3 January 2014 │ 42 pages

Diversified Banks
Western Europe │ Denmark

Danske Bank A/S (DANSKE.CO)

- Estimate Change
- Target Price Change

Borgen Style

- **Denmark is Fashionable, Danske is Not** — Over the past decade, Danish food, television, movies and toys (once again) have become highly fashionable, but its largest bank went in the opposite direction. Danske shares are flat 2003-13; Nordea doubled and DNB trebled (almost). Can Thomas Borgen, Danske's new CEO, be as popular with bank investors as Borgen, the political drama, is with TV viewers?
- **Doubling Profitability** — Danske ROE expected to double from 5% (2013E) to 9% (2015E) and 10% (2017E) driven by cost cutting (+2.7ppt), lower impairments and running off non-core (+2.0ppt), and normalising insurance and trading (+1.2ppt). Better NII is expected from re-pricing underway and repaying expensive State funding, but we do not factor in material NIM improvement beyond 2014.
- **From Macro Headwinds to Tailwinds** — Danske's gearing to economies such as Denmark and Ireland has been a headwind relative to Nordic peers geared to strong Swedish or Norwegian markets. But several core countries in Danske's footprint, eg Denmark (54% of loans, 9M13), Ireland (26% of impaired loans, 9M13) and Finland, should see a c2ppt positive delta in GDP growth rates 2012-15E.
- **Targeted Restructuring** — Mr Borgen has announced an increased absolute cost target (DKr23 billion, 2015 vs DKr24 billion, 2013), putting all Irish operations into non-core and further headcount reductions in non-client facing roles. Danske has been aggressive in cutting branches (-40% since 2011), less so on staff numbers (-6% since 2011). We think Northern Ireland should be sold.
- **Reiterate Buy, Target Price DKr150 (from DKr140)** — Danske is trading at 0.8x 2014E book value and 0.9x tangible book value. Nordic peers trade at P/TB (2014E) of 1.2-1.9x. Peripheral retail banks trade at higher multiples, such as Bank of Ireland at 1.2x and Banco Popular at 1.1x. Our DKr150 target price is based on our DDM model and is raised from DKr140 based on higher 2015 and new 2016-17 forecasts.

Buy	**1**
Price (03 Jan 14)	Dkr124.20
Target price	Dkr150.00
from Dkr140.00	
Expected share price return	20.8%
Expected dividend yield	1.8%
Expected total return	**22.6%**
Market Cap	Dkr125,271M
	US$22,964M

Price Performance
(RIC: DANSKE.CO, BB: DANSKE DC)

Danske Bank A/S (DKK)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Net Income (DkrM)	1,712.0	4,745.0	7,137.2	11,482.3	14,213.9
Diluted EPS (Dkr)	1.95	5.05	7.13	11.46	14.19
Diluted EPS (Old) (Dkr)	1.97	5.06	7.60	11.42	13.13
PE (x)	63.8	24.6	17.4	10.8	8.8
P/BV (x)	0.9	0.9	0.9	0.8	0.8
DPS (Dkr)	0.00	0.00	2.00	4.00	5.50
Net Div Yield (%)	0.0	0.0	1.6	3.2	4.4
ROE (%)	1.5	3.6	5.0	7.7	9.0

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Fiscal year end 31-Dec	2011	2012	2013E	2014E	2015E
Valuation Ratios					
P/E adjusted (x)	63.8	24.6	17.4	10.8	8.8
P/E reported (x)	63.8	24.6	17.4	10.8	8.8
P/BV (x)	0.9	0.9	0.9	0.8	0.8
P/Adjusted BV diluted (x)	0.9	0.9	0.9	0.8	0.8
Dividend yield (%)	0.0	0.0	1.6	3.2	4.4
Per Share Data (Dkr)					
EPS adjusted	1.95	5.05	7.13	11.46	14.19
EPS reported	1.95	5.05	7.13	11.46	14.19
BVPS	135.68	138.00	145.02	153.26	162.50
Tangible BVPS	111.63	116.46	124.28	133.33	143.36
Adjusted BVPS diluted	135.68	138.00	145.02	153.26	162.50
DPS	0.00	0.00	2.00	4.00	5.50
Profit & Loss (Dkrm)					
Net interest income	23,537	24,788	22,265	23,622	24,574
Fees and commissions	8,298	8,782	9,138	9,561	9,937
Other operating Income	11,542	14,115	6,703	9,417	11,007
Total operating income	**43,377**	**47,685**	**38,105**	**42,600**	**45,518**
Total operating expenses	-25,987	-26,588	-23,877	-23,522	-23,180
Oper. profit bef. provisions	**17,390**	**21,097**	**14,228**	**19,078**	**22,338**
Bad debt provisions	-13,185	-12,529	-4,450	-3,347	-2,865
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**4,205**	**8,568**	**9,778**	**15,731**	**19,472**
Tax	-2,482	-3,819	-2,640	-4,247	-5,258
Extraord./Min. Int./Pref. Div.	-11	-4	-1	-1	-1
Attributable profit	**1,712**	**4,745**	**7,137**	**11,482**	**14,214**
Adjusted earnings	1,712	4,745	7,137	11,482	14,214
Growth Rates (%)					
EPS adjusted	-59.6	159.6	41.0	60.9	23.8
Oper. profit bef. prov.	-14.2	21.3	-32.6	34.1	17.1
Balance Sheet (Dkrm)					
Total assets	**3,424,403**	**3,485,181**	**3,345,774**	**3,398,464**	**3,502,798**
Avg interest earning assets	3,153,187	3,282,052	3,244,704	3,203,513	3,278,100
Customer loans	1,847,200	1,894,578	1,818,795	1,847,438	1,904,155
Gross NPLs	113,100	114,300	82,296	65,837	55,961
Liab. & shar. funds	**3,424,403**	**3,485,181**	**3,345,774**	**3,398,464**	**3,502,798**
Total customer deposits	848,994	929,092	901,219	925,442	957,679
Reserve for loan losses	48,600	47,800	47,889	45,546	43,540
Shareholders' equity	**125,795**	**138,234**	**145,264**	**153,523**	**162,777**
Profitability/Solvency Ratios (%)					
ROE adjusted	1.5	3.6	5.0	7.7	9.0
Net interest margin	0.75	0.76	0.69	0.74	0.75
Cost/income ratio	59.9	55.8	62.7	55.2	50.9
Cash cost/average assets	0.8	0.8	0.7	0.7	0.7
NPLs/customer loans	6.1	6.0	4.5	3.6	2.9
Reserve for loan losses/NPLs	43.0	41.8	58.2	69.2	77.8
Bad debt prov./avg. cust. loans	0.7	0.7	0.2	0.2	0.2
Loans/deposit ratio	217.6	203.9	201.8	199.6	198.8
Tier 1 capital ratio	16.0	19.4	18.5	19.5	19.9
Total capital ratio	17.9	21.3	19.3	20.3	20.6

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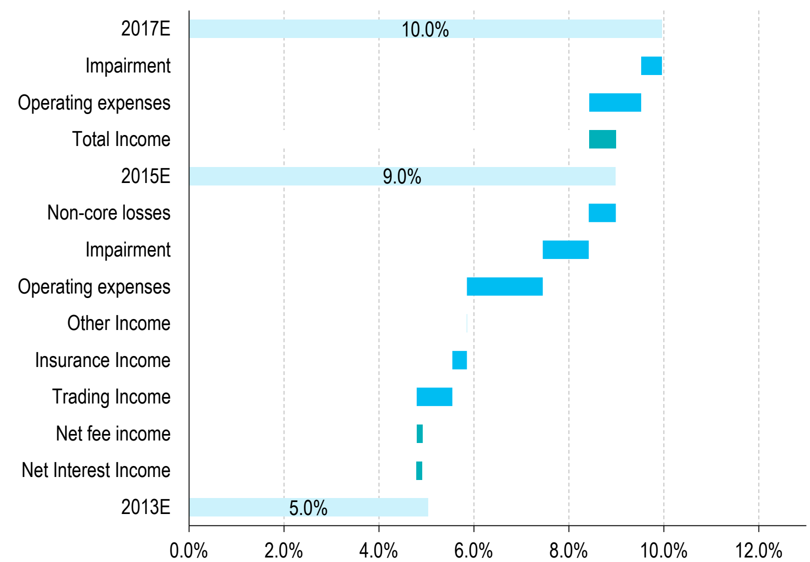
Investment Overview

Investment Thesis

Danske ROE to double from 5% to 10% due to cost cutting, normalising non NII and running down non-core; better NII could boost ROEs further

Doubling Profitability: Danske Bank expected to earn a sub-par c5% ROE in 2013E vs 11% for DNB, 11% for Nordea and an average of c13% for SEB, SHB and Swedbank. We forecast an ROE of c9% in 2015E, in line with management targets, and 10% for 2017E compared to the long-term target of 12%. Higher ROE should be driven by improvements in currently depressed trading and insurance income (+1.2pt), lower impairments and running off non-core losses (+2.0pt), and cost cutting (+2.7pt). Higher interest rates longer term would push up ROEs further.

Figure 1. Danske ROE projection 2013E – 2017E



Source: Citi Research Estimates. Note: 2013E, 2015E and 2017E ROEs are based on Citi estimates. The increase/decrease that contributes to the incremental ROE is calculated as the increase/decrease of individual income statement line item/equity. Note: Individual items on Y-axis on a post-tax basis.

Higher loan losses account for more than all of Danske's ROE underperformance vs Nordea; provision normalisation should help Danske returns through 2015

Lower Loan Losses: Danske's ROE for 2008-12 averaged 2% vs Nordea's 12%. More than all the difference was due to Danske's higher loan losses, especially in Ireland, and greater exposure to a soft Denmark. Danske's headline loan losses in 2013 should fall to only 24bps (as % of loans) from an average of 81bps for 2008-12 due to improving Irish and Danish losses. But adding non-core, 2013E LLP goes up to 31bps, adjusting for repos 35bps. Given declining absolute NPLs, the P+L provision charge may well fall below a "normalised" level in 2015-16.

Figure 2. Segment breakdown of allocated capital, profit before tax and ROE (DKr million)

	9M13 Allocated Capital	9M13 Profit Before Tax	9M13 Annualised RoE
Non-core (Ireland)	8,223	-1083	-17.6%
Danica Pension	11,555	474	5.5%
Danske Capital	2,549	682	21.4%
Corporate & Institutions	31,587	2426	10.2%
Business Banking	45,211	3556	10.5%
Personal Banking	30,401	1883	8.3%
Sum	**129,526**	**7938**	**5.7%**
Group	**143,317**	**7197**	**4.9%**

Source: Company Reports and Citi Research Estimates

Danske's gearing to "problem child" economies such as Denmark and Ireland has been a headwind vs Nordic peers; should now be a tailwind

Improving Economy: Several core countries in Danske's footprint, such as Denmark (54% of loans, 9M13), Ireland (26% of impaired loans, 3Q13), and Finland (9% of loans and low returns) are all experiencing an economic recovery. On IMF forecasts, all three countries should have a GDP growth rate delta of +2ppt from 2012 to 2015E. Relative to peers, focused on Swedish or Norwegian banking markets, Danske's footprint has included a relative macro headwind, now abating.

New CEO Thomas Borgen appointed September 2013 should be investor friendly, execution focused and help rebuild key stakeholder relationships

New Management: Danske Bank's new CEO from September 2013, Thomas Borgen, is not expected to materially change strategy but improve execution and relationships with key stakeholders. The current tail-wind from improving macro, real estate and asset quality in Danske's core markets should make him Danske's "lucky" 13th CEO. Since taking over, Mr Borgen announced an increased absolute cost target (DKr23 billion, 2015E vs DKr24 billion, 2013E) and putting all Irish operations into non-core. In our view, he should consider selling Northern Ireland.

Danske's 2003 cost/income ratio of 50% was among the best in the Nordic region, by 2013 it was the worst by a long way. In 2015 we expect its CIR to return to c50%.

Improved Cost/Income Ratio: Danske's 2013E cost/income ratio of c60% puts it at the bottom of its Nordic peer group and is c10ppt worse than its 2003 cost/income ratio when its CIR lagged only SHB in the Nordic region. We expect Danske's 2015 CIR to be back to c50%, driven by new management's focus on costs (expect more non client facing staff reductions) and a recovery in revenues due to a healthier economy and more "normal" trading/insurance income.

Figure 3. Nordic Banks – Change in CIRs 2003-13E (%pt)

	2003 CIR	2013E CIR	Chg % pt
SE Banken AB	65%	54%	-11%
Nordea	61%	50%	-11%
DnB	58%	49%	-9%
Swedbank	54%	45%	-9%
SHB	44%	47%	3%
Danske Bank	50%	61%	11%

Source: Company Reports, Citi Research

Danish Franchise Profitable: Danske's core franchise has generated returns in-line with Nordea Denmark and its smaller peers such as Jyske Bank or Sydbank. During 2008-12, Danske's underlying Danish ROE was c8%. As the Danish market improves, a 10% plus ROE in Denmark is realistic. The same applies to Norway and Sweden where a 10% ROE is also realistic, albeit behind larger local peers. Ireland aside, Finland is the key ROE drag and further restructuring will be needed.

Restarting Dividends: Danske Bank has not paid a dividend for five years from 2008-12. We expect a small dividend to be paid for 2013 (DKr2/share or 28%) and the bank targets a payout ratio of 40% in the coming years. In the early years of Peter Straarup's CEO-ship during 2000-04, Danske was a capital return and restructuring story. We hope Mr Borgen takes Danske back to those halcyon days.

Figure 4. Fully loaded B3 Capital Ratio with 25% mortgage risk weights for Swedish banks

B3 FL CET1	3Q13
Danske	12.20%
DnB	12.50%
Nordea	12.80%
SEB	13.70%
Swedbank	13.90%
SHB	14.10%

Source: Company Reports and Citi Research Estimates

Figure 5. Capital Position of Nordic Banks

B3 FL CET1	3Q12	4Q12	1Q13	2Q13	3Q13	25% RWA	QoQ	YoY
Danske Bank	10.7%	12.5%	13.1%	13.6%	12.2%		-145	+145
DnB	10.0%	10.7%	10.6%	10.8%	11.0%		+20	+100
Nordea	11.2%	11.7%	12.1%	13.1%	13.4%	12.8%	+30	+222
SEB	13.2%	13.1%	13.3%	14.2%	15.0%	13.7%	+80	+179
SHB	15.9%	16.4%	17.5%	17.8%	18.8%	14.1%	+100	+286
Swedbank	15.4%	15.4%	16.4%	17.2%	18.0%	13.9%	+80	+260

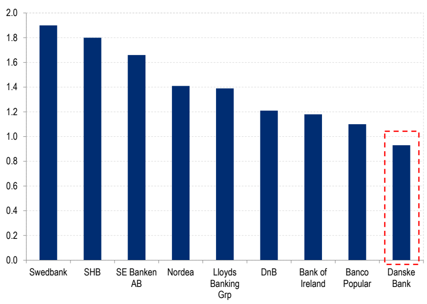
Source: Company Reports and Citi Research Estimates; DNB numbers in Figure 5 show equity T1 capital on B1 transitional rules basis

Figure 6. Nordic Banks Cash Payout Ratio exceeds 50% by 2015

	2012	2013E	2014E	2015E
Danske Bank	0%	28%	35%	39%
DnB	25%	26%	24%	27%
Nordea	43%	58%	63%	74%
SE Banken AB	52%	50%	52%	55%
SHB	47%	51%	51%	52%
Swedbank	75%	83%	75%	75%

Source: Company Reports and Citi Research Estimates

Figure 7. 2014E P/TB for Danske and its European Peers



Source: Citi Research

Attractive Valuation: Danske is trading at 0.8x 2014E book value and 0.9x 2014E tangible book value. While this may appear justified by the 2014E ROE of 7.6% and ROTE of 8.9%, we expect the group's profitability to continue to rise. Based on our DDM-based valuation we justify a target price of DKr150 (PV of 2017E terminal ROE of 10%, dividends and a 9.5% cost of equity). Nordic peers trade at P/TB (2014E) of 1.2-1.9x; other comparable retail/commercial banks all trade at higher multiples, eg Lloyds at 1.4x, Banco Popular 1.1x, and Bank of Ireland 1.2x. Over the past decade, between Dec 03 and Dec 13, Danske Bank shares did a round trip: -3% due its share price halving since its peak. Nordea shares by contrast are almost back at peak levels and have doubled over this past decade. DNB shares trebled.

Investment Risks

Volatile Markets: An important part of the Danske Bank 2014E recovery in ROE is driven by expectations of higher non-interest income, primarily in CIB market making and insurance. Market volatility, especially if bond markets suffer more than expected from Fed tapering in 2014, would be a risk to our short-term forecasts. Danske's trading income line is historically more volatile than many Nordic peers.

High Level of Household Debt: Denmark's financial structure, somewhat like Northern European peers such as the Netherlands, is distinctive. Compared to European peers, Denmark has one of the highest Mortgage Debt to GDP ratios (100% as of 2012), second only to the Netherlands. This high level of structural household debt will raise questions on volume growth and future credit risks.

Covered Bond Funding: Danish banks have a high reliance on covered bond funding. Disruptions in wholesale funding markets may be a risk. The cost of covered bond funding may be affected by regulatory changes — while not our base case, there may be noise around this topic during 1H14.

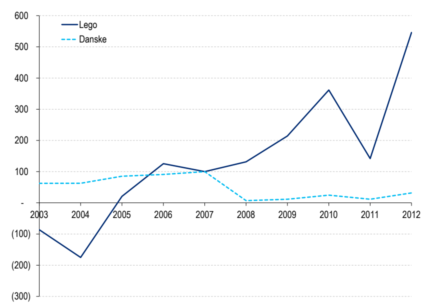
A Decade of Playing Badly

Over the past few years, Danish food, television, movies and toys have become highly fashionable – but its biggest bank has gone in the opposite direction

The world's best restaurant, highly regarded TV exports, controversial films. Lego re-discovered. Denmark has become internationally fashionable in the past decade or so. The Danish food scene, led by Noma and the New Nordic movement, Danish television via exports such as Borgen or The Killing, and the films of Dogme and Lars Von Trier are all now world renowned. Even Lego, one of its more successful longer-term exports (from the Danish "leg godt" which means "play well") has undergone a renaissance. During 2003-04, the recent nadir for Lego, the toy maker generated cumulative losses of almost DKr3 billion out of revenues of DKr13 billion. In 2003, Danske Bank's CFO, Jesper Ovesen, left to join Lego. The bank that Mr Ovesen left behind was quite fashionable at that time, at least amongst investors, and remained so through the mid-2000s. But over 2007-12, just as everything else about Denmark became fashionable, its leading bank became the opposite.

Lego: Playing Well

Figure 8. Lego vs Danske Indexed Profits Trend (2003-12)



Source: Company Reports, Citi Research; Note: 2007 value indexed to 100

Leaving a leading Nordic financial institution for a struggling toy maker may have looked like a surprising career step in 2003. But by 2007, when Mr Ovesen left Lego for its parent company KIRKBI, the toy maker was on the road to recovery. In 2007, Lego earned a DKr1 billion profit. 2007 was the peak year of profitability for Danske Bank, as it was for many European banks, and the group made DKr15 billion net profit. In the five years that followed, Danske Bank's profitability collapsed, felled by soaring loan losses and weak revenues, while the Danish toy-maker's renaissance continued. By 2012, Lego earned DKr5.4 billion in net profit, up 5-fold from 2007. In four of the five years that followed its peak earning year in 2007, Danske Bank earned less than the maker of inter-locking toy bricks.

Following its descent into losses in 2003-04, Lego restructured. Full-time employees were reduced to 4,199 at end 2007 from 8,298 at end 2003 (of which 1,756 had been in discontinued operations). While Lego was restructuring, the firm Mr Ovesen left behind in 2003 was laying the seeds of troubles to come. In 2004-05, Danske Bank expanded into the Republic of Ireland and Northern Ireland (UK) with the purchase of National Irish Bank and Northern Bank from National Australia Bank. In 2006-07, Danske Bank purchased Sampo Bank, strengthening its position in Finland and the Baltic countries, but at a high price.

While Denmark suffered a tougher credit cycle compared to its peers, Danske's recent problems are also self-inflicted via rapid expansion and leverage

Figure 9. Danske Bank – Major M&A Activities

1990	Den Danske Bank creation via 3-way Danish bank merger
1995	Sale of Baltica Forskring, non-life insurer, to Tryg Forsikring
1995	Purchase of Danica, leading Danish life insurer
1997	Purchase of Ostgota Enskilda Bank in Sweden
1999	Purchase of Fokus Bank in Norway
2001	Danske/RD merger
2005	Ireland (National Irish Bank and Northern Bank)
2007	Sampo Bank acquisition

Source: Company Reports

Restructuring in Lego during 2003-04 included bringing in new management, reducing staff numbers, selling capital-intensive international non-core operations (such as Legoland Parks) and outsourcing production to cost-effective emerging markets such as Central Europe and Mexico. While the world of toys and banking may be different, some of the lessons from Lego a decade ago are applicable to Danske: 1. New management: Danske has a new CEO as of last September. 2. Selling capital-intensive non-core operations: Danske has put its Irish business into run-off; we believe it should consider selling Northern Ireland. 3. Cost cutting: the new CEO has pledged to reduce costs by another DKr1 billion versus plan and for 2015 costs to be c6.5% below 2012-13. But before we analyse how to improve returns, first a short detour through what went wrong at Denmark's biggest bank.

Peter Straarup, CEO from 1998 to 2012, presided over good and bad times: up to 2004, everything seemed to go right; from 2007 things went sour

Danske Bank: The Lost Decade

The recent history of Danske Bank was dominated by the tenure of Peter Straarup as CEO from March 1998 to February 2012. When Peter Straarup retired in 2012 he had spent 43 years with the Group, including 25 years on the Executive Board and 14 years as CEO. Such long tenure was not unusual. Mr Straarup took over as the eleventh CEO of Danske Bank in its 127-year history up to 1998. The previous CEO, Knud Sorensen, had spent 47 years working at the group, including 18 years on the Executive Board. The first CEO of Danske Bank, established as Den Danske Landmandsbank in 1871, was Isak Gluckstadt, who served in that role for almost 40 years. However, “the” Danish bank was not averse to change. In 1990, three of Denmark’s largest banks, Den Danske Bank, HandelsBanken and Provinsbanken merged. The process of consolidating the Danish banking sector gave the group a competitive advantage in banking systems and technology, or so it believed.

By 2007, signs of hubris were evident: “the best IT platform in the world”

We have what you could call probably the best IT platform in the world. Our administrative platform was kick-started through the merger of the Danish banks Handelsbanken, Provinsbanken and Danske Bank back in 1990. The merger triggered the development of what we see as one of our core strengths today – our single platform. At the beginning of the 90s we decided to start from scratch and build a completely new core system that had to be multicurrency, multilingual, flexible and scalable. (Peter Straarup, 29 March 2007).

The Good Early Years of Mr Straarup’s CEO-ship

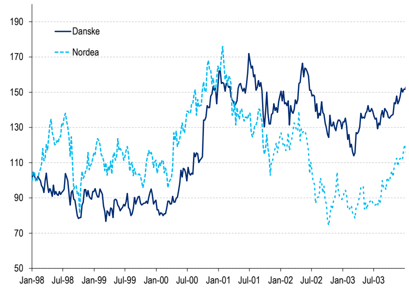
The early years of CEO Peter Straarup were a success as the group focused on retail banking, domestic consolidation and boosting capital return

Peter Straarup’s early years as CEO were a success. As we wrote in our report, Den Danske Bank: An Attractive Corporate Transformation (8 May 2000): “Den Danske is in the midst of a significant cultural and financial change from the bank that investors may have known in earlier years”. Our investment case was based on improving profitability, earnings quality and increased shareholder focus, as we noted: “Core earnings as a percentage of average total assets grew to 80 basis points in 1999 from 50 basis points in 1997. Improved returns will continue to be supported by a reallocation of capital away from wholesale banking to retail banking. The adoption of RAROC in 1999 institutionalised the bank’s increased focus on capital efficiency.” The early promise of the Peter Straarup years was sharpened by the purchase of RealDanmark, the second largest mortgage lender and third largest commercial bank in Denmark.

Danske shares doubled peak-to-trough during 2000-01:

The 2000-01 combination of Danske Bank and RealDanmark/BG Bank, announced October 2000, created an in-market merger with considerable cost reduction potential: the cost reduction target was 46% of RD costs including the effect of restructuring plans pre-dating the Danske/RD merger. Capital return was enhanced: the dividend payout ratio target for the new group was boosted to 40% from 2000 versus Danske’s actual mid 20% payout ratio for 1995-1999 and the group’s share count declined by 13% from 2001 to 2004 due to share buybacks. Following the RD merger, Danske Bank announced it was closing its HK and Singapore branches and reducing its US corporate exposure, further enhancing its retail and Nordic focus. In the first five years of Peter Straarup’s tenure as CEO, the Danske Bank share price increased c20% during a period which included sharply declining bank stock prices — peers such as Nordea declined c30% between 1998 and 2003.

Figure 10. Indexed Share Price Performance – Danske vs Nordea (Jan 98 – Dec 03)



Source: Datastream

Danske Bank's key financial metrics increased steadily post the RD merger during 2001-04, with TBVPS +20%, EPS +20% and DPS +65%

In the first 3 years after the Danske/RD merger, the group performed well: earnings per share increased c20% during 2001-04, dividends per share c65% and reported and tangible book value per share increased c30%. At first glance, the following 3 years looked even better: earnings per share increased c50%, reported book value was up c40% and the share price soared — at its peak in early 2007, the Danske shares had increased almost 200% during the almost 9 years Mr Straarup had been CEO. However, the soaring share price and rising headline EPS and BVPS obscured other worrying trends. During 2004-07, goodwill on the balance sheet increased rapidly due to expensive acquisitions, especially the Sampo Bank purchase, and tangible book value per share failed to grow. Similarly, dividend per share flat-lined and the share count increased c10%. And the TCE/TA ratio deteriorated by almost a third from 3.2% in 2004 to a mere 2.3% in 2007 — it was to trough at a mere 2.1% in 2008, the first of five years of zero dividends.

During 2004-07, Danske's EPS and share price soared but signs of future trouble were emerging: BVPS and DPS flat-lined due to the cost of acquisitions

Figure 11. Danske – Growth in KPIs, 2001–04, 2004–07 and 2008-12 Periods

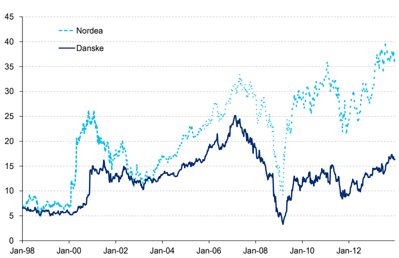
	EPS	BVPS	TBVPS	DPS	Share Price
2001 – 04	21%	34%	33%	65%	17%
2004 – 07	51%	43%	3%	8%	44%
2008 – 12	278%	6%	20%	NM	-48%

Source: Company Reports, Bloomberg, Citi Research

Danske shares flat past decade, Nordea doubled, DNB almost trebled

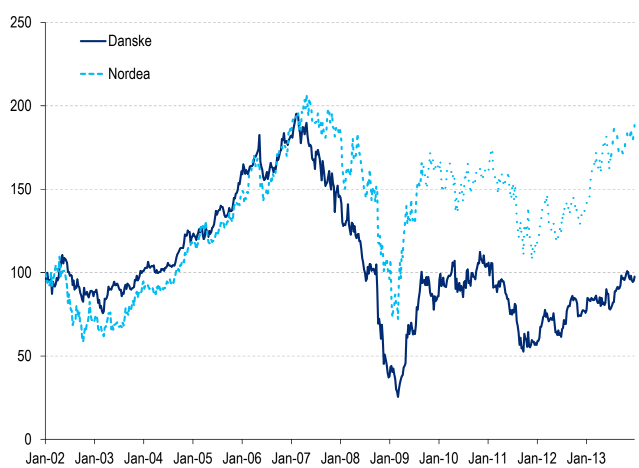
During 2002-03, there were several occasions when Danske Bank's market capitalisation was the same as Nordea's — today it is only c40%. Since 2002-03, Danske has added to its franchise via acquisitions (Ireland, UK, Finland, Baltics) and it has lost market value, while Nordea remained relatively stable in its footprint and added market value through superior execution. For Danske, the past decade has not been much Good Play. Due to the severity of the downturn that buffeted Danske Bank between 2007 and 2012, the Danske shares have effectively done a round trip over the past decade. Between December 2003 and 2013, Danske Bank's share price declined 3%. Over this period, Nordea shares almost doubled; DNB trebled. In this report, via benchmarking versus peers as well as assessing macro trends, we look at what went wrong for Danske Bank and depressed its returns during 2007-13 and why this could change over 2014-15, in our view.

Figure 12. Danske vs Nordea Market Cap – EUR Bn



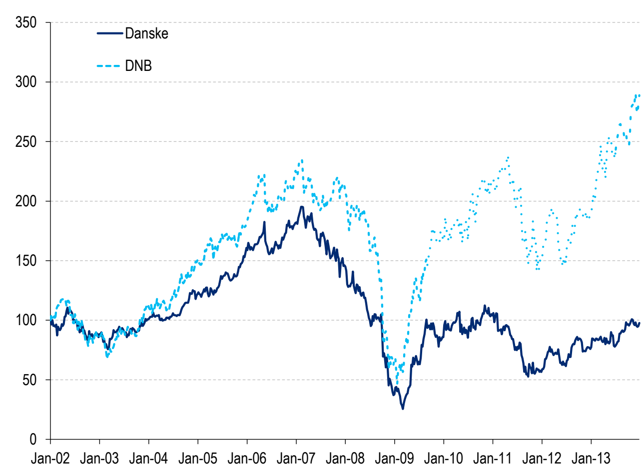
Source: Datastream

Figure 13. Share Price Danske vs Nordea Jan 02-Dec 13, Indexed to 100



Source: DataStream

Figure 14. Share Price Danske vs DnB Jan 02 -Dec 13, Indexed to 100



Source: DataStream

Borgen Style

Can Mr Borgen be as popular with bank investors as Borgen, the political drama, is with TV viewers? Will he be a lucky 13th CEO for Danske Bank?

Thomas Borgen took over as CEO of Danske Bank in September 2013, replacing the short-lived tenure of Eivind Kolding (Feb 2012-September 2013). Mr Kolding was replaced by the Danske Bank Board of Directors as they "*assessed that—notwithstanding Eivind Kolding's professional and personal qualities—it is, in this phase, necessary to have a chief executive officer with stronger qualifications within banking*." (Danske Bank press release 16 September 2013).So what will change? Chairman Andersen noted at the time of Thomas Borgen's appointment as CEO that the bank had already under the tenure of Mr Kolding "*made strategic and structural changes. Those are now in place and it's time to focus more on customers, execution and profitability*". Some recent CEO changes have been about strategy rather than execution (for instance Barclays 2011); others can be more about execution than strategy (Nordea 2002: Lars Nordstrom).

The new Danske Bank CEO has re-based ROE expectations for 2015 to in-line with analyst consensus but is promising higher costs cuts

After taking over as CEO, Mr Borgen announced an additional DKr1 billion cost cutting programme, putting all of Ireland into run-off and (a bit motherhood-and-apple-pie) increased focus on clients, especially in Denmark. With the 3Q13 results on 31 October 2013, Mr Borgen also announced the following updated financial targets (see Figure 15 below). The 2015 ROE target was reduced to 9% from above 12%, but this was in line with existing consensus sell-side analyst estimates. The lower ROE target for 2015 was attributed primarily to a lower interest rate outlook (-3ppt for ROE) and secondarily higher capital requirements (-1ppt for ROE) and included an increased absolute cost reduction target (+1ppt for ROE). On a "long term" view, Danske Bank still aims to deliver an ROE "above 12%" but for now there are not a lot more details on how or when this will be achieved.

Figure 15. Danske – Revised Financial Targets, October 2013

	Target	*Previous Ambition*	Year to be Achieved	Status at 30-Sep-13	Comments
Return on Equity	9% Above 12%	*Above 12%* *Above 12% in 2015*	2015 Long-Term	4.9%	In progress after initiating additional cost savings
Ratings	Improve ratings by at least one notch	*Unchanged*	2015	S&P/Moody's/Fitch A-/Baa1/A Stable/Stable/Stable	In progress
Core Tier 1 Ratio Total Capital Ratio	Minimum 13% Minimum 17%	*Unchanged*	End-2013	14.2% 19.1%	Met at end-2012 ✓ ✓
Nominal Costs Cost/Income Ratio	Below DKK 23bn Below 50%	*Below DKK 24bn* *Below 46%*	2015	DKK 17.5bn (YTD) 60%	In progress after initiating additional cost savings
Dividend Payments	About 40% of net profit	*Unchanged*	2015		On track

Source: Company Reports

Higher revenues from re-pricing and non NII normalisation from trading/insurance, an extra DKr1 billion of cost cuts and tailwind of lower non-core losses

With the 3Q13 results, Danske Bank outlined some of the measures to be taken to boost the 9M13 annualised ROE of c5% to the 2015E target of 9%. On the revenue side, this includes selected business and product line expansion, re-pricing, slightly longer duration on the Group's bond portfolio and normalisation of trading and insurance results. On costs, they are looking for an additional absolute cost saving of DKr1 billion from "internal efficiency measures and further reductions in the number of employees" which we expect to be focused on head office, central functions and similar. Non-core losses will decline as impairments fall. We assume bridging the gap from 9% in 2015E to 12% longer term will be driven by more of the same, as well as an improving economy, especially in Denmark, Finland and Ireland/UK. Investors will be keen to hear more in the coming months from Mr Borgen and his leadership team on how they plan to boost returns longer term.

Who is Thomas Borgen?

We expect the new CEO to be investor friendly and respected by colleagues. He is making the right political noises about looking after (Danish) clients as well …

We believe Danske Bank's new CEO will be shareholder friendly as well as client friendly and our channel-checking with his industry peers suggests investors will find him engaging and a positive for the Danske equity story. For what it is worth, Mr Borgen has already noted the obvious on Danske's shareholder returns in the recent past. *"What we have delivered to our shareholders has not been satisfactory for the last five years, and that we need to improve. To improve that, we really need particularly in Denmark to get back the customer focus, to really get that going and working."* (Bloomberg, 3 October 2013).

The new COE appointment press release (16 September) highlights*: "Thomas F. Borgen has been employed with the Danske Bank Group since 1997 and comes from the position as Member of Danske Bank's Executive Board responsible for Corporate & Institutional Banking. In the period from 2001-2009, Thomas F. Borgen was Managing Director at Fokus Bank ASA. In 2009, Thomas F. Borgen was appointed Head of International Banking Activities and Danske Markets and in the same year he also became member of the Executive Board of Danske Bank."* Mr Borgen's summary CV is set out below:

Mr Borgen has worked with Danske Bank since 1997, initially in his home country Norway, largely in Corporate Banking and Markets roles

Figure 16. Thomas Borgen's Summary CV

Born	27-Mar-64
Hired	1997
Position	CEO, Danske Bank Group
Former employment	Member of the Executive Board and Head of Corporate & Institutions, Danske Bank
	Head of International Banking Activities, Danske Markets, Group Treasury and Corporate & Institutional Banking, 2010-2012
	Member of the Executive Board of Danske Bank A/S and Head of International Banking Activities and Danske Markets, 2009
	Managing Director, Fokus Bank ASA, 2001
	Chief Dealer, Den Danske Bank, Copenhagen, 1999
	Treasurer, Den Danske Bank, Oslo, 1997
	Head of Arbitrage, Nordlandsbanken AS, 1994
	Deputy Manager, Chemical Bank Norge AS, 1991
	Manager/Associate, Chemical Bank Ltd., London, 1989
	Facilities Coordinator, Nevi Finans, Fredrikstad, 1987
Formal training	Master in Business Administration, 1989
	B.A. in Business Organisation, 1987
Directorships & honorary positions	Vice Chairman of the board of directors, Danmarks Skibskredit A/S
	Member of the board of directors, Kong Olav V's Fond
	Member of the board of directors, VP Securities A/S

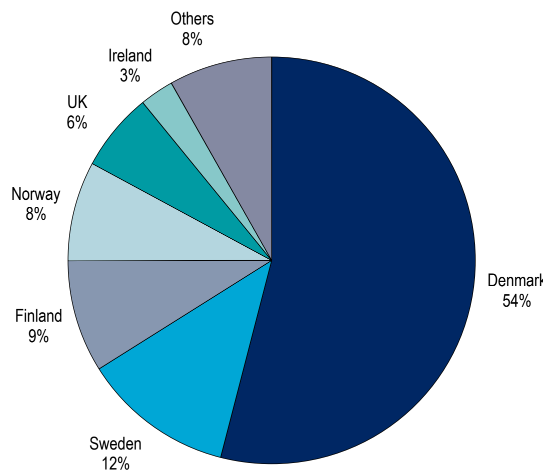
Source: Company

The Lucky Mr Borgen: Credit Improving

Denmark accounts for 54% of Danske Bank's lending and 46% of its impaired loans. Ireland for only 3% of loans but 26% of bad debts.

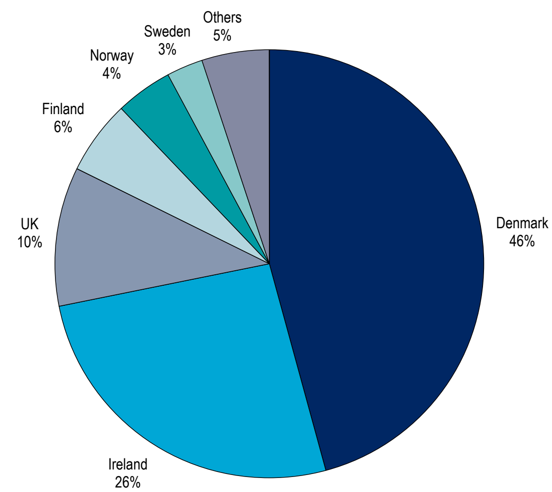
Danske Bank's lending is concentrated to Denmark (54%), Sweden (12%), Finland (9%) and Norway (8%) as shown in Figure 17. However, Ireland, which is only 3% of Danske's total credit exposure, contributes to 26% of group's gross impairments (Figure 18). Ireland has the highest gross impairment ratios and loan loss ratios by a long way followed by the UK (Northern Ireland), Denmark which is broadly similar to the group averages and with the other Nordic countries experiencing negligible bad debts (Figure 19) . We dub the new CEO, "Lucky Mr Borgen", because while he has a challenging task in boosting profitability closer to the levels of peers such as Nordea or neighbouring country champions such as DNB or the Swedes, while restoring the battered morale and reputation of the once fabled institution he leads, he is taking on this task with the tailwind of improving credit conditions, especially in the Republic of Ireland and also the UK and Denmark.

Figure 17. Danske credit exposures to geographical regions as percentage of group total (3Q13)



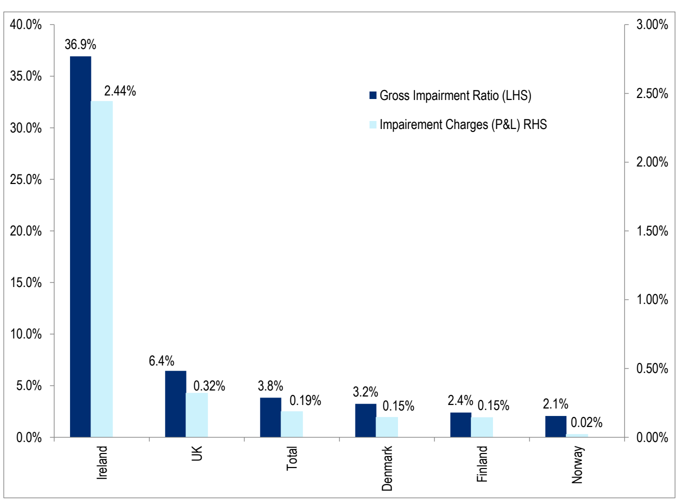
Source: Company Reports

Figure 18. Danske gross impairment of key regions as percentage of group total 3Q13



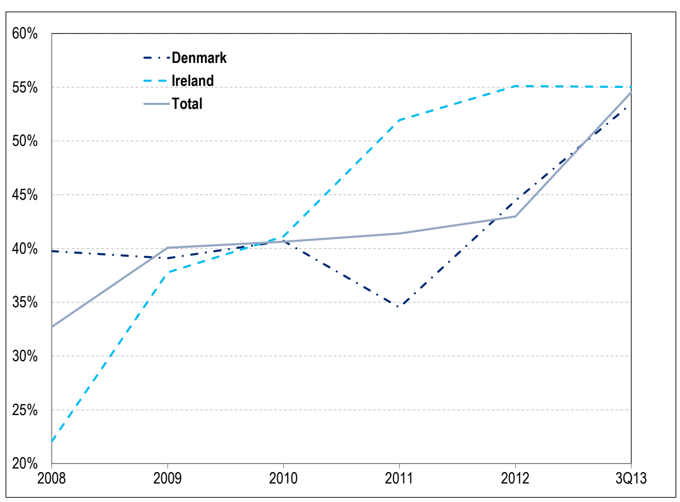
Source: Company Reports

Figure 19. Danske gross impairment ratio and loan loss ratios of key regions 9M13



Source: Company Reports

Figure 20. Coverage Ratio of Danske Group, Danske Denmark and Ireland



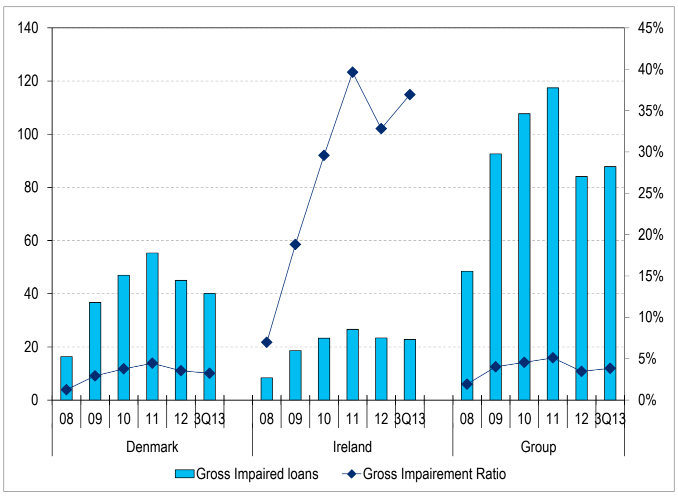
Source: Company Reports

Improving Danish and Irish Credit Metrics

Group gross impaired loans have declined from a peak of c5.1% in 2011 to c3.8% in 3Q13; further declines ahead as Denmark and Ireland continue to improve

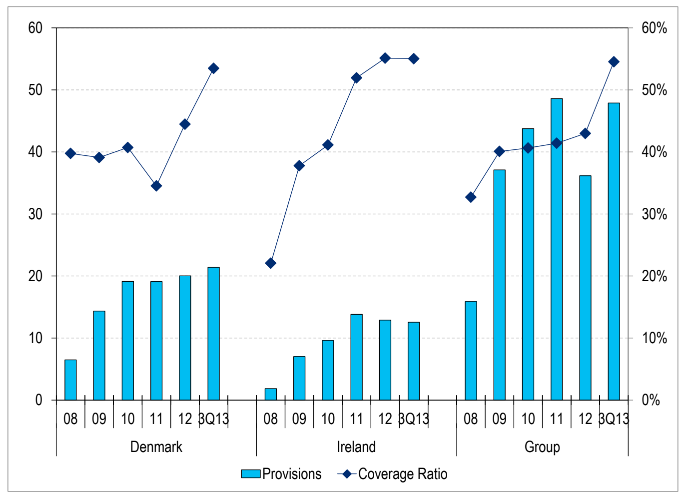
There are clear signs of credit recovery in Ireland and Denmark helped by improved economic conditions and property market (see Figure 21 - Figure 22 below). Group gross impaired loans have declined from a peak of c5.1% in 2011 to c3.8% in 3Q13 and loan loss ratio of the group decreased from 149bps in 2009 to 24bps 3Q13. Loan loss ratios in Ireland decreased to c2.44% in 3Q13 from 9.42% in 2011. There is a slight pick-up in the gross impairment ratio in Ireland in 9M13, partly due to focused asset reduction in Ireland. Credit exposure to Ireland (core + none core) has halved to DKr 60bn 3Q13 from DKr120bn 2008. Credit conditions in Denmark, where Danske is most exposed as a percentage of its book, has also improved: gross impairment ratio decreased from c4.5% in 2011 to c3.2% in 3Q13; loan loss ratio also decreased from peak of 942bps to 244bps 3Q13 (Figure 24).

Figure 21. Danske Gross Impairment(DKr bn) and Gross Impairment Ratio



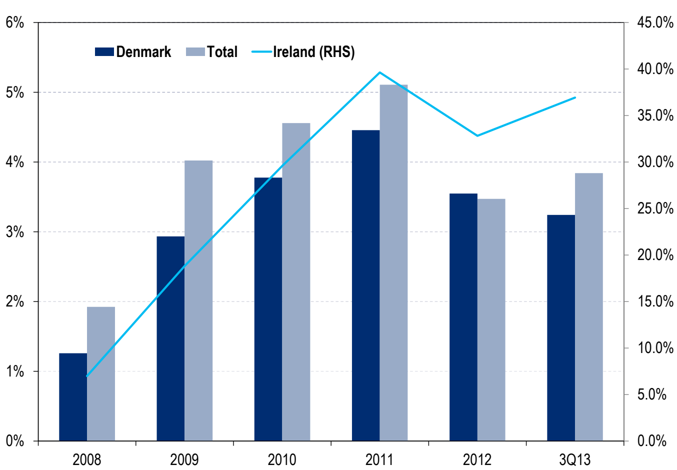
Source: Company Reports

Figure 22. Danske B/S Provisions (DKr bn) and Coverage Ratio



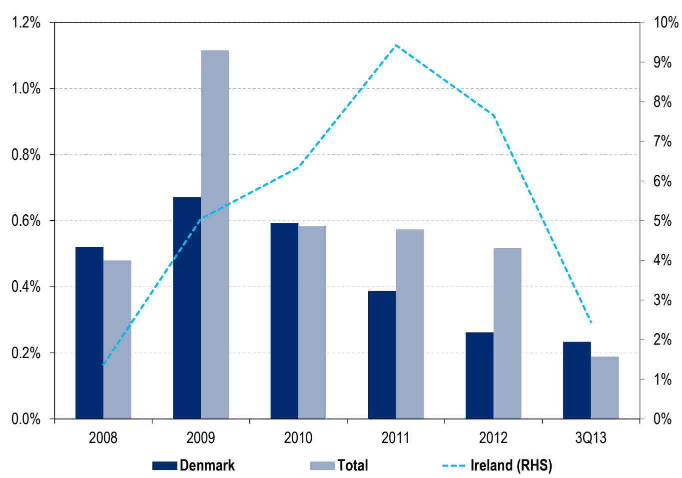
Source: Company Reports

Figure 23. Gross Impairment Ratios of Ireland (RHS), Denmark and group total 3Q13



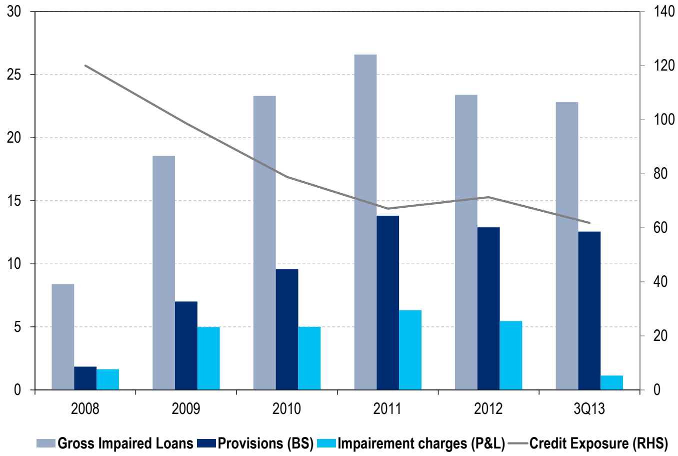
Source: Company Reports

Figure 24. Loan Loss Ratios of Ireland (RHS), Denmark and group total



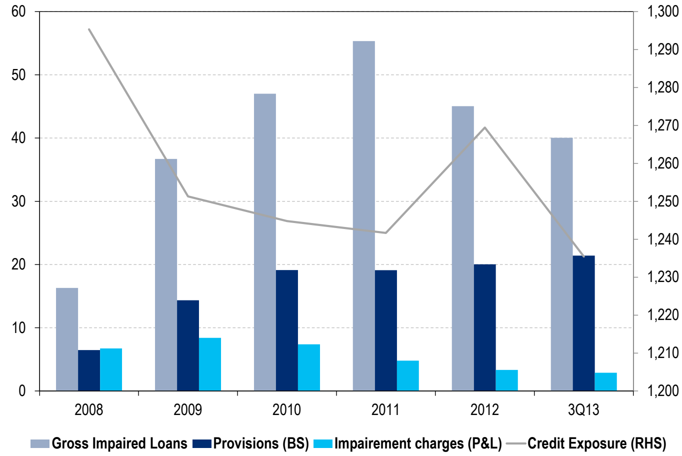
Source: Company Reports

Figure 25. Danske Bank Ireland: Credit Exposure (RHS),Gross Impairment, Provision Allowance and Impairment Charges in DKr bn (Core + Non Core)



Source: Company Reports

Figure 26. . Danske Bank Denmark: Credit Exposure (RHS), Gross Impairment, Provision Allowance and Impairment Charges of Denmark in DKr bn



Source: Company Reports

Irish Loan Portfolio KPIs

Danske's Irish loan book is better than peers for mortgage provision coverage; in-line or worse for CRE

Based on last published Annual Reports, we did a comparison of the asset quality of several international banks active in Ireland (see Figure 27 below). For mortgages, Danske had relatively high NPL coverage ratios and underlying impaired loans in line with peers. For CRE exposures, Danske's level of NPLs was high as at peers and its coverage ratio appears to lag the likes of KBC and Lloyds but is in line with Ulster Bank.

Figure 27. NPL Ratio and NPL Coverage for Major Irish Banks (end-2012)

	NPL Ratio	NPL Coverage
BoI:		
Mortgages	13%	40%
SME	27%	43%
Danske:		
Mortgages	18%	61%
CRE	86%	55%
Other (Corporate/Personal)	35%	51%
KBC:		
Owner mortgages	18%	30%
Buy to let mortgages	29%	43%
SME /corporate	19%	75%
Real estate investment	29%	65%
Real estate development	91%	75%
Lloyds:		
Retail	23%	72%
Commercial Real Estate	91%	70%
Corporate	78%	65%
Ulster Bank:		
Mortgages	16%	48%
Personal Unsecured	15%	97%
Commercial Real Estate	79%	58%
- Investment	63%	47%
- Development	92%	64%
Other Corporate	37%	60%

Source: Company Reports

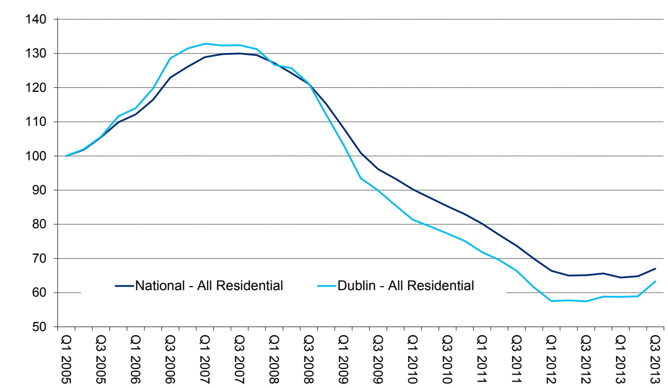
Danske flagged with 3Q13 results that its pipeline of Irish property sales is strong, with sale completions and offers rising. 2014 should see further divestments.

With 3Q13 results, Danske Bank noted that the "sale of properties in (the Irish) Non-core unit is progressing well, and the pipeline of sales is increasing." During 9M 2013, a total of 230 properties were sold, of which 95 were in each of 2Q13 and 3Q13. The number of properties Danske Bank had for sale had increased from 106 in 1Q13 to 886 in 3Q13. Non-core risk-weighted assets were reduced by 25% yoy to DKr28 billion at end 3Q13. At end 3Q13, the existing non-core Irish loan portfolio amounted to DKr26.6 billion, of which CRE accounted for DKr11.5 billion and residential mortgages for DKr7.5 billion. With 3Q13 results, Danske announced the discontinuation of Personal Banking and Business Banking in Ireland. Existing customers will be moved to the Non-core unit for servicing and discontinuance. This will add, pro-forma, another DK17.8 billion of Irish loans to the non-core book, of which DKr14.6 billion is residential mortgages.

Danske's Irish non-core run-off provision guidance (up to DKr2bn, 4Q13-2014) may be conservative given the improvement in the Irish economy and housing market

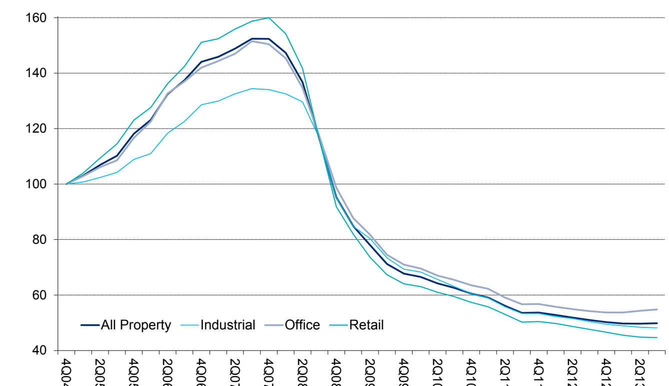
Danske Bank are guiding that this move will lead to expected restructuring charges of DKr250-300 million from Q4 2013 to end-2014 and the "risk of additional impairments of up to DKr 500m towards end-2014, resulting in total estimated impairments over the coming five quarters of up to DKr2 billion". An incremental DKr1.2 billion of provisions were taken during 1Q-3Q13 for the Irish core and non-core loan books. Given the relatively low NPL ratio and higher provision coverage ratio of the Irish mortgage book relative to other loan classes, and the ongoing improvement in the Irish housing market and economy, Danske's latest Irish loan loss guidance may err on the cautious side.

Figure 28. Ireland Residential Property Price Index (Dec-2004 = 100)



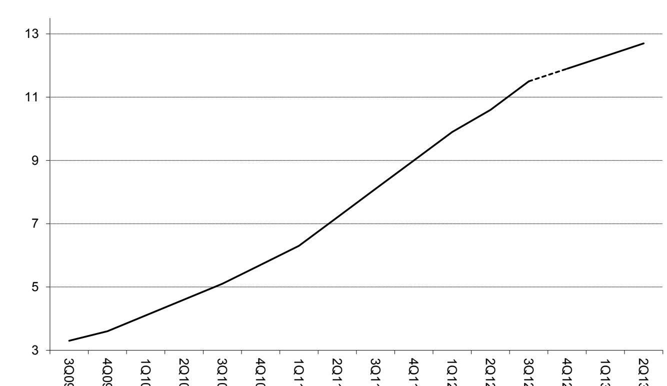
Source: Datastream

Figure 29. Ireland CRE Capital Return Price Index (Dec-2004 = 100)



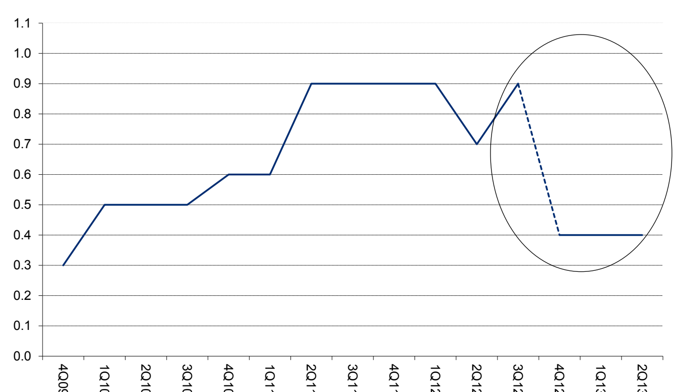
Source: Datastream

Figure 30. Irish Mortgage Arrears – 3Q09-2Q13 (% of 90+day cases)



Source: Central Bank of Ireland, Citi Research

Figure 31. Ireland– Rate of Growth in 90+Day Mortgage Arrears



Source: Central Bank of Ireland, Citi Research

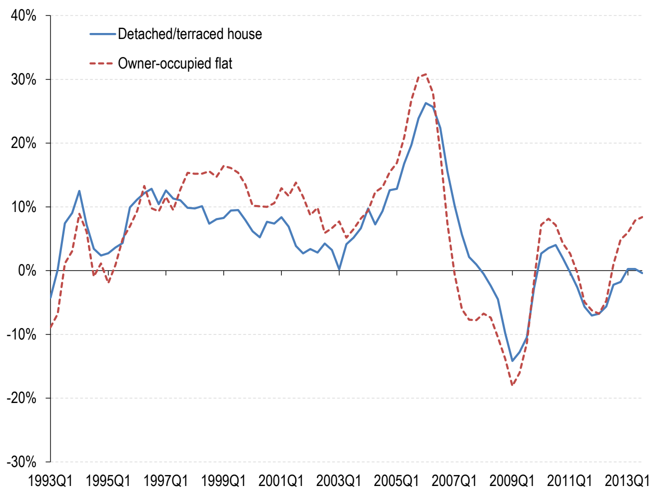
Danish Real Estate Recovery

Improvement in Danish property market evident, especially in Copenhagen, with property prices rising and time on market declining rapidly

There are signs of improvement in property market, particularly in Copenhagen. Flat price across Denmark increased c10% yoy in 2Q13 and c15% in Copenhagen. (Figure 32 - Figure 33). Although the number of transactions remained at low levels, there are noticeable drop in the amount of time taken to sell the properties (Figure 34 - Figure 35). The average time taken to sell a flat in Copenhagen has fallen to less than 3 months, close to the pre-crisis level.

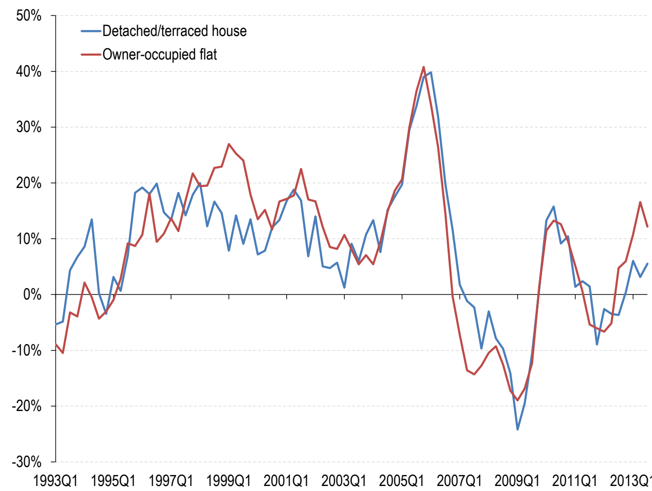
The improvement in property market is positive for Danske in a number of ways. Danske, through its subsidiary Realkredit has 26% mortgage market share in Denmark (based on covered mortgage bonds market share). Recovery in property market will translate into volume growth through increased mortgage lending. Secondly, increasing property prices will improve Danske's credit quality, reducing the non-performing loan ratios and loan loss ratios, which are main drags on its ROE relative to its Nordic peers.

Figure 32. Change in property prices in Denmark (yoy) 1Q99-3Q13



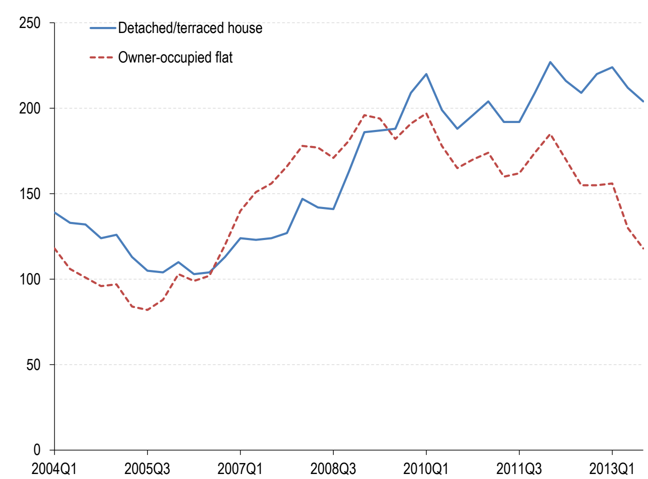
Source: Association of Danish Mortgage Banks

Figure 33. Change in property prices in Copenhagen (yoy) 1Q99-3Q13



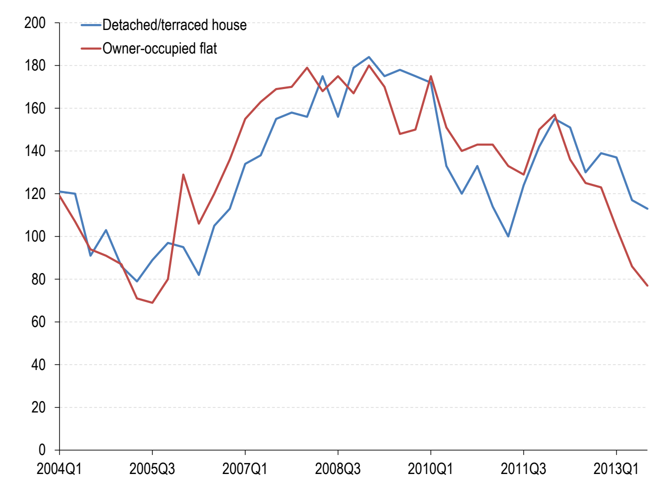
Source: Association of Danish Mortgage Banks

Figure 34. Time-on-market (days) for properties in Denmark 1Q04-3Q13



Source: Association of Danish Mortgage Banks

Figure 35. Time-on-market(days) for properties in capital region 1Q04-3Q13



Source: Association of Danish Mortgage Banks

Economic Recovery in Key Danske Countries

Danske to benefit from recovery in key countries its footprint, with a c2ppt GDP growth rate delta forecast for Denmark, Finland and Ireland

Key Danske Bank markets such as Denmark, Finland and Ireland were either flat-lining or in recession in 2012. But the picture is changing for the better. The IMF forecasts c2ppt plus GDP growth rate deltas between 2012 and 2015E (see Figure 36 below). This should help asset quality improvements, especially in Danske's non-core Irish portfolio, and also potentially volume and NII growth in Denmark and Finland in due course. The growth in Danish GDP is expected to be driven by private consumption and investment (see Figure 37 below).

Figure 36. Nordic and Irish Real GDP Growth Rates, 2012-15E % YoY

	2012	2013E	2014E	2015E
Denmark	-0.4	0.1	1.2	1.5
Finland	-0.8	-0.6	1.1	1.4
Ireland	0.2	0.6	1.8	2.5
Norway	3.0	1.6	2.3	2.3
Sweden	1.0	0.9	2.3	2.3

Source: IMF

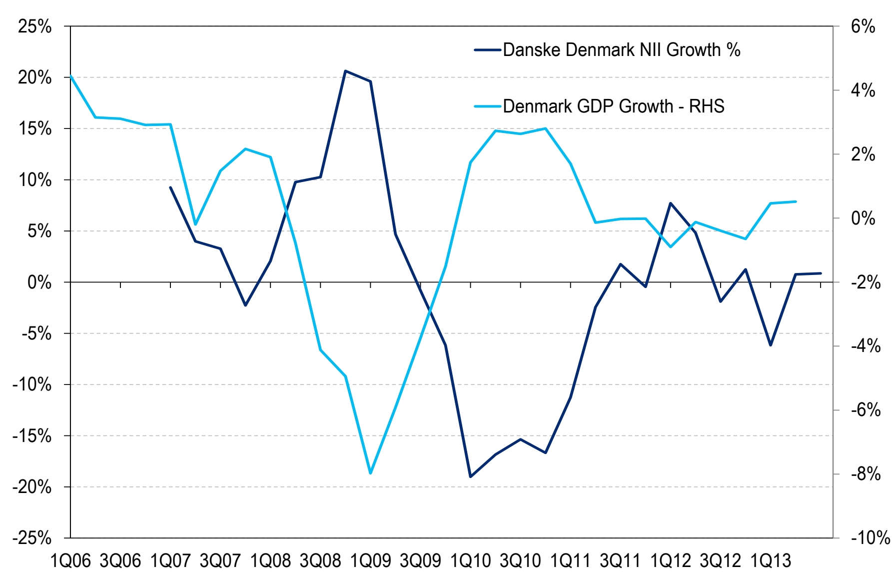
Figure 37. Sweden, Denmark and Norway — Economic Forecasts, 2013F-2014F

		Sweden			Denmark			Norway		
		2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Real GDP	YoY	0.90%	2.10%	2.50%	0.40%	1.20%	1.50%	1.80%	2.10%	2.40%
Final Domestic Demand	YoY	1	2	2.3	0.7	1.4	1.5	2.3	2.3	2.8
Private Consumption	YoY	1.8	2.1	2.5	0.5	1.2	1.6	2.2	2.4	2.9
Government Consumption	YoY	1.1	1.2	0.8	0.2	0.5	0.7	2.1	2.6	3
Investment (Ex Stocks)	YoY	-1.1	2.8	4.1	2.1	3.1	2.2	2.8	1.6	2
Exports	YoY	-1.5	1.8	3.7	0.6	2.5	2.1	0.1	1.1	2.1
Imports	YoY	-2.2	1.4	3.5	2.3	3.1	2.1	2.3	2.5	2.3
CPI(Average)	YoY	0	1.1	1.9	0.8	1.5	1.7	2.1	2	2.2
Unemployment Rate	%	8	7.9	7.6	7	6.9	6.7	3.6	3.8	3.9
Current Account	% of GDP	6.2	5.9	5.6	6.1	5.8	4.7	12.8	13.1	13.4
General Govt Balance	% of GDP	-1.4	-1.6	-0.7	-1.6	-1.8	-1.5	11.3	11.8	11
General Govt Debt	% of GDP	39.5	39.9	38.9	46.9	47.4	47.5	NA	NA	NA

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

Danske Denmark NII growth rates during 2006-12 tracked Danish GDP growth rates relatively well, with a 1 year time lag. Encouraging for 2015-16 NII.

Figure 38. Danske Denmark NII vs Real GDP Growth Rate (1Q06-3Q13)



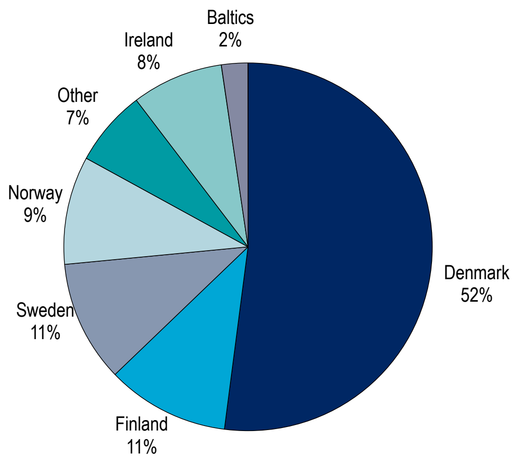
Source: Company Reports, IMF, Citi Research

Benchmarking Danske vs Nordea

Benchmarking Danske against Nordea reveals scope for upside and improves our understanding on why similar ROEs during 2003-07 diverged during 2008-12

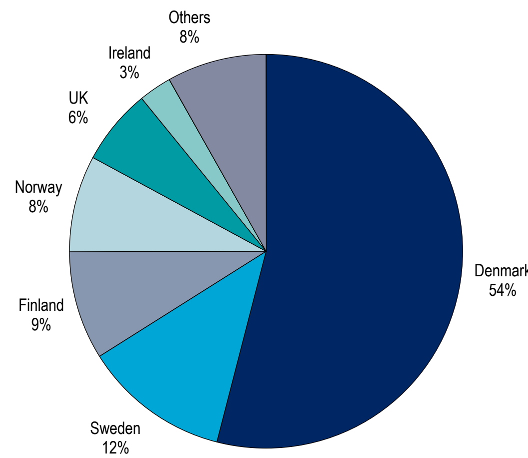
Danske Bank and Nordea are both pan-Nordic banks. While admittedly Danske is heavily geared to its original home market, Denmark, which accounts for about half of group loans and revenues, the group also includes material exposure to other Nordic countries. Nordea's Nordic diversification is more balanced: Denmark is its largest loan exposure at c30% of group loans, with Sweden close behind; Finland and Norway account for a fifth of loans each. During 2003-07, Danske Bank and Nordea's ROEs were broadly similar (16% vs 18%) but during 2008-12 they diverged considerably (2%vs 12%) and despite narrowing, they are expected to remain c6ppt apart in 2013E (5% vs 11%). Why did this divergence happen?

Figure 39. Danske banking activities Revenues split by geography FY2012



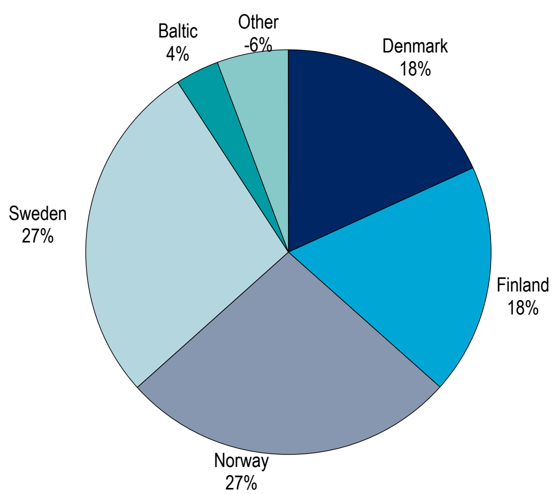
Source: Company reports; Banking Activities were reporting segments until 2012. Ireland includes Northern Ireland, Republic of Ireland and non-core Ireland. Banking activities excludes Corporate banking, Danske Markets, Danske Capital, Danica Pension

Figure 40. Danske loan split by geography 3Q13



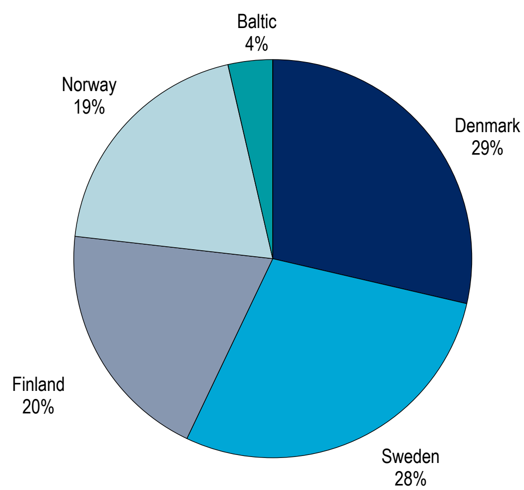
Source: Company reports

Figure 41. Nordea retail banking profit before tax geographical split 9M13



Source: Company Reports

Figure 42. Nordea retail loan split by geography 3Q13



Source: Company Reports

Diverging loan loss experience at Danske vs Nordea during 2008-12 compared to 2003-07 accounts for more than all of the relative change in gross ROAs

Higher loan losses hurt Danske returns 2008-12

Comparing Danske's profitability to Nordea's over the past decade, high loan losses and increased cost to income ratio appear to be the main factors for the low return of Danske Bank in the past few years. During 2003-07, Danske Bank's ROE was only 2ppt below Nordea's, but the deficit widened to almost 10ppt during 2008-12. Similarly, the ROA deficit for Danske Bank relative to Nordea increased from 27bps (2003-07) to 40bps (2008-12) and on a pre-tax basis from 29bps to 47bps. When measured relative to assets, the increase in loan losses for Danske vs Nordea (from a c2bps difference during 2003-07 to 30bps during 2008-12, or a 29bps point widening) more than accounts for the total pre-tax deterioration in ROAs of Danske vs Nordea (19bps widening).

Figure 43. Danske vs Nordea DuPont Decomposition (bps)

	2003-07	2008-12	Difference
ROE	-223	-949	-727
Pre-Tax ROA	-29	-48	-19
LLP/ATA	2	30	29
GOP/ATA	-27	-17	9

Source: Company Reports, Citi Research; Note: Values show difference of Danske vs Nordea for each parameter

Higher loan losses, especially Irish real estate, drove the increase in Danske loan losses, to more than double Nordea's average loan loss ratio for 2008-12.

Danske had much higher credit losses post 2008, both relative to the immediate period before it and compared to Nordea. The 5-year average credit cost for Danske was only 2bps during 2003-07. Over this period, Nordea actually had a small net credit recovery. During 2008-12, Danske's credit losses increased to 82bps as a percentage of average loans, pushed up by Irish and Danish real estate losses. Nordea's loan losses increased for 2008-12 but only to an average of c30bps of average loans. Looking at forecasts for 2013-14E, it would appear as though Danske and Nordea have converged to c20bps provisions as a percentage of loans.

However, the seemingly low headline level of Danske's 2013E loan losses is misleading. Ireland is now classified as non-core and appears in the group P&L as a single net line item. Including non-core loan losses should add c7bps to the Danske Bank group loan loss ratio for 2013E, increasing the ratio to 31bps from 24bps or (if we exclude repos from the denominator) to 35bps. On this latter basis, Danske's 2013E loan loss ratio has not converged with Nordea's but is at almost twice the level. Given the ongoing improvement in Ireland and Denmark, which we discuss in the next section of this report, we expect the underlying loan losses to further decline during 2014-15E.

On a headline level, 2013 loan losses appear to be similar for Danske and Nordea. Adding non-core, pushes up Danske to 31bps from 24bps.

Figure 44. Danske vs Nordea LLPs, Headline and Underlying, 2012-15E

	2012A	2013E	2014E	2015E
Danske:				
LLP	0.41%	0.24%	0.18%	0.15%
LLP Adj for Non-core	0.67%	0.31%	0.25%	0.16%
LLP Adj for Non-core and Repo	0.74%	0.35%	0.29%	0.19%
Nordea:				
LLP	0.26%	0.21%	0.19%	0.15%

Source: Company Reports, Citi Research; Note: For Danske – LLP adjusted for non-core includes non-core LLPs to the denominator while the adjustment for repo excludes repo from the denominator while calculating credit costs

Danske's 2013 Problem is Revenues, especially Non NII

Danske' group's revenue-to-asset ratio averaged 151bps during 2003-07 and 142bps during 2008-12. For FY13E we forecast 116bps

Danske Bank has a revenue problem at the moment, and this is particularly marked in 2013E. The group's revenue-to-asset ratio averaged 151bps during 2003-07 and 142bps during 2008-12. In 2012, the group's revenue/asset ratio was 138bps; adjusted for the internal transfer pricing and organisational changes, this declined to 132bps. During 9M13, revenues/assets have ranged from 110-125bps and for FY13E we forecast 116bps. Reflecting the lack of revenues, Danske Bank's cost to income ratio deteriorated during 2008-12 to c57% up from c53% during 2003-07. However, over this time period the group's cost/asset ratio remained relatively stable at c80bps. While NIMs have trends down in recent years, the drop in revenue productivity is particularly marked for non-interest income: trading, insurance and "other" income are all very weak in 2013E relative to recent years (see Figure 45 below). By contrast, fee income has remained relatively steady in the past few years.

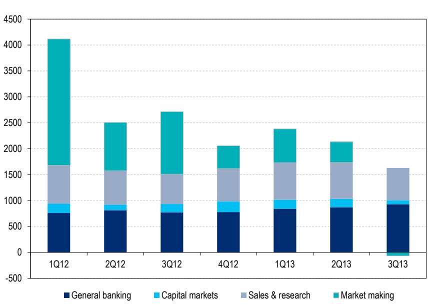
2013E drop in revenue productivity is particularly marked for non-interest income: trading, insurance and "other" income are all very weak vs history

Figure 45. Decomposition of Danske non-NII/ATA

Danske Non-NII/ATA	2008	2009	2010	2011	2012	5 Yr Avg (08-12)	2013E	2014E	2015E
Fees and Commissions/ATA	23.5	23.1	27.0	25.0	25.4	**24.8**	27.1	28.7	29.1
Trading revenue/ATA	17.6	54.9	25.1	22.1	25.8	**29.0**	17.4	22.8	23.8
Insurance income/ATA	-5.0	8.5	6.8	1.7	6.6	**3.6**	1.7	3.8	3.9
Other Operating income/ATA	10.4	9.3	12.2	11.0	8.5	**10.3**	3.8	4.3	4.4
Total	46.5	95.8	71.1	59.8	66.2	**67.7**	50.4	60.3	61.6

Source: Company Reports and Citi Research Estimates
FY2012 results were restated after change in organisational structure and internal transfer pricing. Impact to NII around DKr-2b, Impact to operating expenses around DKr -2bn.

Figure 46. Danske CIB Income Split, 1Q12-3Q13: Market Making Income Collapse



Source: Company Reports

Danske's trading income is expected to amount to only DKr6billion in 2013E, a decline of over 40% compared to DKr10.6 billion in 2012. For 9M13, trading income is half of the level of 9M12, and 3Q13 is down c80% relative to 2Q13. A normalised level of trading income is expected to be around DKr8 billion per annum. Trading income has been weaker due to weaker fixed income market activity and conditions during 2013, especially in 3Q13. July and August 2013 were highlighted by Danske as particularly difficult trading market conditions related to uncertainty around Fed tapering. Within the Corporates & Institutions division, market making income was a negative DKr66m in 3Q13 compared to a positive DKr1.0 billion for 9M13 and DKr2.6 billion for 9M12. The trading income line has also been hurt by one-offs in Treasury in 3Q13 — this was reflected in the trading income line in "Other Activities", which was a negative DKr516m in 3Q13 and a negative DKr130m for 9M13 compared to a positive DKr926m for 3Q12.

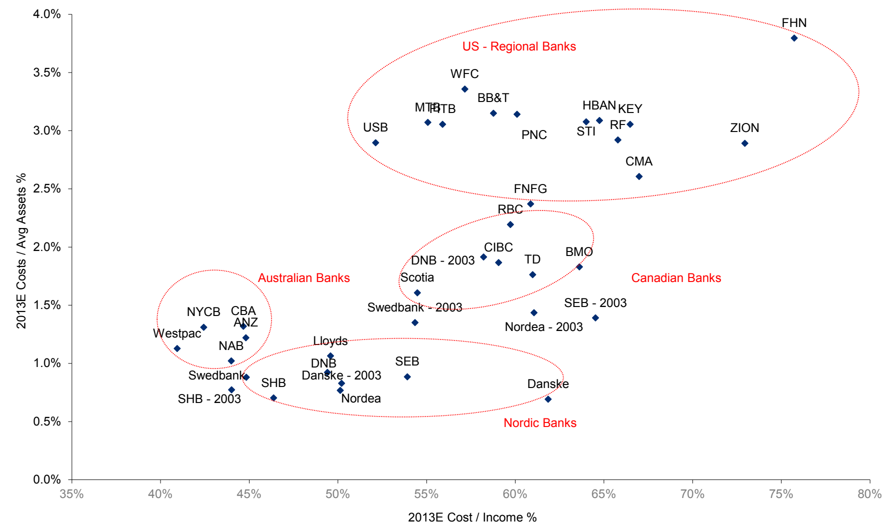
Danske's 2013E net insurance income is expected to be only DKr0.9 billion or less than half 2012's DKr2.2 billion. Over the 9 years since Danske has reported IFRS results starting in 2004, the group's average net insurance income has amounted to DKr1.3 billion per annum. The 3Q13 results for the insurance business improved compared to the previous quarter, with a positive net income of DKr0.5 billion versus a negative DKr0.3 billion previously. The group noted that "higher share prices and returns on alternative investments led to a positive return on investments. As a result, the risk allowance for the third quarter of 2013 could be booked to income in full or in part for three of the four interest rate groups. In the second quarter, the risk allowance could be booked to income for only one of the four interest rate groups. During 9M13, Danica Pension has reported an ROE on allocated capital of only 5.5% compared to 14.6% in 3Q13 standalone and 15.3% for 9M13.

A decade ago, Danske Bank and Svenska Handelsbanken were the best cost ratio banks in Scandinavia – today, Danske is the worst of the big Nordics on CIRs

Cost/Income Ratio Inflated, Cuts Need To Be Surgical

Danske's 2013 cost to income ratio of 60% is high in historical standard and is well behind the other large Nordic peers (Figure 47). However, it is worth noting that its 2012 cost/income ratio was a more respectable 56% and due to a combination of improved revenues, both NII and non NII, and flat costs, we expect the 2014 cost/income ratio to drop to the mid 50s. Even with such a forecast material cost improvement, Danske would still have the poorest cost/income ratio of the large Nordic banks.

Figure 47. 2003 & 2013E Cost / Income vs Cost to Avg Assets by Bank

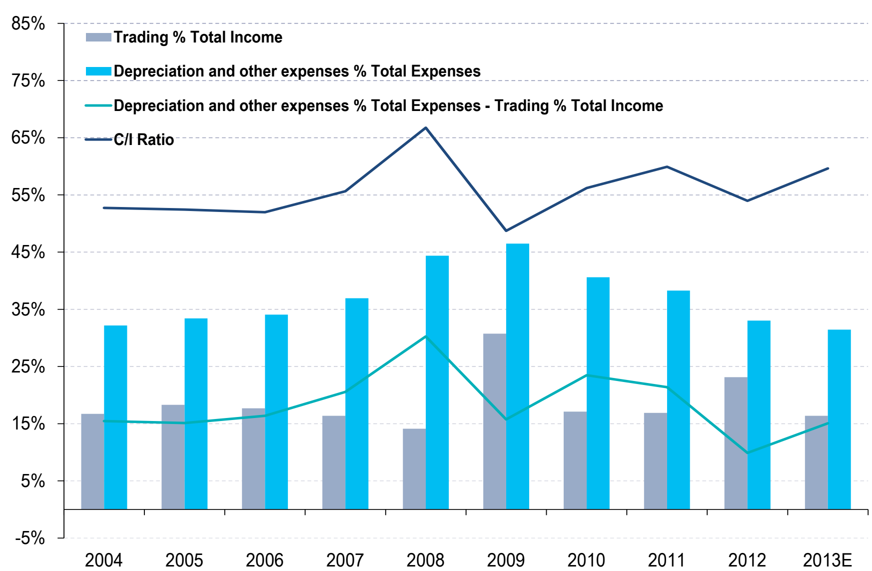


Source: Citi Research, Company Reports

Over the past decade, two main reasons have contributed to Danske's elevated C/I ratios. First, acquisitions and integration increased the restructuring costs and other charges in subsequent years. Secondly, post 08, C/I ratio was affected by volatile trading income.

Danske's cost/income ratio since 2004 has worsened when (1) restructuring and other costs pick up and (2) trading income declines

Figure 48. Costly acquisitions and depressed trading income caused high C/I ratio

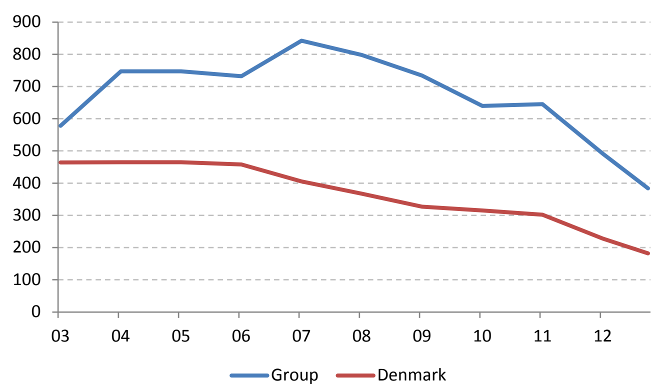


Source: Company Reports, Citi Research

Danske reduced branches aggressively, down 40% from 2011; staff numbers are only down 6% since 2011 and 15% from 2006-08 peak levels

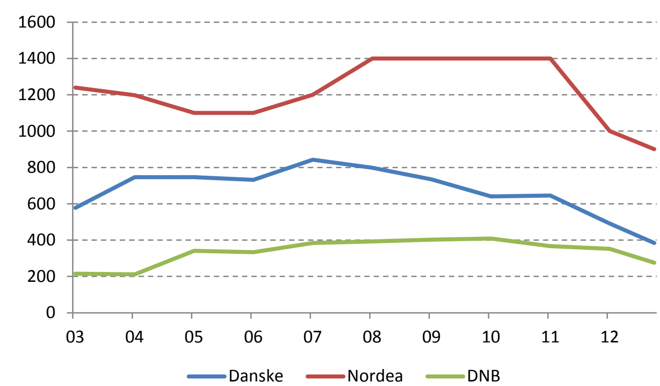
Danske management recognise the need to further cut costs. However, as we note below, they have already undertaken relatively material branch reductions: Danish branches are already down 40% versus 2011 levels and 60% versus 2006 levels. Given the negative Danish PR surrounding Danske Bank over the past year, they will need to be careful about cutting client facing staff. Danske's overall group branch numbers are down 40% versus 2011 levels and c50% from peak 2006-07 levels, whereas Nordea branch numbers are down c35% versus 2008-11. However, we would note that the decline in staff numbers has not matched the much faster decline in branches: Danske group staff numbers are only down 6% from 2011 levels and 15% from 2006-08 peak levels. Nordea's staff numbers are down 13% from 2007-08 peak levels. 9M13 revenue/Avg FTE at Danske group is €0.19 million versus Nordea' €0.24 million.

Figure 49. Danske – Group and Denmark Branches (2003-9M13)



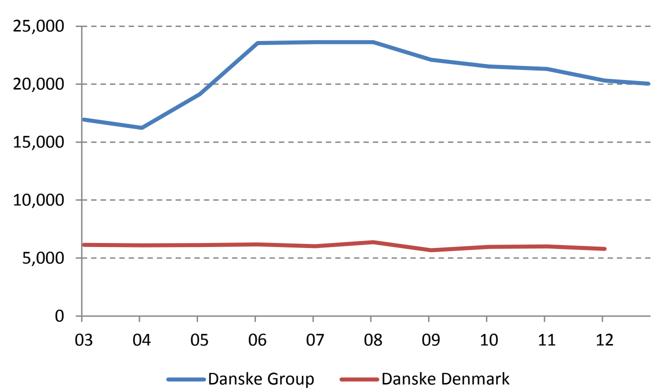
Source: Company Reports

Figure 50. Danske vs Nordic Peers Branch Count Trends



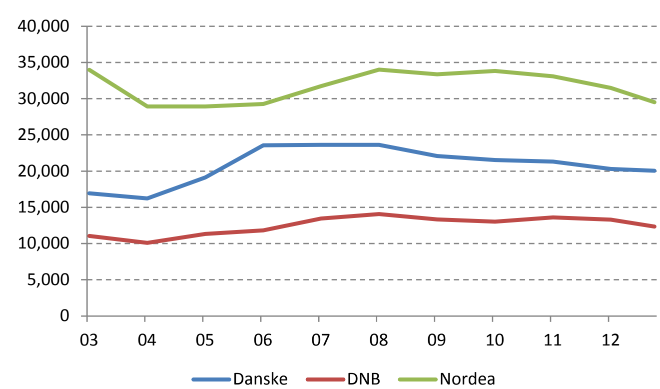
Source: Company Reports

Figure 51. Danske – Group and Denmark FTEs (2003-9M13)



Source: Company Reports; Note: Denmark shows retail banking Denmark FTEs

Figure 52. Danske vs Nordic Peers FTE Trend (2003-9M13)



Source: Company Reports

Figure 53 below sets out a detailed DuPont analysis comparison of Danske Bank and Nordea's returns from 2003-15E

Figure 53. Comparison of Danske and Nordea

	2003	2004	2005	2006	2007	5 yr avg (03-07)	2008	2009	2010	2011	2012	5 yr avg (08-12)	2013E	2014E	2015E
NII/ATA															
-Danske	0.86%	0.76%	0.77%	0.75%	0.80%	**0.79%**	0.78%	0.83%	0.76%	0.71%	0.66%	**0.75%**	0.65%	0.70%	0.71%
-Nordea	1.28%	1.29%	1.21%	1.15%	1.16%	**1.21%**	1.18%	1.08%	0.95%	0.84%	0.80%	**0.94%**	0.85%	0.89%	0.91%
Diff	-0.43%	-0.53%	-0.45%	-0.40%	-0.36%	**-0.43%**	-0.40%	-0.25%	-0.19%	-0.13%	-0.14%	**-0.20%**	-0.19%	-0.19%	-0.20%
Non-NII/ATA															
-Danske	0.76%	0.74%	0.78%	0.70%	0.68%	**0.73%**	0.47%	0.96%	0.71%	0.60%	0.66%	**0.68%**	0.50%	0.60%	0.62%
-Nordea	1.01%	0.98%	0.97%	1.04%	0.98%	**0.99%**	0.72%	0.77%	0.77%	0.62%	0.64%	**0.70%**	0.67%	0.72%	0.74%
Diff	-0.25%	-0.23%	-0.18%	-0.34%	-0.30%	**-0.27%**	-0.26%	0.19%	-0.06%	-0.03%	0.03%	**-0.02%**	-0.17%	-0.12%	-0.13%
Total income/ATA															
-Danske	1.62%	1.51%	1.55%	1.45%	1.48%	**1.51%**	1.25%	1.79%	1.47%	1.31%	1.32%	**1.42%**	1.16%	1.30%	1.33%
-Nordea	2.29%	2.27%	2.18%	2.19%	2.14%	**2.45%**	1.90%	1.85%	1.71%	1.47%	1.43%	**1.64%**	1.52%	1.62%	1.65%
Diff	-0.68%	-0.76%	-0.63%	-0.74%	-0.66%	**-0.94%**	-0.65%	-0.06%	-0.25%	-0.16%	-0.11%	**-0.22%**	-0.36%	-0.31%	-0.32%
Cost/ATA															
-Danske	0.81%	0.79%	0.81%	0.75%	0.82%	**0.80%**	0.83%	0.87%	0.82%	0.78%	0.71%	**0.80%**	0.70%	0.70%	0.67%
-Nordea	1.40%	1.35%	1.22%	1.14%	1.10%	**1.23%**	1.01%	0.92%	0.88%	0.80%	0.71%	**0.85%**	0.76%	0.78%	0.78%
Diff	-0.59%	-0.56%	-0.40%	-0.38%	-0.28%	**-0.43%**	-0.17%	-0.05%	-0.06%	-0.02%	0.00%	**-0.04%**	-0.06%	-0.09%	-0.11%
Cost/Income															
-Danske	50.2%	52.7%	52.4%	52.0%	55.6%	**52.8%**	66.7%	48.7%	56.2%	59.9%	54.0%	**56.5%**	60.5%	53.5%	50.6%
-Nordea	61.1%	59.7%	55.8%	51.9%	51.6%	**55.6%**	52.8%	49.7%	51.6%	54.9%	49.6%	**51.7%**	49.9%	48.5%	47.3%
Diff	-10.86%	-6.91%	-3.37%	0.09%	4.06%	**-2.77%**	13.91%	-1.01%	4.60%	4.98%	4.32%	**4.77%**	10.52%	4.99%	3.30%
GOP/ATA															
-Danske	0.80%	0.71%	0.74%	0.70%	0.66%	**0.71%**	0.42%	0.92%	0.64%	0.52%	0.61%	**0.62%**	0.46%	0.61%	0.66%
-Nordea	0.89%	0.92%	0.96%	1.05%	1.04%	**0.98%**	0.90%	0.93%	0.83%	0.66%	0.72%	**0.79%**	0.76%	0.83%	0.87%
Diff	-0.09%	-0.20%	-0.23%	-0.36%	-0.38%	**-0.27%**	-0.48%	-0.01%	-0.19%	-0.14%	-0.11%	**-0.17%**	-0.30%	-0.23%	-0.21%
LLP/ATA (bps)															
-Danske	9.10	3.91	-4.89	-1.92	2.26	**1.30**	35.1	77.3	43.8	39.7	36.3	**46.29**	13.0	9.9	8.3
-Nordea	13.84	1.00	-4.54	-7.64	-1.63	**-0.42**	10.8	30.3	16.2	11.3	12.8	**15.86**	11.4	10.3	8.6
Diff	-4.74	2.91	-0.35	5.73	3.89	**1.72**	24.3	47.0	27.6	28.4	23.4	**30.43**	1.7	-0.4	-0.3
LLP/Avg Loans (bps)															
-Danske	16.9	7.03	-8.63	-3.25	3.77	**2.27**	60.3	133.9	75.4	71.4	67.0	**81.61**	24.0	18.3	15.3
-Nordea	25.1	1.78	-7.92	-12.80	-2.60	**-0.71**	18.2	54.4	29.7	22.7	26.2	**29.94**	21.2	18.5	15.4
Diff	-8.2	5.25	-0.71	9.55	6.37	**2.98**	42.1	79.5	45.7	48.6	40.8	**51.67**	2.73	-0.28	-0.11
PBT/ATA (bps)															
-Danske	71.4	67.2	78.5	71.5	63.4	**70.0**	6.5	14.3	20.4	12.7	24.8	**15.7**	45.7	60.6	65.6
-Nordea	64.7	101.7	101.1	113.3	105.5	**98.7**	79.0	62.7	66.8	54.7	60.2	**63.5**	64.1	72.9	78.3
Diff	6.7	-34.5	-22.6	-41.7	-42.0	**-28.7**	-72.5	-48.3	-46.4	-42.0	-35.4	**-47.8**	-18.4	-12.3	-12.7
Net Profit/ATA (bps)															
-Danske	50.9	47.9	56.6	52.4	48.7	**51.2**	2.9	5.2	11.5	5.2	13.7	**7.7**	27.0%	27.0%	27.0%
-Nordea	56.8	76.9	75.0	93.5	84.7	**78.6**	62.2	47.1	48.8	40.5	46.2	**48.0**	24.3%	23.5%	23.5%
Diff	-6.0	-29.0	-18.5	-41.1	-36.1	**-27.4**	-59.2	-41.9	-37.3	-35.3	-32.5	**-40.3**	2.7%	3.5%	3.5%
TCE/TA															
-Danske	3.31%	3.23%	2.69%	2.41%	2.24%	**2.69%**	2.06%	2.51%	2.54%	3.02%	3.35%	**2.70%**	20.9	34.1	41.2
-Nordea	3.81%	3.77%	3.29%	3.77%	3.75%	**3.67%**	3.22%	3.84%	3.67%	3.18%	3.63%	**3.50%**	48.5	55.7	59.9
Diff	-0.50%	-0.54%	-0.60%	-1.36%	-1.51%	**-0.99%**	-1.16%	-1.33%	-1.13%	-0.16%	-0.28%	**-0.80%**	-27.6	-21.6	-18.7
CET1 (B1-B2)															
-Danske	7.70%	7.23%	6.7%	7.6%	5.6%		7.8%	9.2%	9.8%	11.8%	14.5%		3.55%	3.70%	3.80%
-Nordea					6.30%		8.50%	10.35%	10.32%	11.16%	13.1%		4.16%	4.36%	4.55%
Diff								-1.1%	-0.5%	0.6%	1.5%		-0.62%	-0.66%	-0.76%
CET1 (Fully loaded B3)															
-Danske	-	-	-	-	-		-	-	-	10.6%	12.5%		14.4%	15.0%	15.5%
-Nordea	-	-	-	-	-	-	-	-	-	9.86%	11.8%		14.5%	15.5%	15.5%
Diff											0.75%		-0.08%	-0.45%	-0.03%
ROE															
-Danske	15.4%	13.9%	18.1%	16.1%	14.8%	**15.7%**	1.0%	1.7%	3.5%	1.5%	3.6%	**2.3%**	12.4%	13.0%	13.5%
-Nordea	12.4%	16.7%	17.7%	22.3%	19.2%	**17.9%**	15.3%	11.5%	11.3%	10.4%	11.6%	**11.8%**	13.5%	14.5%	14.5%
Diff	3.0%	-2.8%	0.5%	-6.2%	-4.4%	**-2.2%**	-14.3%	-9.8%	-7.8%	-8.9%	-8.0%	**-9.5%**	-1.09%	-1.46%	-1.03%

Source: Company Reports and Citi Research Estimates
Danske FY2012 results were restated after change in organisational structure. Impact to NII around DKr-2b; Impact to operating expenses around DKr -2bn.

Danish Banking Benchmarking

We compare Danske's profitability with its peers in its original home market: Denmark, which accounts for about half the group's income and loans. A few key conclusions:

Danske's Danish ROEs have exceeded Group returns over the past five years of low returns and are in-line with or better than Danish peers

1. **Danske Bank's financial performance in Denmark during 2008-12, was better than for the Group overall.** The Danish ROE was an underlying c8%, excluding the cost of the 2008-10 Danish state guarantee schemes. On a headline basis, Danske Bank's Danish ROE was c6% on average during 2008-12. The overall Group average ROE of c2% was dragged down by poor returns in Ireland, UK and Finland — all relatively "new" to the Group, acquired in the 2004-07 expansion phase.

2. **Danske Bank's financial performance in Demark was overall in-line with peers during 2008-12, albeit more cyclical.** Danske's underlying Danish ROE of c8% for 2008-12 is very similar to Nordea Denmark and better than smaller peers such as Jyske and Sydbank (c6%). During the 2009-10 down-turn, Danske's underlying Danish ROE was only c2%, below its Danish peers, due to higher loan losses. Adding in the cost of Danish state guarantee commissions hurts Danske more versus peers.

3. **Danske Bank's Danish cost/income ratio is better than Nordea but the comparison is mixed versus the smaller local peers.** Danske Bank's underlying Danish CIR of 50% for 2008-12 is below Nordea Denmark by c8ppt and has been lower than its largest peer every year over this period. Relative to local smaller banks, Danske also looks better, but not if we strip out Danske's mortgage subsidiary for a like-for-like comparison.

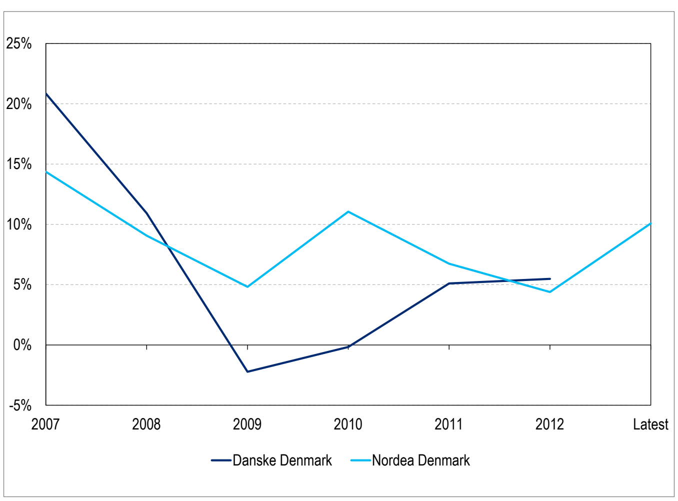
Danske and Nordea are the largest banks in Denmark, together accounting for half the market. Headline performance during 2008-12 was generally better at Nordea.

Figure 54. Deposit and Loan market share of top Danish banks 3Q13

	Deposit Market Share	Loan Market Share
Danske Denmark	28	28
Nordea Denmark	23	24
Jyske	8	7
Sydbank	6	7
Other	35	34

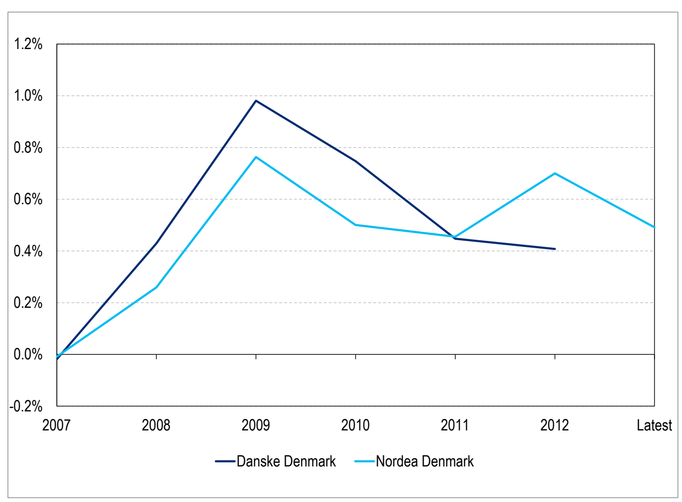
Source: Company Reports

Figure 55. ROE Danske Denmark vs Nordea Denmark (1H13)



Source: Company Reports and Citi Research Estimates

Figure 56. Loan loss Ratio Danske Denmark vs Nordea Denmark (1H13)



Source: Company Reports and Citi Research Estimates

Danske's Danish ROE was an underlying c8% during 2008-12, similar to Nordea Denmark, albeit more volatile due to poorer 2009-10 loan loss experience

Figure 57. Comparison of Danske Denmark and Nordea Denmark

	2007	2008	2009	2010	2011	2012	5 Yr Avg	6M13
ROE								
Danske Group	14.8%	1.0%	1.7%	3.5%	1.5%	3.6%	**2.3%**	2.6%
Danske Denmark	20.8%	10.9%	-2.2%	-1.1%	5.6%	6.0%	**6.4%**	
Nordea Denmark	14.4%	9.1%	4.8%	11.0%	6.7%	4.4%	**7.0%**	10.1%
ROE ex guarantee commission								
Danske Denmark	20.8%	12.1%	2.3%	2.4%	5.6%	6.0%	**7.9%**	
Nordea Denmark	14.4%	9.9%	7.9%	13.3%	6.7%	4.4%	**8.2%**	10.1%
C/I Ratio								
Danske Group	55.6%	66.7%	48.7%	56.2%	59.9%	55.8%	**57.3%**	59.6%
Danske Denmark	48.2%	50.5%	58.5%	60.4%	53.3%	54.4%	**55.4%**	
Nordea Denmark	58.4%	62.1%	58.8%	56.5%	65.1%	62.1%	**60.8%**	56.9%
C/I Ratio ex guarantee commission								
Danske Denmark	48.2%	47.6%	46.8%	49.4%	53.3%	54.4%	**50.0%**	
Nordea Denmark	58.4%	59.4%	51.3%	51.0%	65.1%	62.1%	**57.5%**	56.9%
NII/Loans								
Danske Group	1.34%	1.35%	1.44%	1.30%	1.27%	1.22%	**1.32%**	1.18%
Danske Denmark	1.43%	1.49%	1.60%	1.32%	1.27%	1.32%	**1.40%**	
Nordea Denmark	1.58%	1.79%	1.78%	1.73%	1.73%	1.89%	**1.76%**	1.95%
Loan loss ratios								
Danske Group	0.02%	0.34%	0.83%	0.43%	0.39%	0.36%	**0.82%**	0.26%
Danske Denmark	-0.02%	0.43%	0.98%	0.75%	0.45%	0.41%	**0.61%**	
Nordea Denmark	-0.01%	0.26%	0.76%	0.50%	0.45%	0.70%	**0.54%**	0.49%
Loan/Deposit Ratio								
Danske Group	215%	231%	211%	215%	218%	204%	**216%**	206%
Danske Denmark	329%	342%	317%	341%	351%	326%	**335%**	
Nordea Denmark	192%	194%	207%	196%	194%	191%	**196%**	190%

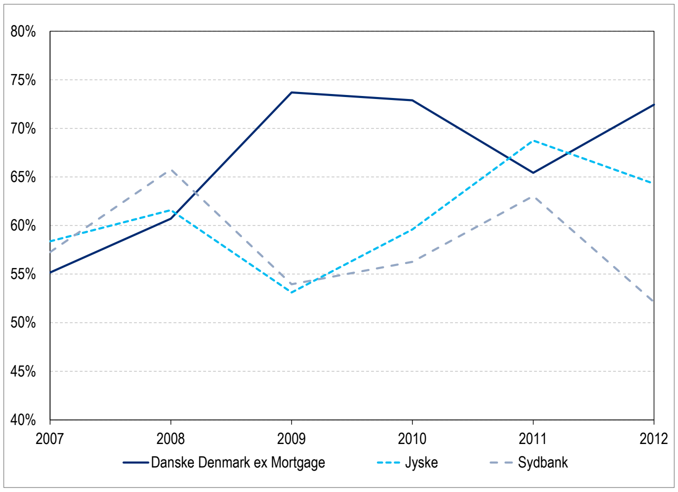
Source: Company Reports and Citi Research Estimates
Danske Denmark is based on Banking Activities Denmark (2007-2009) or Retail Banking Denmark (2010-2012) segment reported; Corporate Banking was split out from Banking Activities since 2010. Guarantee commissions are paid to Danish state as part of guarantee scheme, which was established for three years from 08-10 to guarantee depositors and creditors of scheme banks. Participating banks contribute to the scheme based on solvency rules. Contribution by Danske are DKr625m, DKr 2500m and DKr1875m for 08,09 and 10 respectively. ROE of Danske Denmark is calculated based on Pretax ROE assuming 30% tax rate.FY2010 result of Danske Denmark was restated because of transfer pricing model. PBT is around DKr 500m lower.

Comparing to Smaller Local Peers

It's also meaningful to compare Danske with its local peers: Jyske and Sydbank. Because Jyske and Sydbank do not own mortgage banks like Dankse does, we compare them with Danske Denmark excluding mortgage operations. Realkredit is substracted from Danske Denmark results. We are aware of the risks of comparing apples with oranges: Realkredit is an externally reported legal entity and Danske Denmark is a management segment in group reporting.

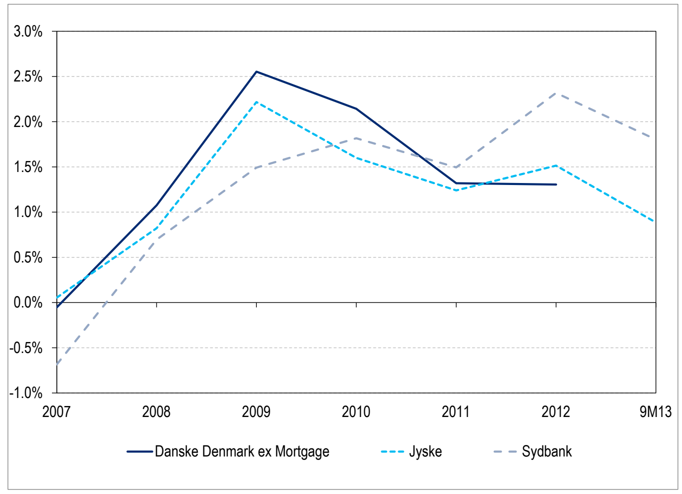
Danske Denmark ex mortgage's 5-year average cost/income ratio is as high as 67.5% vs 61% for Jyske and 58% for Sydbank. Danske's margin is also slightly lower and loan loss ratios are slightly higher. Compared to its local peers, it would appear that Dankse has a lot of room for improvement, particularly on cost reduction, in its non-mortgage operations. It's also worth noting that Jyske's ROE improved from 3.8% in 2012 to 10.5% 9M13, mainly because of lower loan loss. We expect credit losses in Danske to follow similar trends because of a better Danish economy and housing market.

Figure 58. C/I Ratio Danske Denmark ex Mortgage vs Peers ex guarantee commission



Source: Company reports and Citi Research

Figure 59. Loan loss ratio Danske Denmark ex Mortgage vs Peers



Source: Company reports and Citi Research

Figure 60. Comparison of Danske Denmark ex Mortgages and local peers

	2007	2008	2009	2010	2011	2012	5 Yr Avg	6M13
ROE								
Danske Denmark ex Mortgage	38.2%	11.5%	-27.3%	-20.2%	5.9%	4.0%	**2.0%**	
Jyske	17.9%	8.4%	2.9%	5.7%	3.6%	3.8%	**4.7%**	11.5%
Sydbank	24.1%	9.0%	8.6%	4.3%	2.0%	4.7%	**5.5%**	7.3%
ROE ex guarantee commission								
Danske Denmark ex Mortgage	38.2%	14.7%	-12.7%	-7.1%	5.9%	4.0%	**7.2%**	
Jyske	17.9%	9.2%	5.0%	7.2%	3.6%	3.8%	**5.5%**	11.5%
Sydbank	24.1%	9.9%	10.6%	6.0%	2.0%	4.7%	**6.4%**	7.3%
C/I Ratio								
Danske Denmark ex Mortgage	55.2%	60.7%	73.7%	72.9%	65.4%	72.4%	**68.8%**	
Jyske	58.4%	61.6%	53.1%	59.6%	68.7%	64.3%	**61.4%**	57.2%
Sydbank	57.3%	65.8%	54.0%	56.3%	63.0%	52.1%	**57.8%**	53.0%
C/I Ratio ex guarantee commissions								
Danske Denmark ex Mortgage	55.2%	56.8%	57.6%	58.4%	65.4%	72.4%	**61.5%**	
Jyske	58.4%	59.6%	47.8%	55.4%	68.7%	64.3%	**59.2%**	57.2%
Sydbank	57.3%	63.7%	48.7%	51.6%	63.0%	52.1%	**55.3%**	53.0%
NII/Loans								
Danske Denmark ex Mortgage	2.82%	2.91%	3.26%	3.04%	3.21%	3.20%	**3.27%**	-
Jyske	2.40%	2.77%	3.76%	4.21%	3.98%	4.01%	**3.77%**	3.94%
Sydbank	2.56%	3.09%	3.72%	3.76%	3.90%	4.12%	**3.74%**	4.14%
Loan loss ratios								
Danske Denmark ex Mortgage	-0.05%	1.08%	2.55%	2.24%	1.30%	1.13%	**1.77%**	
Jyske	0.06%	0.82%	2.22%	1.60%	1.24%	1.51%	**1.48%**	0.97%
Sydbank	-0.68%	0.70%	1.49%	1.82%	1.50%	2.32%	**1.55%**	1.86%
Loan/Deposit Ratio								
Danske Denmark ex Mortgage	119%	122%	99%	91%	88%	75%	**96%**	-
Jyske	119%	110%	101%	98%	98%	98%	**101%**	102%
Sydbank	114%	119%	116%	116%	102%	98%	**110%**	110%

Source: Company Reports and Citi Research Estimates
Danske Denmark ex Mortgage is based on Banking Activities Denmark (2007-2009) or Retail Banking Denmark (2010-2012) segment reported minus RealKredit Denmark local account; Guarantee commissions are paid to Danish state as part of guarantee scheme, which was established for three years from 08-10 to guarantee depositors and creditors of scheme banks. Participating banks contribute to the scheme based on solvency rules;Participating banks contribute to the scheme based on solvency rules. Contribution by Danske are DKr625m, DKr 2500m and DKr1875m for 08,09 and 10 respectively. ROE of Danske Denmark ex Mortgage is calculated based on Pretax ROE assuming 30% tax rate. FY2010 result of Danske Denmark was restated because of transfer pricing model. PBT is around DKr 500m lower.

Benmarking Danske's Nordic Businesses

Danske Finland vs Peers

Finland is the profitability weak link in its Nordic footprint; Danske Finland's ROE 2008-12 is only 1.5%, well behind market leader Nordea (10.1% ROE).

Danske Finland has been a poor return business ever since its purchase in 2007. The group's restructuring programme coincided with the downturn in the local economy and euro interest rates. During 2008-12, Danske Finland's ROE has been a poor 1.5%, well behind market leader Nordea (10.1% ROE). Danske's low ROE in Finland is driven by (1) a higher reliance on NII versus peers, 2008-12 average of 64% versus c50% at peers, which is a headwind in a low interest rate environment, (2) a considerably higher cost/income ratio, 2008-12 average of 84% versus c40% at Nordea and c60% at Pohjola and (3) higher loan losses in most years since acquisition.

Figure 61. Comparison of Danske Finland and local peers

	2007	2008	2009	2010	2011	2012	5 Yr Avg
ROE							
Danske Finland	5.9%	2.3%	-5.1%	2.9%	1.8%	1.4%	**1.5%**
Nordea Finland	12.6%	12.1%	9.0%	7.7%	9.6%	11.3%	**10.1%**
Pohjola	12.5%	4.8%	5.7%	6.2%	5.6%	6.2%	**5.6%**
C/I Ratio							
Danske Finland	79%	84%	74%	86%	90%	86%	**84%**
Nordea Finland	35%	34%	38%	43%	41%	38%	**39%**
Pohjola	50%	68%	61%	59%	63%	62%	**62%**
NII/Loans							
Danske Finland	1.7%	1.9%	1.9%	1.5%	1.4%	1.4%	**1.6%**
Nordea Finland	1.4%	1.6%	1.0%	0.9%	0.8%	0.8%	**1.0%**
Pohjola	2.3%	2.5%	2.0%	1.7%	1.8%	1.6%	**1.8%**
NII/Total Income							
Danske Finland	66.0%	71.2%	65.9%	59.1%	58.9%	60.1%	**63.6%**
Nordea Finland	58.8%	64.2%	43.1%	47.3%	51.2%	44.5%	**50.1%**
Pohjola	46.5%	65.2%	52.2%	42.2%	47.7%	42.3%	**49.2%**
Loan loss ratios							
Danske Finland	0.16%	0.30%	1.09%	0.06%	0.12%	0.24%	**0.37%**
Nordea Finland	-0.03%	0.19%	0.58%	0.37%	0.07%	0.14%	**0.25%**
Pohjola	0.03%	0.12%	0.34%	0.27%	0.17%	0.16%	**0.20%**
Loan/Deposit Ratio							
Danske Finland	170%	191%	164%	144%	143%	151%	**158%**
Nordea Finland	145%	151%	148%	133%	146%	144%	**144%**
Pohjola	143%	139%	141%	145%	131%	131%	**137%**

Source: Company Reports and Citi Research Estimates
Danske Finland is based on Banking Activities Finland (2007-2009) or Retail Banking Finland (2010-2012) segment reported; Nordea Finland is based on Nordea's local account; ROE of Danske Finland is calculated based on Pretax ROE assuming 30% tax rate.FY2010 result of Danske Finland was restated because of transfer pricing model. PBT is around DKr 10m lower.

While some of the weak financial metrics can be explained by the poor recent banking environment in Finland in recent years (only Nordea makes close to its cost of equity of the big 3 banks during 2008-12), there are also clearly company-specific challenges to be addressed here beyond just hoping for higher returns due to a better economic environment in 2014-15. Ironically, Danske actually has a Finnish market share of lending (10.6%, 9M13) and deposits (11.6%) that is almost twice as high as its Swedish or Norwegian market shares, but it makes higher returns in these markets.

Danske Norway vs Peers

Norway is a relatively successful market for Danske, with ROE and credit losses tracking larger peers

Norway is the best of Danske's three Nordic markets outside Denmark, at least as measured on an ROE basis. During 2008-12, Danske Norway (the bank formerly known as Fokus) averaged a c9% ROE compared to c11% at the market leader DNB and 13% at Nordea. During 2003-07, Danske Norway's ROE averaged 10.5%, well behind DNB's 18% but within range of Nordea's 12%. On the key metric of franchise indicators — asset quality — Danske Norway screens as broadly similar to its larger peers for loan losses. This is not the case for Danske's businesses in Sweden and Finland. One area of relative weakness in Norway: Danske's cost/income ratio is considerably above its larger peers and this may reflect its smaller scale, albeit we would note that many Norwegian savings banks operate at CIRs below Danske as well. A weaker funding position, as reflected in a higher loan/deposit ratio and lower NIMs, may also hold back Danske Norway's results.

Figure 62. Comparison of Danske Norway and local peers

Norway	2003	2004	2005	2006	2007	5 Yr Avg	2008	2009	2010	2011	2012	5 Yr Avg
ROE												
Danske Norway	8.5%	7.1%	10.0%	12.4%	12.2%	**10.5%**	5.3%	10.4%	7.8%	3.3%	9.3%	**8.9%**
Nordea Norway	3.0%	13.9%	17.0%	14.7%	12.4%	**12.4%**	17.3%	9.8%	15.3%	11.2%	13.2%	**12.7%**
DnB	13.1%	17.9%	19.3%	18.7%	20.8%	**18.4%**	11.7%	9.4%	13.2%	11.3%	11.1%	**11.4%**
C/I Ratio												
Danske Norway	68%	75%	72%	65%	62%	**67%**	64%	50%	55%	72%	59%	**59%**
Nordea Norway	59%	56%	52%	56%	55%	**56%**	42%	47%	44%	47%	42%	**44%**
DnB	58%	61%	51%	51%	52%	**54%**	55%	50%	47%	48%	50%	**50%**
NII/Loans												
Danske Norway	2.41%	1.73%	1.47%	1.49%	1.25%	**1.56%**	1.48%	1.77%	1.48%	1.18%	1.50%	**1.49%**
Nordea Norway	2.32%	2.09%	1.98%	1.77%	1.74%	**1.84%**	1.95%	1.99%	1.88%	1.78%	1.84%	**1.85%**
DnB	2.60%	2.32%	2.11%	2.00%	1.99%	**2.16%**	2.03%	1.95%	2.03%	2.04%	2.09%	**2.03%**
NII/Total Income												
Danske Norway					65.0%		70.6%	73.6%	69.1%	60.6%	68.1%	**68.9%**
Nordea Norway					75.3%		76.0%	80.7%	71.1%	73.7%	73.6%	**74.9%**
DnB					56.5%		63.8%	60.2%	59.2%	60.1%	65.2%	**61.7%**
Loan loss ratios												
Danske Norway	0.26%	0.06%	-0.08%	-0.03%	0.04%	**0.03%**	0.35%	0.45%	0.03%	0.29%	0.15%	**0.25%**
Nordea Norway	1.19%	-0.01%	-0.40%	-0.25%	-0.03%	**0.03%**	0.15%	0.47%	0.17%	0.31%	0.21%	**0.26%**
DnB	0.36%	-0.03%	0.02%	-0.03%	0.02%	**0.05%**	0.05%	0.32%	0.67%	0.26%	0.28%	**0.24%**
Loan/Deposit Ratio												
Danske Norway	185%	209%	222%	226%	237%	**220%**	298%	240%	223%	219%	207%	**234%**
Nordea Norway	179%	167%	174%	172%	165%	**171%**	190%	194%	188%	208%	208%	**197%**
DnB	169%	166%	171%	174%	180%	**172%**	200%	191%	184%	174%	161%	**182%**

Source: Company Reports and Citi Research Estimates; Danske Norway is based on Banking Activities Norway (2007-2009) or Retail Banking Norway (2010-2012) segment reported; Nordea Norway is based on Nordea's local account; ROE of Danske Denmark is calculated based on Pretax ROE assuming 30% tax rate.FY2010 result of Danske Norway was restated because of transfer pricing model. PBT is around DKr 630m lower.

Danske Sweden vs Peers

Danske's Swedish profitability is similar to its Norwegian franchise; however it is poor relative to its larger Swedish peers, with higher LLP recently

Danske's Swedish profitability is very similar to its Norwegian franchise: average ROE 2008-12 c9%, following 10.5% for 2003-07. However, relative to its larger Swedish peers, Danske's Swedish ROE is relatively poor: SHB, Swedbank and Nordea in Sweden generate almost double the ROE of Danske Sweden. In the past few years, Danske Sweden's loan losses have also been higher and NIMs lower versus peers. However, its cost/income ratio is relatively competitive, especially compared to Nordea — SHB Sweden is of course in an efficiency league of its own.

Figure 63. Comparison of Danske Sweden and local peers

Sweden	**2003**	**2004**	**2005**	**2006**	**2007**	**5 Yr Avg**	**2008**	**2009**	**2010**	**2011**	**2012**	**5 Yr Avg**
ROE												
Danske Sweden	9.7%	10.4%	10.3%	10.3%	11.2%	**10.5%**	7.3%	6.4%	10.2%	9.1%	8.7%	**8.8%**
Nordea Sweden					24.4%		23.6%	15.1%	13.4%	24.9%	20.2%	**18.8%**
SHB	14.9%	16.1%	17.9%	19.9%	22.0%	**18.4%**	16.2%	13.0%	12.9%	13.5%	14.4%	**14.0%**
SHB Sweden					21.8%		20.3%	17.3%	19.5%	19.6%	18.5%	**19.0%**
Swedbank	16.3%	21.3%	24.1%	19.1%	18.7%	**19.9%**	14.1%	-11.9%	8.0%	12.2%	14.2%	**7.5%**
Swedbank Retail		21.4%	33.4%	22.9%	21.4%		24.1%	30.2%	24.0%	27.2%	26.9%	**26.5%**
C/I Ratio												
Danske Sweden	61%	62%	62%	57%	56%	**59%**	53%	55%	53%	53%	50%	**53%**
Nordea Sweden				58%	55%		53%	57%	66%	55%	56%	**57%**
SHB	44%	43%	42%	42%	46%	**43%**	44%	47%	48%	47%	46%	**47%**
SHB Sweden					39%		37%	39%	40%	36%	35%	**38%**
Swedbank	54%	55%	49%	52%	51%	**52%**	50%	51%	57%	54%	46%	**52%**
Swedbank Retail		56%	47%	52%	52%		52%	52%	56%	50%	46%	**51%**
NII/Loans												
Danske Sweden	1.46%	1.49%	1.29%	1.31%	1.14%	**1.31%**	1.22%	1.19%	1.16%	1.32%	1.49%	**1.28%**
Nordea Sweden				1.71%	1.75%		1.89%	1.48%	1.21%	1.74%	1.70%	**1.59%**
SHB	1.76%	1.76%	1.64%	1.44%	1.30%	**1.55%**	1.39%	1.49%	1.43%	1.52%	1.60%	**1.49%**
SHB Sweden					1.36%		1.40%	1.36%	1.28%	1.49%	1.56%	**1.42%**
Swedbank	2.32%	2.10%	2.02%	1.81%	1.84%	**2.00%**	1.79%	1.61%	1.31%	1.59%	1.73%	**1.60%**
Swedbank Retail		2.00%	1.87%	1.58%	1.44%		1.41%	1.34%	1.14%	1.39%	1.47%	**1.35%**
NII/Total Income												
Danske Sweden	77.3%	73.8%	72.5%	71.2%	69.5%	**72.9%**	71.8%	71.9%	73.0%	75.7%	78.6%	**74.2%**
Nordea Sweden				56.3%	57.3%		62.9%	57.4%	59.9%	67.6%	68.7%	**63.3%**
SHB	65.7%	61.8%	57.3%	50.7%	57.5%	**58.6%**	64.3%	68.0%	68.2%	72.0%	74.4%	**69.4%**
SHB Sweden				71.4%	70.9%		78.0%	77.0%	74.1%	79.2%	80.9%	**77.8%**
Swedbank	66.6%	61.6%	53.2%	54.7%	58.2%	**58.9%**	59.5%	59.7%	51.5%	55.8%	57.9%	**56.9%**
Swedbank Retail		73.0%	60.6%	68.6%	67.5%		64.9%	62.9%	59.2%	64.2%	63.1%	**62.9%**
Loan loss ratios												
Danske Sweden	0.12%	0.05%	-0.03%	0.05%	0.04%	**0.04%**	0.30%	0.30%	0.06%	0.11%	0.23%	**0.20%**
Nordea Sweden				0.00%	0.04%		0.13%	0.26%	0.01%	0.05%	0.06%	**0.10%**
SHB	0.06%	0.02%	-0.03%	-0.01%	0.00%	**0.01%**	0.12%	0.23%	0.10%	0.05%	0.08%	**0.11%**
SHB Sweden				-0.02%	0.01%		0.09%	0.24%	0.01%	0.00%	0.04%	**0.08%**
Swedbank	0.13%	0.07%	0.04%	-0.02%	0.06%	**0.05%**	0.26%	1.95%	0.28%	-0.14%	0.09%	**0.50%**
Swedbank Retail		0.05%	0.00%	-0.07%	0.01%		0.06%	0.10%	0.03%	0.04%	0.03%	**0.05%**
Loan/Deposit Ratio												
Danske Sweden	299%	299%	305%	277%	282%	**290%**	309%	225%	246%	254%	237%	**251%**
Nordea Sweden				195%	204%		193%	197%	205%	197%	215%	**197%**
SHB	271%	252%	241%	206%	252%	**241%**	272%	269%	268%	219%	246%	**253%**
SHB Sweden				93%	96%		97%	107%	121%	122%	124%	**114%**
Swedbank	254%	254%	243%	237%	248%	**246%**	253%	256%	222%	216%	214%	**231%**
Swedbank Retail		291%	294%	285%	281%		272%	265%	252%	245%	242%	**255%**

Source: Company Reports
Danske Sweden is based on Banking Activities Sweden (2007-2009) or Retail Banking Sweden (2010-2012) segment reported; Nordea Sweden is based on Nordea's Sweden Banking segment; SHB Sweden is based on Banking Sweden. Swedbank Retail is the Swedish Banking segment (04-07) or Retail segment (08-12) of Swedbank. ROE of Danske Sweden and SHB Sweden is calculated based on Pretax ROE assuming 30% tax rate.FY2010 result of Danske Sweden was restated because of transfer pricing model. PBT is around DKr 250m lower.

On the following pages, we show the latest group and divisional forecasts for Danske Bank

Financial Forecasts

Figure 64. Danske Bank – Summary Financials (2011-15E)

	2011	% Chg	2012	% Chg	2013E	% Chg	2014E	% Chg	2015E	% Chg
Net interest income	23,537	-1%	24,788	5%	22,265	-2%	23,622	6%	24,574	4%
Net fee income	8,298	-2%	8,782	6%	9,138	3%	9,561	5%	9,937	4%
Net trading income	7,325	-8%	8,901	22%	5,908	-44%	7,838	33%	8,217	5%
Insurance Income	569	NM	2,263	298%	915	-58%	1,593	74%	1,687	6%
Other Income	3,648	-5%	2,951	-19%	1,262	-2%	1,355	7%	1,411	4%
Total income	**43,377**	**-6%**	**47,685**	**10%**	**39,488**	**-14%**	**43,969**	**11%**	**45,825**	**4%**
Operating expenses	-25,987	0%	-26,588	2%	-23,877	-3%	-23,522	-1%	-23,180	-1%
Operating Income	**17,390**	**-14%**	**21,097**	**21%**	**15,611**	**-26%**	**20,447**	**31%**	**22,645**	**11%**
Prov. loan losses (Net)	-13,185	-5%	-12,529	-5%	-4,450	-42%	-3,347	-25%	-2,865	-14%
PBT, Non-Core					-1,383		-1,369		-307	
Income Before Tax	**4,205**	**-35%**	**8,568**	**104%**	**9,778**	**15%**	**15,731**	**61%**	**19,472**	**24%**
Taxes	-2,482		-3,819		-2,640		-4,247	0	-5,258	0
- Implied Tax Rate	59%		45%		27.0%		27.0%	0	27.0%	0
Net Attributed Group Income	**1,723**	**-53%**	**4,749**	**176%**	**7,138**	**51%**	**11,483**	**61%**	**14,215**	**24%**
Minority Interest	-11		-4		-1		-1	0	-1	0
Available Income to Shareholder	**1,712**	**-53%**	**4,745**	**177%**	**7,137**	**50%**	**11,482**	**61%**	**14,214**	**24%**
Per Share Data (DKr)										
EPS	**1.95**	**-60%**	**5.05**	**160%**	**7.13**	**41%**	**11.46**	**61%**	**14.19**	**24%**
Dividend	0.0	NM	0.0	0%	2.0	nm	4.0	100%	5.5	38%
Payout ratio	0.0%		0.0%		28.1%		34.9%	0	38.8%	0
BVPS per share	**135.7**	**-2%**	**138.0**	**2%**	**145.0**	**5%**	**153.3**	**6%**	**162.5**	**6%**
Tangible BVPS per share	111.6	3%	116.5	4%	124.3	7%	133.3	7%	143.4	8%
Number of shares (avg)	879	16%	939	7%	1,002	7%	1,002	0%	1,002	0%
Operating Ratios										
Net interest margin (Citi Calculation)	0.71%		0.72%		0.65%		0.70%		0.71%	
Cost / income ratio	60%		56%		60%		53%		51%	
Provision charge / customer loans (bps)	71		67		24		18		15	
ROA	0.05%		0.14%		0.21%		0.34%		0.41%	
Return on Equity	**1.5%**		**3.6%**		**5.0%**		**7.7%**		**9.0%**	
Return on Tangible Equity			4.3%		5.9%		8.9%		10.2%	
Capital Ratios (DKr in bn)										
Total capital	162	8%	174	8%	167	-4%	178	7%	187	5%
Tier 1 capital	145	16%	159	10%	160	1%	172	7%	181	5%
Risk-weighted assets	**906**	**7%**	**819**	**-10%**	**867**	**6%**	**880**	**2%**	**907**	**3%**
Total capital ratio (B2)	17.9%		21.3%		19.3%		20.3%	0	20.6%	0
Tier 1 ratio (B2)	**16.0%**		**19.4%**		**18.5%**		**19.5%**	**0.0%**	**19.9%**	**0.0%**
Core Tier 1 ratio (B2)	11.8%		14.5%		14.4%		15.0%	0.0%	15.5%	0.0%
Balance Sheet Summary (DKr bn)										
Lending - general public	1,847	0%	1,895	3%	1,819	-4%	1,847	2%	1,904	3%
Total deposits	849	-1%	929	9%	901	-3%	925	3%	958	3%
Total assets	3,424	7%	3,485	2%	3,346	-4%	3,398	2%	3,503	3%
Shareholders' equity	**126**	**20%**	**138**	**10%**	**145**	**5%**	**154**	**6%**	**163**	**6%**

Source: Company Reports, Citi Research

Figure 65. Danske Bank – Divisional Performance Summary (2012-15E)

	2012	2013E	% Chg	2014E	% Chg	2015E	% Chg
PERSONAL BANKING							
Net interest income	11,672	11,217	**-4%**	11,452	**2%**	11,796	**3%**
Net fee income	3,730	4,140	11%	4,347	5%	4,478	3%
Net trading income	819	614	-25%	706	15%	742	5%
Other income	608	638	5%	670	5%	704	5%
Net income from insurance	0	0	0%	0	0%	0	0%
Total income	**16,829**	**16,610**	**-1%**	**17,176**	**3%**	**17,719**	**3%**
Operating expenses	-12,430	-12,057	-3%	-11,937	-1%	-11,817	-1%
Profit before credit losses	**4,399**	**4,553**	**3%**	**5,240**	**15%**	**5,902**	**13%**
Credit loss expenses	-2,749	-2,100	-24%	-1,447	-31%	-1,265	-13%
Profit before tax	**1,650**	**2,453**	**49%**	**3,793**	**55%**	**4,637**	**22%**
Loans	871,759	822,817	-6%	831,045	1%	855,976	3%
Cost/ Income	74%	73%	**0**	69%	**0**	67%	**0**
NII/ Loans	1.34%	1.36%	**0**	1.38%	**0**	1.38%	**0**
Provisions/ Loans	0.32%	0.25%	**0**	0.18%	**0**	0.15%	**0**
BUSINESS BANKING							
Net interest income	9,243	8,938	-3%	9,251	4%	9,528	3%
Net fee income	2,149	1,902	-12%	1,959	3%	2,037	4%
Net trading income	479	647	35%	550	-15%	572	4%
Other income	481	505	0%	525	4%	546	4%
Net income from insurance	0	0	0%	0	0%	0	0%
Total income	**12,352**	**11,991**	**-3%**	**12,285**	**2%**	**12,683**	**3%**
Operating expenses	-5,466	-5,411	-1%	-5,357	-1%	-5,304	-1%
Profit before credit losses	**6,886**	**6,580**	**-4%**	**6,927**	**5%**	**7,380**	**7%**
Credit loss expenses	-3,825	-1,750	-54%	-1,500	-14%	-1,250	-17%
Profit before tax	**3,061**	**4,830**	**58%**	**5,427**	**12%**	**6,130**	**13%**
Loans	641,133	621,899	-3%	640,556	3%	666,178	4%
Cost/ Income	44%	45%	**0**	44%	**0**	42%	**0**
NII/ Loans	1.44%	1.44%	0	1.44%	0	1.43%	0
Provisions/ Loans	0.60%	0.28%	0	0.24%	0	0.19%	0
CORPORATES & INSTITUTIONS							
Net interest income	1,918	2,244	17%	2,334	4%	2,427	4%
Net fee income	1,118	1,129	1%	1,186	5%	1,245	5%
Net trading income	8,341	4,500	NM	6,435	43%	6,757	5%
Other income	19	19	0%	20	5%	21	5%
Net income from insurance	0	0	0%	0	0%	0	0%
Total income	**11,396**	**7,892**	**-31%**	**9,974**	**26%**	**10,450**	**5%**
Operating expenses	-4,307	-4,307	0%	-4,307	0%	-4,307	0%
Profit before credit losses	**7,089**	**3,585**	**-49%**	**5,667**	**58%**	**6,143**	**8%**
Credit loss expenses	-1,160	-600	-48%	-400	-33%	-350	-13%
Profit before tax	**5,929**	**2,985**	**-50%**	**5,267**	**76%**	**5,793**	**10%**
Loans	161,112	165,945	3%	172,583	4%	179,487	4%
Cost/ Income	38%	55%	0%	43%	0%	41%	0%
NII/ Loans	1.19%	1.35%	0	1.35%	0	1.35%	0
Provisions/ Loans	0.72%	0.37%	0	0.24%	0	0.20%	0
DANSKE CAPITAL							
Net interest income	-25	-34	50%	-35	5%	-37	5%
Net fee income	1,945	2,042	5%	2,144	5%	2,252	5%
Net trading income	-3	-3	5%	-3	5%	-3	5%
Other income	0	0	5%	0	5%	0	5%
Net income from insurance	0	0	0%	0	0%	0	0%
Total income	**1,917**	**2,006**	**5%**	**2,106**	**5%**	**2,211**	**5%**
Operating expenses	-982	-1,002	2%	-1,022	2%	-1,052	3%
Profit before credit losses	**935**	**1,004**	**7%**	**1,084**	**8%**	**1,159**	**7%**
Credit loss expenses	0	0	0%	0	0%	0	0%
Profit before tax	**935**	**1,004**	**7%**	**1,084**	**8%**	**1,159**	**7%**
Loans	211	222	5%	235	6%	249	6%
Cost/ Income	51%	50%	0%	49%	0%	48%	0%
NII/ Loans	-11.85%	-15.12%	0	-14.98%	0	-14.84%	0
Provisions/ Loans	0.00%	0.00%	0	0.00%	0	0.00%	0

Source: Company Reports, Citi Research

Figure 66. Danske Bank – Divisional Performance Summary Contd. (2012-15E)

	2012	2013E	% Chg	2014E	% Chg	2015E	% Chg
DANICA PENSION							
Profit before tax	**2,171**	**915**	**-58%**	**1,593**	**74%**	**1,687**	**6%**
OTHER ACTIVITIES							
Net interest income	-30	-100	0%	620	NM	860	39%
Net fee income	-76	-76	0%	-75	15%	-75	0%
Net trading income	926	150	NM	150	NM	150	0%
Other income	177	100	NM	140	0%	140	0%
Net income from insurance	0	0	0%	0	0%	0	0%
Total income	**997**	**74**	**-93%**	**835**	**1028%**	**1,075**	**29%**
Operating expenses	-1,457	-1,100	-25%	-900	-18%	-700	-22%
Profit before credit losses	**-460**	**-1,026**	**123%**	**-65**	**-94%**	**375**	**-677%**
Credit loss expenses	54	0	0%	0	0%	0	0%
Profit before tax	**-406**	**-1,026**	**153%**	**-65**	**-94%**	**375**	**-677%**
NON-CORE							
Net interest income	305	122	-60%	110	-10%	99	-10%
Net fee income	26	10	NM	9	-10%	8	-10%
Net trading income	-8	5	NM	5	-10%	4	-10%
Other income	0	0	0%	0	-10%	0	-10%
Net income from insurance	0	0	0%	0	0%	0	0%
Total income	**323**	**137**	**-58%**	**123**	**-10%**	**111**	**-10%**
Operating expenses	-275	-270	-2%	-243	-10%	-218	-10%
Profit before credit losses	**48**	**-133**	**-376%**	**-119**	**-10%**	**-107**	**-10%**
Credit loss expenses	-4,849	-1,250	-74%	-1,250	0%	-200	-84%
Profit before tax	**-4,801**	**-1,383**	**-71%**	**-1,369**	**-1%**	**-307**	**-78%**
Cost/ Income	85%	197%	0%	197%	0%	197%	0%

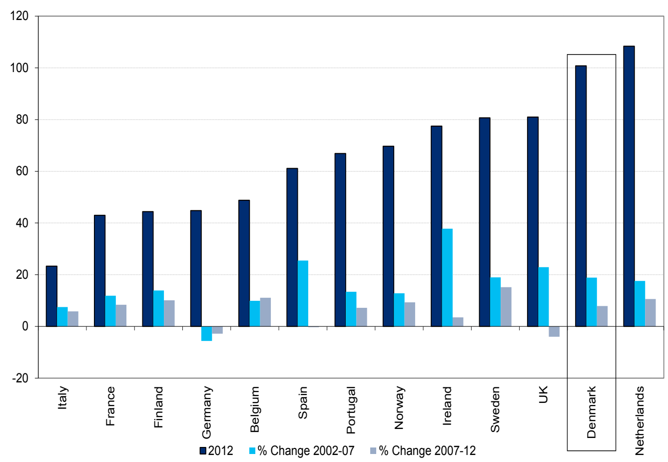
Source: Company Reports, Citi Research

Appendix : Distinctive Denmark

High Level of Mortgage Debt and Savings

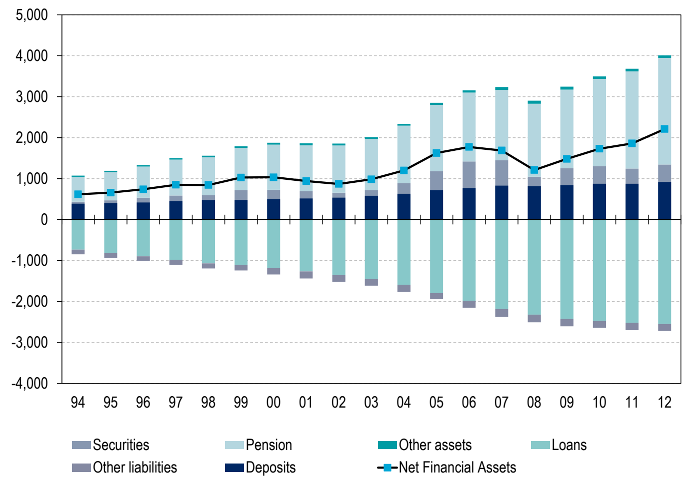
Compared to European peers, Denmark has one of the highest Mortgage Debt to GDP ratios (100% as of 2012) after Netherlands. Post 07, the pace of mortgage debt increase has slowed. Moreover, Denmark households and non-profit institute serving household (NPISH) are in a net asset position and the net assets are growing post crisis.

Figure 67. Europe– Household Mortgage Debt to GDP(%) 2012



Source: European Mortgage Federation

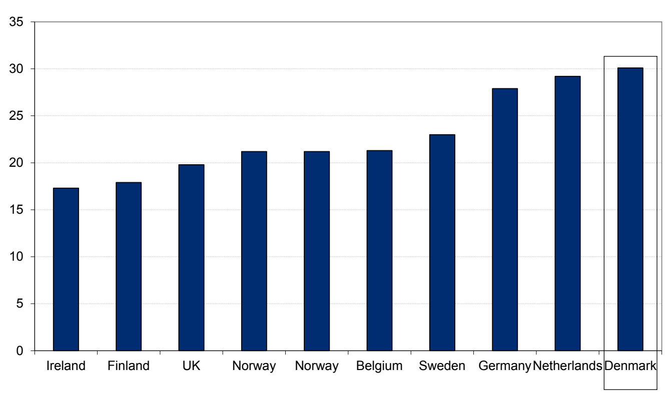
Figure 68. Denmark Households and NPISH net asset growing (DKr bn)



Source: Danmarks Nationalbank

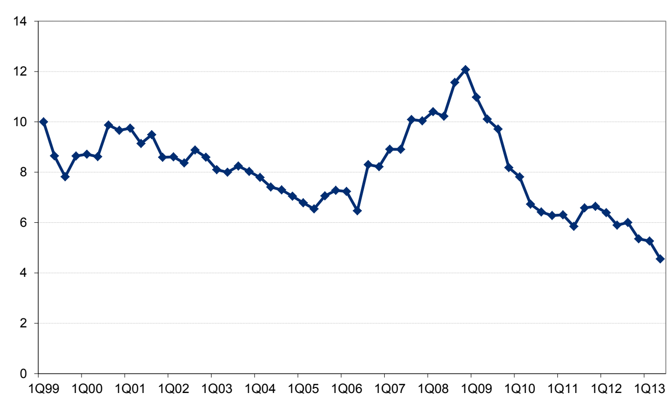
Although Denmark has the highest housing cost measured by total mortgage payments as a percentage of disposable income, as a result of the low interest environment in Denmark post financial crisis, the interest cost has reached historically low levels.

Figure 69. Europe – Housing Costs as Percentage Disposable Income (%) 2012



Source: Eurostat. Note: Total mortgage payments (principal + interest) as a proportion of gross disposable income

Figure 70. Denmark – Household Debt Interest Service Ratio 2Q13

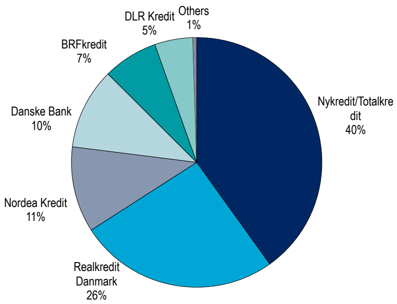


Source: EuroStat. Note: Total household debt interest payments as a proportion of gross disposable income; Indexed to 10 since 1Q99

Covered Bond Funding – (1) Liquidity Rules

An important source of funding for Danish mortgage banks, including Danske, has been their ability to issue covered bonds backed by these mortgages. The Danish US$530bn covered bond market is one of largest and most liquid one in Europe. Danish covered bonds are mostly issued by the mortgage banks with Nykredit/Totalkredit and Realkredit Danmark accounting for 68.0% of all Danish Krone covered bonds issued and 49.5% of all Danish euro covered bonds issues in 2012, showing high reliance of these banks on covered bonds. Realkredit Danmark and Danske Bank together account for 36% of the total Danish (DKK + EUR) covered bond market.

Figure 71. Volumes and Market Shares of Danish MCIs, end-2012



Source: Company Reports, Association of Danish mortgage banks

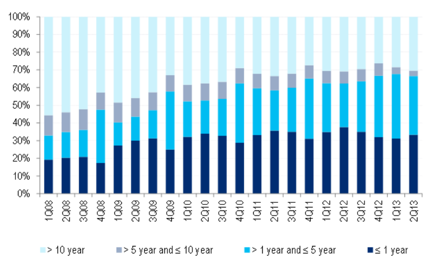
There have been recent discussions about the treatment of such bonds towards calculating the liquidity position of banks. A decision to classify covered bonds as Level 2 would limit banks' ability to use covered bonds to fulfill liquidity requirements could trigger a sell-off of the securities and may send mortgage rates higher. The final decision on the issue will be from the European Commission sometime in June 2014; note the European Banking Authority Board of Supervisors has recently recommended that covered bonds should not be considered Level 1 assets.

Although it is still unclear what the final decision might be, given the liquidity and depth of Danish covered bond market and strong lobbying from Danish banks, we expect covered bond being treated as Level 1 and Level 2A assets depending on factors such as market volume, turnover, and cover pool disclosure etc. We also note that only c21% of Danish covered bonds are held by foreign investors, making it relatively less exposed to funding withdrawal from abroad.

Covered Bond Funding – (2) Maturity Extension

One concern in qualifying Danske's covered bonds under Level 1 asset has been that they are heavily reliant on short tenor (i.e. <1Yr) maturity mortgage covered bonds. For the Danish mortgage covered bonds system, the proportion of <1Yr maturity bonds went up sharply from 19% at 1Q08 to 33% at end-2Q13. A market liquidity freeze could impact the ability to refinance these bonds and impact funding costs.

Figure 72. Outstanding Mortgage Covered Bonds by Maturity in Denmark (%)



Source: Danmarks Nationalbank

The Danish government has recently proposed a legislation that tries to address this concern and facilitate easy refinancing of covered mortgage bonds, in case of a liquidity squeeze. The bill requires that the conditions behind the adjustable-rate mortgage bonds specify that the bond automatically may be extended for one year if the institution, e.g. in a credit squeeze condition, is unable to sell enough new bonds to refinance the underlying loans. When this year has passed the institution may once again try to sell the new bonds. If it is not possible to sell enough bonds after this year the bond may be extended for another year.

When extended for the first time, the bond's interest rate will be the interest rate one year ago plus five percentage points. Should the bond term be extended for another year, the interest rate may be kept unaltered. The rules ensure that an otherwise sound mortgage-credit institution will not become distressed in the very unlikely event that adjustable-rate mortgages cannot be refinanced. The bill will come into force on 1st April 2014 for new bonds with a term up to 14 months. For all other adjustable-rate bonds, the law will come into force from 1st Jan 2015.

Figure 73. Companies Mentioned on This Report

Company	RIC	Rating	Ccy	Current Price
Danske Bank A/S	DANSKE.CO	1	DKK	124.2
DNB ASA	DNB.OL	2	NOK	108.5
Nordea	NDA.ST	1	SEK	86.1
SEB	SEBa.ST	1	SEK	83.9
Svenska Handelsbanken AB	SHBa.ST	2	SEK	314.5
Swedbank AB	SWEDa.ST	2	SEK	179.8
Lloyds Banking Group PLC	LLOY.L	2	GBP	0.8
Bank of Ireland	BKIR.I	3	EUR	0.3
Banco Popolare	BAPO.MI	2	EUR	1.4
KBC	KBC.BR	1	EUR	40.6
Royal Bank of Canada	RY.TO	2	CAD	71.6
Toronto Dominion	TD.TO	1	CAD	98.9
Scotiabank	BNS.TO	2	CAD	66.0
Bank of Montreal	BMO.TO	1	CAD	70.7
CIBC	CM.TO	2	CAD	90.1
ANZ	ANZ.AX	1	AUD	32.2
CBA	CBA.AX	1	AUD	77.6
National Australia Bank Ltd	NAB.AX	2	AUD	34.7
Westpac Banking Corp	WBC.AX	1	AUD	32.3
BB&T	BBT.N	1	USD	36.8
Comerica Inc	CMA.N	2	USD	46.9
Fifth Third Bancorp	FITB.O	2	USD	20.9
First Horizon National Corp	FHN.N	2	USD	11.6
First Niagara Financial Group	FNFG.O	3	USD	10.4
Huntington Bancshares Inc	HBAN.O	2	USD	9.5
Keycorp	KEY.N	2	USD	13.3
M&T Bank Corp	MTB.N	2	USD	115.1
PNC Financial Services Group	PNC.N	2	USD	76.6
Regions Financial Corp	RF.N	2	USD	9.9
State Street Corp	STT.N	1	USD	73.2
SunTrust Banks	STI.N	2	USD	36.5
US Bancorp	USB.N	2	USD	39.9
Wells Fargo & Co	WFC.N	2	USD	45.0
Zions Bancorp	ZION.O	2	USD	29.7

Source: Powered by dataCentral.

Danske Bank A/S

Company description

Danske Bank A/S is a Danish banking group that encompasses Danske Bank, BG Bank, Realkredit Danmark and other subsidiaries. The Group provides financial services including banking, insurance, mortgage, asset management, brokerage, credit card, real estate and leasing services. Danske Bank serves private customers, as well as the corporate and institutional sectors in Scandinavia. In addition, the bank operates in Ireland and Northern Ireland.

Investment strategy

Danske Bank has faced relative headwinds from a slow Danish economy and contracting housing market, as well as concerns in respect of its Irish exposures. We expect loan-loss provisions will improve from here and forecast a notable improvement in provisions in 2014 following better trends in Danske's problem markets (Ireland and Denmark). In addition, management is executing a number of initiatives to improve underlying profitability, including changing distribution channels, considering how to charge various client segments, and reducing staff and branches. We expect improved underlying profitability and normalising provisions will reduce the risk premium and result in a re-rating of Danske's shares. We rate the shares Buy.

Valuation

We value the bank by splitting the capital into two components:

Terminal Value is valued based on our forecasted returns on equity on an expected normalised cost of equity at 9.5%. We estimate an underlying sustainable ROE in 2017 of 10% for Danske Bank.

Dividends are assumed to be paid in spring each year and are in-line with our forecasts with no extraordinary dividends assumed.

We add the components and discount the forecasted components at a cost of equity of 9.5%. We then cross-check this valuation using: (1) comparable P/TB relative to the banks sector and peers; (2) comparable multiple valuation relative to the bank's historical trading range, peers and growth prospects.

Using this approach we set a target price of DKr150 per share, equivalent to 1.0x 2014E book value.

Risks

There are a number of risks that could cause the share price to deviate from our target price. These include: (1) a slowdown in Danish banking growth or materially adverse developments in other markets where Danske Bank is active; (2) continued asset quality deterioration and high loan loss provisions, in particular on Ireland; and (3) adverse conditions in the Markets and Insurance division. 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

Danske Bank A/S (DANSKE.CO)

Ratings and Target Price History
Fundamental Research

Analyst: Ronit Ghose
Covered since July 19 2013

	Date	Rating	Target Price	Closing Price
1	15-Mar-11	1M	*134.18	112.15
2	18-Mar-11	1M	*137.00	119.70
3	1-Jun-11	*2M	*125.00	107.10
4	8-Jul-11	*2H	125.00	98.25
5	11-Aug-11	*1H	*115.00	86.60
6	3-Oct-11	1H	*100.00	79.30

	Date	Rating	Target Price	Closing Price
7	7-Oct-11	Stock rating system changed		
8	7-Oct-11	*1	100.00	77.00
9	1-Nov-11	1	*95.00	69.45
10	10-Feb-12	*2	95.00	88.00
11	17-Apr-12	2	*100.00	91.75
12	4-Jun-12	*1	100.00	76.90

	Date	Rating	Target Price	Closing Price
13	10-Aug-12	*2	100.00	98.60
14	10-Oct-12	2	*110.00	106.50
15	31-Oct-12	2	*105.00	90.00
16	25-Jan-13	2	*110.00	106.70
17	1-Mar-13	*1	*140.00	108.10

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Danske Bank A/S (DANSKE.CO)

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

Analyst: Ronit Ghose
Covered since July 19 2013

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of M&T Bank Corp
Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Huntington Bancshares Inc
Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Comerica Inc
Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Westpac Banking Corp
Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of SunTrust Banks Inc
Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Australia and New Zealand Banking Group Ltd
Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of U.S. Bancorp
Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Regions Financial Corp
Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Svenska Handelsbanken AB

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of PNC Financial Services Group Inc

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of National Australia Bank Ltd

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Nordea Bank AB

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Danske Bank A/S.

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of State Street Corp

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Commonwealth Bank of Australia

Citigroup Global Markets Limited is currently mandated as advisor to Lloyds Banking Group Plc in relation to the announced disposal of the Groups UK bank branches.

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Royal Bank of Canada

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Bank of Nova Scotia

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Toronto-Dominion Bank

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Fifth Third Bancorp

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