

16 June 2014 | 40 pages

Diversified Banks  
Western Europe | Norway

## DNB ASA (DNB.OL)

### The Most Profitable Bank in the World is Also One of the Most Underestimated

- **Highest Implied Discount Rate** — DNB (1.25x P/TB '14E) is trading at a 0.5x price/tangible book discount relative to Swedish peers, not far from a decade high discount of 0.6x. DNB's implied cost of equity is c2ppt higher versus Nordic peers and country averages for retail/commercial banks in North America and Europe. We believe a lot of "bad news" is still reflected in the current share price.
- **Improving Earnings Quality** — DNB's earnings predictability was well above Nordic peers and similar to the regional best in class, SHB, during 2009-13. DNB profit forecasts have over the past decade been subject to consistently positive revisions: on average +22% during the year before results or +10ppt versus peers. We expect consensus EPS and DPS estimates for future years to increase further.
- **The Most Profitable Bank In the World** — DNB is the most profitable bank that we cover globally based on net profit per employee (\$260k, 2014E), ahead of even Goldman Sachs. The strong profitability reflects a very high level of employee productivity. 2014E cost/income ratio should for the first time beat all Nordic peers, even SHB. DNB has several ongoing efficiency initiatives to maintain flat costs.
- **High and Rising Capital Ratios, Dividends to Follow** — DNB's core capital ratios are strong: TCE/TA ratio at 5.7% at end 1Q14 vs c4% for Nordic peers. On a CET1 basis, we expect DNB to exceed the required 13% level by end 2015E, even on a tough transitional Basel 1 basis. We expect the DNB dividend payout ratio, only 25% in 2013, to rise rapidly from 2016 onwards, reaching 65% in 2018.
- **Reiterate Buy, Raising TP to NOK140** — Reflecting our increased confidence on capital and balance sheet trends, new and increased long-term dividend estimates, our analysis of the greater consistency and positive trend in DNB earnings in recent years and modestly raised EPS estimates (due to lower bad debts), we reiterate our Buy rating and raise our target price to NOK140, from NOK120.

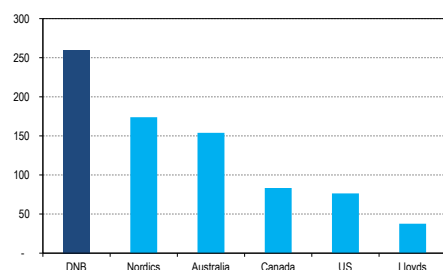
- Estimate Change
- Target Price Change

<b>Buy</b>	<b>1</b>
Price (13 Jun 14)	NOK115.20
Target price	NOK140.00
	from NOK120.00
Expected share price return	21.5%
Expected dividend yield	3.0%
<b>Expected total return</b>	<b>24.6%</b>
Market Cap	NOK187,638M
	US\$31,298M

#### Price Performance (RIC: DNB.OL, BB: DNB NO)

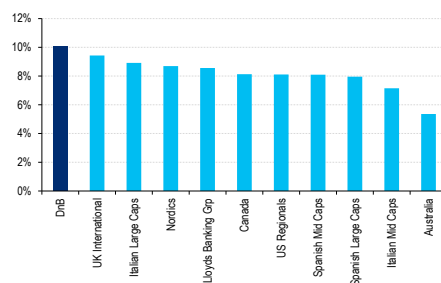


Figure 1. FY14E Profit Per FTE in \$000's



Source: Company data, Citi Research estimates

Figure 2. DNB Highest Implied Cost of Equity



Source: Citi Research; FY16 ROTE divided by FY14 P/TB

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2012	2013	2014E	2015E	2016E
<b>Valuation Ratios</b>					
P/E adjusted (x)	13.6	10.7	9.4	9.0	8.5
P/E reported (x)	13.6	10.7	9.4	9.0	8.5
P/BV (x)	1.5	1.3	1.2	1.1	1.0
P/Adjusted BV diluted (x)	1.5	1.3	1.2	1.1	1.0
Dividend yield (%)	1.8	2.3	3.0	3.9	5.2
<b>Per Share Data (Nkr)</b>					
EPS adjusted	8.47	10.76	12.20	12.84	13.63
EPS reported	8.47	10.76	12.20	12.84	13.63
BVPS	78.61	87.32	99.03	108.36	117.49
Tangible BVPS	74.48	83.32	95.03	104.37	113.50
Adjusted BVPS diluted	78.61	87.32	99.03	108.36	117.49
DPS	2.10	2.70	3.50	4.50	6.00
<b>Profit &amp; Loss (NkrM)</b>					
Net interest income	27,216	30,191	31,521	32,701	34,069
Fees and commissions	6,962	8,537	8,959	9,048	9,139
Other operating Income	7,539	7,890	8,679	8,998	9,651
<b>Total operating income</b>	<b>41,717</b>	<b>46,618</b>	<b>49,159</b>	<b>50,747</b>	<b>52,859</b>
Total operating expenses	-20,759	-21,875	-21,246	-21,392	-21,666
<b>Oper. profit bef. provisions</b>	<b>20,958</b>	<b>24,743</b>	<b>27,913</b>	<b>29,355</b>	<b>31,193</b>
Bad debt provisions	-3,181	-2,034	-1,731	-1,809	-1,942
Non-operating/exceptionals	0	0	0	0	0
<b>Pre-tax profit</b>	<b>17,777</b>	<b>22,709</b>	<b>26,182</b>	<b>27,546</b>	<b>29,250</b>
Tax	-4,080	-5,188	-6,309	-6,638	-7,049
Extraord./Min. Int./Pref. Div.	96	4	0	0	0
<b>Attributable profit</b>	<b>13,793</b>	<b>17,526</b>	<b>19,872</b>	<b>20,908</b>	<b>22,202</b>
Adjusted earnings	13,793	17,526	19,872	20,908	22,202
<b>Growth Rates (%)</b>					
EPS adjusted	6.3	27.1	13.4	5.2	6.2
Oper. profit bef. prov.	-4.0	18.1	12.8	5.2	6.3
<b>Balance Sheet (NkrM)</b>					
<b>Total assets</b>	<b>2,264,845</b>	<b>2,405,239</b>	<b>2,539,072</b>	<b>2,593,838</b>	<b>2,662,477</b>
Avg interest earning assets	2,085,698	2,218,290	2,348,548	2,438,132	2,496,750
Customer loans	1,309,685	1,353,201	1,404,157	1,448,486	1,501,301
Gross NPLs	29,212	30,804	24,574	25,349	26,274
<b>Liab. &amp; shar. funds</b>	<b>2,264,845</b>	<b>2,405,239</b>	<b>2,539,072</b>	<b>2,593,838</b>	<b>2,662,477</b>
Total customer deposits	810,959	867,904	919,168	948,323	982,192
Reserve for loan losses	11,743	11,793	12,370	11,846	11,936
Shareholders' equity	128,035	142,227	161,295	176,502	191,374
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	11.2	13.0	13.1	12.4	12.1
Net interest margin	1.30	1.36	1.34	1.34	1.36
Cost/income ratio	49.8	46.9	43.2	42.2	41.0
Cash cost/average assets	0.9	0.9	0.9	0.8	0.8
NPLs/customer loans	2.2	2.3	1.8	1.8	1.8
Reserve for loan losses/NPLs	40.2	38.3	50.3	46.7	45.4
Bad debt prov./avg. cust. loans	0.2	0.2	0.1	0.1	0.1
Loans/deposit ratio	161.5	155.9	152.8	152.7	152.9
Tier 1 capital ratio	11.0	12.1	12.7	13.5	14.1
Total capital ratio	12.6	14.0	14.6	15.3	15.8

# The Most Profitable Bank in the World

## Investment Positives

**DNB's 1.25x P/TB is trading at a 0.5x discount to Swedish peers**

**DNB Discount Highest Versus Peers:** DNB (1.25x P/TB '14E) is trading at a 0.5x price/tangible book discount relative to Swedish peers, not far from a decade high discount of 0.6x. The highest rated Nordic banks, SHB and Swedbank, trade at 1.9x 2014E P/TB. DNB's implied cost of equity is 2ppt higher versus Nordic peers and most DM retail and commercial bank averages across North America and Europe (using a P/TB model based on 2016E ROTE and zero growth, for simplicity). We believe a lot of "bad news" is still reflected in the current share price. Yet DNB today has bank specific and sovereign fundamentals that are as good as the average Nordic peer, if not better. Today's DNB in terms of earnings quality (predictability of earnings) or balance sheet strength (capital ratios) is not the DNB of the late 1990s/early 2000s, yet it trades at a discount to the Swedish banks comparable to a decade or so ago.

**But the bank's earning quality has improved significantly**

**Improving Earnings Quality:** Legacy DNB of 10-15 years ago had a much more volatile earnings profile relative to Nordic peers. Between 1999 and 2003, DNB's earnings forecast variance was three times Nordic peers (measured as reported profits relative to consensus forecasts a year earlier). By 2009-13, DNB's earnings forecast variance was well below Nordic peers and similar to the regional best in class, SHB. As well as improved earnings predictability, DNB profits have over the past decade been subject to consistently positive earnings revisions: on average, consensus DNB profit forecasts increased 22% during the year before results or 10ppt better than Nordic peers. We expect consensus EPS and DPS estimates for future years to increase further, driven by ongoing positive operating leverage, low sustained loan losses and improving balance sheet trends.

**And its profit/employee of \$260k is highest in the world**

**The Most Profitable Bank In the World:** DNB is the most profitable bank that we cover in the developed world based on attributable profit per employee (\$260k, 2014E), ahead of even Goldman Sachs. The high profitability reflects a very high level of employee productivity as measured by a revenue-per-employee ratio higher than peers and a cost/income ratio superior to all Nordic peers and beaten only by two Australian banks. Only a decade ago, DNB was one of the poorest Nordic banks for cost efficiency – in the early 2000s DNB's cost/income ratio was typically in the 60s and c15ppt or more worse than SHB; for 2014, we forecast a 43% CIR, expected to be the best among regional peers. Despite this high level of efficiency DNB has ongoing cost saving initiatives focused on "One Group" savings, retail distribution efficiencies, corporate banking optimisation and restructuring their life insurance operations.

**We expect payout ratio to reach 65% by 2018, c2.5x the current distribution rate**

**High and Rising Capital Ratios, Dividends to Follow:** DNB's core capital ratios are strong, whether measured as tangible common equity to tangible assets (TCE) at 5.7% at end 1Q14, up from a recent trough of 4% in 2008. Most other Nordic banks have a last reported TCE/TA ratio of c4% at 1Q14. On a CET1 basis, we expect DNB to have exceeded the required 13% level, even on a tough transitional Basel 1 basis. DNB's dividend payout ratio has been only 25% in 2012-13, below the 50% company target, as it has rebuilt capital to meet tough new Norwegian rules. However, we expect the dividend payout ratio to rise rapidly in 2016 onwards and we expect DNB to have an 65% payout ratio in 2018, more in-line with Nordic peers.

## Investment Risks

**Market structure and positive interest rates supports stable margin.**

**Competition and Margins:** DNB's 1Q14 combined loan and deposit spread declined 5bps qoq to 125bps, due to higher volume growth in deposits than lending. The recent drop in DNB's spreads has caused some investor concern but we believe it is a temporary set-back reflecting (1) normal 1Q seasonality and (2) the end of last year's mortgage loan re-pricing push, and (3) rapid deposit growth relative to loans (hurting weighted spreads). We would highlight two structural positives for DNB's margins: (1) despite niche banks capturing share and resulting in the partial rolling back of mortgage spread increases, the Norwegian banking market is relatively consolidated – if we count the Sparebank 1 alliance as a single entity, Norway's top banks have a similar market share as in Sweden; (2) interest rates (NIBOR c1.8%) are not close to zero as in other Nordic countries or the Euro Area and are likely to rise sooner and market rates are already trending up, allowing greater loan/deposit pricing flexibility.

**And shipping quality is improving from a trough in 2013**

**Asset Quality – Shipping A Source of Volatility:** DNB's greater exposure to volatile segments such as shipping has led to concerns over greater credit risks at the group. At end 1Q14, DNB did have a higher bad debt ratio versus the three primary Swedish banks but it was similar to Nordea. Data from the EBA Transparency Exercise (published Dec 2013 based on June 2013 data), DNB's "defaulted loan ratio" is below Nordea's and its coverage ratio was better. Shipping NPLs are still one of the highest balance sheet bad debt segments for DNB, but the ratio has been falling in recent quarters (now c8% down from c13% in 2Q13). Net new shipping provisions amounted to only 50bps in 1Q14, half the level of 1Q13.

**Housing bubble a concern, but should be supported by solid fundamentals.**

**An Expensive Housing Market:** Norwegian house prices are expensive (avg price for new detached house is \$4,900/ square meter. Norway house prices have almost doubled over past 10 years. House price values and transaction volumes began to decline late in 2013 (Sep-Nov), lead to concern in some quarters. However, in 2014 YTD this drop in values and volumes has been reversed. DNB also has a higher average mortgage LTV ratio of 64%, compared to the Swedish banks between 50% and 60%. However, the low unemployment rate in Norway (3.3%) and generous welfare state keeps mortgage (and other consumer) credit losses low. We expect a solid GDP progression of c2% real and c4% nominal in 2014 and 2015. Norway's general government net financial assets amounted to c200% of GDP whereas for most OECD countries the figure is a net liability of c50-100% (OECD, 2013).

**Trading and insurance can add volatility, but DNB non NII trends more predictable**

**Potentially Volatile Non NII, especially Market Return Driven Income:** Non net interest income at DNB includes potentially volatile line items such as traditional life insurance and trading income that are reliant on market returns and intrinsically harder to forecast relative to banking spread income (NII). DNB used to have a high proportion of revenues of c45% in the mid-2000s coming from trading, fee income and insurance. This has decreased to only 35% in 2013 and compared to DNB's Non-NII revenue gearing is now the second lowest after SHB among Nordic. Also, DNB's non NII income, including basis swap income that creates quarterly volatility, has an annual income volatility below the Nordic average (eg more consistent) and is more in-line with the likes of Nordea and SEB.

## Franchise Overview

### The merger of DnB and Gjensidige NOR in 2003 created DNB NOR ASA.

The DNB of today, a dominant domestic Universal banking group with strengths in key Norwegian industries such as shipping, was created by combining the legacy Den norske Bank (DnB) and Gjensidige NOR in 2003. Neighbouring Nordic markets, including Sweden and Denmark, had experienced a wave of financial sector consolidation in the 1990s post financial crisis. In Norway, the transformative domestic combination took place as late as 2003-04.

The new DnB NOR ASA was legally established on 4 December 2003 through the merger of DnB Holding ASA and Gjensidige NOR ASA. Their respective bank units, Den norske Bank ASA and Union Bank of Norway ASA, merged on 19 January 2004, and their insurance units Vital Forsikring ASA and Gjensidige NOR Spareforsikring ASA merged on 9 March 2004. This provided a platform for future expansion into neighbouring Nordic and Baltic countries.

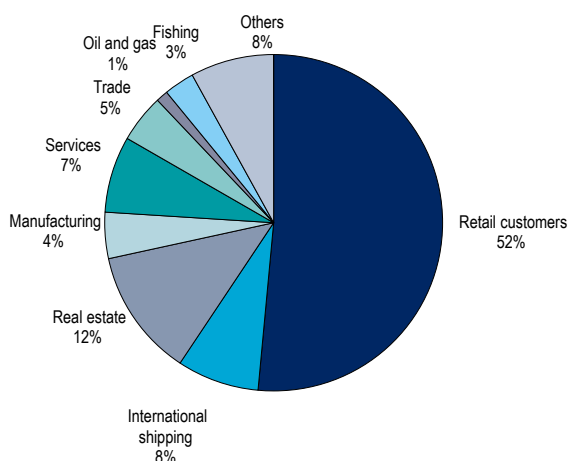
### Legacy DnB was a large corporate and international focused bank

The legacy DnB was Norway's largest bank but primarily focused on corporate banking and capital markets. It had a dominant market share with large clients and international business related to Norway. In 2002, DNB serviced payment flows for greater than 50% of Norway's foreign trade and was the lead bank for 60% of the top 300 companies in Norway. It was also a global leader in ship finance. In 2002, retail clients were only c35% of DNB credit commitments (including undrawn).

### Gjensidige NOR retail and SME client focused, with a mutual heritage

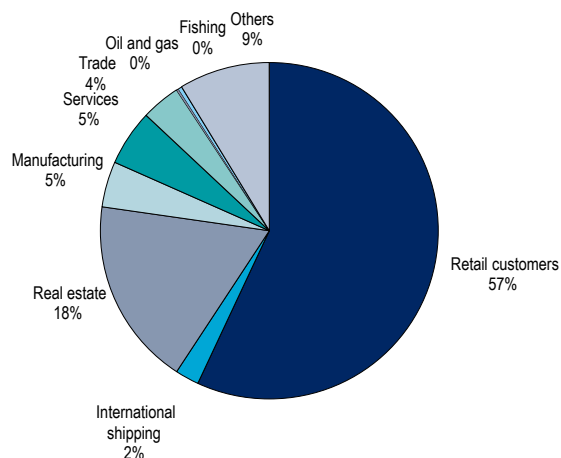
By contrast with the legacy DnB, Gjensidige NOR was a domestic Norwegian focused business with a strength in retail and SME clients via its savings bank (Union Bank of Norway) and its mutual insurance company (Gjensidige NOR Spareforsikring). These entities had only been transformed into public limited companies from their previous savings bank and mutual status following a change in Norwegian law in 2002 permitted it. The business mix and heritage of Gjensidige NOR was very different to DnB.

Figure 3. Den Norske Bank – Loan Portfolio Split by Type 2003



Source: Company Reports

Figure 4. Gjensidige NOR - Loan Portfolio Split by Type 2003



Source: Company Reports

**After consolidating at home in 2003-04,  
DNB expanded in Northern Europe**

The group grew internationally through taking a majority stake in DnB NORD in 2005 (51%), which became a fully owned subsidiary in 2010 (remaining 49%). This company was a JV originally with Nord LB. Headquartered in Denmark, it was set up to serve clients in Finland, the Baltics and Poland. In 2005, the group named Sweden a new home market and doubled its loan book in the country via organic growth and portfolio acquisitions. In 2005 it also expanded into Russia by acquiring Monchebank, a bank in the Murmansk region.

**Figure 5. DNB - Major M&A Transactions**

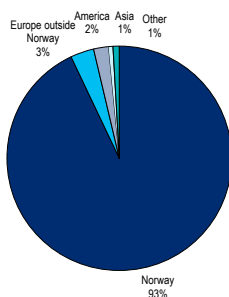
Announce Date	Close Date	Target	Acquirer
16 Dec '13	16 Dec '13	Svensk Fastighetsformedling AB	Swedbank AB
06 Sep '12	06 Sep '12	SalusAnsvar AB	Folksam Omsesidig Livförsäkring
02 Aug '10	23 Dec '10	DnB NORD A/S	DnB NOR ASA
23 Oct '07	31 Jan '08	SkandiaBanken Bilfinans AS	DnB NOR ASA
20 Aug '07	01 Nov '07	SalusAnsvar AB	DnB NOR ASA
18 Apr '07	27 Jun '07	Svensk Fastighetsformedling AB	DnB NOR ASA
22 Dec '06	27 Apr '07	BISE Bank SA	DnB NOR ASA
27 Oct '05	31 Jan '06	DnB NOR Monchebank OAO	DnB NOR ASA
30 Sep '05	30 Sep '05	Norddeutsche Landesbank Girozentrale /Sweden	DnB NOR ASA
31 Mar '04	07 May '04	ELCON Finans AS	Santander Central Hispano SA
<b>13 Mar '03</b>	<b>02 Dec '03</b>	<b>Gjensidige Nor Sparebanken ASA</b>	<b>DnB NOR ASA</b>
20 Dec '02	21 Feb '03	NordlandsBanken ASA	Den Norske Bank AS
08 Jan '02	31 May '02	Skandia Asset Management Ltd	Den Norske Bank AS
23 Mar '99	23 Mar '99	Postbanken AS	Den Norske Bank AS
01 Jun '98	01 Jun '98	Gjensidige Bank ASA	Union Bank of Norway ASA
01 May '95	01 May '95	DNB Livförsäkring ASA	Den Norske Bank AS

Source: FactSet

**DNB's portfolio is now more diversified  
geographically.**

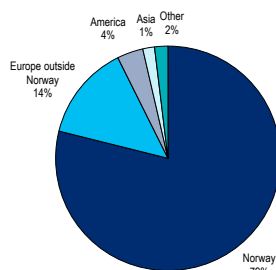
DNB expanded outside Norway over the past decade. Its loans in Norway was 93% of total loan book in 2003, this ratio decreased to c80% in 2007 and now less than 70% of the loans are in Norway. Recently, DNB started to rationalise its overseas business: in 2012, it sold its Swedish insurance and banking business SalusAnsvar to Folksam; in 2013, it divested its Swedish insurance and real estate broking business to Swedbank. Both businesses had been bought in 2007 as part of the group's Swedish expansion.

**Figure 6. DNB - Loan Split by Geography 2003**



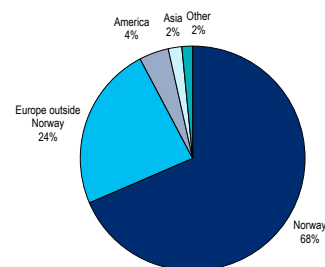
Source: Company Reports

**Figure 7. DNB - Loan Split by Geography 2007**



Source: Company Reports

**Figure 8. DNB - Loan Split by Geography 2013**

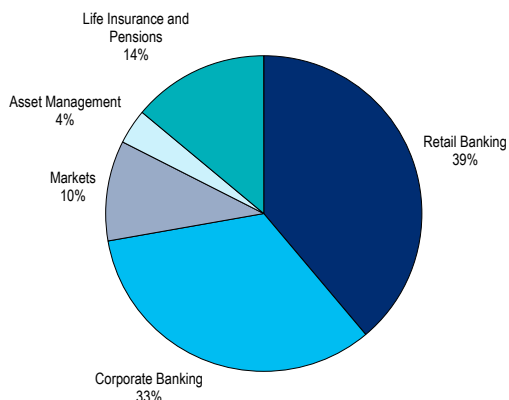


Source: Company Reports

**Revenue contribution from volatile business decreased.**

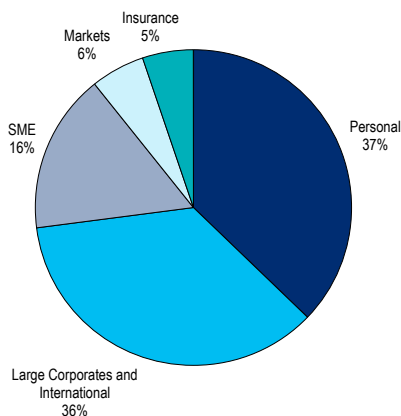
In terms of revenue mix, personal and large corporate divisions contribute more than 1/3 each to the total revenue. The revenue contribution from markets and life insurance has decreased since 2003. This in our opinion has reduced the earnings volatility of DNB over the years.

**Figure 9. DNB – Revenue Split by Division 2003**



Source: Company Reports

**Figure 10. DNB – Revenue Split by Division 2013**

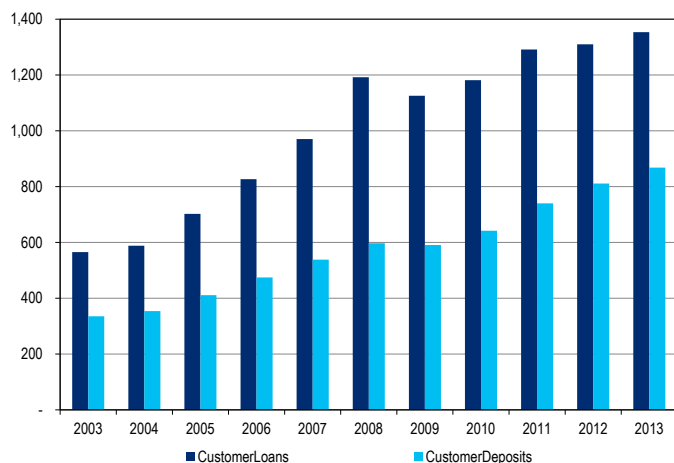


Source: Company Reports

**DNB has high profitability throughout the cycle, with an ROA averaging c0.8%**

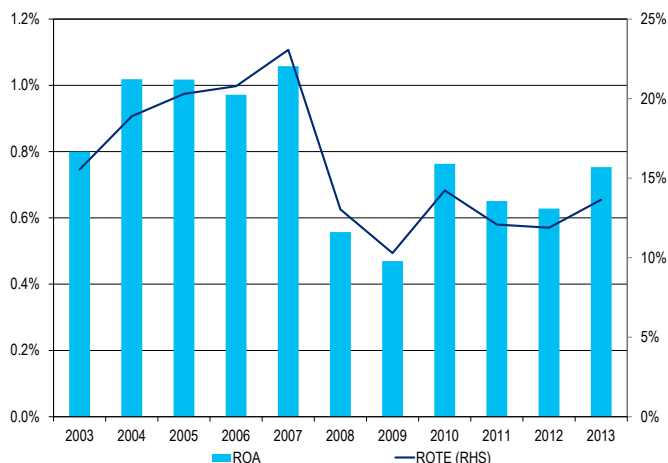
Through acquisition and organic growth, DNB's customer loans more than doubled in the past decade and its customer deposits almost tripled. DNB's profitability measured by ROA was as high as 1% from 2004 to 07, albeit loan losses in these years were close to zero. After a 2 year decline during global financial crisis, DNB's ROA is expanding again – it was c75bps in 2013 and we expect it to increase to c90bps in 2018E. Its return on tangible equity has been consistently above 10% in the past decade, even in crisis years; it is now c13%.

**Figure 11. DNB – Loan vs Deposits 2003-2013 (Nkr in Billions)**



Source: Company Reports

**Figure 12. DNB – ROA vs ROTE 2003-2013**



Source: Company Reports



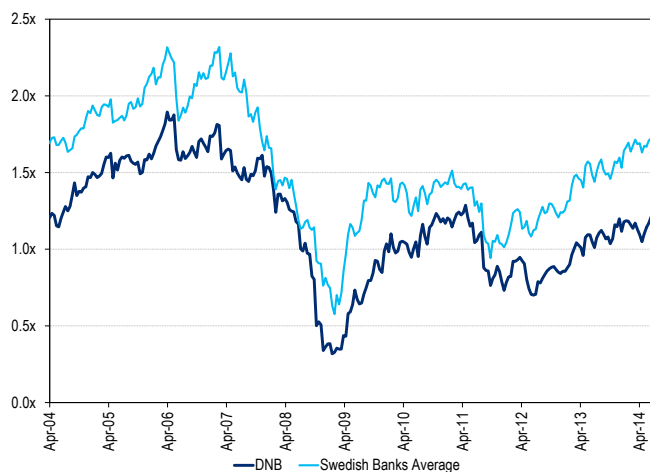
# Valuation – High Discount Given Increasing Earnings Quality

## DNB Valuation Discount to Swedes Close to Decade Wide

**DNB is trading close to decade wides (eg discount) relative to Swedish banks on a P/TB basis**

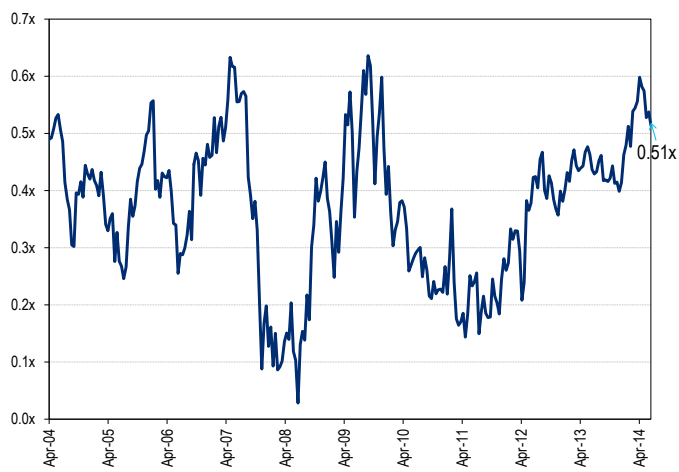
DNB's valuation discount to the Swedish banks, based on the latter's sector average price/tangible book ratio, reached a decade high of 0.6x in April 2014 and has subsequently narrowed somewhat. DNB is currently trading at c1.25x 2014E tangible book value versus a market-cap weighted average for Swedish banks of c1.8x. The P/TB valuation spread between DNB and the Swedes is now at c0.5x, which is not far off the peak valuation divergence in 2007, 2009 and early this year.

Figure 13. P/TB 1Y Forward DNB vs Swedish Banks Average



Source: Powered by dataCentral

Figure 14. P/TB Swedish Banks Premium over Norway

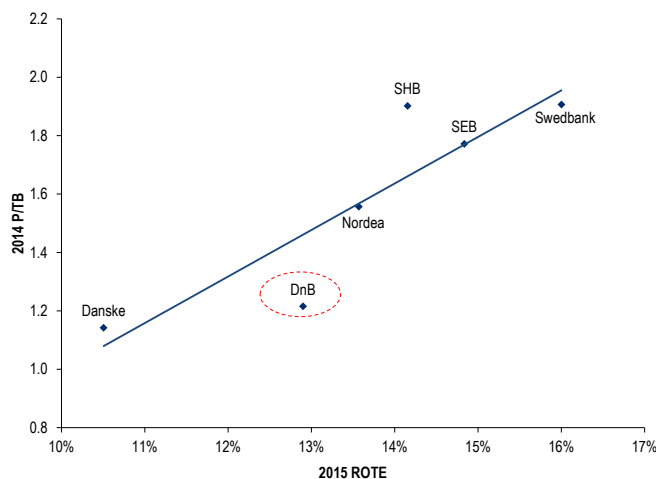


Source: Powered by dataCentral

**Risk-free rates in Norway may merit a higher COE for DNB, but the bank also benefits from predictable earnings, high capital levels and a strong sovereign**

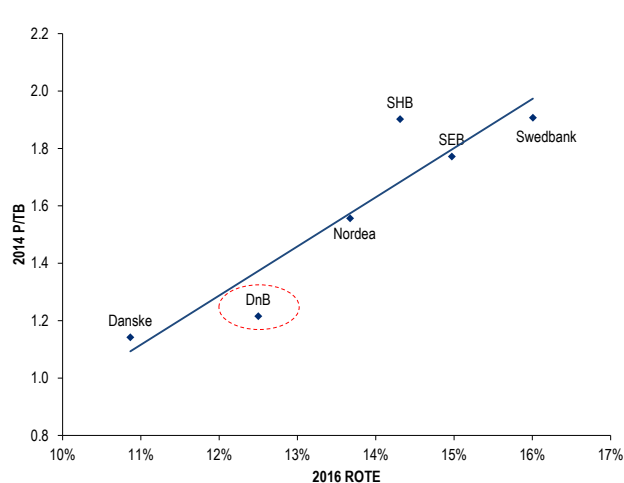
As we highlight in the charts below, based on P/TB relative to forecast 2015-16E ROTE, DNB appears mispriced. Due to higher risk-free rates in Norway versus neighbouring Nordic countries, DNB may warrant a higher COE, but how risky is it fundamentally? As we will discuss in this report, we believe that DNB's earnings predictability and balance sheet characteristics (capital, bad debts) are similar to, or better than, most Nordic bank peers. Despite this the implied cost of equity for DNB is above all major Nordic peers and averages for other DM commercial and retail banks (see Figure 17- Figure 18).

Figure 15. Nordic Banks 2014 P/TB vs 2015 ROTE



Source: Citi Research estimates

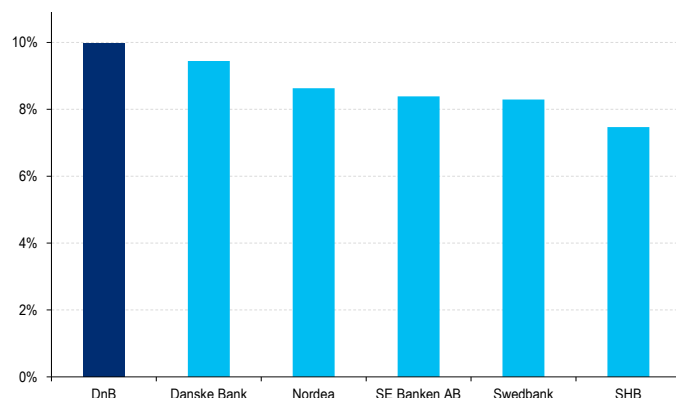
Figure 16. Nordic Banks 2014 P/TB vs 2016 ROTE



Source: Citi Research estimates

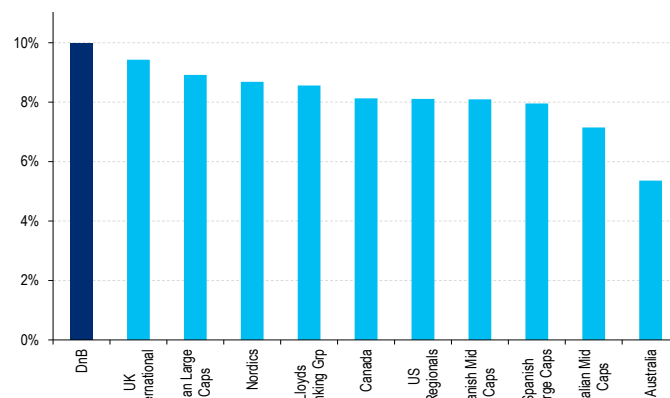


Figure 17. Nordic Banks – Implied Cost of Equity



Source: Citi Research; Implied Cost of Equity is estimated as FY16 ROTE divided by FY14E P/TB

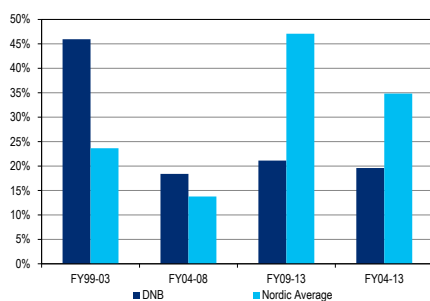
Figure 18. Global Banks - Implied Cost of Equity



Source: Citi Research; Implied Cost of Equity is estimated as FY16 ROTE divided by FY14E P/TB

**DNB's earnings predictability has improved over the past decade.**

Figure 19. DNB Profits are Now More Predictable



Source: DataStream IBES Estimates; Citi Research Estimates. Data based on difference between 2000-13 annual reported EPS vs IBES consensus estimates a year earlier

## Earnings Predictability and Positive Momentum Has Increased

Over the past decade, DNB's earnings predictability has improved. During the 5-year period 1999-2003, DNB on average reported earnings 4% ahead of consensus forecast a year earlier, similar to the average for Nordic peers but well behind the best in class in the region which in this period was Danske Bank followed by SEB and SHB. The unpredictability of outcomes was also much greater for DNB during 1999-2003: the standard deviation of earnings versus consensus forecast was twice as high and variance three times as high for DNB versus peers.

Over the past 5 years, 2009-2013, DNB on average reported earnings 17% ahead of consensus forecast a year earlier, in-line with the best in class in the Nordic bank sector and well ahead of the average. The predictability of outcomes also narrowed for DNB during 2009-2013: the standard deviation and variance of earnings versus consensus forecast was much lower for DNB versus peers and as low as the best in class in the region, SHB.

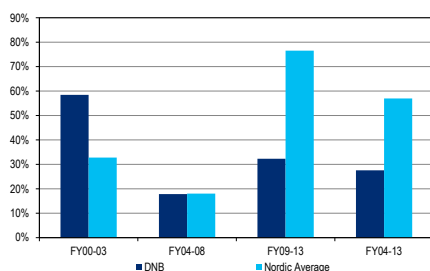
Figure 20. Nordic Banks Earnings Predictability (Reported vs Consensus 1 Year ago)

FY99-03	DNB	SWED	SEB	SHB	NDA	DANSKE	AVERAGE
Stdev	46%	16%	16%	16%	29%	18%	24%
Variance	21%	3%	2%	3%	9%	3%	7%
Average	4%	-4%	8%	8%	-5%	13%	4%
Median	10%	-9%	4%	-1%	-10%	8%	0%
FY04-08	DNB	SWED	SEB	SHB	NDA	DANSKE	AVERAGE
Stdev	18%	19%	10%	15%	8%	12%	14%
Variance	3%	4%	1%	2%	1%	1%	2%
Average	28%	25%	10%	12%	25%	12%	19%
Median	16%	20%	7%	10%	21%	10%	14%
FY09-13	DNB	SWED	SEB	SHB	NDA	DANSKE	AVERAGE
Stdev	21%	112%	46%	17%	28%	57%	47%
Variance	4%	126%	21%	3%	8%	33%	33%
Average	17%	18%	-4%	16%	14%	-31%	5%
Median	22%	2%	-7%	10%	11%	-28%	2%
FY04-13	DNB	SWED	SEB	SHB	NDA	DANSKE	AVERAGE
Stdev	20%	76%	32%	15%	21%	45%	35%
Variance	4%	58%	10%	2%	4%	20%	17%
Average	22%	22%	3%	14%	20%	-10%	12%
Median	22%	11%	7%	10%	19%	3%	12%

Source: DataStream IBES Estimates; Citi Research Estimates; Data based on difference between 2000-2013 annual reported EPS vs IBES consensus estimates EPS a year earlier.

**DNB's earnings volatility is less than half of Nordic peers.**

**Figure 21. DNB Profits are Now Less Volatile**



Source: Citi Research. Volatility measured as standard deviation of EPS Change YoY

**DNB's above average returns creates buffers to absorb volatility.**

Not only have earnings become more predictable, DNB's underlying yoy earnings volatility has also not surprisingly decreased. The group's earnings volatility was as high as 58% during 2000-03 (standard deviation of EPS change yoy), 25ppt above the Nordic peer average. This is partly because the group changed rapidly during the period through M&A and the legacy DNB had a greater gearing to intrinsically volatile businesses such as trading and large corporate banking. DNB's earning volatility decreased during 04-08, in-line with the Nordic average. During the recent turbulent years, DNB did see an increase in earnings volatility but it remained better than average – only SHB and Nordea had more consistent annual earnings trends.

**Figure 22. Nordic Banks Earnings Volatility**

FY00-03	DNB	SWED	SEB	SHB	NDA	DANSKE AVERAGE
Stdev	58%	28%	19%	20%	49%	23%
Variance	34%	8%	4%	4%	24%	5%
Average	21%	0%	2%	11%	6%	13%
Median	12%	-10%	6%	5%	-2%	11%
FY04-08	DNB	SWED	SEB	SHB	NDA	DANSKE AVERAGE
Stdev	18%	27%	18%	11%	25%	11%
Variance	3%	7%	3%	1%	6%	1%
Average	27%	24%	22%	16%	34%	14%
Median	12%	37%	18%	18%	24%	14%
FY09-13	DNB	SWED	SEB	SHB	NDA	DANSKE AVERAGE
Stdev	32%	64%	205%	17%	18%	122%
Variance	10%	41%	421%	3%	3%	150%
Average	4%	-8%	77%	-1%	-2%	46%
Median	-13%	13%	8%	8%	0%	70%
FY04-13	DNB	SWED	SEB	SHB	NDA	DANSKE AVERAGE
Stdev	28%	47%	140%	16%	28%	84%
Variance	8%	22%	197%	3%	8%	70%
Average	16%	10%	50%	8%	16%	30%
Median	20%	27%	13%	13%	15%	16%

Source: DataStream; Citi Research Estimates; Volatility measured as standard deviation of EPS Change YoY.

**High NIM, Profits Helps – as does lower and less volatile Non NII**

DNB's greater earnings predictability is partly a reflection of better returns overall versus peers, both on an ROA and ROE basis in the past decade, and this creates a greater earnings buffer to absorb volatility. DNB has benefited over the years from improved cost efficiency (cost/asset ratio declined to 1.0% in 2009-13 from 1.3% in 2004-08 and 2.2% in 1999-2003). Also the group's lower gearing to trading and insurance income versus its results in the late 1990s/early 2000s helps.

**Figure 23. DNB vs Nordic Banks ROE DuPont Analysis**

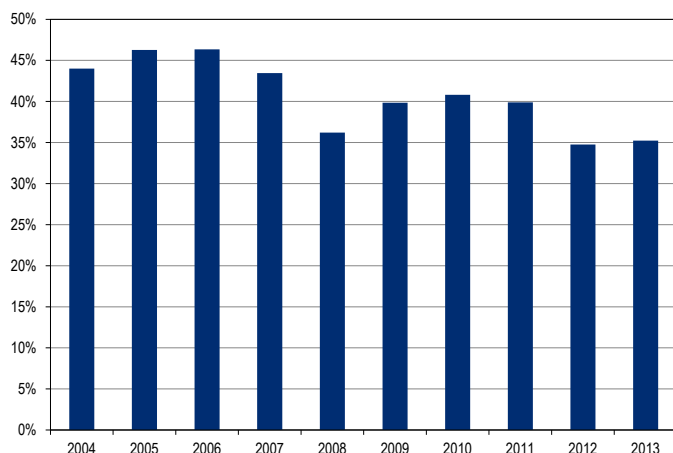
	1999-03		2004-08		2009-13		2013	
	DNB	Nordic Avg	DNB	Nordic Avg	DNB	Nordic Avg	DNB	Nordic Avg
Net Interest Income	2.2%	1.4%	1.4%	1.1%	1.3%	1.0%	1.3%	1.0%
Non Interest Income	1.3%	1.1%	1.1%	0.9%	0.8%	0.7%	0.7%	0.7%
<b>Total Revenue</b>	<b>3.5%</b>	<b>2.5%</b>	<b>2.4%</b>	<b>2.0%</b>	<b>2.0%</b>	<b>1.7%</b>	<b>2.0%</b>	<b>1.6%</b>
Total Operating Expense	-2.2%	-1.5%	-1.3%	-1.1%	-1.0%	-0.9%	-0.9%	-0.8%
PPOP	1.3%	1.0%	1.1%	0.9%	1.1%	0.8%	1.1%	0.8%
Provisions	-0.1%	-0.1%	0.0%	0.0%	-0.2%	-0.2%	-0.1%	-0.1%
<b>PBT</b>	<b>1.2%</b>	<b>0.9%</b>	<b>1.2%</b>	<b>0.9%</b>	<b>0.9%</b>	<b>0.6%</b>	<b>1.0%</b>	<b>0.7%</b>
Tax / Minorities / Others	-0.3%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%
<b>ROA</b>	<b>0.9%</b>	<b>0.7%</b>	<b>0.9%</b>	<b>0.7%</b>	<b>0.7%</b>	<b>0.4%</b>	<b>0.8%</b>	<b>0.5%</b>
Leverage	16.1x	22.7x	22.3x	25.4x	18.0x	22.9x	17.2x	21.0x
<b>ROE</b>	<b>14.8%</b>	<b>14.5%</b>	<b>20.8%</b>	<b>17.5%</b>	<b>11.6%</b>	<b>9.4%</b>	<b>13.0%</b>	<b>11.1%</b>

Source: Company Reports and Citi Research Estimates

**Revenue is now more stable with 65% coming from NII.**

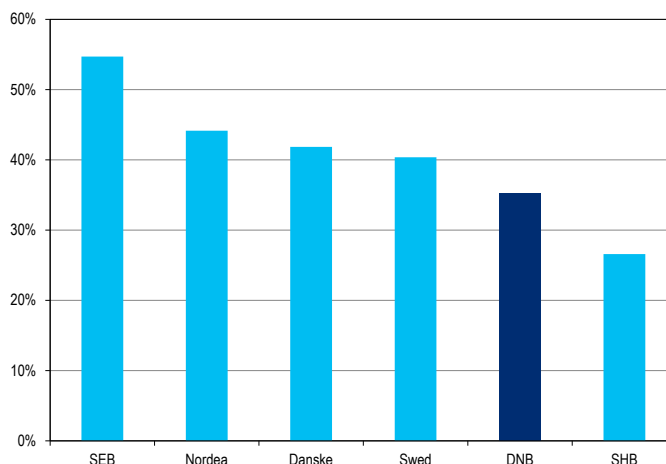
The decreasing proportion of Non-NII income contributes to the decreasing earnings volatility. DNB used to have a high proportion of other income, c45% in 2005, coming from trading, fee income and insurance. This has decreased to only 35% in 2013. Compared to other Nordic peers, DNB's Non-NII revenue is now the second lowest after SHB.

**Figure 24. DNB – Non NII Revenue % Total Revenue 2004-2013**



Source: Company Reports

**Figure 25. Nordic Banks– Non NII Revenue % Total Revenue 2013**



Source: Company Reports

We measured the volatility of Non-NII revenue by the standard deviation of YoY change in Non-NII revenues. In each sub-period and full period we measured since 2004, DNB's non-NII income volatility is below the Nordic average (eg more consistent) and is more in-line with the likes of Nordea and SEB.

**The Non-NII revenue volatility for DNB has been low compared to peers.**

**Figure 26. Nordic Banks – Non-NII Revenue Volatility**

FY04-08	DNB	Danske	Nordea	SEB	SHB	Swed	Average
Stdev	13.2%	16.8%	12.5%	15.5%	21.8%	19.1%	16.5%
Variance	1.7%	2.8%	1.6%	2.4%	4.8%	3.6%	2.8%
Average	9%	4%	4%	11%	9%	14%	9%
Median	11%	4%	3%	21%	20%	7%	11%
FY09-13	DNB	Danske	Nordea	SEB	SHB	Swed	Average
Stdev	12.8%	51.6%	10.1%	10.8%	5.6%	5.7%	16.1%
Variance	1.6%	26.6%	1.0%	1.2%	0.3%	0.3%	5.2%
Average	6%	7%	7%	1%	-2%	0%	3%
Median	8%	-12%	10%	2%	-3%	-2%	0%
FY04-13	DNB	Danske	Nordea	SEB	SHB	Swed	Average
Stdev	12.3%	36.2%	10.9%	13.7%	16.0%	15.1%	17.4%
Variance	1.5%	13.1%	1.2%	1.9%	2.6%	2.3%	3.8%
Average	8%	6%	6%	6%	3%	7%	6%
Median	10%	-3%	6%	5%	-3%	3%	3%

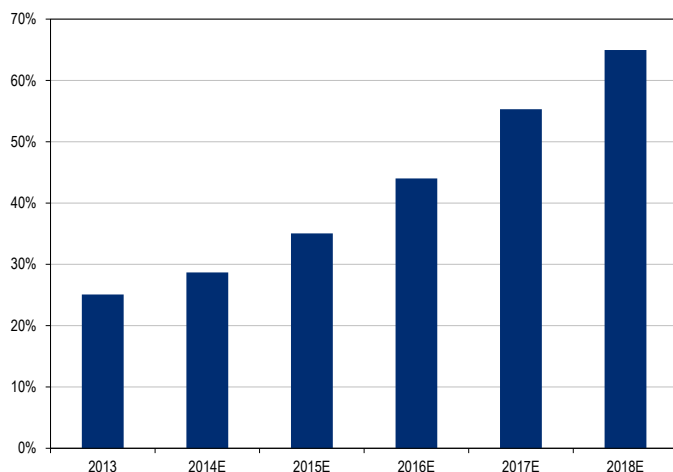
Source: Company Reports and Citi Research Estimates; Volatility calculated as standard deviation of YOY change in Non-NII income.

## From Capital Rebuild to Capital Return

**DNB's dividend payout ratio is expected to reach 65% by 2018.**

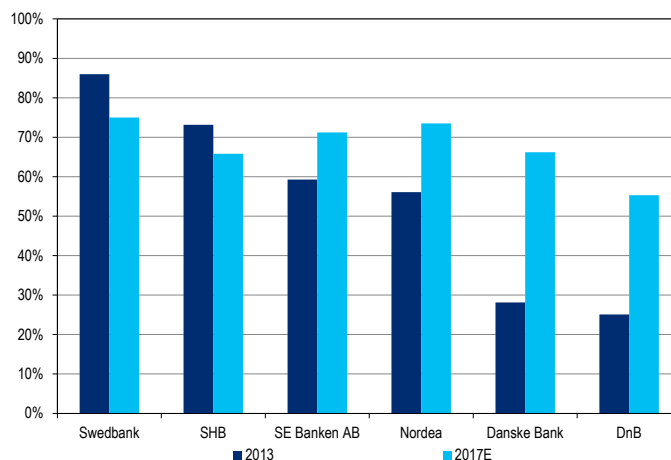
While DNB's earnings quality has been improving, rising regulatory pressures on minimum requirements has led to a reduction in the group's dividend which has in the past couple of years lagged Swedish banks. DNB's dividend payout ratio has been only 25% in 2012-13, below the 50% company target, as it has rebuilt capital to meet tough new Norwegian rules. However, we expect the dividend payout ratio to rise rapidly in 2016 onwards and we expect DNB to have a 65% payout ratio in 2018, more in-line with Nordic peers. We believe this is not priced into the shares.

**Figure 27. DNB – Dividend Payout Ratio**



Source: Company Reports and Citi Research Estimates

**Figure 28. Nordic Banks – Dividend Payout Ratio 2013 vs 2017E**

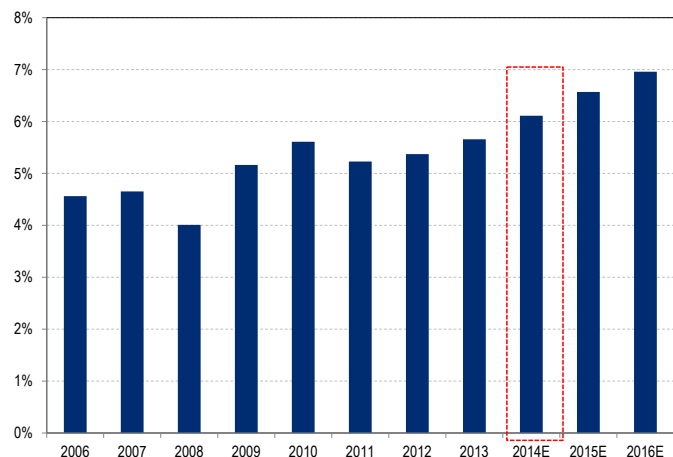


Source: Company Reports and Citi Research Estimates

**DNB has a best-in-class 5.7% TCE/TA ratio, Nordic peers are at levels similar to DNB's 2008 trough levels**

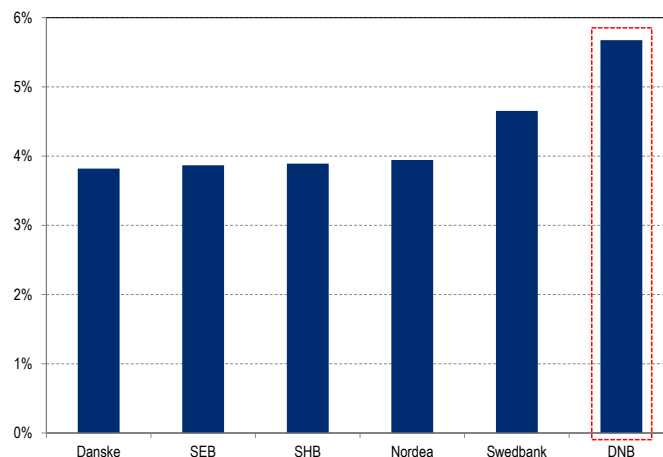
DNB has steadily built up its capital ratios. If we track a simple balance sheet leverage metric such as tangible common equity (TCE) to tangible assets (TA), we can see a material improvement in DNB's TCE/TA ratio and also how much higher versus Nordic peers it is. DNB's TCE/TA ratio reached 5.7% in 1Q14, up from a recent trough of 4% in 2008. Most other Nordic banks have a last reported TCE/TA ratio of c4% at end-1Q14 – similar to DNB at its 2008 trough.

**Figure 29. DNB – Tangible Common Equity to Tangible Assets**



Source: Company data, Citi Research estimates

**Figure 30. Nordic Banks – Tangible Common Equity to Tangible Assets 1Q14**

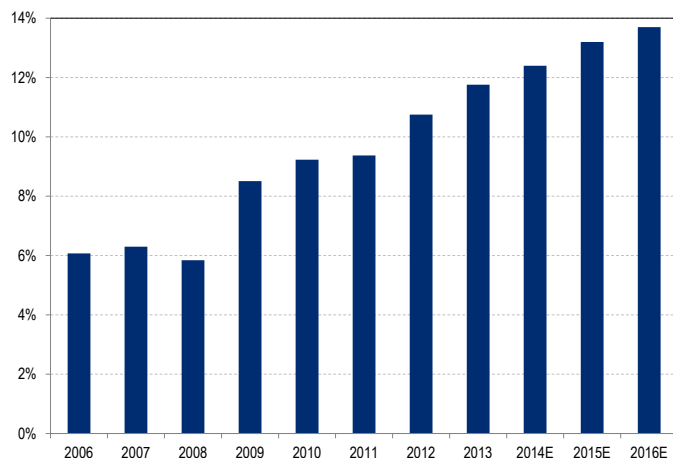


Source: Company data, Citi Research estimates

**We forecast DNB will exceed the required 13% CET1 capital ratio, on a tough Basel 1 transitional basis, in advance of the 2016 deadline.**

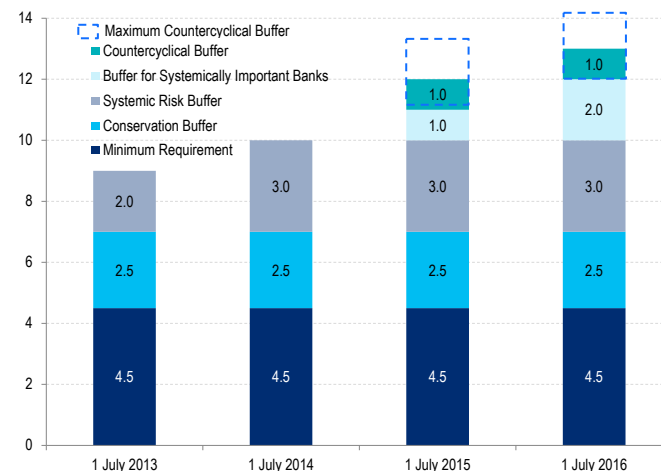
How much capital does DNB need? According to Norwegian regulatory rules, DNB will need to hold between 12% core equity Tier 1 (CET1) capital by 1 July 2016, plus a 1ppt counter-cyclical buffer. We expect DNB to have exceeded the required 13% CET1 capital ratio, even on a tough Basel 1 transitional basis, by the end of 2015. By end 2016, DNB should be close to 14% CET1 on a B1 transitional basis and above 16% on a fully loaded B3 basis.

**Figure 31. DNB – CET1 Ratio, B1 Transitional Rules**



Source: Company data, Citi estimates

**Figure 32. Common Equity Tier 1 capital requirements in the new regulatory framework. Percent. 1 July 2013 – 1 July 2016**

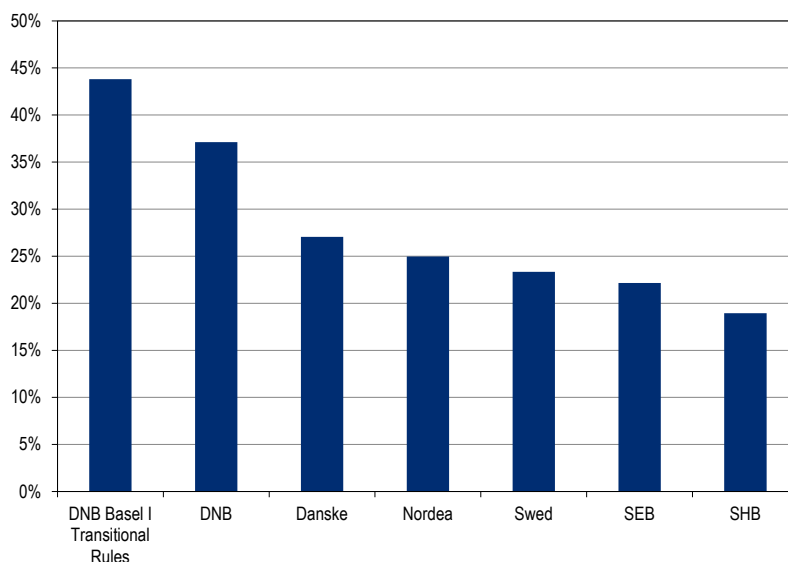


Source: Norges Bank

**DNB has the highest RWA density among Nordic peers.**

We derive comfort from the fact that DNB's RWA density is amongst the highest in its peer-group, partly reflecting exposure to higher risk segments such as shipping but also pointing to a lower probability of potential regulatory action towards RWA calculation methodologies given that the existing Basel 1 transitional rules are already adequately tough (eg residential mortgages at 40% RWA).

**Figure 33. Nordic Banks – RWA Density (1Q14)**



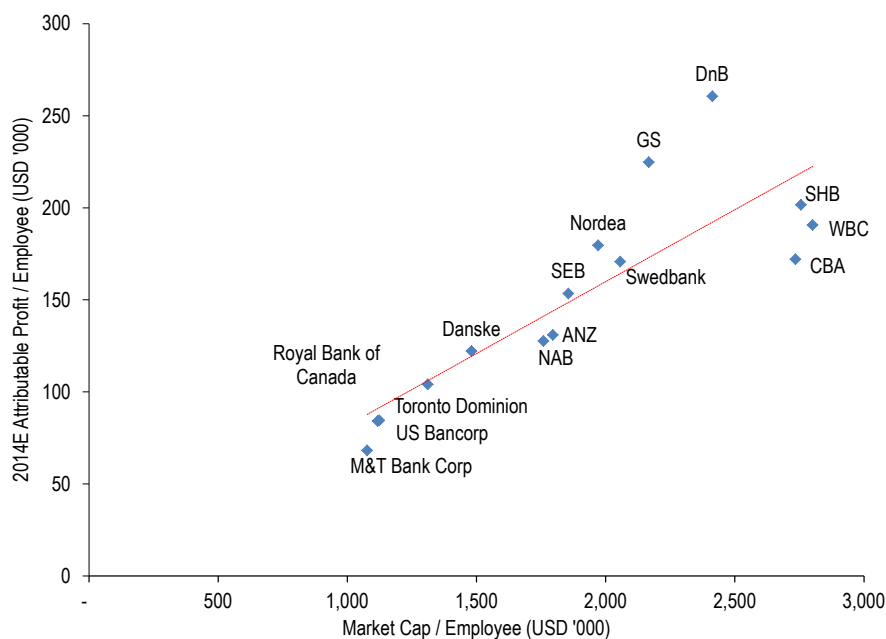
Source: Company Reports and Citi Research Estimates; RWAs are based on CRD IV final rules unless otherwise stated. Danske's RWA is based on CRD IV transitional rules.

## Cost Efficiency and the Most Profitable Bank in the World

DNB is more profitable than Goldman Sachs per employee. Based on forecast 2014E net profit per employee (last reported), DNB has the highest net profit per employee of any bank we cover in developed economies. Goldman Sachs is in second place followed by Svenska Handelsbanken (SHB) and a group of other Nordic and Australian banks. The most valuable banks in the world, based on equity market capitalization per employee, are SHB and a couple of Australian banks. DNB is not far behind on this metric either, albeit it is not number one.

**DNB is the most profitable bank in the world and also among the most valuable banks in the world, as measured by profit and equity market value per employee**

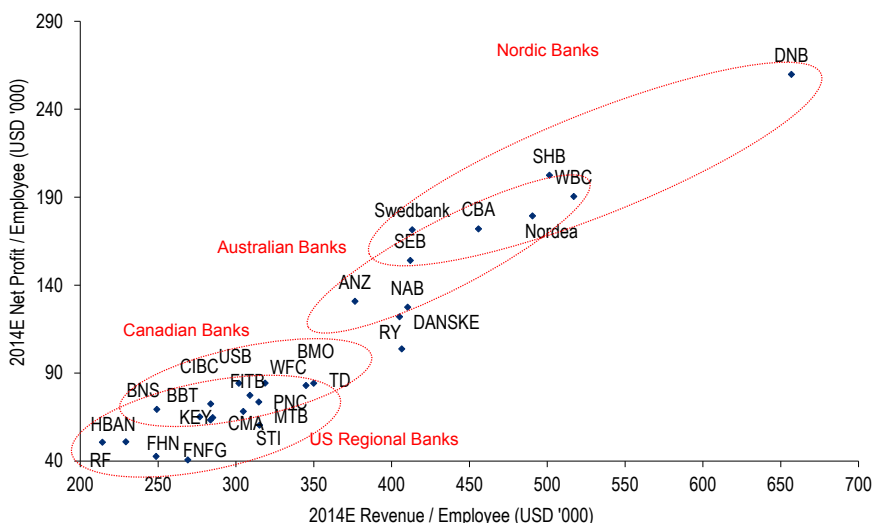
Figure 34. Profit per Employee vs Market Cap Per Employee (in \$'000's)



Source: Bloomberg; dataCentral; Note: Based on top 15 banks on market cap/employee metric

**We forecast DNB is to have the highest 2014 net profit per employee (\$260,000) and revenue per employee (\$660,000)**

Figure 35. 2014E Revenue / Employee and Net Profit / Employee by Bank



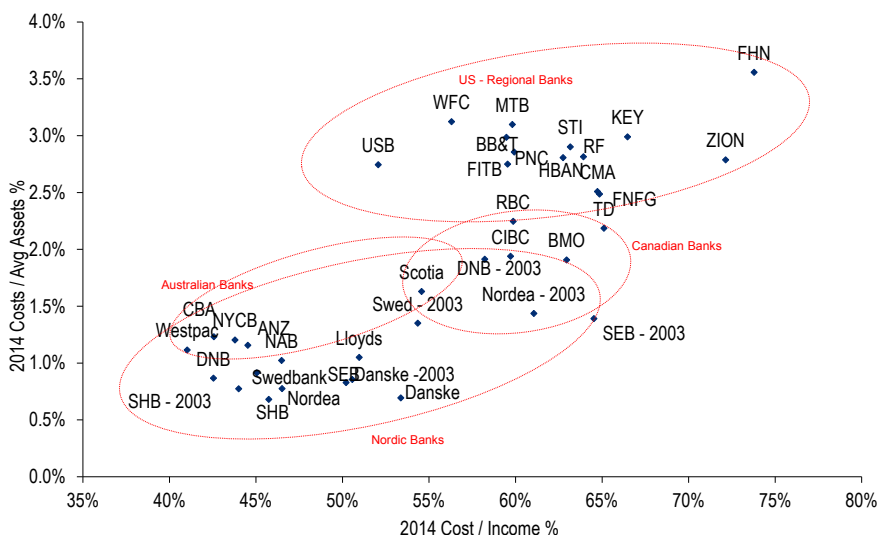
Source: Company data, Citi Research estimates; Note: Headcount data as of 1Q14.

**DNB FY14 expected cost/income ratio of low 40% will likely be the best among Nordic peers – it should better SHB**

### Cost Efficiency: DNB moving ahead of Nordic peers on Cost/Income

DNB's high profitability per employee is reflected in a very competitive cost/income ratio. In 2014E, we expect DNB's cost/income ratio to be close to 40%, which is the best among its Nordic peers and lags only a very small number of developed market commercial banks. If we scroll back a decade, DNB's cost/income ratio was 15ppt higher and a similar gap behind the Nordic best in class (at the time, SHB). On a cost/asset basis, DNB today is sub 1%, half the level of a decade ago, but it is not as low as the likes of SHB (68bps) or Nordea (77bps).

**Figure 36. 2003 & 2014 Cost/Income vs Cost to Avg Assets by Bank**



Source: Company data, Citi Research

**There are cost initiatives in place to keep cost flat.**

DNB has already achieved its cost/income and headcount targets between 1-3 years ahead of target (see Figure 37 below). However, we expect improvements in the bank's cost/income ratio driven by ongoing operating leverage and further cuts to headcount.

**Figure 37. DNB: Cost Related targets**

**Cost Related Targets:** Flat average nominal cost (excluding restructuring costs) towards 2016  
Cost/income ratio below 45 per cent towards 2016  
ROE > 12%  
2014E FTE of approx. 12,000: 300-400 FTE Reduction between 3Q13 and end-2014

Source: Company Reports

DNB had announced an extensive cost control initiative at its 2012 Capital Markets Day involving 4 pillars of (1) increased efficiency – “One Group” initiative, such as IT consolidation and increased offshoring, (2) more efficient retail distribution, closing branches and adapting services and products (3) Optimising corporate banking across geographies, and (4) restructuring life insurance.

The group expanded its previous cost saves target during the 2013 Capital Market Day in November and also providing a status update of cost saves achieved relative to the initial targets, as set out in the table below. We would expect DNB to continue to focus on these cost saving measures, with a lot of further upside from “One Group” savings and to a lesser extent from retail distribution and restructuring insurance.



Figure 38. Cost Control Initiatives at DNB

Cost Initiative	Steps / Features
<b>Increased efficiency – One Group:</b> Developing a more dynamic and lean organization Total cost initiatives estimated at NOK 450–550 million in the 2012 to 2016 period: Realized c50m by 3Q13	Change IT sourcing model, consolidate and decommission IT systems Scale and optimise back office/support functions  Offshore bank production to the Baltics Procurement Savings
<b>More efficient retail distribution:</b> Cost savings driven mainly by changes in distribution model Total cost initiatives estimated at NOK 400–450 million in the 2012 to 2016 period: Realized 250m by 3Q13	33 branches shut down Number of management levels reduced  SalusAnsvar divested Nordlandsbanken integrated Increased self service Continuous adaptation of distribution channels Reductions in product range Additional divestments
<b>Optimising corporate banking across geographies:</b> Continued restructuring of international activities Total cost initiatives estimated at NOK 300–350 million in the 2012 to 2016 period: Realized 200m by 3Q13	Optimised core functions across geographic and industry segments Restructured banking activities in Poland  Further restructuring of international activities
<b>Restructuring life insurance:</b> Discontinuation of public sector activities and further streamlining measures Total cost initiatives estimated at NOK 450–500 million in the 2012 to 2016 period: Realized 250m by 3Q13	Process automation, standardisation and lean back-office operations Streamlining of customer service and sales  Public sector activities discontinued Co-localisation and closer group integration Streamlining of customer service and sales Further downscaling of resources to reflect reduced activity

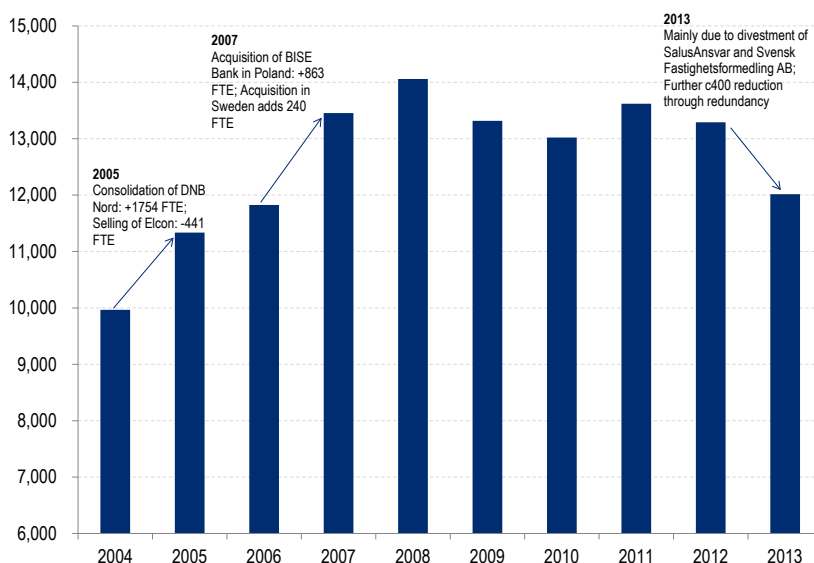
Source: Company Reports. Nov 2013 Capital Markets Day.

**DNB staff numbers declined 9% due to business sales, redundancies and a new group structure; in the previous five years, DNB cut relatively few staff**

### Scope for Headcount Reduction – Longer Term Cuts So Far Small

DNB's FTE numbers declined c9% last year, the decline has been largely driven by the new group structure and the divestment of Svensk Fastighetsförmedling AB and SalusAnsvar AB and a further 400 headcount reduction through redundancy. While the 2013 headcount reduction is large, we would note that DNB over the previous five year period only reduced headcount by 5%, the lowest among Nordic peers. Most other Nordic banks, with the exception of SHB, reduced their staff numbers at a considerably faster pace during the 2008-12 period relative to DNB.

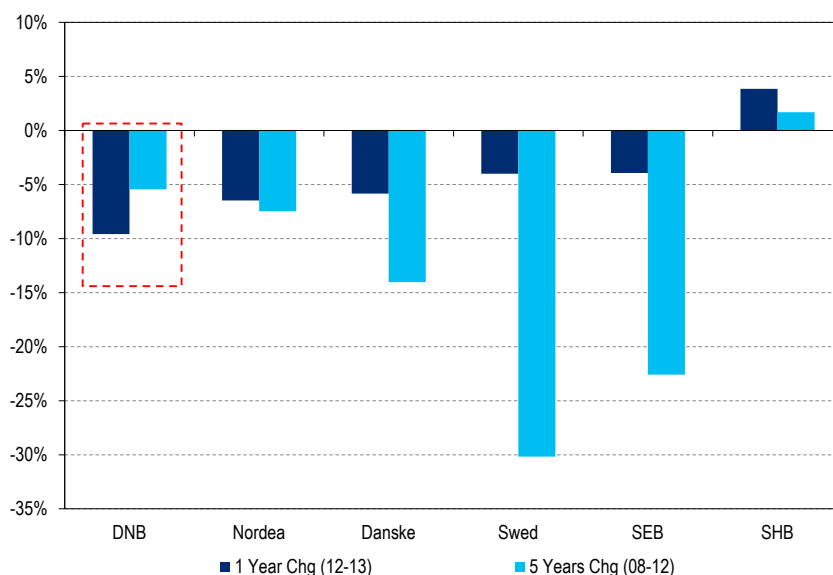
Figure 39. DNB – FTE Employees



Source: Company Reports

**DNB only cut c5% of their headcount during 2008-12, when most banks cut more aggressively, especially Baltic crisis hit Swedbank and SEB**

Figure 40. Nordic Banks - Change in FTE



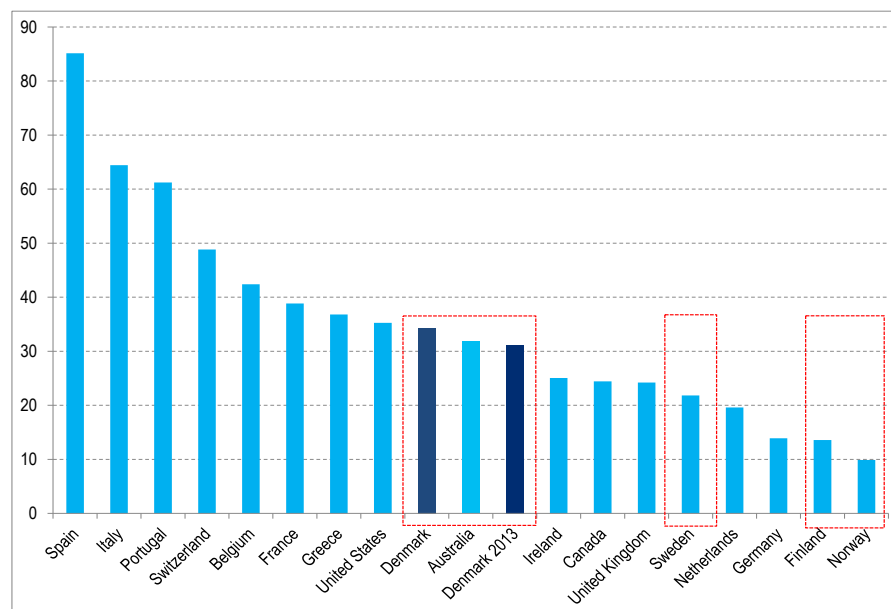
Source: Company Reports and Citi Research Estimates

**Norway has the most efficient branch distribution network in developed markets, based on the number of commercial bank branches per capita**

## Efficient Branch Distribution

Another driver and reflection of the high productivity of the Norwegian banking business is that Norway's relative branch density is lowest amongst the major developed markets. Based on IMF data, Norway has approximately half the level of branches per capita as Sweden and a third of Denmark's level. At end 1Q14, DNB had 146 branches in Norway, along with distribution via the Post Office network, in-store outlets as well as of course direct banking channels. Further headcount and cost cuts at DNB are unlikely to be driven from material branch closures but more from restructuring the business model (eg divesting non-core businesses overseas), further adoption of direct banking technology, especially for transaction based services, and ongoing "One Bank" efficiency gains.

**Figure 41. Major DMs – Number of Commercial Bank Branches per 100K Adults (2012, unless specified)**



Source: IMF, Company Reports and Citi Estimates; Note: Data for UK is as of 2011. Denmark 2013 branch density is estimated based on Danske, Nordea Denmark, Jyske and Sydbank reported numbers. Assumed that other branches declined at the same pace as the average of top 4 banks (c9%).

## Competition, Rates and Margins

**Rising margins was a positive support for the DNB shares during much of 2013, but this turned negative in 1Q14**

DNB's 1Q14 combined loan and deposit spread declined 5bps qoq, to 125bps. The recent drop in spreads has caused some investor concern but we believe it is a temporary set-back reflecting (1) normal 1Q seasonality and (2) the end of mortgage loan re-pricing upside as well as (3) rapid deposit growth (margin negative impact).

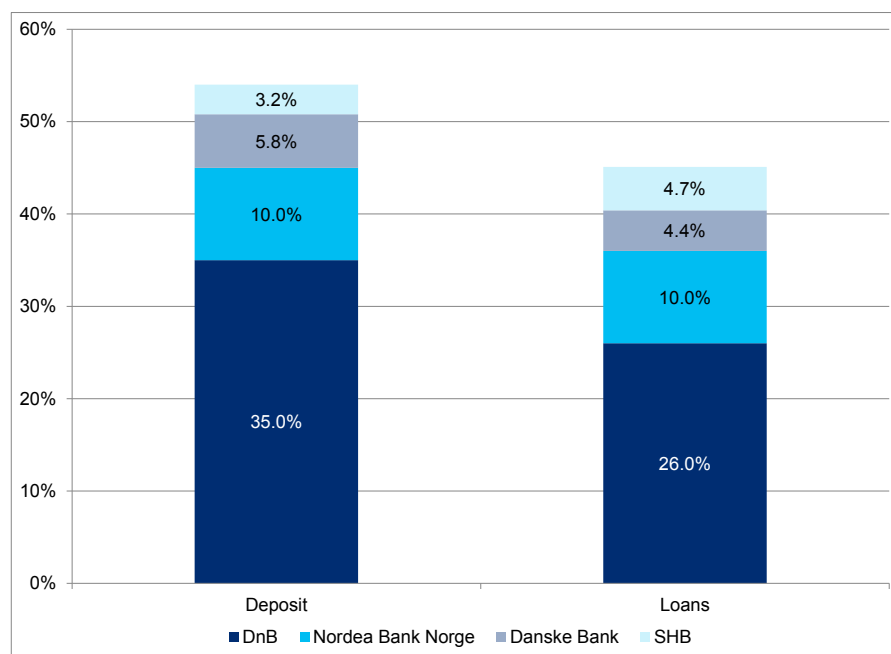
We would highlight two structural positives for DNB's margins: (1) despite niche banks capturing share and resulting in the partial rolling back of mortgage spread increases, the Norwegian banking market is relatively consolidated – if we count the Sparebank 1 alliance as a single entity, Norway's top banks have a similar market share as in Sweden; (2) interest rates (NIBOR c1.8%) are not close to zero as in other Nordic countries or the Euro Area and are likely to rise sooner and market rates are already trending up, allowing greater loan/deposit pricing flexibility.

### How consolidated is Norwegian banking?

**Between 45-55% of Norwegian banking sector is dominated by the top 4 banks – DNB accounts for 35% of deposits alone**

The top four commercial banks comprise c55% of system deposits, led by DNB with a disproportionately high 35% share. The same four commercial banks comprise c45% of system lending. This level of banking consolidation in Norway is low relative to Sweden – or even more concentrated Finland. However, if we include the Sparbank 1 alliance of savings banks, Norway ranks amongst some of the most consolidated banking markets, similar to Sweden, at c70% deposit market share for the top four banking players.

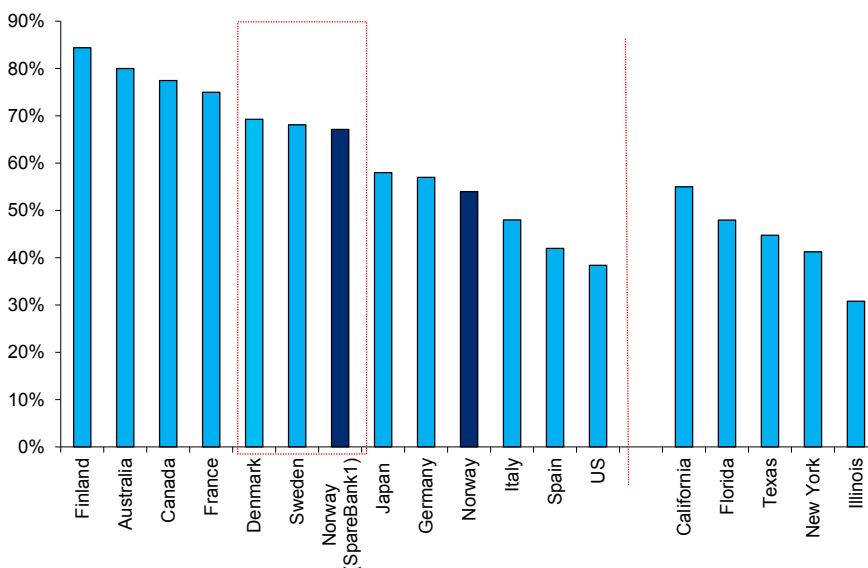
**Figure 42. Norway Top 4 Banks Loan and Deposit Market Share 2013**



Source: Company Reports and Citi Research Estimates.

Including the Sparebank 1 alliance, the top 4 Norwegian banking groups have a similar share of system deposits as the top 4 in Sweden: 70%

Figure 43. Deposit Market Share of Top 4 Banks %

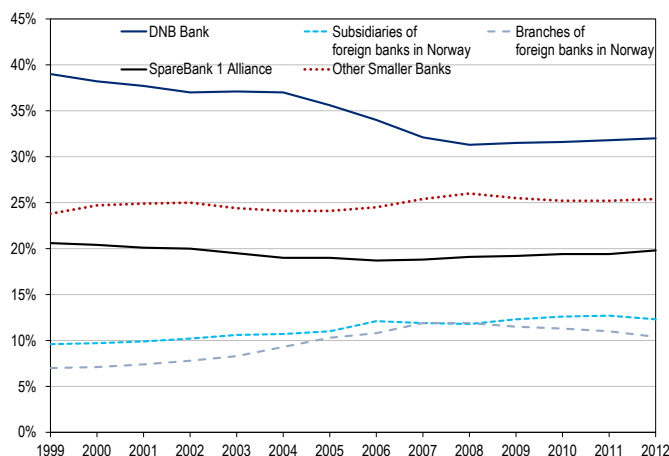


Source: Company Reports, Citi Research, Central Banks; The first bar of Norway consists of DNB, Sparebank1 Alliance; Nordea and Danske; The second bar contains DNB, Nordea, Danske and SHB.

DNB has over 30% market share in Norway, the Sparebank 1 group c15-20%, followed by Nordea at c10%

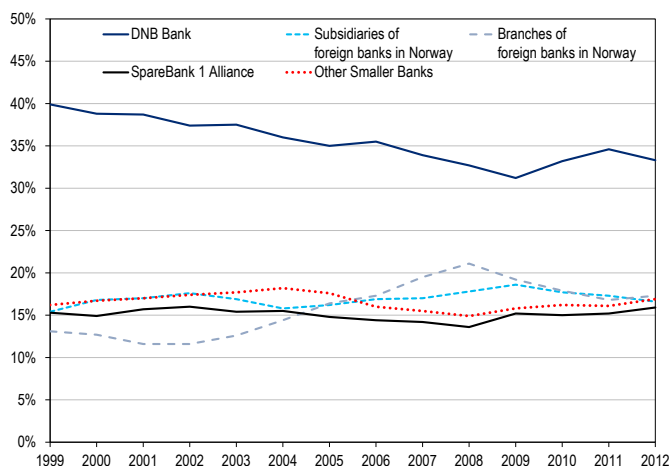
Norway is a relatively concentrated market but it is an unusual distribution compared to Sweden, where four big banks dominate the market, or Denmark where there are two large commercial banks and mortgage providers. In Norway, there is a relatively dominant bank, DNB, with over a 30% share of retail and corporate banking, albeit this is down from almost 40% pro-forma for DNB/Gensidige NOR pre-merger. The next largest bank in the country is the Spare Bank 1 (savings banks) alliance, at about 20% of retail banking and just over 15% of corporate banking. Foreign owned subsidiaries and branches account for about the same share of the retail banking market as the Spare Bank 1 alliance combined whereas in corporate banking they are closer to the market share of DNB.

Figure 44. Banks in Norway – Retail Market Share



Source: Norges Bank; Subsidiaries of foreign banks in Norway includes Nordea Bank Norge, Santander Consumer Bank and Nordea Eiendomsrett; Branches of foreign banks in Norway includes Danske Bank, Handelsbanken, Handelsbanken Eiendomsrett, Skandiabanken + 9 other branches.

Figure 45. Banks in Norway – Corporate Market Share



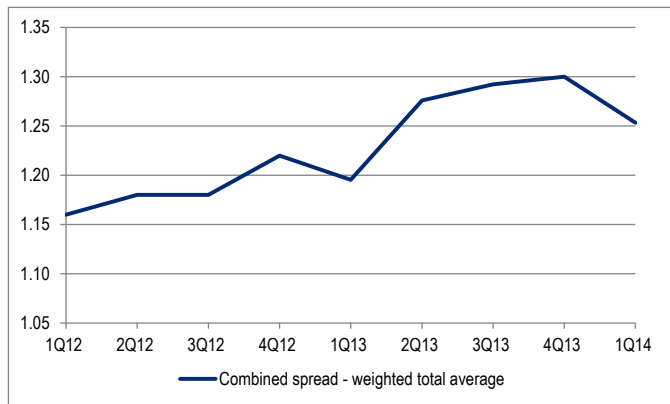
Source: Norges Bank; Subsidiaries of foreign banks in Norway includes Nordea Bank Norge, Santander Consumer Bank and Nordea Eiendomsrett; Branches of foreign banks in Norway includes Danske Bank, Handelsbanken, Handelsbanken Eiendomsrett, Skandiabanken + 9 other branches.

## Scope for Deposit Re-pricing, Reversing A Negative

**Weighted spreads declined for DNB in 1Q14 qoq due to the growth in expensive deposits**

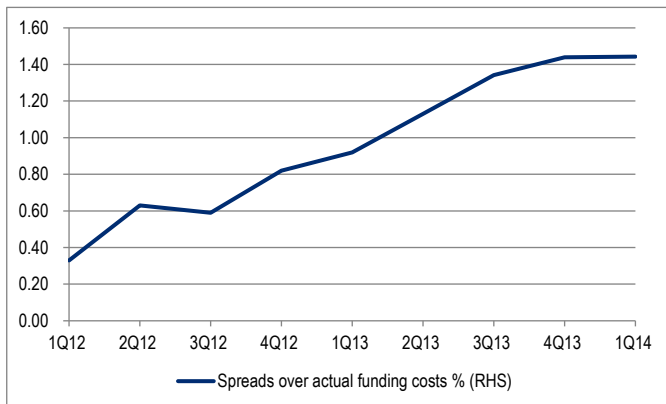
DNB's interest margin increased c15bps from 1Q12 to 4Q13, before declining 5bps in 1Q14. Adjusting for seasonality, DNB's margin is now broadly stable. Most of the margin expansion in the recent years has come from loan re-pricing offset by lower deposit spread. The average mortgage lending spread has reached 140bps, higher than other Nordic countries such as Sweden. While the company is guiding towards stable NIMs, there is potential for further margin expansion on the deposit side – from active re-pricing and also the benefit of rising market interest rates.

**Figure 46. Combined Interest Rate Spreads**



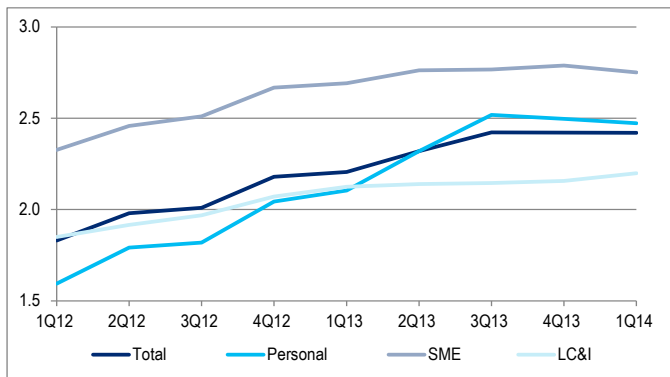
Source: Company Reports; Combined spread = lending rate – deposit rate

**Figure 47. DNB – Average Mortgage Lending - Spreads**



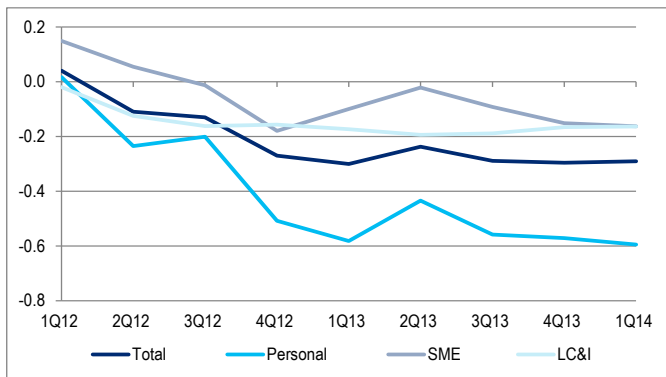
Source: Company Reports

**Figure 48. Lending Spreads - Split by Segments**



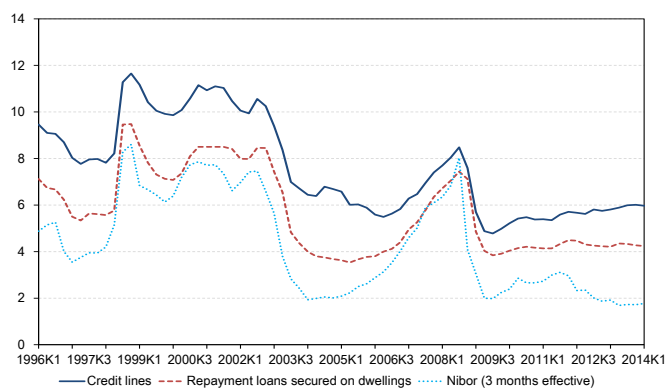
Source: Company Reports; Lending spread = lending rate – NIBOR 3m effective rate.

**Figure 49. Deposits Spreads - Split by Segments**



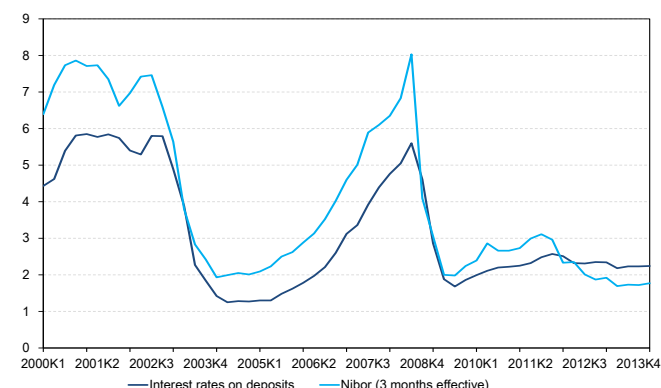
Source: Company Reports; Deposit Spread = NIBOR 3m effective rate – deposit rate.

**Figure 50. Norway Banking System – Interest Rate on Loans**



Source: Statistic Norway

**Figure 51. Norway Banking System – Interest Rate on Deposits**

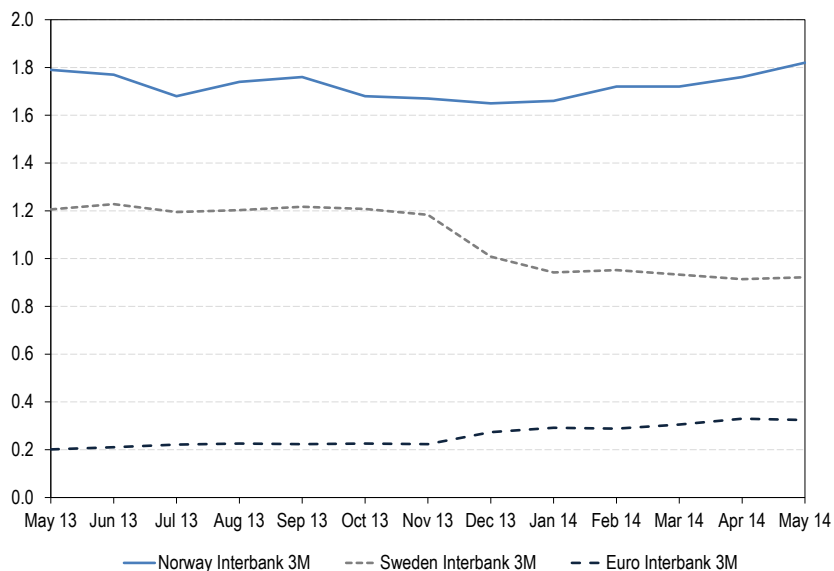


Source: Statistic Norway

The interest rate environment may remain stable to slightly supportive to any potential margin expansion, especially improved deposit margins. Based on our economics team forecasts, 10Yr benchmark interest rates in Norway may decline slightly by end-2015 vs 2014 value but should rise eventually in 2016. In fact, interest rates in Norway are likely to rise sooner than other Nordic and EU countries – the 3-month NIBOR has risen steadily over the past 6 months unlike STIBOR or Euribor.

Norwegian short term interest rates have increased over the past 6 months, with 3 month NIBOR up 17bps

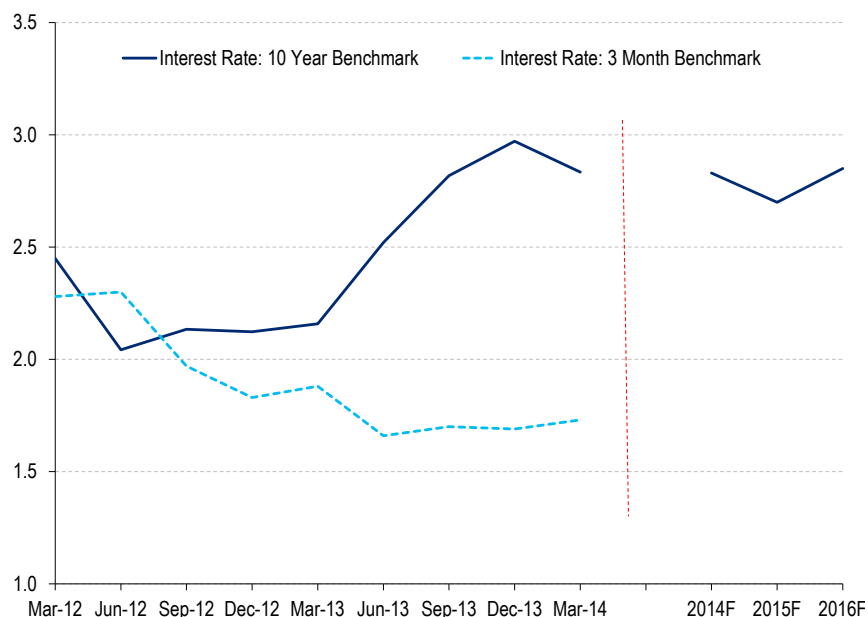
Figure 52. 3 Month NIBOR, STIBOR and Euribor Last Twelve Month



Source: DataStream

Norwegian interest rates are low by historical standards but are higher than Nordic and Euro Area peers

Figure 53. Norway – Benchmark Interest Rates



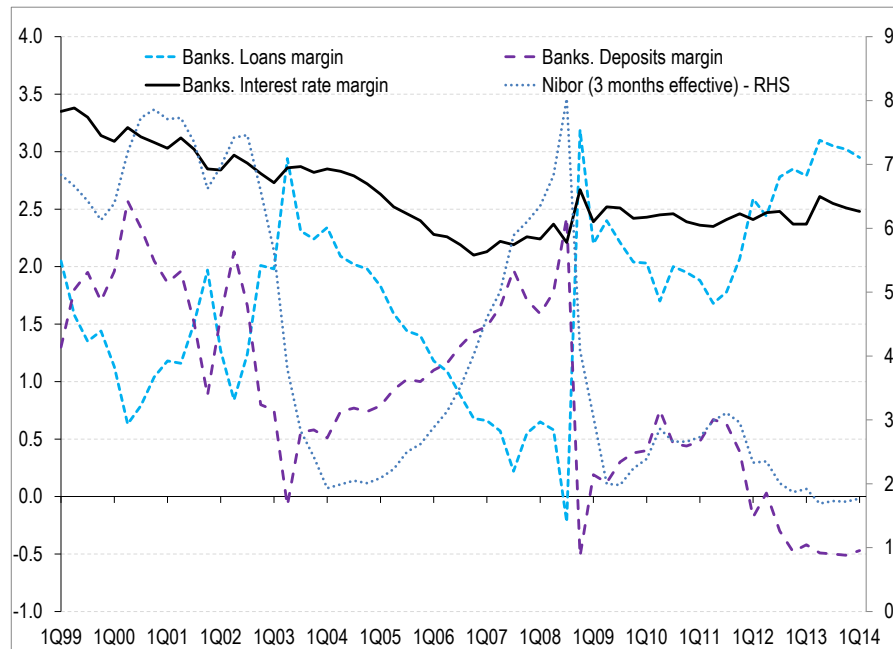
Source: DataStream, Citi Research Estimates, Note: Includes data from Citi economists



## Long Term Norwegian System Rates

From 2003 to 2008, the loan margin of Norwegian banks gradually declined. Post the financial crisis, banks started to re-price its loans. Lending margins improved following the crisis to more than 3%. Deposit margins on the other hand have been negative for the past two years, as for the first time in Norway's recent banking history deposit rates have been higher than the 3M Nibor rate for a sustained period of time.

Figure 54. Margin Development for Norway Banking System



Source: Statistic Norway

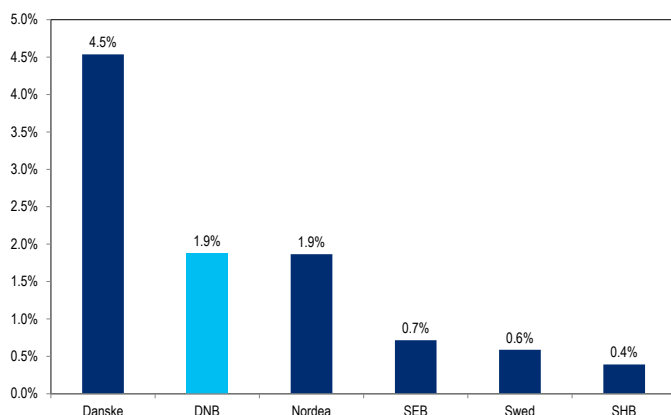
# Asset Quality

## Bad Debts Worse than Swedes but Recovering Rapidly

**DNB's NPL ratio is similar to Nordea but worse than Swedish peers, although on an EBA standardized basis their NPLs are lower than Nordea**

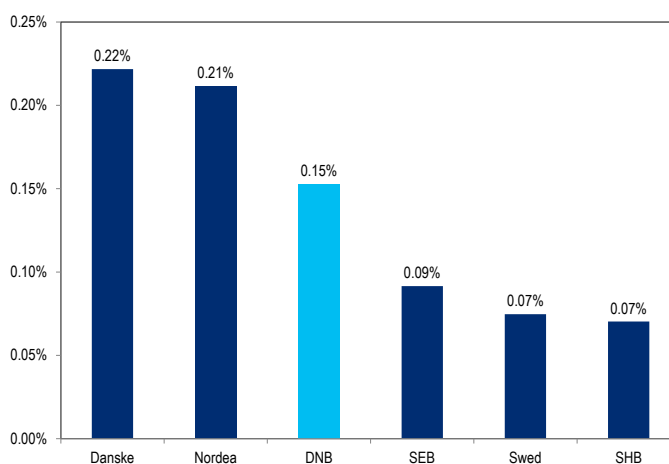
DNB's greater exposure to volatile segments such as shipping has led to concerns over greater credit risks relative to Nordic peers. At end-1Q14, DNB did have a higher gross NPL ratio (1.9%) versus the three primarily Swedish banks but it was similar to Nordea and much lower than Danske. The 2013 P&L loan loss provision ratio for DNB of 0.15% was lower than Nordea's 0.21%, although higher than the other three Swedish banks we cover. DNB's P&L provision charge in the last two quarters has been close to zero due to shipping driving recoveries in the Large Corporate division and continued low loan losses in the Retail business areas.

Figure 55. Nordic Banks – NPL Ratio By Bank 1Q14



Source: Company Reports. NPL is defined as PD11 and above for DNB; 90 days past due for Nordea; Rating category 10 and 11 for Danske; 60 days past due for SEB and SHB; Between 60-90 days past due for Swedbank

Figure 56. Nordic Banks – Loan Loss Ratio By Bank 2013

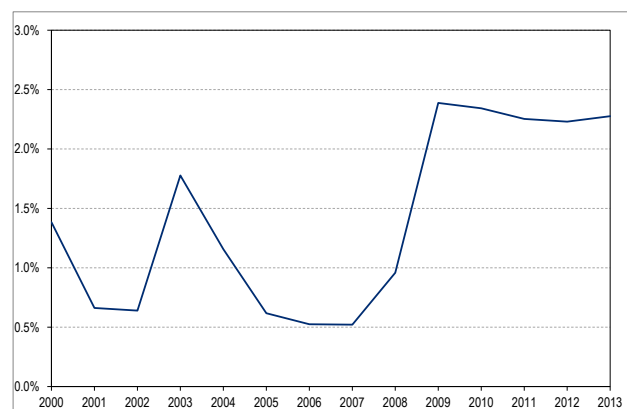


Source: Company Reports.

**DNB NPL ratios have been in the 2.2-2.4% range during 2009-13; 1Q14 was a notable improvement to c1.9%, helped by an improving shipping book**

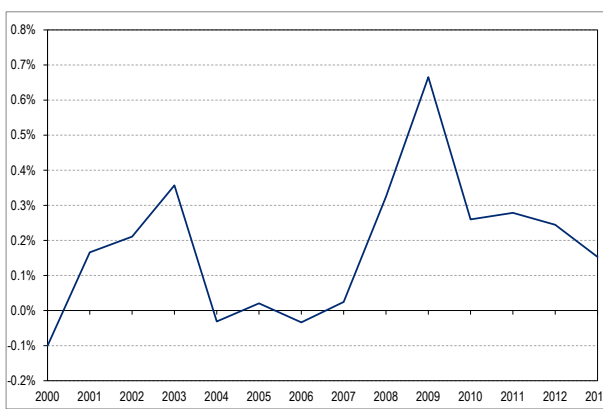
DNB's NPL ratios have moved with the economic cycle and peaked in 2009 at a relatively low ratio of c2.4%. Since 2009, DNB's NPL ratio has declined slightly but remained in a 2.2-2.3% range. In 1Q14, there was a notable step lower (eg better) to 1.9%. Again this improvement was helped by an improving shipping loan book, especially for tanker exposures. Similarly, the loan loss ratio peaked for DNB in 2009 at close to 0.65% but has declined relatively sharply recently. During strong economic periods, such as 2003-07, net credit losses were close to zero. DNB has only experienced credit losses above 30bps three times in the past dozen years.

Figure 57. DNB – NPL Ratios From 2000



Source: Company Reports.

Figure 58. DNB – Loan Loss Ratios From 2000 (P&L Provisions)



Source: Company Reports.

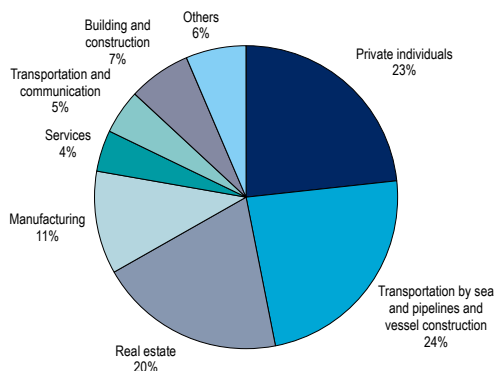
## Shipping and CRE Recent Problem Segments

**Shipping and related items are the largest bad debt exposure for DNB in terms of size and severity**

NPLs for the segment 'transportation by sea and pipelines and vessel construction' are one of the highest balance sheet bad debt segments for DNB, comprising close to a quarter of total NPLs at end-2013, followed by private individuals and CRE at 23% and 20% respectively. The gross NPL ratio for "transportation by sea and pipelines and vessel construction" segment stood close to 5% at 1Q14 compared to the group NPL ratio of sub 2%.

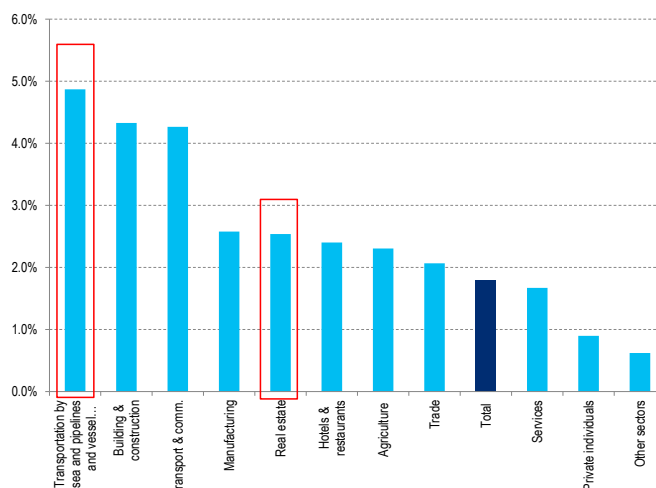
Looking specifically for the Shipping segment and comparing with other Nordic banks with similar issues (ie high shipping and CRE NPL exposures), we find that DNB's NPL ratios are better than core Danske for both the shipping and CRE segments but poorer than Nordea.

Figure 59. DNB – NPL Split by Loan Type 2013



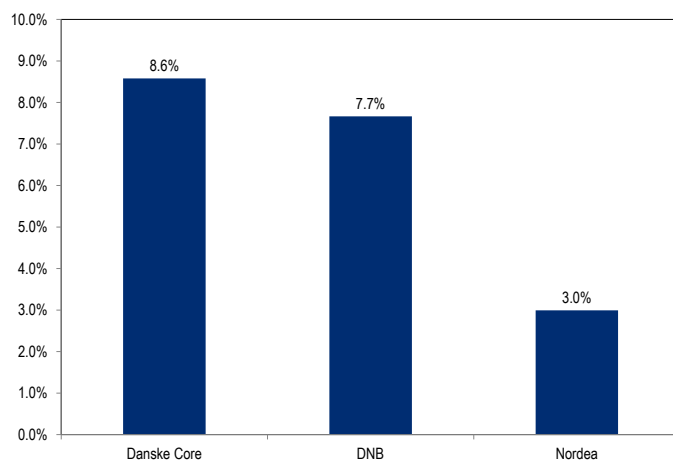
Source: Company Reports

Figure 60. DNB – NPL Ratio by Loan Type 1Q14



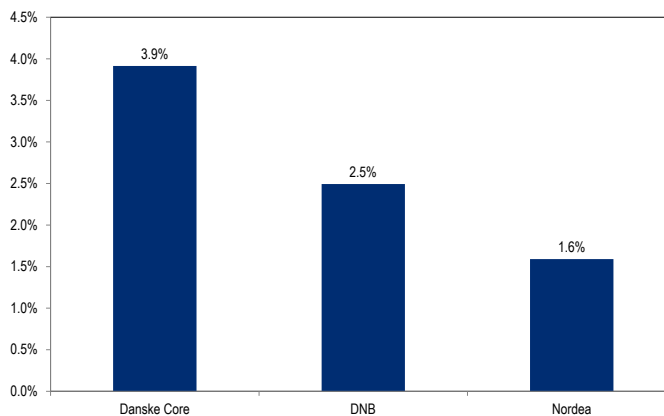
Source: Company Reports

Figure 61. Nordic Banks – Shipping NPL Ratio 1Q14



Source: Company Reports

Figure 62. Nordic Banks Commercial Real Estate NPL Ratio 1Q14



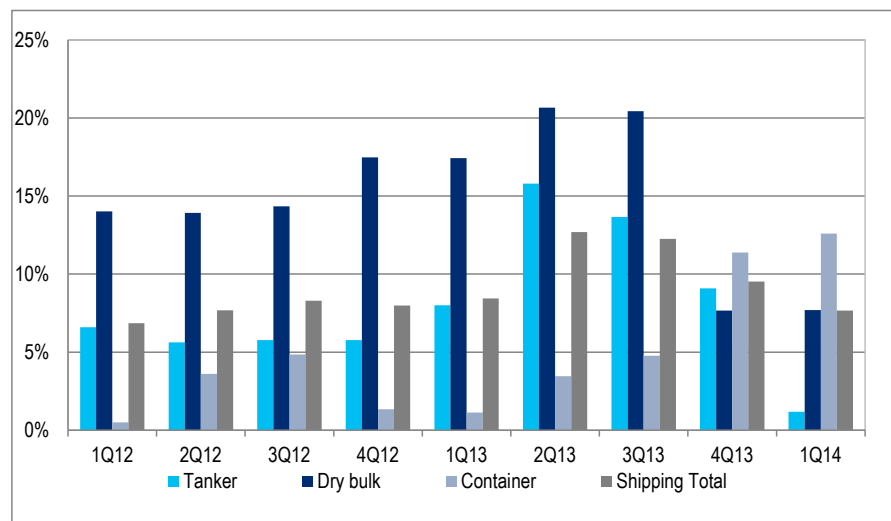
Source: Company Reports

**DNB's shipping NPL ratio peaked at c13% in 2Q13 and has improved to sub 8% by 1Q14**

### But the Shipping Portfolio is improving

DNB's shipping portfolio has been improving since mid-2013. The overall shipping sector NPL ratio for DNB has improved to 7.7% vs c13% in 2Q13. The improvement has been driven largely by decline in NPL ratios for the tanker and the dry-bulk segments – the tanker segment NPL ratio declining to 1% from 16% in 2Q13, while the dry-bulk segment NPL ratio declined to 8% in 1Q14 vs 21% in 2Q13. The container segment is the only segment where NPL ratios have deteriorated vs mid-2013 levels, and are now in the low teens.

Figure 63. DNB Shipping NPL By Type

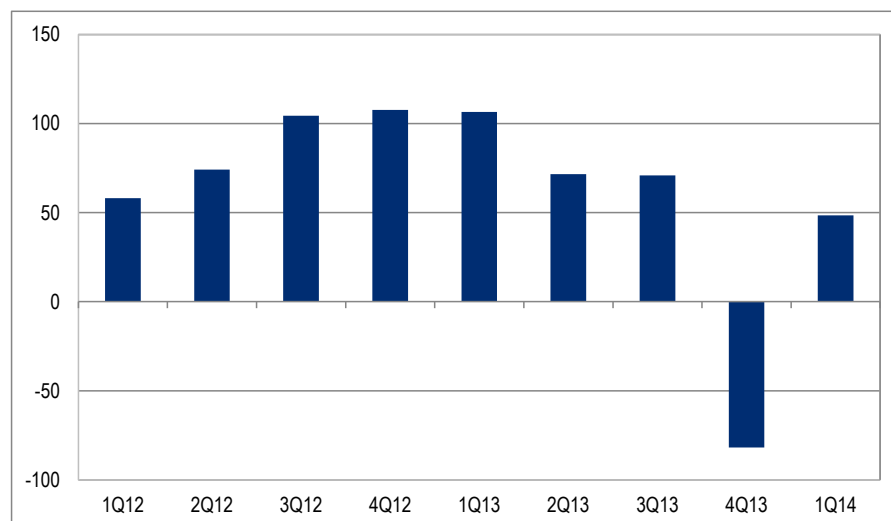


Source: Company Reports; NPL is defined as Net non-performing and net doubtful commitments

**DNB's net shipping loan loss provision was only 50bps in 1Q14, half the level of a year ago**

The decline in shipping NPL is also supported by trends in new shipping loss provisions. Net new shipping provisions amounted to only 50bps in 1Q14, half the level of 1Q13. This was its lowest point in the past two years excluding the write back driven 4Q13. DNB executives, similar to Nordea, sound increasingly confident on the outlook for their shipping book.

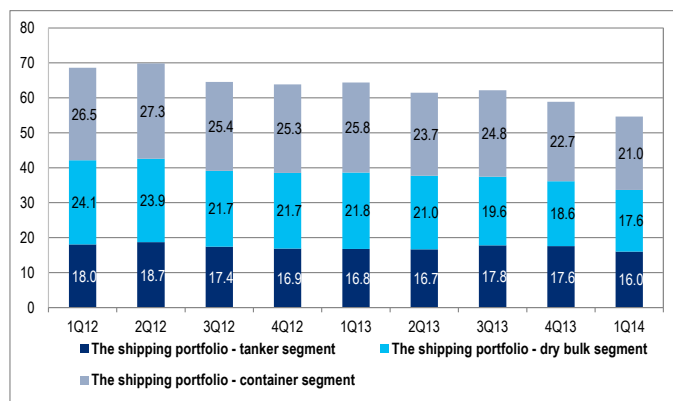
Figure 64. DNB – Shipping Related Annualised Loan Loss Ratios (in bps)



Source: Company Reports and Citi Research Estimates;  
Loan losses for industry segment: Transportation by sea and pipelines and vessel construction

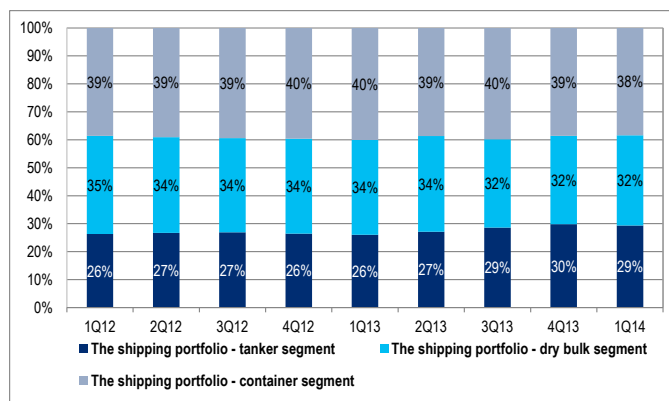
The mix of the shipping sector portfolio for DNB has hardly undergone any change in the past few years. Although the overall portfolio size has gone down from just around NOK70bn at 1Q12 to NOK55bn at 1Q14, the relative weight of the container section has remained stable within the shipping portfolio at c40% while the dry bulk sector relative exposure has gone down slightly (-3ppt, 1Q12-1Q14) offset by higher tanker exposure. Currently, the DNB tanker shipping book has close to zero NPLs.

Figure 65. DNB – Shipping Portfolio By Type (NOK bn)



Source: Company Report

Figure 66. DNB – Shipping Portfolio By Type



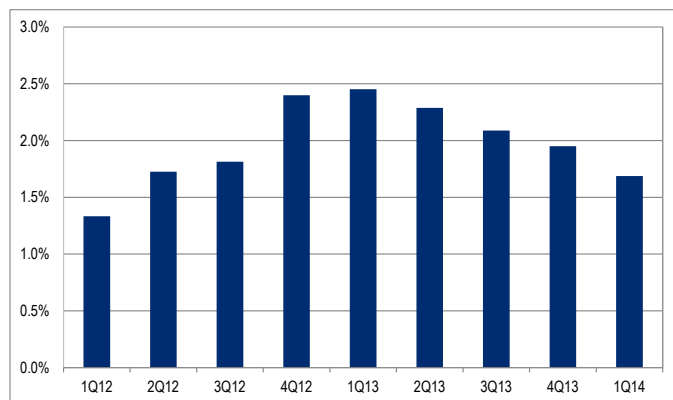
Source: Company Report

### Improving commercial real estate portfolio

**DNB's CRE bad debt ratio peaked at 2.4% in 1Q13 and has subsequently been improving – with net recoveries in 1Q14**

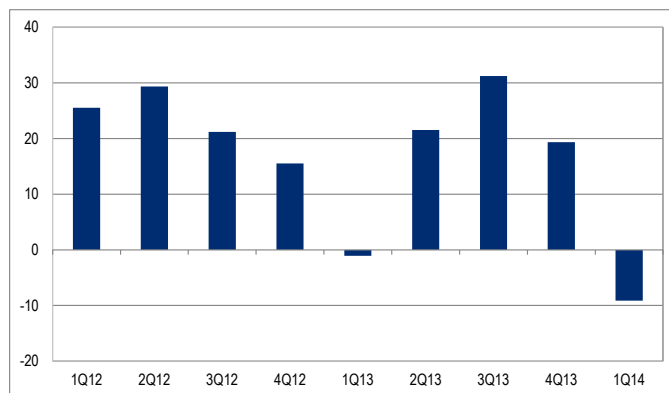
Similar to the shipping sector, the CRE sector has also witnessed NPL ratios decline significantly from its peak. CRE NPL ratio at 1Q14 was 1.8% compared to 2.4% at 1Q13. Net new CRE provisions amounted to a recovery of c10bps in 1Q14, compared to a recent peak provision of c30bps in 3Q13, and was at its lowest point in the past two years.

Figure 67. DNB – Commercial Real Estate NPL



Source: Company Reports; NPL is defined as Net non-performing and net doubtful commitments

Figure 68. DNB –Real Estate Loan Loss Ratio



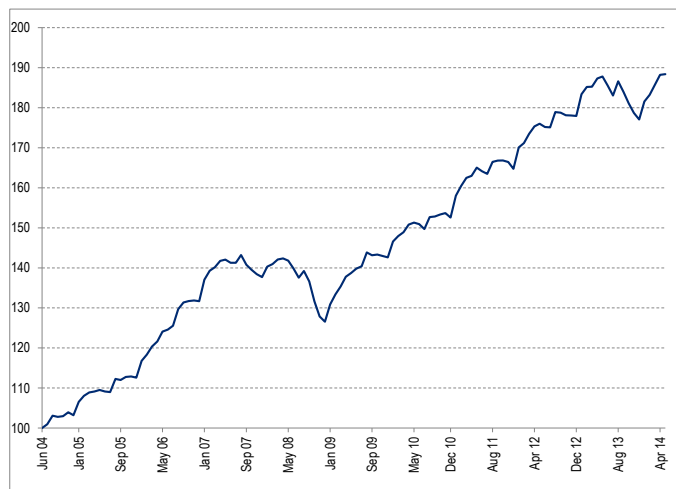
Source: Citi Research; Loan losses for industry segment: Real Estate

## Norwegian Housing Market and Mortgage Asset Quality

**Concern over the Norwegian housing market increased in Autumn 2013, but house prices and transaction volumes have rebounded during 2014**

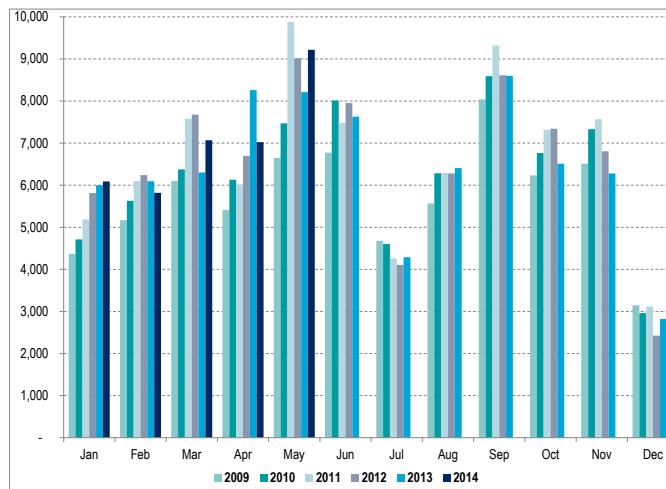
Norwegian house prices are expensive (avg price for new detached house is \$4,900/ square metre). Norway house price almost doubled over past 10 years. House prices and transaction volumes began to decline late in 2013 (Sep-Nov). However, in 2014 YTD this drop in values and volumes has been reversed.

Figure 69. Norway House Prices



Source: NEF; Indexed to 100 at Jun 2004. Latest Data: May 2014.

Figure 70. Norway Number of Housing Transaction Per Month

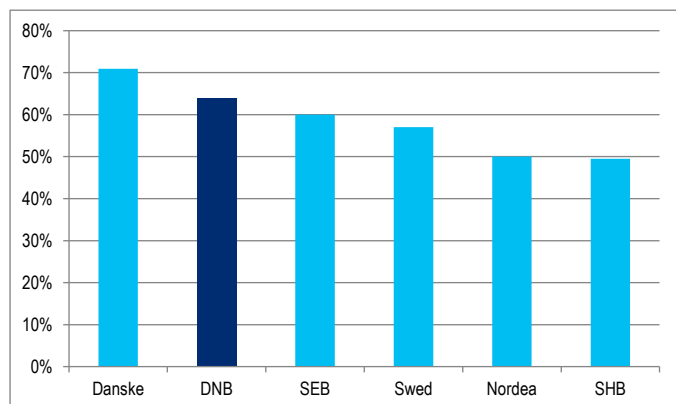


Source: NEF

**DNB's average mortgage LTV of 64% is above peers, but the strong Norwegian economy and welfare state provides a cushion for households**

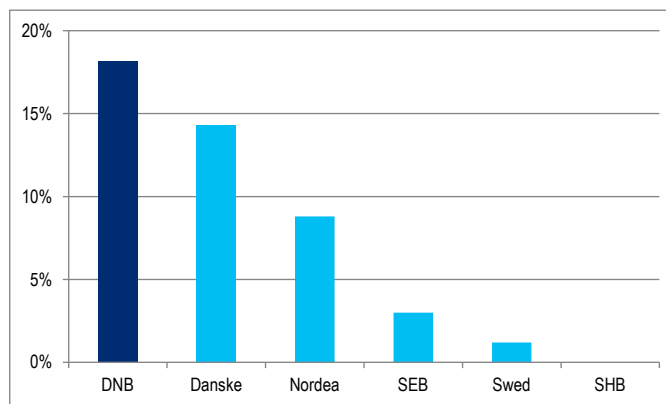
DNB also has a higher average mortgage LTV ratio of 64%, compared to the Swedish banks between 50% and 60%. We also note that DNB has the highest share of loans at LTV>70% within our Nordic coverage universe. However, the low unemployment rate in Norway (3.3%) and generous welfare state keeps mortgage (and other consumer) credit losses low, which we believe will remain a supporting factor even if house prices decline and housing negative equity increases.

Figure 71. Average LTV on Mortgage Loans Outstanding



Source: Company Reports

Figure 72. Mortgage LTV > 70%



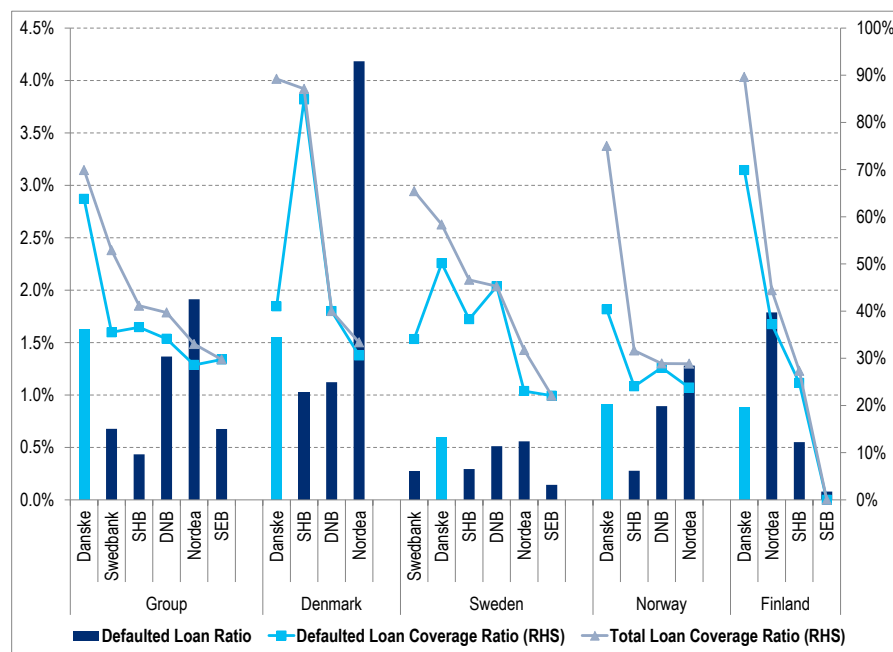
Source: Company Reports; DNB's is LTV > 75%; Danske LTV calculation assumes half of mortgages with LTV between 60-80% has LTV between 70%-80%.

**DNB bad debt data looks relatively better on a standardised EBA basis, relative to company reported data**

## DNB Bad Debts Better on an EBA Basis

Data from the EBA Transparency Exercise (published Dec 2013 based on June 2013 data) shows that DNB's "defaulted loan ratio" is below Nordea's, both in Norway and at the group level. In fact, coverage for both defaulted loans and overall loans for DNB is higher than Nordea and SEB and similar to SHB.

**Figure 73. Danske Has the Highest Loan Coverage Ratio Among Nordic Banks**



Source: EBA Transparency Exercise Dec 2013; Based on June 2013 company data.

*On the following pages, we include macro-economic indicators relevant to Norway and our updated DNB group and divisional forecasts.*

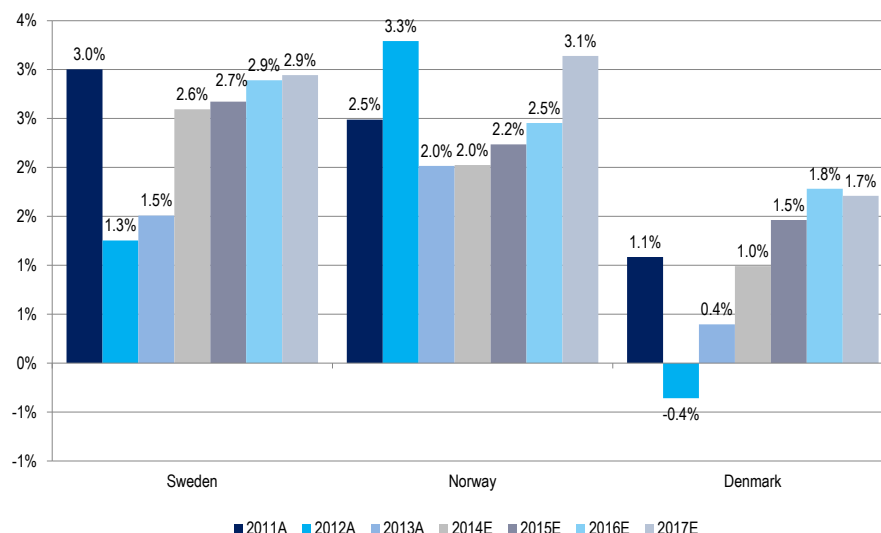


## Appendix I: Macro-Economic Overview

### GDP Growth and Economic Forecasts

Norwegian banking benefits from the backdrop of solid GDP growth, currently 2% and expected to increase to 3%, low unemployment and a strong fiscal posn

Figure 74. GDP YoY Forecasts



Source: dataCentral<sup>1</sup>, Citi Research

Figure 75. Norway — Economic Forecasts, 2013-2015F

		Norway		
		2013	2014F	2015F
Real GDP	YoY	2.0%	2.0%	2.2%
Final Domestic Demand	YoY	2.5	1.8	2.2
Private Consumption	YoY	2.2	2.1	2.5
Government Consumption	YoY	1.8	2.2	2.3
Investment (Ex Stocks)	YoY	4.5	0.1	1.1
Exports	YoY	0.8	1.2	2.8
Imports	YoY	2.9	1.2	2.9
CPI (Average)	YoY	2.1	2.0	2.1
Unemployment Rate	%	3.5	3.7	3.9
Current Account	% of GDP	10.6	11.1	11.4
General Govt Balance	% of GDP	11.4	11.9	11.0

For Norway, mainland GDP. F Citi forecast. YoY Year-on-year growth rate. Sources: National sources and Citi Economics team Research forecasts

Nominal GDP growth in Norway expected to be above 4% in 2015, current loan growth is c5% YoY, similar to Swedish levels

Figure 76. Nordic Countries – Macro Economic Data

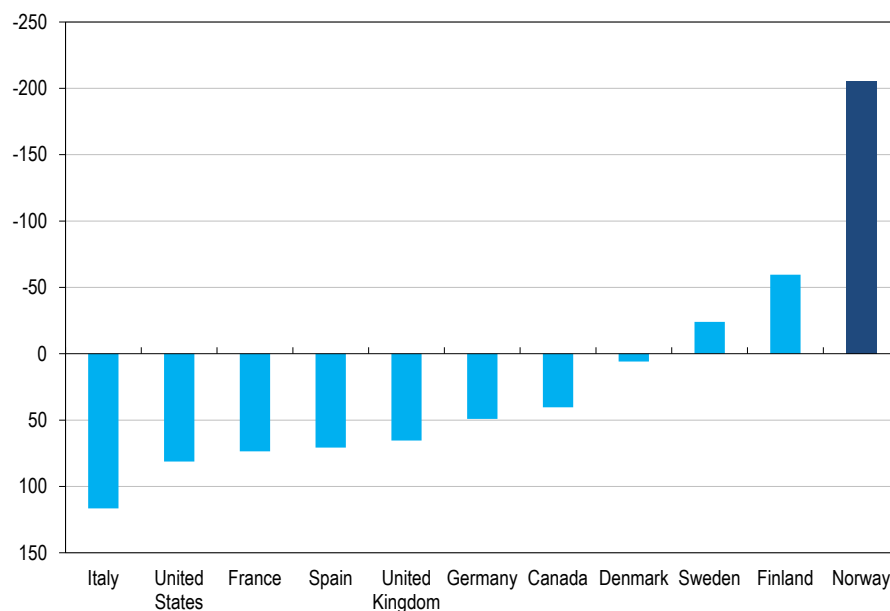
	Norway	Sweden	Denmark	Finland
10Y Government Bond Nominal Yield	2.7%	1.9%	1.4%	1.7%
10Y Government Bond Real Yield	0.7%	1.8%	-0.1%	0.0%
2015 Real GDP growth	2.2%	2.7%	1.5%	1.1%
2015 Nominal GDP Growth	4.3%	3.9%	3.2%	2.6%
System Loan Growth YoY (Last Rep.)	4.8%	4.9%	2.0%	5.9%
2015 Average Inflation	2.1%	1.2%	1.7%	1.5%

Source: Citi Research Estimates; Finland estimates is based on IMF forecasts

<sup>1</sup> Citi Research's proprietary database, dataCentral, sources data from Citi Research estimates, published company data, Thomson Reuters, DataStream, IBES and Toyo Keizai.

The Norwegian State is in a very strong financial position relative to both Nordic peers and other OECD countries, leaving scope for a counter cyclical buffer

Figure 77. General Government Net Financial Liabilities % GDP in 2013



Source: OECD Economic Outlook 95 database. May 2014; Net financial liabilities are defined as the gross financial liabilities of the general government sector less the financial assets of the general government sector. Such assets may be cash, bank deposits, loans to the private sector, participation in private sector companies, holdings in public corporations or foreign exchange reserves. The status and treatment of government liabilities in respect of their employee pension plans in the national accounts have been diverse across countries. More details are available from OECD <http://www.oecd.org/eco/sources-and-methods.htm>

Norway has been the most consistent grower of the Nordic economies over the past decade and a half

Figure 78. Nordic Countries – Real GDP Growth YOY

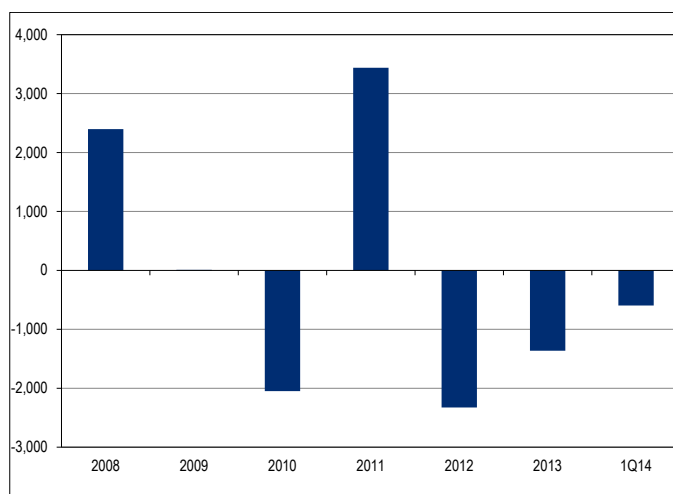
GDP YoY	Mainland Norway	Sweden	Denmark	Finland
1999	2.57%	4.41%	2.56%	3.91%
2000	2.92%	4.59%	3.53%	5.32%
2001	2.03%	1.40%	0.70%	2.28%
2002	1.41%	2.50%	0.47%	1.83%
2003	1.27%	2.47%	0.38%	2.01%
2004	4.47%	3.74%	2.30%	4.13%
2005	4.42%	3.16%	2.45%	2.92%
2006	4.81%	4.55%	3.39%	4.41%
2007	5.32%	3.43%	1.58%	5.34%
2008	1.45%	-0.76%	-0.78%	0.29%
2009	-1.42%	-4.98%	-5.67%	-8.54%
2010	1.72%	6.29%	1.39%	3.36%
2011	2.49%	3.00%	1.07%	2.82%
2012	3.29%	1.25%	-0.36%	-1.01%
2013	2.01%	1.51%	0.40%	-1.26%

Source: Citi Research; DataStream

## Appendix II: Basis Swaps

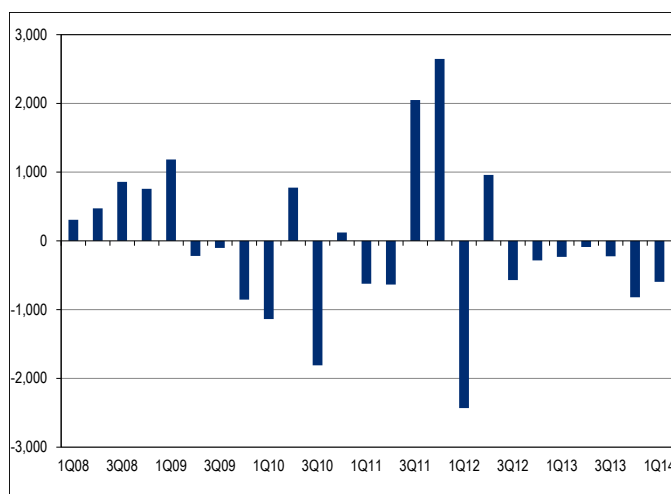
One source of volatility in the DNB accounts is the mark-to-market adjustments of swap contracts entered into in connection with the bank's long-term funding. These contracts may have significant effects on the accounts from one quarter to the next. However, as the contracts are generally held to maturity, these effects should be balanced out over time. The effect of basis swaps caused a NOK363m reduction in income in 1Q14.

Figure 79. Gain/Losses from Basis Swaps Per Annum



Source: Citi Research

Figure 80. Gain/Losses from Basis Swaps Per Quarter



Source: Citi Research

## DNB Financial Forecasts

Figure 81. DNB Citi Estimates Old vs New

GROUP P&L	2014E			2015E			2016E		
(amounts in NOK million)	14E Old	14E New	% Chg	15E Old	15E New	% Chg	16E Old	16E New	% Chg
Pre-tax Operating Profit Before Losses	28,286	27,913	-1%	29,681	29,355	-1%	31,541	31,193	-1%
Net Losses on Loans etc.	-2,332	-1,731	-26%	-2,404	-1,809	-25%	-2,487	-1,942	-22%
Pre-tax Operating Profit	25,954	26,182	1%	27,277	27,546	1%	29,054	29,250	1%
Profit for the Period	19,465	19,872	2%	20,458	20,908	2%	21,791	22,202	2%
Earnings per Share	11.95	12.20	2%	12.56	12.84	2%	13.38	13.63	2%

Source: Citi Research

Figure 82. DNB Group Model

	2013	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg	2017E	% Chg	2018E	% Chg
Net Interest Income	30,191	11%	31,521	4%	32,701	4%	34,069	4%	35,500	4%	37,047	4%
Net Profit/(Loss) from Life Insurance	0	0%	0	0%	0	0%	0	0%	0	0%	0	0%
Net Commissions	8,537	23%	8,959	5%	9,048	1%	9,139	1%	9,322	2%	9,508	2%
Trading	4,250	9%	5,853	38%	5,553	-5%	5,608	1%	5,664	1%	5,721	1%
Other Income	3,640	0%	2,827	-22%	3,445	22%	4,043	17%	4,582	13%	5,152	12%
<b>Total Revenues</b>	<b>46,618</b>	<b>12%</b>	<b>49,159</b>	<b>5%</b>	<b>50,747</b>	<b>3%</b>	<b>52,859</b>	<b>4%</b>	<b>55,068</b>	<b>4%</b>	<b>57,428</b>	<b>4%</b>
Total Operating Expenses	-21,875	5%	-21,246	-3%	-21,392	1%	-21,666	1%	-21,944	1%	-22,227	1%
<b>Pre-tax Operating Profit Before Losses</b>	<b>24,743</b>	<b>18%</b>	<b>27,913</b>	<b>13%</b>	<b>29,355</b>	<b>5%</b>	<b>31,193</b>	<b>6%</b>	<b>33,123</b>	<b>6%</b>	<b>35,201</b>	<b>6%</b>
Net Losses on Loans etc.	-2,034	-36%	-1,731	-15%	-1,809	4%	-1,942	7%	-2,080	7%	-2,171	4%
Net Gain/(Loss) on Long-term Securities	0	NM	0	NM	0	NM	0	NM	0	NM	0	NM
<b>Pre-tax Operating Profit</b>	<b>22,709</b>	<b>28%</b>	<b>26,182</b>	<b>15%</b>	<b>27,546</b>	<b>5%</b>	<b>29,250</b>	<b>6%</b>	<b>31,043</b>	<b>6%</b>	<b>33,029</b>	<b>6%</b>
Taxes	-5,188	27%	-6,309	22%	-6,638	5%	-7,049	6%	-7,481	6%	-7,959	6%
Minorities	4		0		0		0		0		0	
<b>Profit for the Period</b>	<b>17,526</b>	<b>27%</b>	<b>19,872</b>	<b>13%</b>	<b>20,908</b>	<b>5%</b>	<b>22,202</b>	<b>6%</b>	<b>23,562</b>	<b>6%</b>	<b>25,070</b>	<b>6%</b>
<b>Per Share Data</b>												
<b>Earnings per Share</b>	<b>10.76</b>	<b>27%</b>	<b>12.20</b>	<b>13%</b>	<b>12.84</b>	<b>5%</b>	<b>13.63</b>	<b>6%</b>	<b>14.47</b>	<b>6%</b>	<b>15.39</b>	<b>6%</b>
Dividend per Share	2.70	29%	3.50	30%	4.50	29%	6.00	33%	8.00	33%	10.00	25%
Pay Out Ratio	0.25		0.29		0.35		0.44		0.55		0.65	
<b>Book Value per Share</b>	<b>87.32</b>	<b>11%</b>	<b>99.03</b>	<b>13%</b>	<b>108.36</b>	<b>9%</b>	<b>117.49</b>	<b>8%</b>	<b>125.96</b>	<b>7%</b>	<b>133.35</b>	<b>6%</b>
<b>Tangible BVPS</b>	<b>83.32</b>	<b>12%</b>	<b>95.03</b>	<b>14%</b>	<b>104.37</b>	<b>10%</b>	<b>113.50</b>	<b>9%</b>	<b>121.96</b>	<b>7%</b>	<b>129.35</b>	<b>6%</b>
Share count, Average	1,628,799	0%	1,628,799	0%	1,628,799	0%	1,628,799	0%	1,628,799	0%	1,628,799	0%
<b>Operating Ratios</b>												
Net Interest Margin (on Assets)	1.29%		1.28%		1.27%		1.30%		1.32%		1.34%	
<b>Cost / Income Ratio</b>	<b>47%</b>		<b>43%</b>		<b>42%</b>		<b>41%</b>		<b>40%</b>		<b>39%</b>	
Provision Charge / Customer Loans	0.15%		0.13%		0.13%		0.13%		0.14%		0.14%	
ROA	0.75%		0.80%		0.81%		0.84%		0.87%		0.91%	
<b>ROE</b>	<b>13.0%</b>		<b>13.1%</b>		<b>12.4%</b>		<b>12.1%</b>		<b>11.9%</b>		<b>11.9%</b>	
Return on Tangible Equity	13.6%		13.7%		12.9%		12.5%		12.3%		12.2%	
<b>Balance Sheet</b>												
Gross Lending to Customers	1,353,201	3%	1,404,157	4%	1,448,486	3%	1,501,301	4%	1,556,075	4%	1,612,882	4%
Net lending to Customers	1,340,831	3%	1,392,311	4%	1,436,266	3%	1,488,636	4%	1,542,948	4%	1,599,275	4%
Deposits from Customers	867,904	7%	919,168	6%	948,323	3%	982,192	4%	1,017,294	4%	1,053,675	4%
<b>Total Equity</b>	<b>142,227</b>	<b>11%</b>	<b>161,295</b>	<b>13%</b>	<b>176,502</b>	<b>9%</b>	<b>191,374</b>	<b>8%</b>	<b>205,164</b>	<b>7%</b>	<b>217,203</b>	<b>6%</b>
Total Liabilities and Equity	2,405,239	6%	2,539,072	6%	2,593,838	2%	2,662,477	3%	2,732,992	3%	2,805,434	3%
<b>Capital Ratios</b>												
<b>Tier 1 Capital</b>	<b>131,587</b>	<b>11%</b>	<b>143,582</b>	<b>9%</b>	<b>157,161</b>	<b>9%</b>	<b>169,589</b>	<b>8%</b>	<b>180,121</b>	<b>6%</b>	<b>188,903</b>	<b>5%</b>
Total Capital	152,752		164,216		177,795		190,223		200,755		209,537	
RWAs (transitional rules)	1,089,114	1%	1,126,746	3%	1,162,316	3%	1,204,697	4%	1,248,650	4%	1,294,234	4%
Tier 1 ratio (Basel 1 Transitional Rules)	12.1%		12.7%		13.5%		14.1%		14.4%		14.6%	
<b>Equity T1 Ratio (B1 Transitional Rules)</b>	<b>11.8%</b>		<b>12.4%</b>		<b>13.2%</b>		<b>13.7%</b>		<b>14.1%</b>		<b>14.2%</b>	
Tier 1 (Full B2)	14.0%		15.0%		16.0%		16.6%		17.0%		17.2%	
<b>Core Tier 1 (B3 estimate)</b>	<b>13.6%</b>		<b>14.8%</b>		<b>15.7%</b>		<b>16.3%</b>		<b>16.7%</b>		<b>16.9%</b>	
Total capital ratio (B1 Transitional Rules)	14.0%		14.6%		15.3%		15.8%		16.1%		16.2%	
TCE/Tangible Assets	5.7%		6.1%		6.6%		7.0%		7.3%		7.5%	

Source: Citi Research, Company Reports

Figure 83. DNB Divisional Model

	2013	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg	2017E	% Chg	2018E	% Chg
<b>Large Corporates and International</b>												
Net Interest Income	11,458	1%	11,854	3%	12,210	3%	12,576	3%	12,954	3%	13,342	3%
Other Operating Income	5,319	2%	5,485	3%	5,704	4%	5,932	4%	6,170	4%	6,416	4%
<b>Total Revenues</b>	<b>16,777</b>	<b>1%</b>	<b>17,339</b>	<b>3%</b>	<b>17,914</b>	<b>3%</b>	<b>18,509</b>	<b>3%</b>	<b>19,123</b>	<b>3%</b>	<b>19,759</b>	<b>3%</b>
Operating Expenses	-6,054	-1%	-6,339	5%	-6,339	0%	-6,466	2%	-6,595	2%	-6,727	2%
<b>Operating Income</b>	<b>10,723</b>	<b>2%</b>	<b>11,000</b>	<b>3%</b>	<b>11,575</b>	<b>5%</b>	<b>12,043</b>	<b>4%</b>	<b>12,528</b>	<b>4%</b>	<b>13,031</b>	<b>4%</b>
Provisions	-1,380	NM	-892	NM	-937	NM	-983	NM	-1,033	NM	-1,084	NM
<b>Pre-tax Profit</b>	<b>9,343</b>	<b>13%</b>	<b>10,108</b>	<b>8%</b>	<b>10,638</b>	<b>5%</b>	<b>11,059</b>	<b>4%</b>	<b>11,495</b>	<b>4%</b>	<b>11,947</b>	<b>4%</b>
Net lending (billions)	473	2%	492	4%	507	3%	522	3%	538	3%	554	3%
Deposits to customers	362	0%	386	6%	397	3%	409	3%	421	3%	434	3%
Provisions/Loans	0.32%		0.18%		0.19%		0.19%		0.19%		0.20%	
NII/ Loans	2.42%		2.41%		2.41%		2.41%		2.41%		2.41%	
C/I Ratio	36%		37%		35%		35%		34%		34%	
<b>Personal Customers</b>												
Net Interest Income	12,632	23%	13,390	6%	13,925	3%	14,622	4%	15,353	4%	16,120	4%
Other Operating Income	4,829	5%	4,829	0%	5,070	5%	5,324	5%	5,590	5%	5,869	5%
<b>Total Revenues</b>	<b>17,461</b>	<b>18%</b>	<b>18,219</b>	<b>4%</b>	<b>18,996</b>	<b>4%</b>	<b>19,945</b>	<b>5%</b>	<b>20,943</b>	<b>5%</b>	<b>21,990</b>	<b>5%</b>
Operating Expenses	-8,655	7%	-8,482	-2%	-8,567	1%	-8,652	1%	-8,739	1%	-8,826	1%
<b>Operating Income</b>	<b>8,806</b>	<b>31%</b>	<b>9,737</b>	<b>11%</b>	<b>10,429</b>	<b>7%</b>	<b>11,293</b>	<b>8%</b>	<b>12,204</b>	<b>8%</b>	<b>13,164</b>	<b>8%</b>
Provisions	-219	-51%	-274	25%	-282	3%	-294	4%	-306	4%	-318	4%
<b>Pre-tax Profit</b>	<b>8,586</b>	<b>37%</b>	<b>9,462</b>	<b>10%</b>	<b>10,146</b>	<b>7%</b>	<b>10,999</b>	<b>8%</b>	<b>11,898</b>	<b>8%</b>	<b>12,846</b>	<b>8%</b>
Net lending (billions)	656	3%	679	4%	700	3%	728	4%	757	4%	787	4%
Deposits to Customers	345		358		369		384		399		415	
Provisions/Loans	0.03%		0.04%		0.04%		0.04%		0.04%		0.04%	
NII/ Loans	1.93%		1.97%		1.99%		2.01%		2.03%		2.05%	
C/I Ratio	50%		47%		45%		43%		42%		40%	
<b>SME</b>												
Net Interest Income	6,176	5%	6,345	3%	6,663	4%	6,996	4%	7,346	4%	7,713	4%
Other Operating Income	1,489	27%	1,563	5%	1,642	5%	1,724	5%	1,810	5%	1,900	5%
<b>Total Revenues</b>	<b>7,665</b>	<b>8%</b>	<b>7,909</b>	<b>3%</b>	<b>8,304</b>	<b>5%</b>	<b>8,720</b>	<b>5%</b>	<b>9,156</b>	<b>5%</b>	<b>9,613</b>	<b>5%</b>
Operating Expenses	-3,724	5%	-3,724	0%	-3,761	1%	-3,799	1%	-3,837	1%	-3,875	1%
<b>Operating Income</b>	<b>3,941</b>	<b>12%</b>	<b>4,185</b>	<b>6%</b>	<b>4,543</b>	<b>9%</b>	<b>4,921</b>	<b>8%</b>	<b>5,319</b>	<b>8%</b>	<b>5,738</b>	<b>8%</b>
Provisions	-598	0%	-615	5%	-640	4%	-665	4%	-692	4%	-719	4%
<b>Pre-tax Profit</b>	<b>3,343</b>		<b>3,570</b>		<b>3,904</b>		<b>4,256</b>		<b>4,627</b>		<b>5,019</b>	
Net lending (billions)	209		218		227		236		245		255	
Deposits to Customers	149		154		161		167		174		181	
Provisions/Loans	0.29%		0.29%		0.29%		0.29%		0.29%		0.29%	
NII/ Loans	2.95%		2.91%		2.94%		2.97%		2.99%		3.02%	
C/I Ratio	49%		47%		45%		44%		42%		40%	
<b>Trading</b>												
<b>Total Revenues</b>	<b>2,588</b>	<b>-42%</b>	<b>2,763</b>	<b>7%</b>	<b>2,896</b>	<b>5%</b>	<b>3,035</b>	<b>5%</b>	<b>3,181</b>	<b>5%</b>	<b>3,334</b>	<b>5%</b>
Operating Expenses	-645	-17%	-527	-18%	-543	3%	-559	3%	-576	3%	-593	3%
<b>Pre-tax Profit</b>	<b>1,943</b>	<b>-48%</b>	<b>2,236</b>	<b>15%</b>	<b>2,353</b>	<b>5%</b>	<b>2,476</b>	<b>5%</b>	<b>2,605</b>	<b>5%</b>	<b>2,741</b>	<b>5%</b>
C/I Ratio	25%		19%		19%		18%		18%		18%	
<b>Traditional Pension Products</b>												
<b>Total Revenues</b>	<b>2,445</b>	<b>14%</b>	<b>2,045</b>	<b>-16%</b>	<b>2,106</b>	<b>3%</b>	<b>2,169</b>	<b>3%</b>	<b>2,234</b>	<b>3%</b>	<b>2,301</b>	<b>3%</b>
Operating Expenses	-846	-2%	-773	-9%	-781	1%	-789	1%	-796	1%	-804	1%
<b>Pre-tax Profits</b>	<b>1,599</b>	<b>25%</b>	<b>1,272</b>	<b>-20%</b>	<b>1,325</b>	<b>4%</b>	<b>1,381</b>	<b>4%</b>	<b>1,438</b>	<b>4%</b>	<b>1,497</b>	<b>4%</b>
C/I Ratio	35%		38%		37%		36%		36%		35%	
<b>Other Operations/ Eliminations</b>												
<b>Pre-tax Profit</b>	<b>-2,106</b>	<b>-55%</b>	<b>-467</b>	<b>-78%</b>	<b>-821</b>	<b>76%</b>	<b>-921</b>	<b>12%</b>	<b>-1,021</b>	<b>11%</b>	<b>-1,021</b>	<b>0%</b>

Source: Company Reports and Citi Research Estimates

## DNB ASA

### Company description

DNB ASA offers services including retail, commercial, corporate and investment banking, and life, pension and non-life insurance. The services are provided to private customers, small businesses, and large companies. DNB offers special services to the shipping industry. The Bank operates through several subsidiaries in Norway and abroad.

### Investment strategy

We have a Buy rating on DNB. DNB is trading at close to record high discount of 0.5x price/tangible to Swedish peers. Its earnings quality is improving measured by lower earnings volatility and better predictability. It's also the most profitable bank in the world on profit/employee matrix. Furthermore, DNB's core capital ratio is high and rising. We expect it to more than double its dividend payout ratio to 65% by 2018.

### Valuation

We use a two-stage dividend discount model (DDM) to value DNB, including the present value of 2014-18E dividends and a terminal value assuming 2% growth at a sustainable RoE of 12%. We use a 9.5% cost of equity. We cross-check this valuation using: (1) justified price to book valuation; (2) comparable P/E and P/GOP valuation relative to the banks sector; and (3) comparable valuation relative to DNB's historical trading range and growth prospects. We set a target price of NOK140 based on this methodology.

### Risks

There are a number of risks and factors that could cause the share price to deviate from our target price. These include: (1) a slowdown in Norwegian banking growth or materially adverse developments in specialist markets such as shipping; (2) the Norwegian economy is an oil economy and thus exposed to price fluctuations which may impact the banking market; (3) adverse conditions in the bank's Markets division; (4) regulatory risks relating to the implementation of capital adequacy rules for the bank and the bank's insurance operations; and (5) adverse development in the property market could also dampen the growth and credit outlook of the company. If the impact on the company from any of these factors proves to be greater or less than we anticipate, the stock may undershoot or outperform our financial forecasts and target price.

## Appendix A-1

### Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

## IMPORTANT DISCLOSURES

### DNB ASA (DNB.OL)

#### Ratings and Target Price History Fundamental Research

Analyst: Ronit Ghose

Covered since January 18 2013



	Date	Rating	Target Price	Closing Price
1	3-Oct-11	1M	*75.00	58.50
2	7-Oct-11	Stock rating system changed		
3	8-Oct-11	*1	75.00	58.30
4	28-Oct-11	1	*78.00	66.10
5	9-Jan-12	1	*71.00	57.50

\* Indicates change

	Date	Rating	Target Price	Closing Price
6	10-Feb-12	1	*77.00	68.20
7	4-Jun-12	1	*75.00	54.00
8	7-Sep-12	1	*80.00	69.50
9	10-Oct-12	1	*83.00	71.70
10	17-Jan-13	*2	83.00	77.55

	Date	Rating	Target Price	Closing Price
11	1-Mar-13	2	*85.00	85.25
12	9-Jul-13	2	*92.50	94.05
13	1-Sep-13	2	*100.00	95.00
14	17-Jan-14	2	*115.00	112.80
15	8-Apr-14	*1	*120.00	100.80

Rating/target price changes above reflect Eastern Standard Time

### DNB ASA (DNB.OL)

#### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Ronit Ghose

Covered since January 18 2013



	Date	Rating	Target Price	Closing Price
1	28-Aug-12	*ADD MP	-	66.70
2	15-Oct-12	*REM MP	-	72.60

\* Indicates change

	Date	Rating	Target Price	Closing Price
3	23-Sep-13	*ADD LP	-	96.15
4	12-Oct-13	*REM LP	-	93.70

Rating/target price changes above reflect Eastern Standard Time

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#### Citi Research Equity Ratings Distribution

Data current as of 31 Mar 2014

Citi Research Global Fundamental Coverage

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
49%	40%	12%	1%	98%	1%



% of companies in each rating category that are investment banking clients 55% 53% 45% 58% 53% 42%

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