MOODY'S INVESTORS SERVICE

CREDIT OPINION
25 April 2019

Update

Rate this Research

RATINGS

Sydbank A/S

Domicile	Denmark
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	(P)A1
Type	Senior Unsecured MTN - Fgn Curr
Outlook	Not Assigned
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn 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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Sydbank A/S

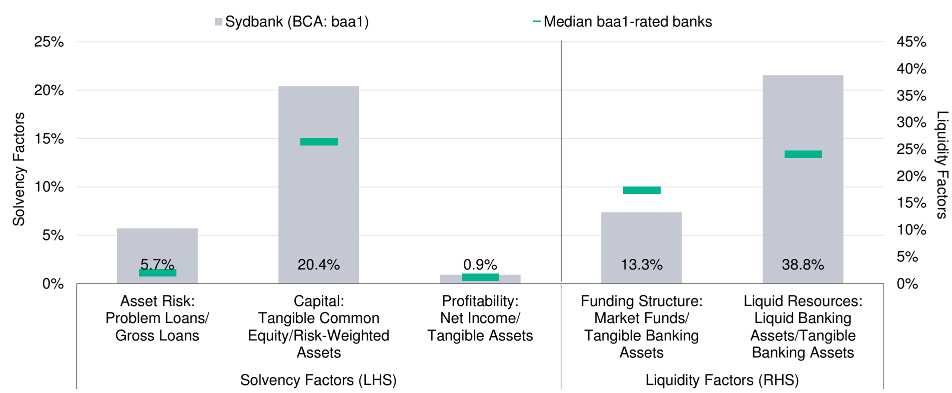
Update following upgrade to A1, outlook changed to stable

Summary

Sydbank A/S's (Sydbank) A1 long-term deposit and (P)A1 senior unsecured ratings, with a stable outlook, reflect (1) the bank's baa1 standalone Baseline Credit Assessment (BCA); and (2) three notches of rating uplift from our Advanced Loss Given Failure (LGF) analysis, which 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. Sydbank's short-term deposit ratings are Prime-1, the Counterparty Risk Ratings (CRR) are A1/Prime-1 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 17.3% as of December 2018; (2) sound funding structure and liquidity profile; and (3) relatively sustained profitability, although similar to peers it is 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. The bank's asset quality has been strong in recent years, with provisioning charge-backs in 2017 and 2018.

Exhibit 1
Rating Scorecard - Key financial ratios



These represent our Banks methodology scorecard ratios. Asset risk and profitability reflect the weaker of either the three-year average and latest figure. Capital is the latest reported figure. Funding structure and liquid resources 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 has been broadly 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 stable outlook on the bank's long-term deposit rating reflects our expectation 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 pressure on Sydbank's ratings could develop from (1) a reduction in credit concentrations and the bank demonstrates stronger asset quality through an economic cycle; (2) a sustained improvement in the bank's profitability without an increase in the its risk profile; (3) capital and leverage strengthen materially.

» Sydbank's deposit and senior unsecured ratings already benefit from the highest possible uplift under the LGF framework and, therefore, there would not be positive pressure on these ratings from changes in the bank's liability structure.

Factors that could lead to a downgrade

» Downward pressure on Sydbank's ratings could emerge if we observe: (1) a material deterioration in asset quality, or, if concentrations and exposures to more volatile asset classes rise; (2) a persistent weakening in 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.

» Negative pressure on the bank's ratings would also arise if there is a shift in the bank's funding mix, such as lower subordinated instrument volumes or a material reduction in junior deposits amounts, which would result in lower rating uplift than currently assumed under our Advanced LGF framework.

Key indicators

Exhibit 2

Sydbank A/S (Consolidated Financials) [1]

	12-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (DKK million)	134,423	131,755	137,453	133,253	137,248	-0.5[4]
Total Assets (EUR million)	18,013	17,696	18,486	17,856	18,432	-0.6[4]
Total Assets (USD million)	20,592	21,249	19,498	19,397	22,303	-2.0[4]
Tangible Common Equity (DKK million)	11,319	11,548	11,372	11,024	10,887	1.0[4]
Tangible Common Equity (EUR million)	1,517	1,551	1,529	1,477	1,462	0.9[4]
Tangible Common Equity (USD million)	1,734	1,862	1,613	1,605	1,769	-0.5[4]
Problem Loans / Gross Loans (%)	4.6	6.5	6.0	8.0	9.4	6.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	20.4	19.6	17.9	16.2	15.0	17.8[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	21.0	30.4	33.2	41.3	44.9	34.1[5]
Net Interest Margin (%)	1.4	1.5	1.7	1.7	1.9	1.7[5]
PPI / Average RWA (%)	2.3	3.2	3.0	2.5	2.8	2.8[6]
Net Income / Tangible Assets (%)	0.9	1.2	1.1	0.9	0.8	0.9[5]
Cost / Income Ratio (%)	68.2	58.3	57.2	60.1	57.4	60.2[5]
Market Funds / Tangible Banking Assets (%)	13.3	11.3	20.1	21.4	29.3	19.0[5]
Liquid Banking Assets / Tangible Banking Assets (%)	38.8	37.0	30.2	27.6	38.0	34.3[5]
Gross Loans / Due to Customers (%)	79.4	83.8	102.1	101.9	98.6	93.1[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully-loaded or transitional phase-in; IFRS. [3] May include rounding differences due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime. [6] 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 the end of 2018, the bank reported total assets of DKK140.5 billion (around €18.8 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.

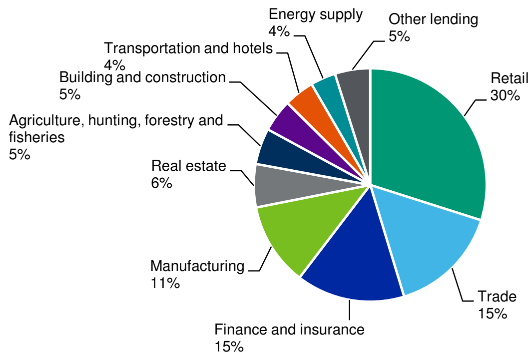
Detailed credit considerations

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 concentrations to single borrowers and some higher-risk or cyclical sectors, although the latter are declining.

As of the end of 2018, Sydbank's 20 largest exposures were equivalent to 147% of CET1 capital (2017: 131%). In addition, real estate loans made up 6% of total loans, build and construction loans 5%, while loans to the agriculture sector were 5% of total (see Exhibit 3). The bank was also indirectly exposed to the real estate sector because real property collateral accounted for 27% of total collateral against facilities as of end-2018, and most of the bank's retail facilities related to housing and mortgage-like loans. For the troubled agriculture sector, the bank's provisions for the sector are high and include a DKK100 million management estimate.

Exhibit 3
Sydbank has some concentrations in specific sectors
Loan portfolio and guarantees breakdown by sector as of December 2018



Sources: Moody's Investors Service, company reports

Our assessment of Sydbank's asset risk also takes into account the bank recent strong asset quality and 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 and 2018. The bank's problem loans (defined as IFRS 9 stage 3 loans) were 4.6% of gross loans as of end-2018, and were adequately provisioned at 54%. Stage 2 loans accounted for a further 8.4% of loans and advances. The bank's stage 3 loans will increase slightly in 2019 because of revisions in the bank's method in allocating loans to stages following a review by the Danish FSA. 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.

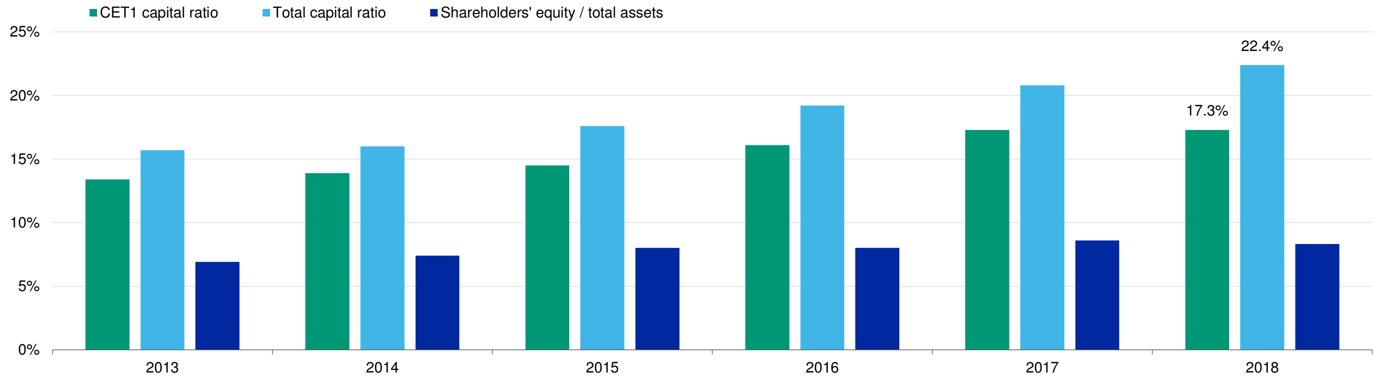
Sydbank benefits more than other large Danish banks from the positive economic trend in Denmark, given that 70% of its lending exposure was related to business entities, and only 30% was related to retail customers as of the end of 2018. Unlike other systemic Danish banks, Sydbank does not own/consolidate 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 the end of 2018, Sydbank had on-balance sheet loans and advances of DKK61.0 billion and had transferred mortgages and mortgage-like loans of DKK81.2 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 that are 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 17.3% as of the end of 2018 and its total capital ratio reached 22.4% (see Exhibit 4). These metrics, which will decline by around 70-80 basis points because of a resumed share buyback program in 2019, are well above the bank's fully loaded requirements that will rise to 10.8% for the CET1 ratio and to 15.8% for the total capital ratio by the end of September and include both the Danish FSA pillar 1 and pillar 2 components, a systemically important financial institution buffer of 1%, a 2.5% capital conservation buffer and an additional 0.9% countercyclical buffer.

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, 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 (RWAs) compared with total assets, was 39% as of the end of 2018, rendering the bank relatively less sensitive to potential amendments in regulatory methods for calculating RWAs, including floor requirements, compared with Danish MCIs. Sydbank's shareholder's equity-to-total assets was 8.3% as of the end of 2018, which compares well with other Nordic and international banks, which typically have such ratios in the range 4%-10%. Further, its fully loaded Basel III leverage ratio was 6.7%.

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, repo transactions and secured lending) accounted for the bulk 57% of total assets as of the end of 2018 (YE2017: 55%). Furthermore, the bank's reliance on confidence-sensitive market funding remained low at 13% of tangible banking assets as of end-2018. Market funding reliance had increased modestly following the bank's first EUR500 million (equivalent to DKK3.7 billion) issuance of junior senior debt (broadly known as non-preferred senior debt) to meet its MREL in September 2018, and we expect it will rise slightly further following a second issuance of a similar size in 2019 that has allowed the bank to be in compliance with its MREL ahead of the July 2019 deadline. Reliance on short-term interbank liabilities decreased significantly between 2014 and 2017, and only accounted for 4% of assets as of December 2018, which also reflects a change in the funding agreement with Totalkredit.

Similarly 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-December 2018, Sydbank's liquid banking assets accounted for around 39% of tangible banking assets. 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 an adequate liquidity coverage ratio of 184% by the end of 2018 (YE2017: 176%). Sydbank's liquidity coverage ratio is well above the 100% minimum requirement, set by the Danish FSA.

Profitability under pressure from negative interest rates

We expect Sydbank's profitability will continue to be under pressure because competition and more expensive (compared to cheap deposits) junior senior debt issuances are compressing margins during a period of extremely low interest rates. Nevertheless, we believe that the bank will continue to report relatively healthy profits, sustained by low credit costs and tight cost control. This view is reflected in our assigned Profitability score of baa1. Sydbank's profitability is stronger than rated Danish peers that consolidate MCIs. This is because profitability for mortgage banking activities is typically lower than for commercial lending.

Sydbank's profitability has been relatively resilient over the last few years, despite the low interest rate environment. Sydbank's net income fell to 0.9% of tangible assets in 2018 (2017: 1.2%), due to a combination of lower net interest income, lower contribution from fair value gains on its investment securities and higher costs which offset the higher provisioning charge-backs. The bank's net interest margin contracted further to 1.4% in 2018 (2017: 1.5%; 2016: 1.7%), and core income for the bank of DKK4.0 billion in 2018 was 5% lower compared to the same period in 2017.

Our assessment of the bank's profitability continues to takes into account the quality of the bank's earnings in recent years, noting the volatility in fair value gains on securities, which declined to DKK335 million in 2018 (2017: DKK727 million; 2016: DKK553 million) along with a reduction in net interest and fee income to DKK3,698 million in 2018 (2017: DKK3,820 million; 2016: DKK3,955 million).

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 9 August 2018.

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 to reflect the bank's more retail-based deposit structure.

For Sydbank's A1 deposit and (P)A1 senior unsecured debt ratings our forward-looking Advanced LGF analysis indicates an extremely low loss-given-failure, leading to three notches of rating uplift from the bank's baa1 Adjusted BCA. For the bank's junior senior ratings the forward-looking Advanced LGF analysis indicates moderate loss severity, leading to a position in line with the bank's Adjusted BCA.

The assigned LGF notching for the above instruments incorporates Sydbank's EUR500 million 3 year junior senior debt issuance in 2019. The total EUR1 billion (equivalent to around DKK7.4 billion) in junior senior debt outstanding, along with hybrid instruments and common equity, allow the bank to meet an MREL of 29.5% based on bank's risk exposure amount (REA) as of the end of 2017 that will apply from July 2019. MREL will rise to 30% as of 30 September 2019 because of an increase in the countercyclical capital buffer in Denmark.

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 Rating

Counterparty Risk Ratings (CRRs) are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements

Sydbank's CRR is positioned at A1/Prime-1

The CRR is positioned three notches above the Adjusted BCA of baa1, reflecting the extremely low loss-given failure from the high volume of instruments that are subordinated to CRR liabilities.

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.

Methodology and scorecard

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**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	5.7%	baa2	←→	ba1	Sector concentration	Long-run loss performance
Capital						
TCE / RWA	20.4%	aa1	↓↓	a1	Expected trend	Nominal leverage
Profitability						
Net Income / Tangible Assets	0.9%	baa1	←→	baa1	Expected trend	
Combined Solvency Score		a2		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	13.3%	a2	↓	a3	Expected trend	Extent of market funding reliance
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	38.8%	a1	↓	baa1	Asset encumbrance	
Combined Liquidity Score		a2		a3		
Financial Profile				baa1		
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	28,614	24.3%	34,229	29.0%
Deposits	80,225	68.0%	74,609	63.3%
Preferred deposits	72,203	61.2%	68,592	58.2%
Junior Deposits	8,023	6.8%	6,017	5.1%
Junior senior unsecured bank debt	3,706	3.1%	3,706	3.1%
Dated subordinated bank debt	1,301	1.1%	1,301	1.1%
Preference shares (bank)	560	0.5%	560	0.5%
Equity	3,538	3.0%	3,538	3.0%
Total Tangible Banking Assets	117,944	100%	117,944	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 Rating	12.8%	12.8%	12.8%	12.8%	3	3	3	3	0	a1
Counterparty Risk Assessment	12.8%	12.8%	12.8%	12.8%	3	3	3	3	0	a1 (cr)
Deposits	12.8%	7.7%	12.8%	7.7%	1	1	1	3	0	a1
Senior unsecured bank debt	12.8%	7.7%	7.7%	7.7%	1	0	1	3	0	a1
Junior senior unsecured bank debt	7.7%	4.6%	7.7%	4.6%	-1	-1	-1	0	0	baa1
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 Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1 (cr)	--
Deposits	3	0	a1	0	A1	A1
Senior unsecured bank debt	3	0	a1	0	--	(P)A1
Junior senior unsecured bank debt	0	0	baa1	0	--	Baa1
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)

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
SYDBANK A/S	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Senior Unsecured MTN	(P)A1
Junior Senior Unsecured	Baa1
Junior Senior Unsecured MTN	(P)Baa1
Subordinate	Baa2
Jr Subordinate MTN	(P)Baa3
Pref. Stock Non-cumulative	Ba1 (hyb)
Other Short Term	(P)P-1

Source: Moody's Investors Service

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