MOODY'S
INVESTORS SERVICE

Credit Opinion: Sydbank A/S

Global Credit Research - 30 Nov 2010

Aabenraa, Denmark

Ratings

Category	**Moody's Rating**
Outlook	Stable(m)
Bank Deposits	A1/P-1
Bank Financial Strength	C+
Senior Unsecured	A1
Subordinate	Baa1
Preferred Stock	Baa2
Other Short Term	(P)P-1

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Key Indicators

Sydbank A/S (Consolidated Financials)[1]

	[2]**9-10**	[2]**12-09**	[2]**12-08**	[3]**12-07**	[3]**12-06**	**Avg.**
Total Assets (DKK million)	**153,659.00**	**157,821.00**	**156,094.00**	**132,323.00**	**114,758.00**	[4]**7.57**
Tangible Common Equity (DKK million)	**10,433.13**	**9,316.00**	**7,306.25**	**6,930.25**	**6,673.25**	[4]**11.82**
Total Assets (EUR million)	**20,619.14**	**21,209.86**	**20,971.31**	**17,745.90**	**15,394.51**	[4]**7.58**
Tangible Common Equity (EUR million)	**1,400.00**	**1,251.99**	**981.60**	**929.42**	**895.20**	[4]**11.83**
Total Assets (USD million)	**28,149.38**	**30,430.66**	**29,151.11**	**25,945.43**	**20,300.01**	[4]**8.52**
Tangible Common Equity (USD million)	**1,911.28**	**1,796.29**	**1,364.47**	**1,358.86**	**1,180.46**	[4]**12.80**
PPI / Avg RWA	**2.92%**	**3.05%**	**1.57%**	**2.08%**	**2.41%**	[5]**2.52%**
Net Income / Avg RWA	**0.79%**	**1.03%**	**0.60%**	**2.15%**	**1.95%**	[5]**0.81%**
(Market Funds - Liquid Assets) / Total Assets	**11.84%**	**7.36%**	**13.28%**	**4.98%**	**9.86%**	[6]**9.46%**
Core Deposits / Average Gross Loans	**72.97%**	**75.46%**	**82.20%**	**83.29%**	**66.98%**	[6]**76.18%**
Tier 1 Ratio	**14.10%**	**13.00%**	**9.67%**	**8.90%**	**9.00%**	[5]**12.26%**
Tangible Common Equity / RWA	**13.81%**	**11.96%**	**8.75%**	**8.46%**	**8.49%**	[5]**11.51%**
Cost / Income Ratio	**55.29%**	**53.83%**	**67.43%**	**57.01%**	**51.83%**	[6]**57.08%**
Problem Loans / Gross Loans	**4.41%**	**3.50%**	**2.02%**	**2.09%**	**2.51%**	[6]**2.91%**
Problem Loans / (Equity + Loan Loss Reserves)	**28.10%**	**27.86%**	**22.68%**	**22.16%**	**23.05%**	[6]**24.77%**

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] Basel II & IFRS reporting periods have been used for average calculation [6] IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's rates Sydbank A/S C+/A1/P-1. The C+ bank financial strength rating (BFSR), which translates into a Baseline Credit Assessment (BCA) of A2, reflects the Danish bank's strong regional franchise and satisfactory financial strength. However, it is constrained by its high credit risk concentration and its reliance on interbank funding. The bank's overall profitability has weakened significantly from 2006 and 2007 - and the economic outlook in Denmark remains challenging.

The A1 rating incorporates three elements: (i) the bank's BCA of A2; (ii) Denmark's local currency deposit ceiling of Aaa; and (iii) Moody's assessment of a high probability of systemic support for the bank in the event of a stress situation (a component of Moody's Joint Default Analysis methodology). As a result of our support assessment, the A1 ratings enjoy a one-notch uplift from the A2 BCA.

Credit Strengths

- Strong local brand and solid retail franchise in southern and central Jutland

- Adequate earnings from core banking operations and margin improvements

- Satisfactory capitalisation; improved by a capital increase in September 2009

- Co-operation agreements, which allow for a wider product range

Credit Challenges

- Preserving asset quality in the economic downturn

- Relatively high level of single-loan exposures and some industry concentration

- Enhancement and sustainability of fee & commission income

- Improvement in overall profitability

- Reliance on interbank funding

Rating Outlook

Sydbank's C+ BFSR has a negative outlook to reflect the potential deterioration in its financial strength when considering credit exposures and the still challenging economic outlook in Denmark. However, taking into account its systemic importance, we believe the bank is well positioned in the A1 category, and have therefore assigned a stable outlook to the long-term debt and deposit ratings.

What Could Change the Rating - Up

The bank's ratings are unlikely to be upgraded any time soon, as reflected by the negative outlook on the BFSR and recent downgrade of the long-term ratings.

What Could Change the Rating - Down

The BFSR could be adversely affected if credit quality weakens to a greater extent than we assume in our base case, which would exert pressure on the bank's earnings and capitalisation.

Recent Results

Sydbank Bank reported pre-tax profit of DKK581 million for the first nine months of 2010 , down 23% year-on-year. The result was negatively impacted by lower net interest income (down 4% year-on-year) and higher loan impairments, more than offsetting a 25% increase in fee and commission income. Contributions under the Danish banking package I, which ended 30 September 2010, were DKK 368 million (DKK 211 million in guarantee commission and DKK 157 million in increased provisions) during the first 9 months of 2010. In addition the bank provisioned DKK 16 million to cover the bankruptcy of Capinordic Bank.

Sydbank's total capital ratio, as calculated under the transitional rules towards Basel II, was 16.1% at end-September 2010, up from 15.2% at YE2009, and substantially higher than the calculated individual solvency requirement of 9.6%.

Recent Events

Moody's downgraded its ratings of certain hybrid securities in February 2010 in line with its revised guidelines for Rating Bank Hybrids and Subordinated debt published in November 2009.

DETAILED RATING CONSIDERATIONS

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

Bank Financial Strength Rating

The BFSR is in line with the score generated by Moody's bank financial strength scorecard.

Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

Sydbank's franchise value is underpinned by its being the fourth-largest banking group in Denmark, reporting around 382,000 customers, including approximately 30,000 corporate clients. Its core business consists of corporate, investment and private banking, with a focus on private individuals and small and medium-sized enterprises (SMEs) through a network of 110 branches in Denmark. It also has three branches in northern Germany and a subsidiary bank in Switzerland. While the bank has a national presence, its heartland is southern and central Jutland, Funen and the greater Copenhagen area, where most of its branch network is based.

Moody's views Sydbank's well-established regional presence as an important factor underpinning its ratings. The bank reports a market share of 5-8% depending on customer segment and type of business, with the majority of its customers being based in Jutland.

In Switzerland, the bank has a private banking subsidiary in St Gallen, which was set up in 2003 to support its long-established private banking international branch in Gråsten, Denmark. Sydbank intends to develop its businesses in Germany and Switzerland further, but we do not expect these operations to be significant contributors to its profit over the medium term.

The bank continues to subscribe to an open architecture model, providing its customers with alternatives across a full range of banking services and third party pension and life product. Co-operation agreements include the primary mortgage credit institutions Totalkredit and DLR Kredit.

A C score for franchise value reflects the bank's good position in its region, but its lack of geographic diversification and some volatility in its earnings.

Factor 2: Risk Positioning

Trend: Neutral

Sydbank has 146,000 shareholders, and each of its shares carries one vote at the annual general meeting, with the maximum number of votes per shareholder restricted to 5,000. These limitations would make a hostile takeover expensive - and thus highly unlikely. Two shareholders own more than 5% of the shares, Nykredit (a Danish mortgage credit institution) and ATP (a Danish pension fund).

The board of managers consists of 12 members, of which four are employee representatives. The group's executive management has four members, and the chief executive officer has been with the bank for a number of years. The bank has good risk management processes and uses the internal ratings-based (IRB) approach to determine credit risk related to retail and corporate exposures under Basel II. However, high credit risk concentration remains a constraining factor for the score on risk management.

Interest rate risk (in relation to 100 bps change in interest rates) was approximately 1% of tier 1 capital at end-2009. The bank's currency risk is limited and is mainly denominated in euros. Its equity risk consists of listed and unlisted shares, as well as holdings in associates. The combined figure was DKK1.9 billion at end-2009. A stress-test scenario of a 25% decline in equity prices corresponds to around 5% of tier 1 capital.. In our view, Sydbank's market risk appetite is therefore limited.

Overall, Sydbank scores C for risk positioning.

Factor 3: Regulatory Environment

This factor does not address bank-specific issues; instead, it evaluates whether regulatory bodies are independent and credible, whether they demonstrate enforcement power, and whether they adhere to global standards of best practice for risk control. Please refer to Moody's analysis of Denmark's regulatory environment in the latest Banking System Outlook, published in July 2009.

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. Please refer to Moody's analysis of Denmark's operating environment in the latest Banking System Outlook, published in July 2009.

Quantitative Rating Factors (50%)

Factor 5: Profitability

Trend: Weakening

Sydbank's overall profitability improved in 2009 despite a 120% increase in loan loss provisions (excluding the provisions for the Danish guarantee scheme). The increase was due to a higher net interest margin and positive valuation adjustments in the investments portfolio. As a result, pre-tax earnings increased by 23% and pre-provision income by more than 80% year-on-year. Risk-weighted recurring earnings power (pre-provision income in relation to risk-weighted assets) duly improved significantly, to 3.0% in 2009, from 1.6% in 2008 and 2.1% in 2007. We note that the bank has not used the option under IAS39 to reclassify its holdings to the hold-to-maturity or available-for-sale categories.

More than 65% of Sydbank's operating income takes the form of net interest income, which improved by close to 23% in 2009. The net interest margin has improved to 2.6% (2.2% in 2008), reflecting the bank's ability to pass on higher funding costs to its customers. Market value adjustments of the investment portfolio also contributed positively to the 2009 results (DKK667 million vs. DKK115 million in 2008). On the other hand, fee & commission income fell by 11%, mainly reflecting the decline in activity in securities trading.

The score for profitability is D+ and is calculated according to Basel II risk-weighted assets. It therefore includes only profitability ratios for 2008 and 2009.

We assign a weakening trend to the bank's profitability score to reflect our expectations of lower fee & commission income, reduced lending growth, increased funding costs, and the expectation of increased competition (although this is less strong at the moment). Due to the continued challenging economic environment and its potential effect on asset quality, we also expect problem loans to continue increasing, and a subsequently greater need for loan loss provisions.

Factor 6: Liquidity

Trend: Neutral

Although the bank's reliance on interbank funding remains high, Moody's notes that it is offset by the size of its securities portfolio, which mainly comprises Danish mortgage bonds and government bonds. As of end-2009, Sydbank's liquid assets amounted to close to 40% of total assets, and they cover its relatively high level of interbank funding. The bank's deposit base represents about 50% of funding, but has declined since YE2008.

The Danish government support scheme has made it easier for Danish banks to obtain liquidity in the domestic market, but we note that it is temporary. We also note that Sydbank, in common with other regional and local banks, funds its retail and commercial mortgage loans through Totalkredit, Nykredit and DLR.

The bank scores C for liquidity, with a neutral trend.

Factor 7: Capital Adequacy

Trend: Neutral

Sydbank completed a share issue of about DKK855 million on 21 September 2009. We view this as positive development, also from the quality of capital point of view. All in all, increased capital should provide a buffer with which to absorb additional credit-risk-related costs and limit the downside risks in terms of capitalisation. Sydbank has chosen to opt out of receiving a hybrid capital injection from the Danish government under the Danish banking package II.

At YE2009, the tier 1 ratio was 13.1% under Basel II.

The bank applies the advanced IRB approach for credit risk in the retail portfolio and foundation IRB in the corporate portfolio. Basel II has had a positive impact on the capital ratios, but we do not expect the bank to release capital, as there are some concentrations in its loan book. Despite a decline in the loan portfolio, we also note that a capital charge for credit risk has increased since YE2008

Considering Sydbank's risk profile and internal capital-generation capability, we continue to view its economic capital as satisfactory, giving it an A score.

Factor 8: Efficiency

Trend: Neutral

Sydbank's cost-to-income ratio stood at 54% in 2009, an improvement from 68% in 2008 (57% in 2007). The figure for 2008 includes integration costs related to bankTrelleborg.

Sydbank continues to reshape its branch coverage in Denmark and is currently focusing on improving its work processes. In 2008, it merged five branches, which it took over from bankTrelleborg, closed six small branches, and opened two new branches and in 2009 it closed two branches. However, in Moody's opinion, the bank's relatively small size may make it difficult to improve the level of costs, as it will be difficult to achieve economies of scale.

Sydbank, similar to other Danish banks, has had to bear the costs of participating in the Danish government guarantee scheme and support mechanism. For 2009, the total cost including monthly guarantee commission and provision for the guarantee amounted to DKK443 million.

The score for cost efficiency is C.

Factor 9: Asset Quality

Trend: Weakening

At end-2009, Sydbank's problem loans (measured as gross loans subject to individual impairments) represented 4.1% of its gross loans, compared with 2.3% at YE2008.

Around 35% of Sydbank's loan portfolio is to retail customers (mortgage loans financed by Totalkredit/Nykredit or DLR Kredit do not appear on Sydbank's balance sheet). Sydbank provides a guarantee on losses on loans transferred to DLR Kredit, whereas losses on loans transferred to Totalkredit/Nykredit are deducted from the fees paid by these mortgage credit institutions.

Typical to Nordic, and in particular regional banks, Sydbank displays high credit risk concentration. The 20 largest commitments represent more than 130% of the bank's tier 1 capital and we note that the ratio has increased slightly despite the increased capital base. There is also some industry concentration in the loan book - property-related exposures account for 13% of loans and credit, and finance & insurance exposures for 19%. The exposure to agriculture accounts for 7% of loans and guarantees. Overall, corporate lending accounts for around 65% of the loan portfolio.

Although losses have been low in past years, the overall macroeconomic situation in Denmark is now less favourable, putting pressure on the corporate and retail sectors. This situation is behind our expectation of a weakening trend for Sydbank's asset quality in the near/medium term.

The score for this factor is C, with a weakening trend.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A1 to Sydbank. The rating receives a one-notch uplift from the A2 BCA, based on Moody's assessment of a high probability of systemic support in the event of a stress situation and the Aaa local currency deposit ceiling of Denmark. A high probability of support is a result of Sydbank's importance to its region and the region's importance to the national economy.

Notching Considerations

The ratings for the Bank's hybrid obligations are notched off the BCA according to "Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt" released on 17 November 2009.

Foreign Currency Deposit Rating

Sydbank's A1 foreign currency deposit rating is unconstrained given that Denmark has a country ceiling of Aaa.

Foreign Currency Debt Rating

Sydbank's A1 foreign currency debt rating is unconstrained given that Denmark has a country ceiling of Aaa.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Sydbank A/S

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**C+**	
Factor: Franchise Value						**C**	**Neutral**
Market Share and Sustainability			x				
Geographical Diversification			x				
Earnings Stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						**C**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management		x					

- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		**x**					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration				**x**			
- Borrower Concentration				x			
- Industry Concentration		x					
Liquidity Management			**x**				
Market Risk Appetite	**x**						
Factor: Operating Environment						**A**	**Neutral**
Economic Stability	**x**						
Integrity and Corruption	**x**						
Legal System	**x**						
Financial Factors (50%)						**C**	
Factor: Profitability						**D+**	**Weakening**
PPI / Average RWA - Basel II			2.31%				
Net Income / Average RWA - Basel II				0.82%			
Factor: Liquidity						**C**	**Neutral**
(Mkt funds-Liquid Assets) / Total Assets			8.54%				
Liquidity Management			x				
Factor: Capital Adequacy						**A**	**Neutral**
Tier 1 Ratio - Basel II	11.34%						
Tangible Common Equity / RWA - Basel II	10.35%						
Factor: Efficiency						**C**	**Neutral**
Cost / Income Ratio			59.42%				
Factor: Asset Quality						**C**	**Weakening**
Problem Loans / Gross Loans			2.54%				
Problem Loans / (Equity + LLR)			24.23%				
Lowest Combined Score (15%)						**C-**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**C+**	
Assigned BFSR						**C+**	

[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