

CREDIT OPINION

18 May 2018

Update

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RATINGS

Sydbank A/S

Domicile	Denmark
Long Term Debt	A2
Type	Senior Unsecured - Fgn Curr
Outlook	Positive
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

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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Sydbank A/S

Update following upgrade to A2, outlook remains positive

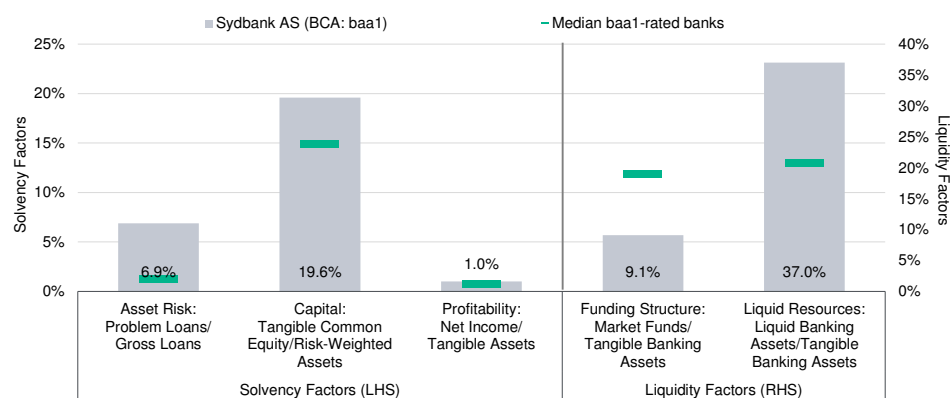
Summary

We assign A2 long-term deposit and senior unsecured ratings to [Sydbank A/S](#) (Sydbank), both ratings carry a positive outlook. The deposit and senior unsecured ratings incorporate two notches of rating uplift from the bank's baa1 standalone Baseline Credit Assessment (BCA) based on our Advanced Loss Given Failure (LGF) analysis. LGF takes into account the risks faced by different liability classes should the bank enter into resolution. The bank's ratings do not benefit from government support uplift based on our assessment of a low probability of support. We also assign Prime-1 short-term deposit ratings and the Counterparty Risk (CR) Assessment is A1(cr)/Prime-1(cr).

Sydbank's baa1 standalone BCA reflects the bank's (1) solid capitalisation with a common equity tier 1 (CET1) capital ratio of 16.6% and a shareholders' equity-to-total assets of 8.4% as of March 2018; (2) sound funding structure and liquidity profile; and (3) sustained profitability, although under pressure by the low interest rate environment. At the same time, Sydbank's BCA also takes into account credit concentrations, including to single borrowers and some higher-risk or volatile sectors, and the bank's through-the-cycle asset quality performance.

Exhibit 1

Rating Scorecard - Key financial ratios



These represent our Banks methodology scorecard ratios, whereby asset risk and profitability reflect the weaker of either the three-year average and the latest annual figure. Capital ratio is the latest reported figure. Funding structure and liquid resource ratios reflect the latest fiscal year-end figures.

Source: Moody's Investors Service

Credit strengths

- » Solid capital ratios, well in excess of regulatory requirements
- » Sound funding structure and liquidity profile
- » Profitability is stable

Credit challenges

- » Credit concentrations, while through-the-cycle impairments were higher compared to peers
- » Pressure on net interest margins, in light of the low interest rate environment

Rating outlook

- » The positive outlook on Sydbank's deposit and senior unsecured debt ratings reflects the likely evolution of the bank's liability structure and further potential upward pressure that may arise on these rating should the bank issue more instruments, for example in order to maintain a management buffer over its bank-specific minimum requirements for own funds and eligible liabilities (MREL) set by the Danish Financial Supervisory Authority (FSA). The increased issuance might result in lower losses-given-failure for junior deposits and senior unsecured debt under our Advanced LGF analysis by providing a higher degree of protection to these debt classes.
- » In addition, we expect that the bank's key credit characteristics will be supported by a benign domestic operating environment over the next 12-18 months, despite continued pressure on the bank's earnings from the persistent low interest rate environment.

Factors that could lead to an upgrade

- » Upward rating momentum for the long-term senior and deposit ratings of Sydbank could develop from the issuance of increased volumes of bail-in-able debt, above the minimum amounts expected for the bank to meet its MREL, that may improve these creditors' position in a resolution scenario.
- » The bank's ratings could also be upgraded following an improvement in its fundamental profile, as indicated by the bank's BCA, for instance if: (1) asset quality improves, especially in relation to agricultural lending, and credit concentrations reduce; (2) profitability improves without an increase in the bank's risk profile; (3) capital and leverage strengthen materially.

Factors that could lead to a downgrade

- » The positive outlooks assigned to Sydbank's deposit and senior unsecured ratings would be revised to stable if the bank does not issue junior debt volumes in line with our expectation or if the liability structure changes in a way that negatively affects the volume or subordination amounts of these instruments. Sydbank's ratings could even be downgraded if such a shift in the bank's funding mix is material and results in lower rating uplift, than currently assumed, under our Advanced LGF framework.
- » The ratings could be downgraded due to a deterioration in the bank's fundamental credit profile, for instance if we observe: (1) a deterioration in asset quality or if the bank's risk profile deteriorates (for example, as a result of increased concentrations or exposures to more volatile asset classes); (2) a persistent weakening of the bank's recurring earnings power and operating efficiency; (3) a substantial increase in market funding reliance beyond our current expectations; and/or (4) weaker capital ratios that are below the bank's current capital targets.

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 for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Sydbank A/S (Consolidated Financials) [1]

	12-17 ²	12-16 ²	12-15 ²	12-14 ²	12-13 ³	CAGR/Avg ⁴
Total Assets (DKK million)	131,755	137,453	133,253	137,248	147,892	-2.8 ⁵
Total Assets (EUR million)	17,696	18,486	17,856	18,432	19,824	-2.8 ⁵
Total Assets (USD million)	21,249	19,498	19,397	22,303	27,316	-6.1 ⁵
Tangible Common Equity (DKK million)	11,548	11,372	11,024	10,887	9,805	4.2 ⁵
Tangible Common Equity (EUR million)	1,551	1,529	1,477	1,462	1,314	4.2 ⁵
Tangible Common Equity (USD million)	1,862	1,613	1,605	1,769	1,811	0.7 ⁵
Problem Loans / Gross Loans (%)	6.5	6.0	8.0	9.4	9.1	7.8 ⁶
Tangible Common Equity / Risk Weighted Assets (%)	19.6	17.9	16.2	15.0	13.5	17.2 ⁷
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	30.4	33.2	41.3	44.9	48.7	39.7 ⁶
Net Interest Margin (%)	1.5	1.7	1.7	1.9	1.9	1.8 ⁶
PPI / Average RWA (%)	3.2	3.0	2.5	2.8	2.8	2.9 ⁷
Net Income / Tangible Assets (%)	1.2	1.1	0.9	0.8	0.1	0.8 ⁶
Cost / Income Ratio (%)	58.3	57.2	60.1	57.4	56.5	57.9 ⁶
Market Funds / Tangible Banking Assets (%)	9.1	18.2	18.9	29.3	34.1	21.9 ⁶
Liquid Banking Assets / Tangible Banking Assets (%)	37.0	30.2	27.6	38.0	38.0	34.1 ⁶
Gross Loans / Due to Customers (%)	81.3	99.2	98.2	98.6	108.2	97.1 ⁶

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] May include rounding differences due to scale of reported amounts [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of periods presented for the latest accounting regime. [7] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

Profile

Sydbank is a full-service commercial bank in Denmark that provides retail, corporate, investment and private banking services, primarily to private individuals, and small and medium-sized enterprises. As of end-March 2018, the bank reported total assets of DKK134.3 billion (around €18.0 billion) and operated through a network of 62 branches in Denmark and three branches in Germany.

Sydbank was established in 1970 as a result of the merger of four local banks in Southern Jutland. In the 1980s the Bank began expanding its domestic branch network outside Southern Jutland. Sydbank is listed on the NASDAQ Copenhagen Stock Exchange (Ticker: SYDB).

For further information on the bank's profile see [Sydbank A/S : Key Facts and Statistics](#), published on 5 January 2018.

Detailed credit considerations

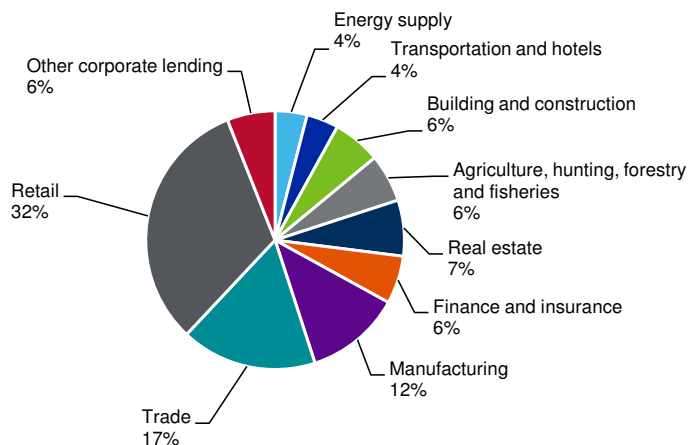
Credit concentrations, while through-the-cycle impairments were higher compared to peers

Our assessment of Sydbank's asset risk, reflected in our assigned Asset Risk score of ba1, takes into account concentration to single borrowers and some higher-risk or cyclical sectors. As of March 2018, Sydbank's 20 largest exposures were equivalent to 140% (2017: 131%) of CET1 capital. In addition, real estate loans made up 7% of total loans (the bank was also indirectly exposed to this sector, real property collateral accounted for 34% of total collateral against facilities as of end-2017, and most of the bank's retail facilities related to housing and mortgage-like loans), while loans to the agriculture sector were 6% of total (see Exhibit 3). As of end-March 2018, around 20% of Sydbank's problem loans were related to agriculture, hunting, forestry and fisheries (2017: 20%) indicating the continued difficulties faced by this sector driven by a large debt burden. The bank's provisioning coverage for agriculture loans remained unchanged at around 50% as of year-end 2017.

Exhibit 3

Sydbank has some concentrations in specific sectors

Loan portfolio breakdown by sector as of March 2018



Sources: Moody's Investors Service, company reports

Our assessment of Sydbank's asset risk also takes into account its through-the-cycle asset quality performance, which was relatively weaker than some similarly-rated Nordic peers. Credit costs averaged 1.2% during 2008-2017, and reached a high 1.7% during the 2009-2014 period. Impairment charges have come down significantly in recent years, however, and the bank recorded provisioning charge-backs in 2017. The bank's problem loans (measured as gross loans subject to individual impairment) were 6.5% of gross loans as of year-end 2017 (2016: 6.0%; 2015: 8.0%) and were adequately provisioned at 66%. Sydbank's allowance account increased by DKK216 million in Q1 2018 because of the implementation of IFRS 9, which will improve provisioning coverage further. We expect that low interest rates and the relatively robust economic growth in Denmark will continue to support the bank's asset quality over the next 12-18 months.

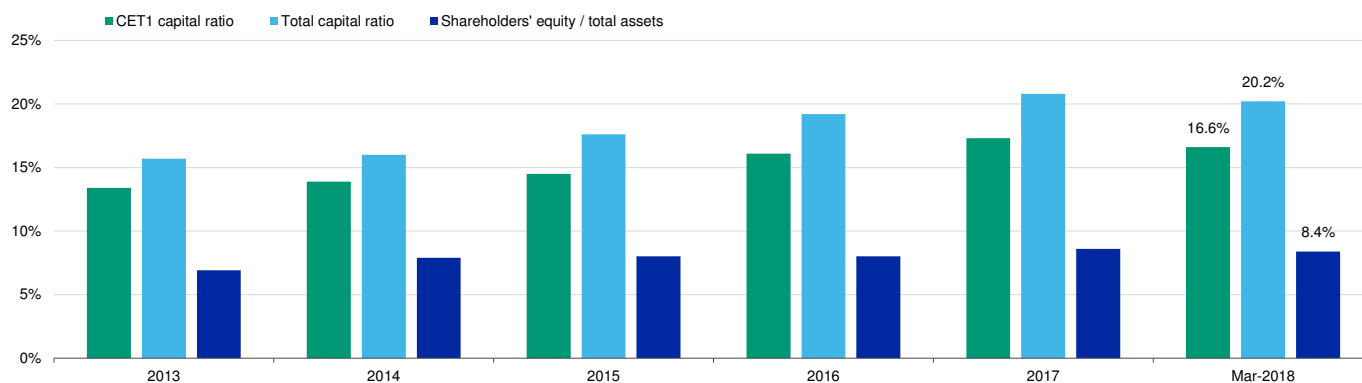
Sydbank stands to benefit more than other large Danish banks from the positive economic trend in Denmark, given that 68% of its credit exposure was related to corporates and small and medium sized entities, and only 32% was related to retail customers as of year-end 2017. We note that unlike other systemic Danish banks, Sydbank does not own/consolidate a mortgage credit institution (MCI). Under a number of funding agreements, Sydbank transfers mortgage loans to Totalkredit and DLRKredit and provides a guarantee for a portion of the loan; Sydbank carries no credit risk for the transferred loan to Totalkredit in the loan-to-value (LTV) range of 0%-60%, for example. Therefore its asset quality metrics, against on-balance sheet loans appear weaker, compared to what they would have been if it were to consolidate these predominantly first-lien and lower risk mortgages. As of March 2018, Sydbank had on-balance sheet loans and advances of DKK63.5 billion and had transferred mortgages and mortgage-like loans of DKK80.3 billion to MCIs on which it earns a fee. Conversely, its profitability and market funding ratios are stronger for this same reason compared to Danish banks that consolidate an MCI.

Solid regulatory capital ratios, well above regulatory requirements

Our assigned a1 Capital score reflects Sydbank's solid capital position, a relative strength in our assessment of the bank's standalone profile. Sydbank's CET1 capital ratio was 16.6% as of March 2018 and its total capital ratio reached 20.2% (see Exhibit 4). The metrics were well above than the bank's fully loaded requirements that will rise to 10.2% for the CET1 ratio and to 15% for the total capital ratio by 2019 and include both the Danish Financial Supervisory Authority (FSA) pillar 1 and pillar 2 components, a systemically important financial institution buffer of 1%, a 2.5% capital conservation buffer and an additional 0.5% countercyclical buffer that will apply for all banks in Denmark from 31 March 2019.

Our assessment also takes into account the bank's capital targets, with a CET1 ratio target of around 14%. In light of the bank's current capitalisation and targets, we expect it will maintain strong (although declining) capital ratios about three-to-four percentage points higher than the fully loaded regulatory requirements by 2019, also supported by its ability to generate capital internally.

Exhibit 4

Sydbank's capitalisation is solid and well above regulatory requirements

Sources: Moody's Investors Service, company reports

Sydbank's risk density, measured as risk-weighted assets (RWA) compared with total assets, was adequate at 43% as of March 2018, rendering the bank relatively less sensitive to potential amendments in regulatory methods for calculating RWA, including floor requirements, compared with Danish MCIs. Sydbank's shareholder's equity-to-total assets was 8.4% as of March-2018 (2016: 8.0%), which compares well with other Nordic and international banks, which typically have such ratios in the range 4%-10%.

Finally, the post-tax impact of the new IFRS 9 impairment rules was DKK168 million at 1 January 2018, or about 1.4% of the bank's equity. The bank has decided to apply the transitional rules and phase in the negative impact on its regulatory capital over five years.

Stable funding structure and adequate liquidity profile

Our a3 combined Liquidity score reflects Sydbank's relatively solid funding and liquidity profiles. Sydbank's customer deposits (excluding deposits from pooled plans) accounted for 61% of total assets as of end-March 2018 (YE2017: 60%). Furthermore, the bank's reliance on confidence-sensitive market funding was 12% of tangible banking assets as of end-March 2018. Specifically, reliance on short-term interbank liabilities decreased significantly between 2014 and 2017, and only accounted for 4% of assets as of March 2018, which also reflects the change in the funding agreement with Totalkredit.

Similar to other Danish banks, Sydbank funds a portion of its mortgage loans off-balance sheet through Totalkredit and, to a lesser extent, through DLR Kredit. Sydbank has become the largest independent distribution partner for Totalkredit, which has strengthened its position in this relationship.

As of end-March 2018, Sydbank's liquid banking assets accounted for around 35% of tangible banking assets. However, our assigned baa1 Liquidity score takes into account some asset encumbrance, which results from the bank's market-making activities in covered bonds. The bank also reported a solid liquidity coverage ratio of 181% by end-March 2018 (YE2017: 176%). Sydbank's liquidity coverage ratio is comfortably above the 100% minimum requirement, set by the Danish FSA.

Profitability is stable but under pressure from negative interest rates

Sydbank's profitability has been resilient over the last few years, despite the low interest rate environment. The bank's net interest margin contracted further in 2017 to 1.5% (2016: 1.7%). It was 1.4% in Q1 2018. However, Sydbank's net income to tangible assets improved to 1.2% in 2017 (2016: 1.1%) mostly driven by provisioning charge-backs and a positive contribution from fair value gains on its investment securities. Net income to tangible assets was 1.3% in the first three months of 2018. We believe that the bank will continue to report healthy profit, sustained by relatively low credit costs and tight cost control. This view is reflected in our assigned Profitability score of baa1. Sydbank's profitability is higher than those rated Danish peers who consolidate MCIs. This is because profitability for mortgage banking activities is typically lower than for commercial lending.

However, our assessment of the bank's profitability also takes into account the quality of the bank's earnings in recent years, noting the increase in fair value gains on securities to DKK727 million in 2017 from DKK553 million in 2016 along with a reduction in net interest and fee income to DKK3,856 million in 2017 from DKK4,002 million in 2016.

Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Bank specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to the document [Financial Statement Adjustments in the Analysis of Financial Institutions](#), published on 13 June 2017.

Support and structural considerations

Loss Given Failure (LGF) analysis

Sydbank operates in Denmark and is subject to the EU Bank Recovery and Resolution Directive (BRRD), which we consider an operational resolution regime. In accordance with our methodology, we therefore apply our Advanced LGF analysis to Sydbank's liabilities, considering the risks faced by different debt and deposit classes across the liability structure should the bank enter resolution.

In our Advanced LGF analysis, we use our standard assumptions and assume residual tangible common equity of 3%, losses post-failure of 8% of tangible banking assets, a 25% runoff in junior wholesale deposits, and a 5% runoff in preferred deposits. We assign a 25% probability to deposits being preferred to senior unsecured debt. For Sydbank, however, we assume that 10% of deposits can be considered as junior deposits.

For Sydbank's A2 deposit and senior unsecured debt ratings our forward-looking Advanced LGF analysis indicates a very low loss-given-failure, leading to two notches of rating uplift from the bank's baa1 Adjusted BCA. The assigned LGF notching for long-term deposit and senior unsecured bank debt is positioned higher than the corresponding LGF notching guidance. This reflects our expectation that Sydbank will need to issue at least around DKK5-6 billion of non-preferred senior debt over the coming quarters to meet its MREL. In March 2018, Sydbank received its final MREL by the Danish FSA at 12.4% of total liabilities and own funds (see [Denmark's MREL implementation for large banks will increase their loss-absorbing capacity](#) published 5 April 2018). This represents 27.3% of its risk-weighted exposures, equal to DKK17 billion as of year-end 2016.

The positive outlook on the bank's long-term deposit and senior unsecured ratings reflects the likely evolution of the bank's liability structure and further potential upward pressure that may arise on these ratings should the bank issue more junior instruments than the minimum amounts estimated above, for example in order to maintain a management buffer over MREL, leading to lower loss-given-failure.

Government support considerations

We do not incorporate any government support uplift on Sydbank's ratings because we consider the probability of government support, in case of need, to be low. Our government support assumptions are driven by the implementation of the EU's BRRD in Denmark.

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, 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 (for example, swaps), letters of credit, guarantees and liquidity facilities.

Sydbank's CR Assessment is positioned at A1(cr)/Prime-1(cr)

For Sydbank, our Advanced LGF analysis indicates an extremely low loss-given-failure for the CR Assessment, leading to three notches of rating uplift from the bank's baa1 Adjusted BCA.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement 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 5

Sydbank A/S

Macro Factors

Weighted Macro Profile **Strong +** **100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	6.9%	ba1	← →	ba1	Sector concentration	Long-run loss performance
Capital						
TCE / RWA	19.6%	aa2	↓ ↓	a1	Expected trend	Nominal leverage
Profitability						
Net Income / Tangible Assets	1.0%	a3	↓	baa1	Earnings quality	
Combined Solvency Score		a3		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	9.1%	a1	↓	a3	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	37.0%	a1	↓	baa1	Asset encumbrance	
Combined Liquidity Score		a1		a3		
Financial Profile						
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				a3-baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	in-scope (DKK million)	% in-scope	at-failure (DKK million)	% at-failure
Other liabilities	25,679	22.3%	31,295	27.2%
Deposits	80,230	69.8%	74,614	64.9%
Preferred deposits	72,207	62.8%	68,597	59.7%
Junior Deposits	8,023	7.0%	6,017	5.2%
Senior unsecured bank debt	3,722	3.2%	3,722	3.2%
Dated subordinated bank debt	1,296	1.1%	1,296	1.1%
Preference shares (bank)	558	0.5%	558	0.5%
Equity	3,448	3.0%	3,448	3.0%
Total Tangible Banking Assets	114,933	100%	114,933	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted 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	13.1%	13.1%	13.1%	13.1%	3	3	3	3	0	a1 (cr)
Deposits	13.1%	4.6%	13.1%	7.9%	1	1	1	2	0	a2
Senior unsecured bank debt	13.1%	4.6%	7.9%	4.6%	1	-1	0	2	0	a2
Dated subordinated bank debt	4.6%	3.5%	4.6%	3.5%	-1	-1	-1	-1	0	baa2
Junior subordinated bank debt	3.5%	3.5%	3.5%	3.5%	-1	-1	-1	-1	-1	baa3
Non-cumulative bank preference shares	3.5%	3.0%	3.5%	3.0%	-1	-1	-1	-1	-2	ba1 (hyb)

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1 (cr)	--
Deposits	2	0	a2	0	A2	A2
Senior unsecured bank debt	2	0	a2	0	--	A2
Dated subordinated bank debt	-1	0	baa2	0	--	Baa2
Junior subordinated bank debt	-1	-1	baa3	0	--	(P)Baa3
Non-cumulative bank preference shares	-1	-2	ba1 (hyb)	0	--	Ba1 (hyb)

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
SYDBANK A/S	
Outlook	Positive
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Senior Unsecured	A2
Subordinate	Baa2
Jr Subordinate MTN	(P)Baa3
Pref. Stock Non-cumulative	(P)Ba1 (hyb)
Other Short Term	(P)P-1

Source: Moody's Investors Service

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