

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

**Ringkjøbing Landbobank A/s**

Denmark

**Ratings**

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A1/P-1
Bank Financial Strength	C+

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**Key Indicators**

**Ringkjøbing Landbobank A/s**

	[1]2007	2006	2005	2004	2003	Avg.
Total assets (DKK billion)	19.63	17.27	13.36	9.46	7.53	[2]27.06
Total assets (EUR billion)	2.63	2.32	1.79	1.27	1.01	--
Total capital (DKK billion)	2.25	2.19	1.72	1.37	1.15	[2]18.24
Return on average assets	1.93	2.82	2.32	2.52	--	2.40
Recurring earnings power [3]	2.46	3.29	3.12	3.63	--	3.13
Net interest margin	2.75	2.87	3.12	4.03	--	3.19
Cost/income ratio (%)	34.54	29.25	34.77	37.42	32.64	33.72
Problem loans % gross loans	0.09	0.16	0.34	0.25	0.41	0.25
Tier 1 ratio (%)	11.20	10.40	11.60	12.20	15.10	12.10

[1] As of December 31. [2] Compound annual growth rate. [3] Preprovision income % average assets

**Opinion**

**SUMMARY RATING RATIONALE**

Moody's assigns a C+ Bank Financial Strength Rating (BFSR) to Ringkjøbing Landbobank A/S, which translates into Baseline Credit Assessment (BCA) of A2. The rating reflects the Danish bank's strong intrinsic financial strength and solid regional presence. It also takes into account the challenges facing the bank such as borrower concentration and exposure to selected niche sectors.

Ringkjøbing Landbobank is among the 15 largest banking groups in Denmark. Headquartered in Ringkøbing in western Denmark, the bank is a full-service regional bank, and has a total of 16 branches and around 280 full-time employees. The bank's core operations concentrate on retail, SME and corporate banking as well as specialised/niche products, in particular financing of wind turbines and private banking.

Moody's believes that the probability of systemic support for Ringkjøbing Landbobank in case of need is moderate, given its strong regional franchise, which results in a one-notch uplift in the deposit ratings to A1/Prime-1 from the A2 BCA. Thus the deposit and debt ratings of Ringkjøbing Landbobank incorporate three elements: (1) the bank's BFSR of C+, (2) Moody's assessment of a moderate probability of systemic support (a component of Joint-Default Analysis, referred to as JDA), and (3) the seniority of its deposits and debt.

**Credit Strengths**

- Strong local brand in western Jutland region
- Stable and healthy earnings from core operations
- High operating efficiency
- Good asset quality
- Solid capitalisation

### **Credit Challenges**

- Maintaining profitability levels
- High borrower concentration
- Concentrated credit exposure to electricity production by wind turbines and also to other niche sectors
- Reducing reliance on interbank funding
- Further integration and upgrade of risk management practices
- Preserving good asset quality across the economic cycle

### **Rating Outlook**

All the ratings of Ringkjøbing Landbobank have a stable outlook.

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

The BFSR could enjoy positive rating pressure if there was an improvement in the bank's risk positioning including a reduction in borrower concentration and an improvement in both liquidity and risk management practices. However, given the bank's current rating profile we do not see an upgrade of the BFSR likely in the medium term. The global local currency (GLC) deposit rating could be upgraded if the BFSR were upgraded.

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

A downgrade of Ringkjøbing Landbobank's BFSR would likely be triggered by any material franchise erosion, increase in either market or credit risk appetite, any problems with large exposures or a softening of its current strong financial fundamentals to less than a B score. The GLC deposit rating could be downgraded if the probability of systemic support were to decrease or if the BFSR were to be downgraded.

### **Recent Results and Developments**

In the first quarter of 2008 the bank's core earnings decreased by 4% to DKK119 million (EUR 16 million) from the same period in 2007. The result was affected by lower fee and commission income as well as significantly lower trading income. On the other hand, the bank has been able to retain its high cost efficiency demonstrated by the cost-income ratio of 33%. Pre-tax profit increased by 6% and was positively affected by a profit of DKK32 million related to the bonus agreement connected to the sale of Totalkredit shares. The value of the bond portfolio and listed shares decreased. Credit quality has remained good resulting write-backs in loan loss provisions although smaller than in the same period last year. We also note that in the first quarter of 2008, the loan book has remained stable compared to year-end 2007. Capital adequacy is strong demonstrated by the Tier 1 ratio of 11.6% and the total capital ratio of 13.4%.

As regards funding, deposits still represent about 50% of total funding although the proportion has been decreasing over the past years. At end-March 2008 interbank funding maturing in less than 12 months matched liquid assets of the bank. At end-March 2008, liquid assets represent over 20% of the balance sheet.

### **DETAILED RATING CONSIDERATIONS**

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

#### **Bank Financial Strength Rating**

Ringkjøbing Landbobank's C+ BFSR is primarily underpinned by the bank's solid financial fundamentals - in

particular, good profitability that is higher than its peers, although risk-weighted recurring earning power in 2007 was not as high as in the previous years. Other strengths are high operating efficiency and the bank's solid regional positioning. The BFSR is constrained by the bank's limited national market share, high credit risk concentration, above-average loan growth in 2006 and 2005, leading to a less seasoned loan portfolio, as well as concentrations in financing niche sectors.

Moody's believes the assigned C+ rating is an appropriate measure of the bank's intrinsic financial strength, given still strong financials and the continuing good operating and regulatory environments in Denmark.

As a point of reference, the assigned rating of C+ is in line with the outcome of Moody's bank financial strength scorecard.

#### Qualitative Factors (50%)

##### Factor 1: Franchise Value

Trend: Neutral

Ringkjøbing Landbobank is a regional bank and among the 15 largest banking groups in Denmark in terms of assets. Headquartered in Ringkjøbing, its main region of operation is central and western Jutland. At the end of 2007, the bank held a market share of over 40% for both corporate and retail lending in western Jutland. Overall, the bank enjoys a well-established market position in its region, but also lacks geographical diversification - Ringkjøbing Landbobank's country-wide market share in retail lending is estimated to be close to 1%. In addition, Moody's notes that, although the area in which the bank operates is the largest local government area in Denmark in terms of size, the population is sparse and also competitive pressure is strong.

It is a full-service bank, with a total of 16 branches, and around 280 full-time employees at year-end 2007. The bank's core operations can be divided into two business areas. The first is banking in the local area of central and western Jutland, for which 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. The second is banking in niche areas concentrating on financing of wind turbines, private banking/asset management, financing doctors in private practices, first-priority financing of lending properties, primarily in Germany, and financing purchases of vacation homes, outside Denmark.

Around 55% of the bank's loan portfolio is classified as retail (includes some SMEs), 14% is corporate, and the remainder is specialised lending, including financing for wind turbines (14% of the loan portfolio), most of which carry state guarantees. 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 fares well in comparison to its domestic peers.

A franchise value score of D+ reflects our view of the bank's strong regional presence, moderate nationwide position and satisfactory earnings stability.

##### Factor 2: Risk Positioning

Trend: Neutral

Ringkjøbing Landbobank has no corporate governance issues and operates in accordance with the general guidelines set forth by the OMX Nordic Exchange Copenhagen. The bank is owned by over 18,000 shareholders (most of which are customers), with Denmark's largest pension fund, ATP, its largest shareholder, owning a stake of over 5%. Approximately 70% of the share capital is owned by private investors, approximately 20% is owned by Danish institutional investors, and foreign institutional investors own approximately 10%. Under the bank's Articles of Association, "a shareholding of up to and including nom. DKK500 carries one vote, and shareholdings exceeding that level carry two votes". These limitations would make a hostile takeover extremely difficult; however, this protection has not led to a relaxed management style or a departure from its prudent risk management.

The information in the annual and quarterly accounts is in line with other regional Nordic banks and we note that the level of information on risk and asset quality has improved.

Although the bank has an independent Chief Risk Manager, and risk management practices are adequate for the level and type of risk in the bank, the risk systems and procedures lack the sophistication of other regional players in the Nordic region. In addition, operating in and being supportive to its small operating region means that the bank has relatively large customer exposures when compared to its European peers. The 20 largest exposures represent over 150% of Tier 1 capital but Moody's notes that concentrations are mitigated by prudent collateral. There is also some industry concentration in the loan portfolio but we note that several of these exposures would not be deemed corporate exposures under the Basel II framework. The two largest industry sectors are investment credits (15% of loans at year-end 2007) and wind turbines (14%). As regards wind turbines, the bank has over 20 years' experience in financing for wind turbines and there have not occurred any losses so far. Agricultural loans include loans to cattle farming, pig farming and mink farming. We also note that the exposure to real estate is

relatively small - 6% of the loan portfolio.

Loans to private customers account for around 45% of Ringkjøbing Landbobank's loan portfolio. As with most Danish regional and local banks, Ringkjøbing Landbobank can transfer its mortgage loans to the specialised mortgage lenders Totalkredit/Nykredit and DLR. Before mortgages were guaranteed for eight years by the originating bank for loan-to-value ratios over 60%. In return for the loss guarantee, Totalkredit paid commissions to the originating bank. However, from 1 April 2008 Ringkjøbing Landbobank has converted this guarantee to an agreement with Totalkredit in which loan losses will be set off by commissions earned by the bank. It is important to note that the agreement is limited to set-off of commissions. The new agreement is not limited to eight years per loan, but will remain in place until the loan matures. This change resulted in a release of DKK 1.2 billion from loss guarantees given to Totalkredit.

The bank's liquid assets amounted to DKK4.3 billion, a decrease from DKK5.3 billion at year-end 2007. However, liquid assets as a percentage of total assets has remained pretty stable at over 20%. In addition, the bank has committed credit facilities worth DKK1.4 billion, which are not normally used. The bank's bond portfolio of DKK730 million at end-March 2008 includes mainly Danish bonds and its shareholdings are valued at DKK244 million consist largely of strategic stakes.

The bank's funding structure is divided between customer deposits, more than 50% of total funding, interbank funding almost 45% and long-term market funding 5%. Of the interbank funding, almost half matures after one year. The level of interbank funding with a maturity of less than one year has been decreasing but remains high and may add some volatility to the bank's overall funding structure. The bank has satisfactory liquidity management by showing a positive figure of outflows in the form of scheduled payments and inflows over 12 months, with non-access to the capital market being covered by liquid assets, a repoable securities portfolio and un-drawn committed back-up lines. Under this stress scenario, the loan portfolio remains unchanged. However, Moody's will continue to monitor the bank's efforts to shift its funding structure towards more long-term funding.

The bank started developing and using a Value at Risk (VaR) model in 2007. Its total VaR, a statistical measurement of market risk, with a 10-day holding period and 99% confidence interval, varied from possible losses of DKK4.9 million to DKK14.6 million in 2007. Although according to the bank's own calculations the market risk is low, in Moody's opinion the bank's VaR measure lacks a track record and we therefore take a conservative view with regard to it. We also note that the diversification gain due to spreading the risk across various asset classes is quite high, which reduces the bank's VaR considerably. The bank's total interest rate risk in relation to 100 bps change in interest rates was DKK16 million at year-end 2007 or 1% of Tier 1 capital. Currency risk of the bank is negligible.

The score for risk positioning is C and is constrained by high credit risk concentration.

### 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 Outlook 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 Outlook on Denmark for an analysis of the country's operating environment.

### Quantitative Factors (50%)

#### Factor 5: Profitability

Trend: Neutral

Ringkjøbing Landbobank's core earnings before write-downs for 2007 increased by 15% to DKK462 million and reflected good volume growth in lending and increasing fee and commission income which is mainly derived from pension and asset management operations. However, in the first quarter of 2008 the growth has slowed down and core earnings were at the same level compared to 2007. Net interest income continued to increase - by 8% in Q1 2008 vs. Q1 2007 - but fee and commission income decreased. Loan growth has also slowed down in the first three months of 2008.

Ringkjøbing Landbobank's pre-tax profit for 2007 declined more than 20% from 2006 which was due to value adjustments in the bank's investment portfolio and a lower reversal of provisions. It is also important to note that

the sale of the last part of Totalkredit's shares had a positive impact on the results for 2006 of DKK31 million. Also in the first quarter of 2008, pre-tax income was positively affected by value adjustment related to the bonus agreement connected to the sale of Totalkredit shares.

At year-end 2007, the bank's risk-adjusted profitability measured by pre-provision income as a percentage of risk-weighted assets stood at 2.9% and has been steadily declining since 2004 when it was 3.6%; however, it still compares well to that of its peers. Net interest income is the most important component of earnings representing close to 70% of operating income. Lower profitability therefore reflects declining net interest margins - 2.8% in 2007 compared to 4.0% in 2004. The pressure on net interest margins has been somewhat mitigated by the bank's expanding loan book but in the near future we expect to see slower loan growth which combined with higher lending costs could put pressure on profitability. In the recent years Ringkjøbing Landbobank's profitability has also been supported by the sale of niche products which have relatively low overhead costs. In addition, there have been positive loan loss provisions in the past three years, although write-backs have started to decrease.

Overall, we believe the B+ score is an adequate representation of the bank's profitability.

#### Factor 6: Liquidity

Trend: Neutral

Over 20% of the bank's total assets are 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 Totalkredit/Nykredit and DLR. The loans funding by the specialized mortgage lender will not show on the banks balance as they are transferred to the mortgage lenders.

The bank's funding structure at year-end 2007 is divided between customer deposits (53% of total funding), interbank funding (43%) and long-term market funding (4%). The interbank funding can be further divided into money market operations and bilateral credits maturing within 1 year (58% of interbank funding) and bilateral credits with a maturity over 1 year (42%).

In 2007, the deposit growth considerably outpaced the loan growth, at 30% and 10% respectively. This is a different picture from the previous three years, when the loan growth ranged from almost 40% to 25% and the deposit growth from 12% to 22%. In the first three months of 2008 however, the deposits decreased by 6% and loan portfolio remained close to year-end level.

The bank is currently working on diversifying its funding profile. Moody's will continue to monitor the existing funding trends of Ringkjøbing Landbobank, especially considering the volatility of interbank funds.

Moody's views a score of C- as appropriate for the bank's liquidity.

#### Factor 7: Capital Adequacy

Trend: Neutral

The bank's capital adequacy ratios have been stable over recent years, partly helped by a DKK200 million hybrid core capital loan issued in 2005 and a DKK300 million subordinated loan issued in 2006.

The total capital and Tier 1 ratios were 13.4% and 11.6%, respectively at end-March 2008, compared to 12.3% and 10.4% at year-end 2006. The Tier 1 ratio without hybrid capital was 10.4% at end-March 2008.

Under the new capital adequacy rules under the Basel II framework Ringkjøbing Landbobank has in 2007 experienced a relief in its risk-weighted assets due to (a) a lower risk weight of retail customers, (b) security in financial collaterals (credit risk reducing method - financial collaterals), and (c) a lower risk weight of loans with collateral in private homes. In addition, the bank expects further reliefs in 2008, when the new rules are fully implemented. Ringkjøbing Landbobank has also used its option to end the agreement with Totalkredit on providing loss guarantees which will lead to a further reduction in the bank's risk-weighted assets in 2008.

The bank scores A for capital adequacy but when the Tier 1 ratio is adjusted for hybrid capital the score becomes B+.

#### Factor 8: Efficiency

Trend: Weakening

Ringkjøbing Landbobank's cost efficiency is one of the best in Denmark. Its cost-to-income ratio was 33% in Q1 2008 and 35% in 2007, a slight deterioration from 29% in 2006. This decline in efficiency is due to a combination of lower operating income and higher operating expenses (growing number of employees). Furthermore, operating

expenses have been declining steadily as a percentage of average assets over the recent years to 1.3% at year-end 2007, also one of the best levels among Danish banks.

However, Moody's expects this strong efficiency to weaken as the bank upgrades its risk management practices and thereby increases its add-on costs. Also increased funding costs are likely to affect the cost efficiency.

The bank scores A for efficiency but we have assigned a weakening trend due to factors discussed above.

#### Factor 9: Asset Quality

Trend: Weakening

Ringkjøbing Landbobank continues to demonstrate strong asset quality. A key positive aspect is low problem loans 0.1% at year-end 2007 (vs. 0.2% for 2006). It is also comforting that the bank's loan growth for 2007 has slowed down to 10% from 26% in 2006, and 37% in 2005. Moody's will continue to monitor the effect of previous years' rapid loan growth on the bank's asset quality, since many of the loans are less seasoned.

Problem loans coverage by reserves has remained at considerably strong levels over the past three years (above 1500%), especially keeping in mind that a large part of the portfolio has good-quality collateral. Going forward, we view Ringkjøbing Landbobank's ability to further reduce sector- and single-name concentration as an important rating driver, combined with success in preventing loan growth from impairing the asset quality.

The score of A is appropriate for the bank's current asset quality but the weakening trend reflects unseasoned loan portfolio and concentration risks as well as increased uncertainty in the Danish economy.

#### **Global Local Currency Deposit Rating (Joint Default Analysis)**

Ringkjøbing Landbobank's long-term global local currency (GLC) deposit and debt ratings are at the A1 level. These incorporate the following main elements: (1) its A2 Baseline Credit Assessment (BCA), and (2) Moody's opinion on the probability of systemic support for this bank.

In light of its position in the Danish market, Moody's believes that the probability of systemic support for Ringkjøbing Landbobank in the event of a financial crisis is moderate.

Under Moody's joint default analysis (JDA) methodology, the above-mentioned considerations result in a one-notch uplift in the deposit ratings to A1 from the A2 BCA. Moody's assigns a GLC deposit rating of A1 for Ringkjøbing Landbobank.

#### **Foreign Currency Deposit Rating**

The foreign currency deposit ratings of Ringkjøbing Landbobank are unconstrained given that Denmark, in common with other EU members, has a country ceiling of Aaa. The foreign currency deposit ratings of Ringkjøbing Landbobank are A1.

#### **Foreign Currency Debt Rating**

The foreign currency debt ratings of Ringkjøbing Landbobank are unconstrained given that Denmark, in common with other EU members, has a country ceiling of Aaa. The foreign currency debt ratings of Ringkjøbing Landbobank are A1.

#### **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



<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>		x					
- 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>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>B</b>	
<b>Factor: Profitability</b>						<b>B+</b>	<b>Neutral</b>
PPP % Avg RWA		3.09%					
Net Income % Avg RWA	2.47%						
<b>Factor: Liquidity</b>						<b>C-</b>	<b>Neutral</b>
(Mkt funds-Liquid Assets) % Total Assets				17.13%			
<b>Liquidity Management</b>			x				
<b>Factor: Capital Adequacy</b>						<b>A</b>	<b>Neutral</b>
Tier 1 ratio (%)	11.07%						
Tangible Common Equity % RWA	9.91%						
<b>Factor: Efficiency</b>						<b>A</b>	<b>Weakening</b>
Cost/income ratio	32.85%						
<b>Factor: Asset Quality</b>						<b>A</b>	<b>Weakening</b>
Problem Loans % Gross Loans	0.20%						
Problem Loans % (Equity + LLR)	1.07%						
<b>Lowest Combined Score (15%)</b>						<b>C-</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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