23,882                 | 100%       | 23,882                   | 100%         |

| Debt class                   | De jure waterfall                 |                | De facto waterfall                |                | Notching |          | LGF notching guidance versus BCA | Assigned LGF notching | Additional notching | Preliminary Rating Assessment |
|------------------------------|-----------------------------------|----------------|-----------------------------------|----------------|----------|----------|----------------------------------|-----------------------|---------------------|-------------------------------|
|                              | Instrument volume + subordination | Sub-ordination | Instrument volume + subordination | Sub-ordination | De jure  | De facto |                                  |                       |                     |                               |
| Counterparty Risk Assessment | 19.5%                             | 19.5%          | 19.5%                             | 19.5%          | 3        | 3        | 3                                | 3                     | 0                   | aa3 (cr)                      |
| Deposits                     | 19.5%                             | 4.6%           | 19.5%                             | 4.6%           | 2        | 2        | 2                                | 2                     | 0                   | a1                            |

| Instrument Class | Loss Given Failure notching | Additional notching | Preliminary Rating Assessment | Government Support notching | Local Currency rating | Foreign Currency rating |
|------------------|-----------------------------|---------------------|-------------------------------|-----------------------------|-----------------------|-------------------------|
|                  |                             |                     |                               |                             |                       |                         |
| Deposits         | 2                           | 0                   | a1                            | 0                           | A1                    | A1                      |

Source: Moody's Financial Metrics

## Ratings

Exhibit 5

| Category                            | Moody's Rating  |
|-------------------------------------|-----------------|
| <b>RINGKJOBING LANDBOBANK A/S</b>   |                 |
| Outlook                             | Stable          |
| Bank Deposits                       | A1/P-1          |
| Baseline Credit Assessment          | a3              |
| Adjusted Baseline Credit Assessment | a3              |
| Counterparty Risk Assessment        | Aa3(cr)/P-1(cr) |

Source: Moody's Investors Service



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