

28 March 2014 | 32 pages

Diversified Banks
Western Europe | Denmark

Danske Bank A/S (DANSKE.CO)

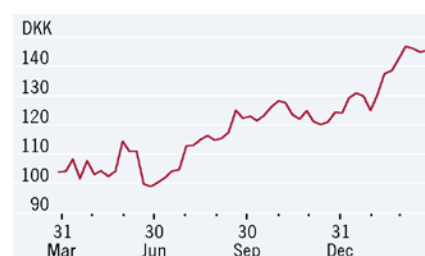
The Bridge

- **Borgen Style** — In our "[Borgen Style](#)" report (3 January 2014) we asked if Thomas Borgen, Danske's new CEO, can be as popular with bank investors as Borgen, the political drama, is with TV viewers. The early answer is: Yes. Danske shares are up +17% ytd versus Nordic banks +1% and European banks +1%. Since Mr Borgen took over as CEO in Sep 2013, Danske shares are +29% versus Nordic banks +15% and European banks +16%.
- **The Bridge** — In this report we look at what Danske management can do to make the bridge from 2013's 5% ROE to 2015's 9% ROE and the long-term 12% ROE ambition. Structural change in Danish banking — the number of banks halved in the past decade — should allow loan re-pricing and cost reduction. Danske has scope to further reduce headcount, in particular in group functions: cost cuts should add c2ppt to ROE between 2013 -15. Improved credit losses and non-NII should also help get the 2015 ROE to 9%.
- **Crossing The Rubicon** — Getting to 12%+ from our 10% estimate will require (1) divestments of non-Danish retail businesses (ROE +1ppt) and (2) higher margins structurally (ROE +1ppt >). Management has said there are "no sacred cows" as they analyse what to restructure, divest or invest in. We expect Northern Ireland to be sold following the categorisation of the Republic of Ireland as non-core (3Q13). Nordic asset sales are less likely – but not immediately.
- **Reiterate Buy, Dividend Positives** — We raise our target price to DKK175, from DKK150, based on a 10% ROE, 9% COE (9.5% previously), higher 2016-17E EPS (+3-4%) and DPS (up to +33%). As Danske's ROE increases towards 10%+ (ROTE 11%+), with low single-digit balance sheet and RWA growth and relatively clear Danish capital rules, we expect it to be very capital generative. We expect 2013's c30% dividend payout ratio to reach 50% and above from 2016 onwards.

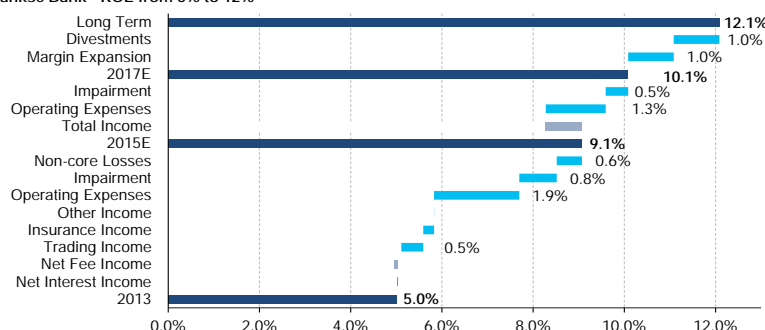
- Target Price Change
- Estimate Change

Buy	1
Price (28 Mar 14)	Dkr148.00
Target price	Dkr175.00
	from Dkr150.00
Expected share price return	18.2%
Expected dividend yield	2.7%
Expected total return	20.9%
Market Cap	Dkr149,276M
	US\$27,472M

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



Danske Bank - ROE from 5% to 12%



Source: Company reports and Citi Research Estimates.

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

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Fiscal year end 31-Dec	2012	2013	2014E	2015E	2016E
Valuation Ratios					
P/E adjusted (x)	29.3	20.8	12.5	10.1	8.8
P/E reported (x)	29.3	20.8	12.5	10.1	8.8
P/BV (x)	1.1	1.0	1.0	0.9	0.8
P/Adjusted BV diluted (x)	1.1	1.0	1.0	0.9	0.8
Dividend yield (%)	0.0	1.4	2.7	4.1	5.4
Per Share Data (Dkr)					
EPS adjusted	5.05	7.11	11.88	14.58	16.82
EPS reported	5.05	7.11	11.88	14.58	16.82
BVPS	138.00	145.60	155.48	166.06	176.88
Tangible BVPS	116.85	124.96	135.65	147.03	158.64
Adjusted BVPS diluted	138.00	145.60	155.48	166.06	176.88
DPS	0.00	2.00	4.00	6.00	8.00
Profit & Loss (Dkrm)					
Net interest income	24,788	22,245	23,479	24,453	25,375
Fees and commissions	8,782	9,525	10,254	10,646	11,182
Other operating Income	14,115	6,820	8,986	10,283	11,099
Total operating income	47,685	38,590	42,719	45,381	47,655
Total operating expenses	-26,588	-24,344	-23,404	-22,610	-22,360
Oper. profit bef. provisions	21,097	14,246	19,315	22,771	25,295
Bad debt provisions	-12,529	-4,187	-3,030	-2,786	-2,250
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	8,568	10,059	16,285	19,985	23,045
Tax	-3,819	-2,944	-4,397	-5,396	-6,222
Extraord./Min. Int./Pref. Div.	-4	0	0	0	0
Attributable profit	4,745	7,115	11,888	14,589	16,823
Adjusted earnings	4,745	7,115	11,888	14,589	16,823
Growth Rates (%)					
EPS adjusted	159.6	40.6	67.2	22.7	15.3
Oper. profit bef. prov.	21.3	-32.5	35.6	17.9	11.1
Balance Sheet (Dkrm)					
Total assets	3,485,181	3,227,057	3,226,872	3,294,338	3,382,141
Avg interest earning assets	3,282,052	3,188,313	3,065,616	3,097,575	3,171,327
Customer loans	1,894,578	1,791,200	1,791,097	1,828,545	1,877,280
Gross NPLs	114,300	81,327	65,062	55,302	52,537
Liab. & shar. funds	3,485,181	3,227,057	3,226,872	3,294,338	3,382,141
Total customer deposits	929,092	939,000	960,238	984,162	1,018,580
Reserve for loan losses	47,800	46,900	44,779	42,829	41,254
Shareholders' equity	138,234	145,657	155,543	166,131	176,951
Profitability/Solvency Ratios (%)					
ROE adjusted	3.6	5.0	7.9	9.1	9.8
Net interest margin	0.76	0.70	0.77	0.79	0.80
Cost/income ratio	55.8	63.1	54.8	49.8	46.9
Cash cost/average assets	0.8	0.7	0.7	0.7	0.7
NPLs/customer loans	6.0	4.5	3.6	3.0	2.8
Reserve for loan losses/NPLs	41.8	57.7	68.8	77.4	78.5
Bad debt prov./avg. cust. loans	0.7	0.2	0.2	0.2	0.1
Loans/deposit ratio	203.9	190.8	186.5	185.8	184.3
Tier 1 capital ratio	19.4	19.0	20.3	20.9	21.4
Total capital ratio	21.3	21.4	22.7	23.3	23.6

Contents

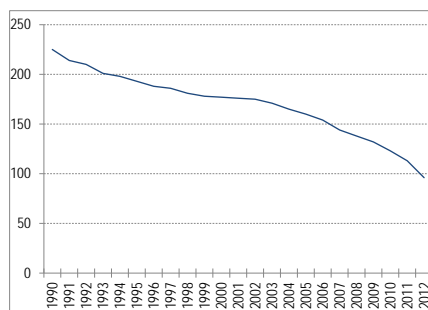
Investment Summary	4
Investment Positives	4
Investment Risks	7
Valuation	7
Structural Change: A New Danish Banking	8
Better Margins: Mortgages & Corporate	11
Danish Discount: Funding & Capital Costs	14
Fixing Danske Costs and Productivity	17
“No Sacred Cows”	20
Danske Bank A/S	26
Appendix A-1	28

Investment Summary

Investment Positives

Structural Change in Danish Banking

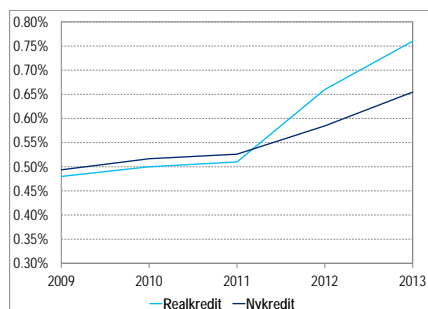
Figure 1. Number of Banks in Denmark



Source: Danish FSA

A 25bps mortgage margin boost, which would be a repeat of the 2011-13 spread increase, adds almost 20% to Danske Bank's depressed 2013 earnings

Figure 2. Lending Spread of Danish Mortgage Banks



Source: Company Reports

Danish banking is changing from being somewhat like Germany or Italy to looking more like Sweden or Norway, and this should boost structural profitability in the Danish banking market, which currently accounts for just over half of Danske Bank's loan portfolio. Denmark's banking system has consolidated rapidly in recent years: from above 200 banks in the early 1990s, c175 in the early 2000s and 90 today. Denmark is now an oligopoly like the other Nordic countries: the top 4 Danish financial institutions control c90% of loans and 75% of system deposits. We expect further reduction in the long tail of bank, with local champions such as Jyske Bank pursuing a roll-up strategy. Despite a one-third branch reduction since 2007 in Denmark, branch density levels in this relatively small country still remains c50% higher than in Sweden, 2x Finland and 3x Norway.

Margin Improvement: (1) Strategic Change in Mortgages

Danish mortgage margins have historically been around 50 basis points but in the past few years have increased sharply. Between 2011 and 2013, Danske Bank's mortgage subsidiary has increased their lending spread from c50bps to c75bps and Nykredit (the largest mortgage lender in Denmark) has increased their spread from c52bps to c65bps. Nykredit, a mutual institution, is now run by an ex-Nordea banker and focused on raising profitability and capital ratios ("Nykredit 2015"). During 2014, we expect that Danske Bank will focus on raising spreads on corporate mortgages where it sees considerable re-pricing scope. Residential loan pricing will probably only increase slowly given both leading mortgage lenders desire to protect their client franchises and (for Danske Bank, to rebuild their public profile) but in the long term we expect to see Danish mortgage margins closer to Sweden at c100bps. We estimate a 25bps mortgage margin increase would boost Danske Bank group profits by 18% for 2013 and a smaller 12% for 2014E.

Margin Improvement in 2014: (2) State Hybrids, Funding Re-Pricing

The single largest margin positive near term is the repayment by Danske Bank of the state hybrid capital, which should add DKK1 billion to NII, equivalent to c5% of 2013 group NII or c10% of 2013 group profits (or c6% of 2014E group profits). Additional capital raised is being funded at a lower rate — for example the recent AT1 coupon was 5.75% for the Eur750 million transaction launched in early March versus an effective 6.67% rate for the state hybrid capital. It should also be noted that there will not be a 1:1 replacement of the State hybrid capital with private capital. The reduced risk premium for Danske hybrid capital or debt issued currently helps not just lower financing expenses but it also has a spill-over positive for client funding costs. In other recovery markets, such as Spain or UK banking in 2013, we have seen domestic banks benefit from reduced funding costs, especially retail funding costs. For Danske in 2014, we believe corporate and institutional client funding costs could fall further.

Poor Productivity: Lowering Headcount, Tacking Support Functions

Headline 2013 costs of DKK24.3bn but management appear confident of meeting their 2015 cost target of "below DKK23bn". Danske's 2013 cost/income ratio lags all Nordic and Australian peers and half of the relatively inefficient North American banks. By contrast, in 2003, Danske's cost/income ratio was second only to SHB in the Nordic region. Danske's has poor revenue and profit per employee metrics relative to other Nordic countries — SEB and Swedbank's revenues/employee is c10% higher, Nordea is c25% higher. Danske has in the past 5 years or so reduced branch numbers materially but not tackled headcount as aggressively, especially it would appear non client-facing staff. Danske has the highest number of employees

in group functions relative to other Nordic banks. In April, Danske announced the appointment of a new American COO from outside banking to accelerate efficiency gains.

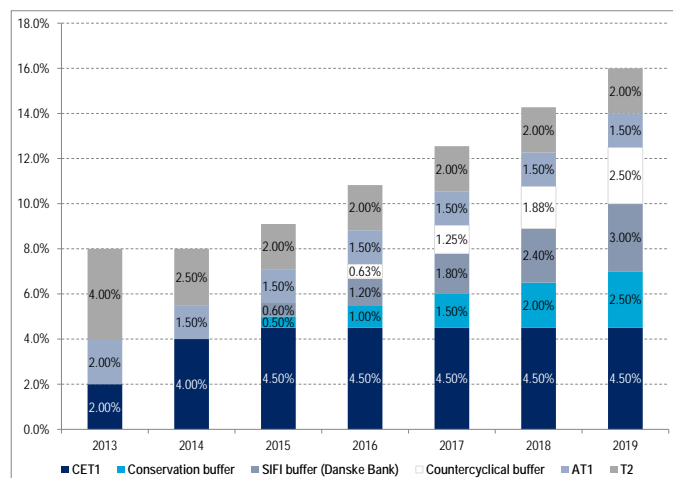
“No Sacred Cows”

Danske Bank's management has said there are “no sacred cows” as they assess what businesses should be core to the future group and those units that should be restructured and / or divested. We believe that Danske's new CEO should unwind many of the past generation's mistakes: exit all of Ireland, sell Baltics and evaluate divesting Nordic retail banking. Assuming the sale of Retail and Business Banking outside Denmark would add c1ppt to group ROE. While we expect Northern Ireland is most likely to be divested, we do not believe that the Danske management have got to the stage that they consider the Nordic retail businesses outside Denmark non-core. If these retail businesses were for sale, who could be the likely buyers? Firstly, strategic investors could consider part (eg SEB for Swedish retail, Nordea for Norwegian retail) or all of the franchises (for example Santander, already active in the UK and in the Nordic region via consumer finance), while private equity could be interested in individual assets (for example Northern Ireland, as they have been in markets such as UK or Spain).

Regulatory Clarity and an Evolving Capital Return Story

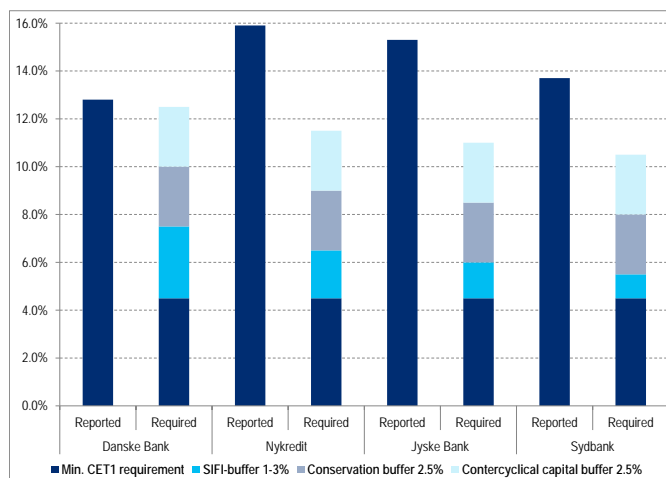
The Danish FSA's required minimum capital requirements are transparent and appear to be less ambiguous than in countries such as Sweden or the UK. As set out in Figure 3 and Figure 4 below, Danske needs to be at a Basel III CET1 of 12.5% by 2019 based on the FSA's rules. We expect Danske management will want to operate with a small buffer above this level, so 13-13.5% will likely become the de facto minimum. Also based on our industry and regulatory channel checks, we do not expect any material changes to Danish capital rules, for example via Pillar 2 interventions. As we think Danske Bank's ROE will be increasing towards 10% by 2016E (ROTE 11%) and balance sheet and RWA growth will be limited to low single digits per annum, we expect the group to be very capital generative and able to support a rapidly increasing distribution policy. Danske positively surprised the market by re-starting its dividend in 2013 (DKr2, c28% payout ratio) after a hiatus of five years of no dividends. We expect a dividend increase of DKr2 per annum with the group reaching a dividend payout ratio of close to 50% in 2016 (DKr8/share) and c55% in 2017 (DKr10/share).

Figure 3. Danish FSA – Phasing-in of New Capital Requirements



Source: Finanstilsynet

Figure 4. FY13 Fully Loaded CET1 and End Requirement



Source: Finanstilsynet

Figure 5. Nordic Banks Cash Payout Ratio exceeds 50% by 2015

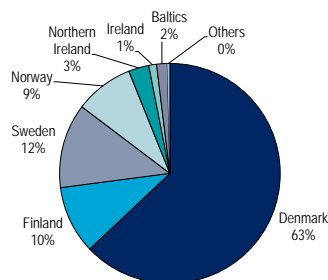
	2012	2013	2014	2015	2016	2017
Danske Bank	0%	28%	34%	41%	48%	54%
DnB	25%	25%	22%	25%	23%	na
Nordea	43%	56%	63%	74%	74%	74%
SE Banken AB	52%	59%	60%	64%	67%	na
SHB	47%	73%	51%	52%	52%	na
Swedbank	75%	86%	75%	75%	75%	na

Source: Company Reports and Citi Research Estimates

Economic Cycle and Asset Quality

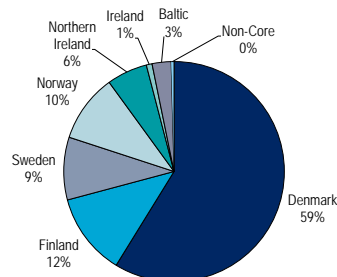
As we noted in our "[Borgen Style](#)" report, Danske's gearing to economies such as Denmark and Ireland have been a headwind relative to Nordic peers geared. But several countries in Danske's footprint, eg Denmark (65% of loans), Ireland (27% of gross impaired loans) and Finland (10% of loans) should see a c2ppt pick-up in GDP growth rates between 2013-15E. In addition, Danske Bank is relatively well provided for its bad debts, as evidenced by the EBA Transparency Exercise (16 Dec 2013), and this could result in future recoveries.

Figure 6. 2013 Loan Mix – Personal & Business Banking



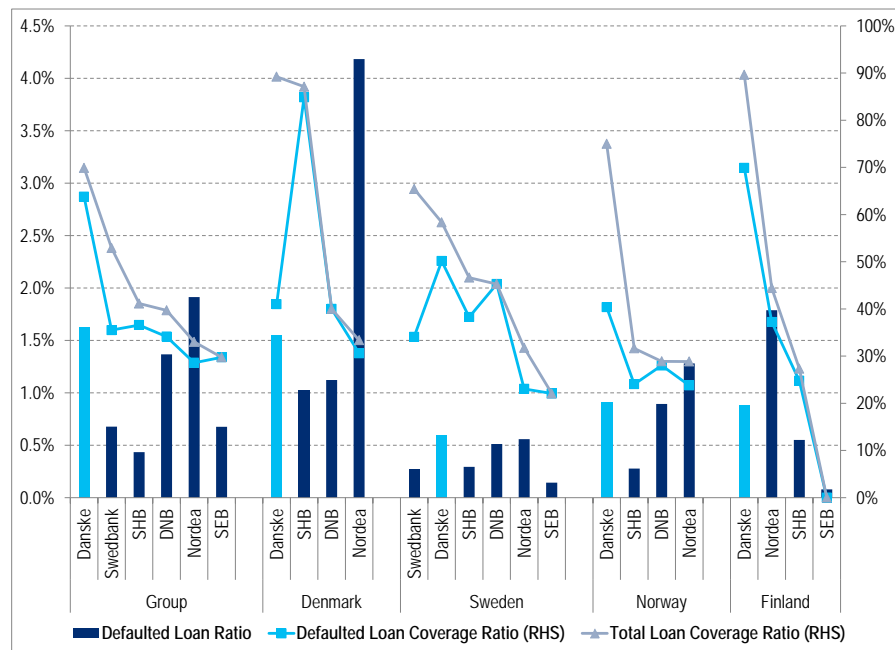
Source: Company Report

Figure 7. 2013 Revenue Mix – Personal & Business Banking



Source: Company Report

Figure 8. Danske Has the Highest Loan Coverage Ratio Among Nordic Banks



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

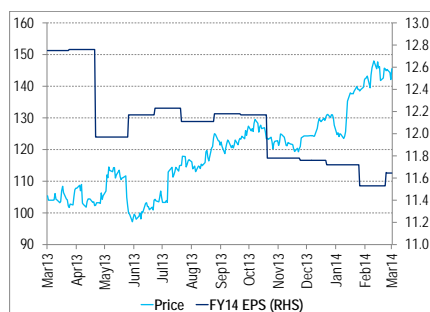
Investment Risks

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 and this is likely part of the reason why consensus earnings estimates have been downgraded over the past year.

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.

Figure 9. Danske – Share Price vs FY14 Consensus EPS



Source: DataStream

Valuation

We value Danske Bank shares primarily using a Dividend Discount Model (DDM). The terminal value is valued based on a ROE of 10.1% in 2017 and a cost of equity at 9% (cost of equity is company estimated, see 2013 Annual Report). We expected dividends to grow DKr2/share per annum from DKr2/share in FY13 to DKr10/share in FY17, corresponding to a dividend payout ratio close to 55%. Using this DDM approach we set a target price of DKr175 per share, equivalent to 1.1x 2014E book value.

As our ROE assumed is below the long term goal of management (12%+) we show in Figure 10 below Danske's fair value share price sensitivity to a range of ROE and COE assumptions. Using a 12% ROE and a 9% COE would imply a DKr 195 fair value based on 1-stage ROE/PB model.

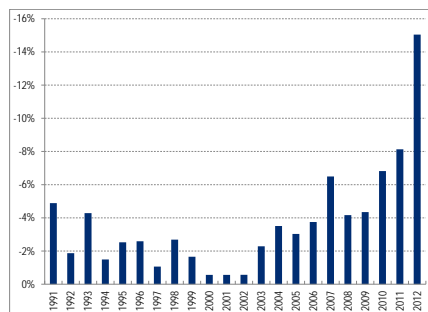
Figure 10. Danske Share Price Sensitivity Analysis

		COE						
		8.0%	8.5%	9.0%	9.5%	10.0%	10.5%	11.0%
ROE	5%	93	87	82	78	74	70	67
	6%	111	105	98	93	88	84	80
	7%	130	122	115	108	103	97	93
	8%	148	139	131	123	117	111	106
	9%	166	156	147	139	131	125	119
	10%	184	173	163	154	146	138	132
	11%	202	190	179	169	160	152	145
	12%	221	207	195	184	174	166	158
	13%	239	224	211	199	189	179	171
	14%	257	241	227	215	203	193	184
	15%	275	258	243	230	218	207	196

Source: Citi Research; The analysis is based on FY14E BVPS, DPS and 0% terminal growth rate

Denmark's banking system has consolidated rapidly in recent years: from above 200 banks in the early 1990s, c175 in the early 2000s and 90 today

Figure 11. Change YoY in Number of Banks in Denmark (Inverse Scale)



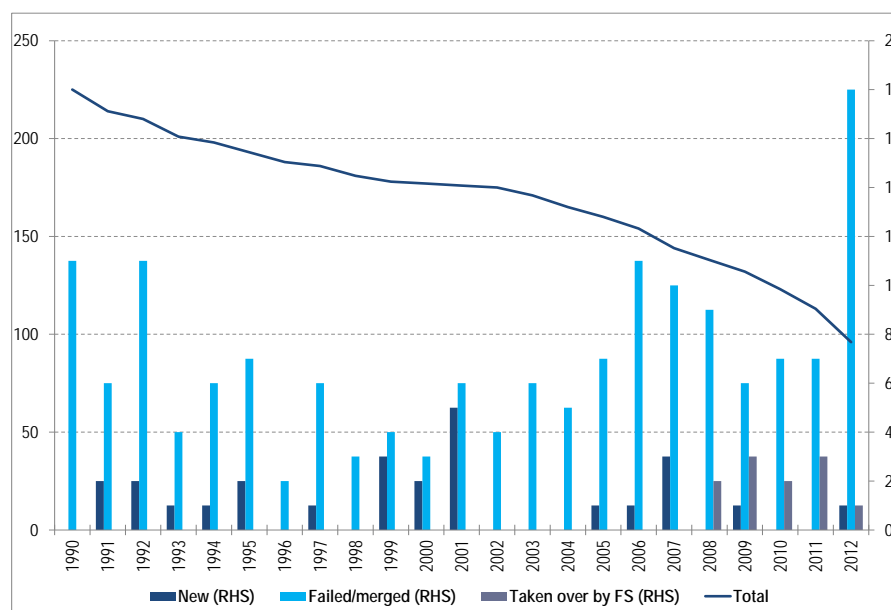
Source: Danish FSA; Ministry of Business and Growth Denmark;

Structural Change: A New Danish Banking

Danish banking is changing from being somewhat like Germany or Italy to looking more like Sweden or Norway. Denmark is moving from being an over-banked system with a lot of non-profit maximising institutions towards a more oligopolistic market with all of the major players now increasingly ROE focused, albeit Denmark remains a market with a relatively long tail of smaller banks.

In the early 1990s, Denmark had over 200 banks. By the turn of the millennium, Denmark still had as many as circa 175 banks. But by the end of 2012 this number had declined to about 100 banks with the rate of decline accelerating during the recent financial crisis years as numerous small Danish banks failed, got merger or taken over (see Figure 11- Figure 12). During 2013, there was further consolidation — the total numbers of banks had declined further to 90 (data as of 3Q13).

Figure 12. Number of Banks in Denmark, 1990 - 2012



Source: Danish FSA; Ministry of Business and Growth Denmark; FS is an abbreviation of Financial Stability Company A/S. The data for 2012 was calculated at the end of 2012. The data excludes branches of foreign banks in Denmark and Faroese banks.

The leading banks in Denmark have a very high market share. The top 3 lenders in the country — Danske Bank, Nykredit and Nordea — have a combined 80% of loans. If we widen our sample to include Jyske Bank, along with their recent BRF purchase, it increases the market share of the top 4 lenders in Denmark to c90%. The combined market share of the leading banks has increased in recent years.

Denmark is now an oligopoly like the other Nordic countries: the top 4 Danish financial institutions control c90% of loans and 75% of system deposits

Figure 13. Denmark – Loan and Deposit Market Share of Banks and Mortgage Institutes

	Loan Market Share		Deposits Market Share	
	2013	2008	2013	2008
Danske Bank	32.0%	33.6%	29.9%	34.4%
Nykredit	32.1%	25.8%	5.2%	4.1%
Nordea Bank Danmark	15.6%	15.9%	24.7%	21.2%
Jyske Bank	2.9%	3.1%	9.2%	7.1%
BRFkredit	5.4%	5.6%	0.4%	0.2%
Sydbank	1.9%	2.5%	5.5%	5.0%
Top 6 lenders	89.8%	86.5%	74.9%	72.1%

Source: Company Reports, Statistic Denmark; Citi Research Estimates; System Loan and Deposit data is from Statistic Denmark, Aggregated MFI Balance Sheets Loan and Deposit data; Each individual bank's loan and deposit data excludes repos and loan/deposits from central banks and credit institutions. * Jyske bank agreed to acquire BRFkredit, Deal expected to close April 2014.

Bank lending and deposits, excluding mortgage institutions, are a little bit more fragmented vs total system figures: the top 4 banks control c80% of loans and c70% of deposits

Oligopoly banking markets: the Big 4 banks in Australia account for 80% of deposits, in Sweden about 70% and Denmark is not far behind

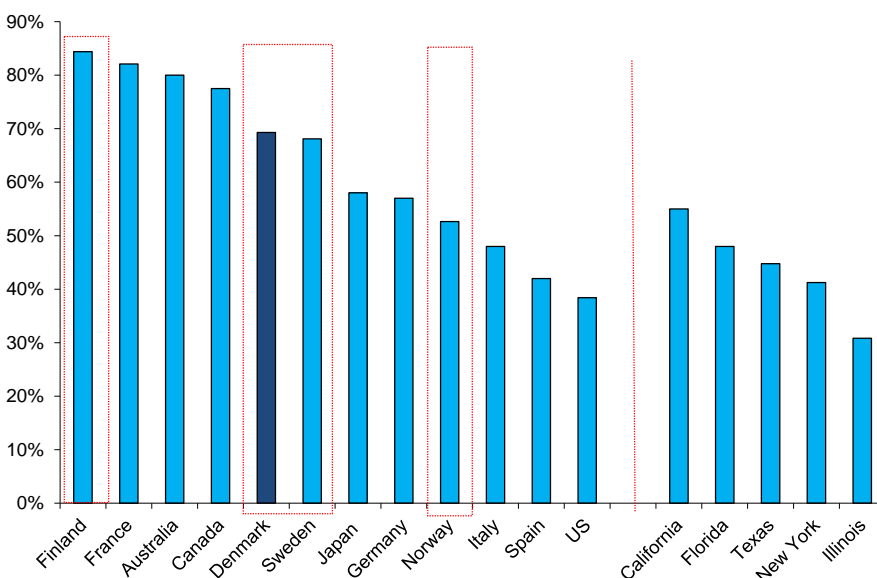
Figure 14. Denmark – Loan and Deposit Market Share of Banks (Excluding Mortgage Loans)

	Loan Market Share		Deposits Market Share	
	2013	2008	2013	2008
Danske Bank	36.0%	36.1%	29.9%	34.4%
Nordea Bank Danmark	27.5%	25.6%	24.7%	21.2%
Jyske Bank *	7.9%	6.8%	9.2%	7.1%
Sydbank	5.1%	5.5%	5.5%	5.0%
Top 4 Banks	76.5%	74.1%	69.3%	67.8%

Source: Company Reports, Statistic Denmark; Citi Research Estimates; System Loan and Deposit data is from Statistic Denmark, Banks Balance Sheets Loan and Deposit data; Each individual bank's loan and deposit data excludes mortgage loans, repos and loan/deposits from central banks and credit institutions. * Jyske bank agreed to acquire BRFkredit, Deal expected to close April 2014.

At an international level, countries such as Australia, Canada, Finland and France are among the most concentrated domestic banking markets, followed by the likes of Denmark and Sweden. The Swedish market is consensually viewed by investors as oligopolistic and attractive but Denmark as fragmented and unattractive — yet the market share data for the leading banks in both countries are similar, as set out below.

Figure 15. Selected Key Countries – Deposit Market Share of Top 4 Banks. 2013 %



Source: Citi Research Estimates, Company Reports, Central bank Websites, SNL Financial Services; Note: Canada ratio based on banks "only" data; French numbers combine Banques Populaires & Caisses d'Epargnes as both are part of same group (BPCE). We also combine CA regional banks and LCL (Credit Agricole); For Germany we include savings banks and cooperative banks as a single category since banks of each type are unique to every different region so we feel that it is appropriate to combine them.

Fewer Banks, Fewer Branches

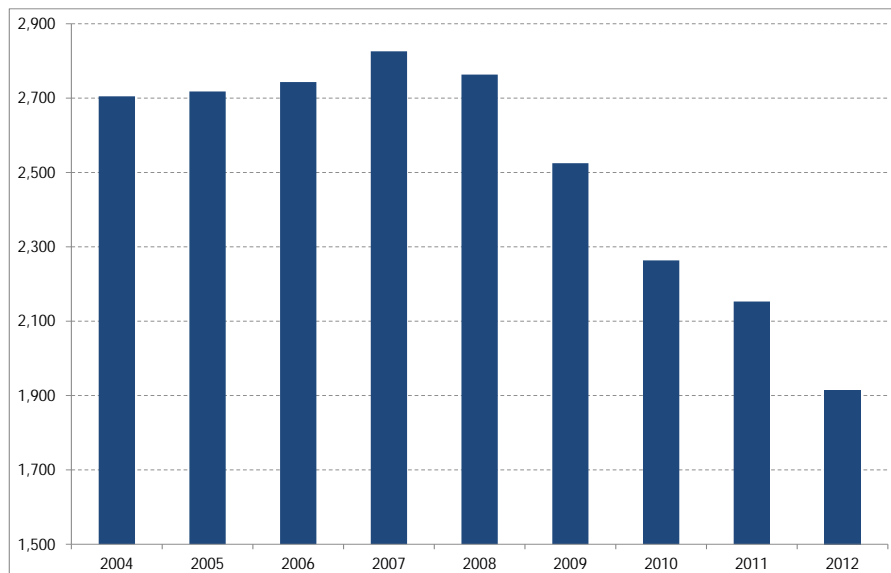
While the number of Danish banks has been dropping for several decades, the rate of decline has accelerated since 2007. Similarly, the number of bank branches has declined by about a third from its peak in 2007. Not only are Danish banks merging or being closed down, the larger and more successful Danish banks have also been cutting branch numbers in response to a sluggish revenue environment, changing technology and client behaviour and a consolidating industry context.

2007 was a recent peak for Danish bank branches — their numbers subsequently declined by one-third as the total number of banks declined and the bigger banks also cut their networks

The Danish branch network has declined to below 1900 branches from a peak over 2800 — reaching Norwegian density levels would result in a c650 branch network; to match Sweden equals c1200 branches

Despite a one-third branch reduction since 2007 in Denmark, branch density levels in this relatively small country still remains c50% higher than in Sweden, 2x Finland and 3x Norway

Figure 16. Number of Bank Branches in Denmark

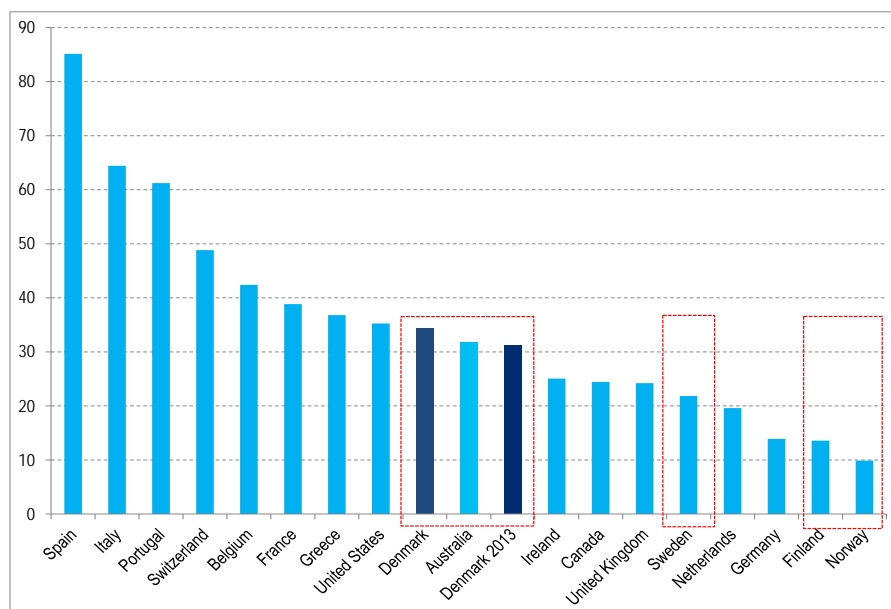


Source: IMF, World Bank, Statistic Denmark and Citi Research Estimate; The branch number is estimated based on IMF branch density data and population data from Statistic Denmark

Despite the rapid shrinkage of branches, Danish branch penetration remains as high as in Australia or the USA at about 30 commercial bank branches per 100k adults. Neighbouring Nordic markets have even lower branch density relative to adult population with Sweden at about 20, Finland circa 15 and Norway 10.

Moving to Norwegian levels of branch density would result in the Danish bank system losing about two-thirds or a further 1200 branches. While becoming Norwegian is unlikely in the near future, further convergence towards Swedish branch density levels is feasible given the ongoing pressure to boost bank returns.

Figure 17. Major DMs – Number of Commercial Bank Branches per 100K Adults

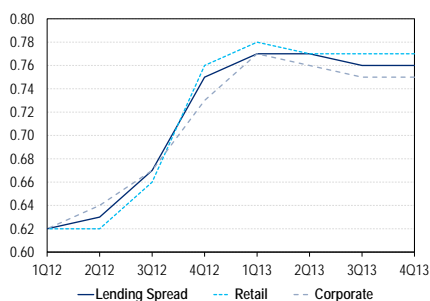


Source: IMF, Company Reports and Citi Estimates; Note: Data for UK is as of 2011. Denmark 2013 branch density is estimated based on Danske, Nordea Denmark, Jyske and Sydbank reported numbers. Assumed that other branches declined at the same pace as the average of top 4 banks (c9%).

Danish mortgage margins, historically been among the lowest in the world, due to low credit risk and an efficient funding market, are moving up rapidly in the past couple of years

Realkredit (Danske) raised corporate loan spreads c15bps 1Q12-1Q13 and more is likely in 2014-15: each 10bps increase in corporate mortgage spreads adds c2% to group pre-tax profits

Figure 18. Realkredit Lending Spread



Source: Company Reports

A 20-25bps price increase for Danske Bank's corporate mortgages would add c5% to group profits

Better Margins: Mortgages & Corporate

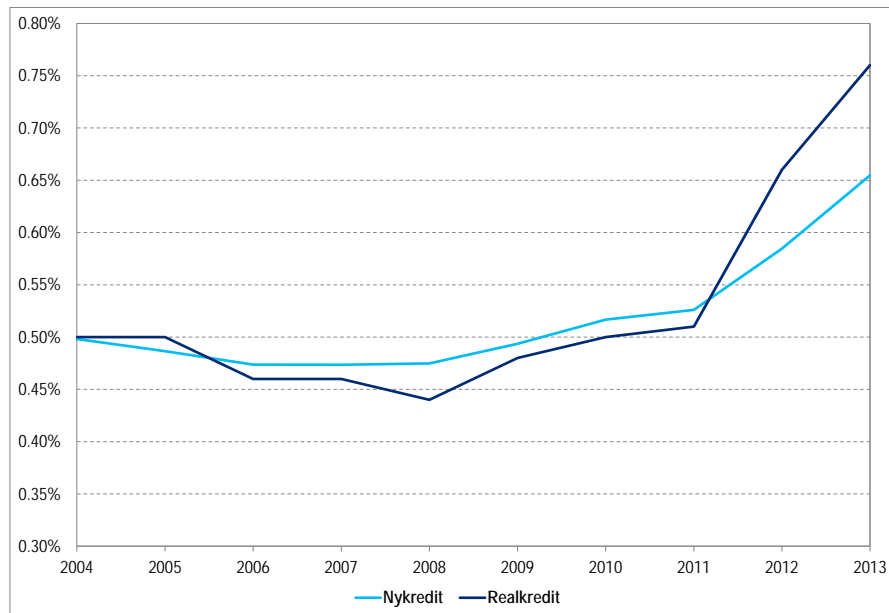
Danish mortgage margins have historically been around 50 basis points but in the past few years have increased sharply. Between 2011 and 2013, we calculate that Realkredit (Danske Bank's mortgage subsidiary) has increased their lending spread from c50bps to c75bps and Nykredit (the largest mortgage lender in Denmark) has increased their spread from c52bps to c65bps.

We see further mortgage spread increases in Denmark as likely led by Nykredit, given its leading position in mortgages and management's stated focus on raising profitability and capital ratios. We would expect Realkredit to follow any Nykredit price increases on household mortgages, albeit residential loan pricing will probably only increase slowly given both leading mortgage lenders' desire to protect their client franchises and (for Danske Bank) rebuild their public profile.

In the short term, we would expect Danske Bank to be more active in leading re-pricing for corporate mortgages given the lower political and media focus on this loan portfolio. Of Realkredit's DKr731 billion loan portfolio (at fair value), residential mortgages account for 58%, corporate and other 42%. Danske Bank management believe there is "quite a lot of re-pricing potential" in the corporate Realkredit book.

Increasing spreads by 10bps across the Realkredit corporate and other (non-home loan) segments would add approximately DKr300 million or 2% additional pre-tax profit. As set out in Figure 21. Danske and Nykredit ROE Sensitivity to Mortgage Lending Margin on the left, Realkredit's corporate lending spread increased c15bps from 1Q12 to 1Q13 and has subsequently trended sideways. During 2014, we expect the corporate spread to resume its upward trend.

Figure 19. Lending Spread of Danish Mortgage Banks



Source: Company Reports and Citi Research Estimates

Danske Bank has not given any public indication of how much or how fast it will seek to further increase commercial mortgage pricing but as they managed to raise spreads c15bps over the course of a year from 1Q12, we would expect the total re-pricing potential to be several tens of basis points over the coming years.

Nykredit's share of total Danish lending increased from 26% in 2008 to 32% in 2013 – in mortgages, Nykredit has a dominant 43% market share. And this market leader wants to improve spreads.

Nykredit and the Need to Raise Prices, Profitability and Capital

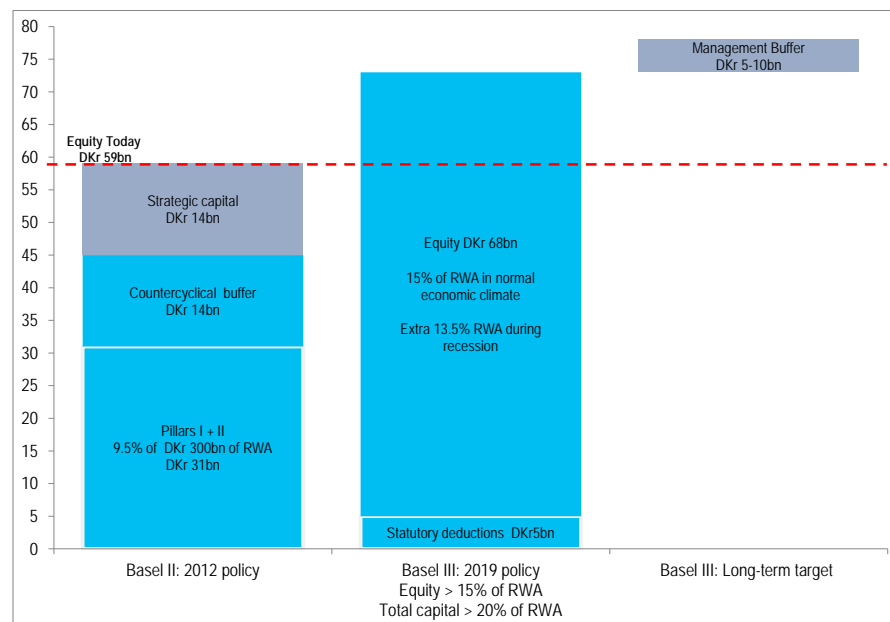
Nykredit was established as a mortgage bank in 1851 and is today still the largest Danish mortgage lender (43% market share). Nykredit is also the largest domestic Danish lender overall given the weight of mortgages in total lending in the country and also their balance sheet growth during the recent crisis years when peers, such as Danske Bank, grew at a slower speed. Management of Nykredit have a stated ambition of evolving towards being a full service financial institution, not just a mortgage factory for other banks.

Nykredit has a mutual ownership structure. About 90% of Nykredit Holding is owned by Foreningen Nykredit and the remaining 10% by 3 minority shareholders. As it is a mutual, Nykredit has historically not been run as a profit-maximising institution. During 2009-13, the average ROE (excluding discontinued insurance operations) was c3% for Nykredit. Over the same period, Nykredit increased its lending by DKr181 billion whereas the rest of the Danish financial sector reduced its lending by DKr242 billion.

While Nykredit remains a mutual, its equity requirement going forward is increasing due to regulatory change. At end 2013, Nykredit had DKr59 billion of equity capital, DKr14 billion in excess of the required regulatory minimum under Basel II. From 2019, the group's Basel III requirement would be DKr68 billion of equity capital (equity @ 15% of RWA = DKr61 billion plus another 13.5% increased RWAs in recessions) as well as another DKr5-10 billion for operations, growth and regulatory changes.

Nykredit, based on their own disclosure, aims to increase their current equity capital of DKr59 billion by one-third in order to meet Basel 3 requirements

Figure 20. Nykredit – Capital Position Today vs Target



Source: Company Reports

How will Nykredit fill the DKr15-20 billion gap between current and required equity capital levels? Their new CEO Michael Rasmussen, formerly from Nordea, has a "Nykredit 2015" strategy to boost profits. With full effect from 2016, core revenues are to be increased by DKr1.0 billion, mainly from cross-selling more to Nykredit clients and mortgage re-pricing, and costs are to be reduced by DKr0.5 billion. Secondly, the group intends to also issue equity in the form of AT1 or CoCos.

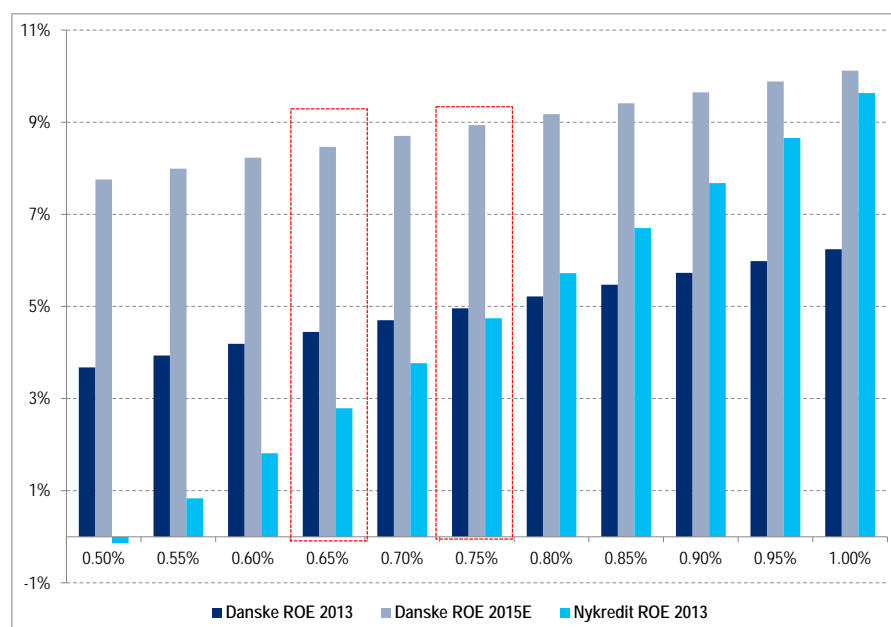
Sensitivity To Higher Mortgage Margins

In the last 2 years, the two Danish mortgage lenders have boosted their mortgage margins by c15-25 basis points and based on their profitability objectives, there is more to come. We would expect Nykredit, currently at c65bps mortgage margin, to look to increase their spread further. If we assumed a long-term spread closer to c100bps, similar to Swedish mortgage margin levels, this would transform the profitability of Nykredit: raising 2013's ROE from 3% to almost 10%, albeit this declines to c7.5% ROE due to higher capital requirements under Basel III.

Realkredit would also benefit materially from an increase in mortgage margins to c100bps from its current c75bps: all else equal this would increase Realkredit 2013 profits by c50%). Danske's group profits would also increase, albeit not as much as for its mortgage subsidiary: a 25bps mortgage margin increase would boost group profits by 18% for 2013 and a smaller 12% for 2014E (the lesser impact for 2014 is due to a higher base given expected improved pre-provision profits and lower loan loss provisions).

Should Nykredit increase their mortgage margins from c65bps to c100bps over the long term, this would boost their ROE by 3x pre-higher capital requirements

Figure 21. Danske and Nykredit ROE Sensitivity to Mortgage Lending Margin



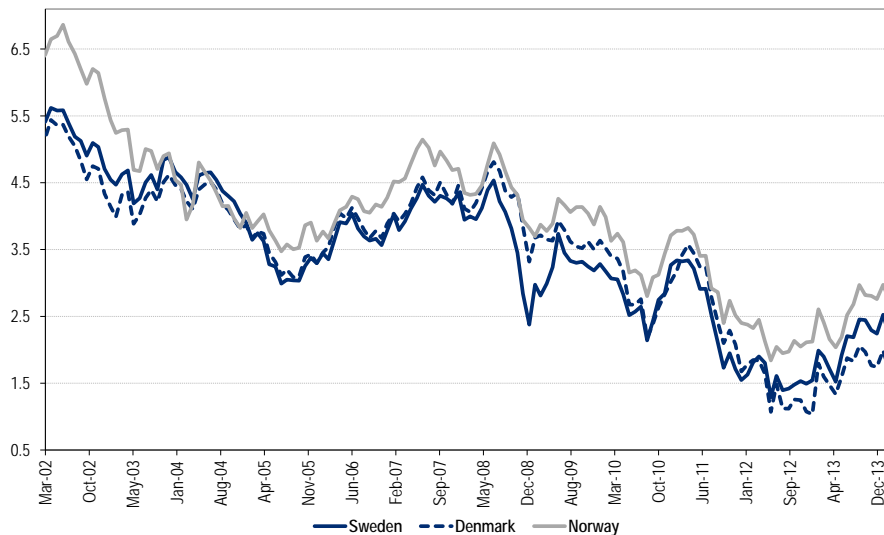
Source: Company Reports and Citi Research Estimates

Danish Discount: Funding & Capital Costs

Denmark's sovereign is very highly rated but its banks have been much less so in the past few years, hurting profitability and valuation

Denmark is a AAA-rated sovereign with a low cost of borrowing. Throughout the recent crisis years, Danish 10-year benchmark bond yields have traded broadly in-line with Sweden and over the past year or so traded at a lower yield (eg premium valuation) relative to Swedish benchmark 10 year bonds. However, despite the Danish sovereign's low funding costs, its banks have been in a tougher spot. The higher Danish bank industry risk premium has weighed on both net interest income, via relatively elevated funding costs, and a potentially higher equity risk premium.

Figure 22. Nordic Countries 10Y Benchmark Yield

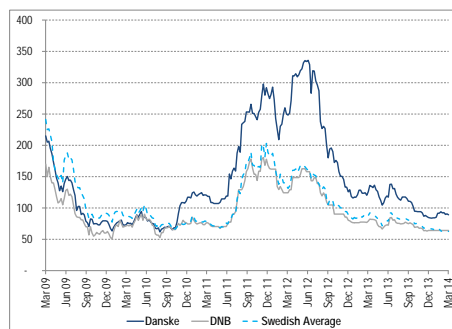


Source: DataStream

Danske Bank's CDS spreads widened significantly relative to Swedish banks from late 2010 through 2012, before subsequently narrowing rapidly

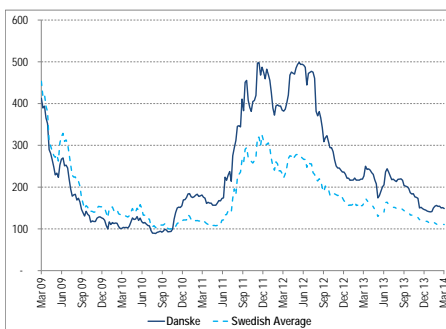
During 2009 and up to 3Q10, Danske Bank CDS spreads traded tighter than the Swedish banks on average. From 3Q10 onwards, Danske Bank risk premium widened materially. Danske Bank's CDS premium relative to the Swedish banks' average peaked in 2Q12 at 160bps for senior debt and as high as almost 250 bps for subordinated debt. This Danish discount has largely reversed in the past year or so and during 2013, especially in 2H13, the Danish premium relative to the Swedish banks tightened to c20-40bps.

Figure 23. Danske 5Y Senior CDS Spread vs DNB and Swedish Average



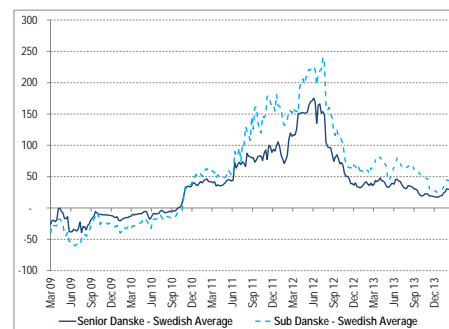
Source: DataStream

Figure 24. Danske 5Y Sub CDS Spread vs Swedish Average



Source: DataStream

Figure 25. Difference of Danske 5Y CDS Spread vs Swedish Average



Source: DataStream

Danske Bank: Falling Cost of Funding and Capital

Danske Bank recently issued AT1 at a 5.75% coupon, better than expectations and cheaper than similar instruments issued by other EU banks; the AT1 cost is booked directly to equity, not via NII

As a result of the improved investor interest in Danske Bank, the group, like many other European peers, has been able to successfully issue AT1 capital recently. The issue was completed with considerable investor interest, with demand of €13bn from 700 investors. Driven by the high level of demand, Danske was able to tighten guidance on its €750m deal to 5.75%, tighter than the early 6% expectation. Note that the cost of the AT1 coupon will be charged directly to equity and not via NII.

Figure 26. Recent Hybrid Issuance- AT1

Issuer	ISIN	Issuer Date	Maturity	Ccy	Cpn	Reset	Amount (mn)	Coupon language	Basis of Trigger	Loss Absorption Mechanism	Trigger	Reg Call / Cap. event
Danske	XS1044578273	05-Mar-14	Perp-20		5.75%	6yr € m/s + 464bps	750	Fully opt.	B3 (Transitional) CET1 / RWAs	Temporary principal write-down	B3 Transitional CET1 <7%	Par
Santander	XS1043535092	05-Mar-14	Perp-19		6.25%	5yr€ m/s + 541bps	1,500	Fully opt.	B3 (Transitional) CET1 / RWAs	Full Conv. Into Equity	B3 Transitional CET1 (Grp or Bk) <5.125%	Par
BBVA	XS1033661866	11-Feb-14	Perp-19		7.00%	5yr€ m/s + 615.5bps	1,500	Fully opt.	B3 (Transitional) CET1 / RWAs	Full Conv. Into Equity	B3 Transitional CET1 <5.125%	Par
ACAIFP	XS0989394589	15-Jan-14	Perp-24	\$	7.88%	5y\$ m/s +489.8	1,750	Fully opt.	B3 (Transitional) CET1 / RWAs	Temporary principal write-down	Transitional CET1 <5.125% (S.A.) or CET1 <7% (Group)	Current Principal Amount=100
SocGen		11-Dec-13	Perp-23	\$	7.88%	5y\$ m/s +503.6	1,750	Fully opt.	B3 (Transitional) CET1 / RWAs	Temporary principal write-down	B3 CET1 <5.125%	Current Principal Amount (CPA)
Credit Suisse	XS0989394589	04-Dec-13	Perp-23	\$	7.50%	5y\$ m/s +459.8	2,250	Opt. - incl. divi. stopper	B3 (Transitional) CET1 / RWAs	Full Permanent Writedown	CET1 + high trigger instruments <5.125% or non-viability	103
Barclays	XS1002801758	03-Dec-13	Perp-20	€	8.00%	5y€ m/s +675	1,000	Fully opt.	B3 (fully loaded) CET1 / RWAs	Full Conv. into Equity and/or cash	B3 fully loaded CET1 <7.00%	Par
Barclays	US06738EAA38	13-Nov-13	Perp-18	\$	8.25%	5y\$ m/s +670.5	2,000	Fully opt.	B3 (fully loaded) CET1 / RWAs	Full Conv. Into Equity &/or cash	B3 fully loaded CET1 <7.00%	Par
Banco Popular	XS0979444402	03-Oct-13	Perp-18	€	11.50%	5y€ m/s +1,023.7	500	Fully opt.	B3 (Transitional) CET1 / RWAs	Full Conv. into Equity	B3 CET1 <5.125%, T1<6% AND Bank/Group losses 4MRQs AND Capital+Reserves down by 1/3rd	Par
SocGen	XS0867614595	29-Aug-13	Perp-18	\$	8.25%	5y\$ m/s +639.4	1,250	Fully opt.	B3 (Transitional) CET1 / RWAs	Temporary principal write-down	B3 fully loaded CET1 <5.125%	CPA
BBVA	XS0926832907	26-Apr-13	Perp-18	\$	9.00%	5y\$ m/s +826.2	1,500	Fully opt.	CET1 / Capital Principal / EBA CT1 / T1 Ratio	Full Equity Conv.	1) CET1 < 5.125%; 2) EBA CT1 < 7.0% 3) Cap. Principal < 7.0% 4) T1 < 6.0%	Par

Source: Bond Prospectuses, Citi

The issuance of AT1 capital is, for now, the final part of the pre-funding for Danske Bank to repay its DKr24 billion state hybrid capital during 2Q14. There is a one month "call window" starting on 11 April. All else equal, the repayment by Danske of the state hybrid capital would add DKr1 billion to NII, equivalent to c5% of 2013 group NII. The coupon is 9,765% but the swapped cost for Danske Bank is a lower 6,67% or DKr1,600m per annum.

The replacement of Danske Bank's state hybrid capital has been completed by a number of Lower Tier 2 capital issues in Scandinavian currencies and the Swiss Franc, with an average cost of +254bps above 3m Euribor. These LT2 issues were done in 2H13 and amounted to about DKr6.5 billion. Along with the March 2014 AT1 issue, Danske Bank has effectively raised DKr12 billion of private capital to replace 2x that amount of State hybrid capital — that also had a higher coupon.

Danske Bank's reduced risk premium and wholesale funding costs should also feed through to reduced client funding costs. During the 2011-12 financial crisis years, it is likely the group would have paid a premium for client funding relative to other top Nordic banks, such as a Nordea or a Svenska Handelsbanken. As risk premia have dropped in general, and also specifically for Danske Bank, we would expect to see the cost of institutional and corporate client deposits to continue to drop.

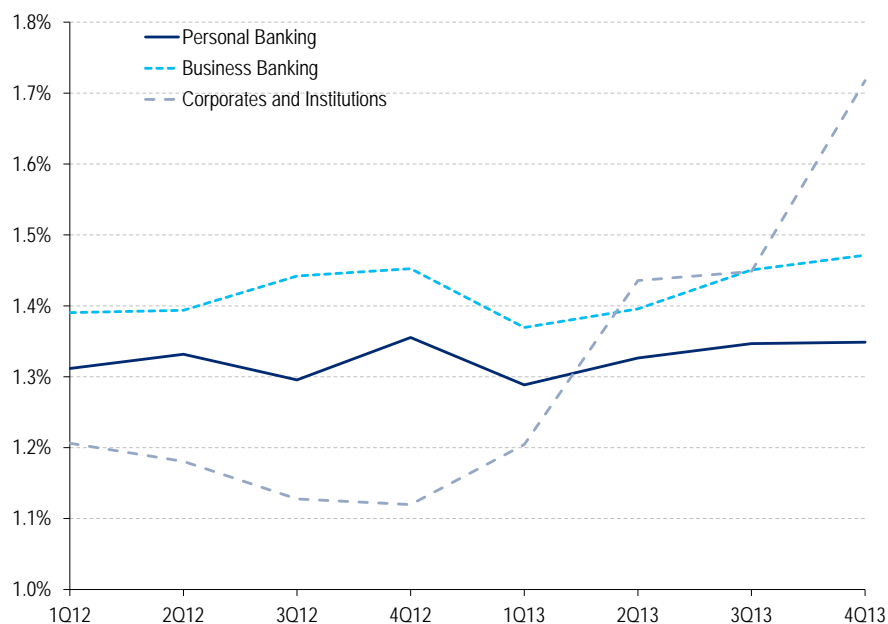
Margins – Divisional Trend

Danske's margin trended up in all business segments in FY13 with the C&I business leading the re-pricing. C&I business had the lowest margin of 1.2% at 1Q12, c10bps below Personal Banking margin and 20bps below Business Banking. In 2013, Danske was able to re-price some of its C&I deposit portfolio and it also benefitted from deal-related NII, especially in 4Q13.

Part of the increase in divisional NII during 2013 across all segments was due to internal allocation timing issues – interest expense was charged to the Treasury unit that will get allocated out to the business units during 2014.

We believe that there is scope to further increase the C&I spread by re-pricing loans during 2014, based on management comments.

Figure 27. Danske Bank – NII/Avg Loans by key Divisions (1Q12-4Q13)



Source: Company Reports, Citi Research

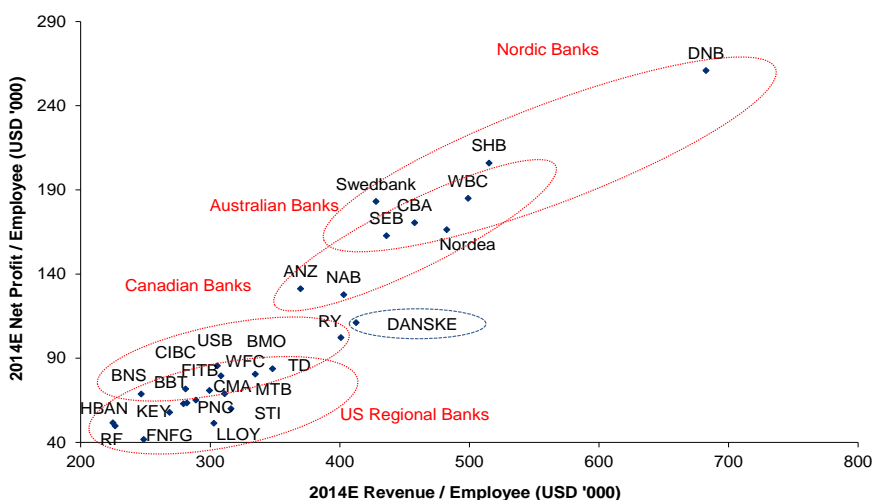
Fixing Danske Costs and Productivity

Danske Bank screens poorly relative to Nordic banks when we measure profitability and revenue on a per employee basis. It also lags all four major Australian banks on a profit/employee basis but interestingly it is ahead of ANZ and NAB on a revenue/employee basis.

However, even with its expected relatively low level of expected 2014E profitability (ROE 7.9%), we forecast Danske's per employee productivity metrics to exceed all North American regional and commercial banks in our peer group. However, on a cost/income ratio basis many leading US and Canadian banks handily outperform.

Danske's has poor revenue and profit per employee metrics relative to other high labour cost Nordic countries – SEB and Swedbank's revenues/employee is c10% higher, Nordea is c25% higher

Figure 28. 2014E Revenue / Employee and Net Profit / Employee by Bank

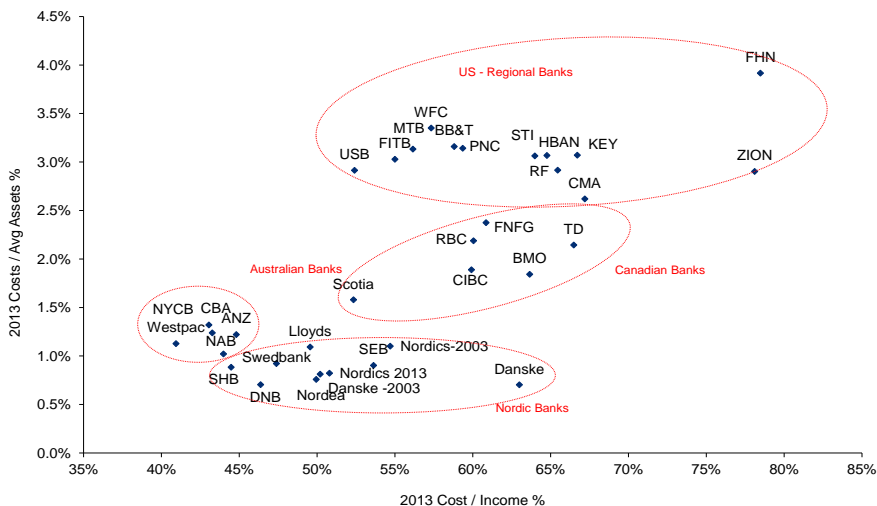


Source: Citi Research; Company Reports; Note: Headcount data used for Nordic banks 4Q13, for Australian and Canadian banks 2Q13 and for US banks 1Q13.

In 2003, Danske Bank had the second best (eg lowest) cost/income ratio among the Nordic banks — only Svenska Handelsbanken was better. Danske Bank also had a lower cost/income ratio in 2003 relative to all the larger Australian, Canadian and US regional banks. By 2013, Danske had fallen a long way: its cost/income ratio was worst amongst all the Nordic peers.

Danske's 2013 cost/income ratio lags all Nordic and Australian peers — half of the relatively inefficient North American banks also outperform Danske

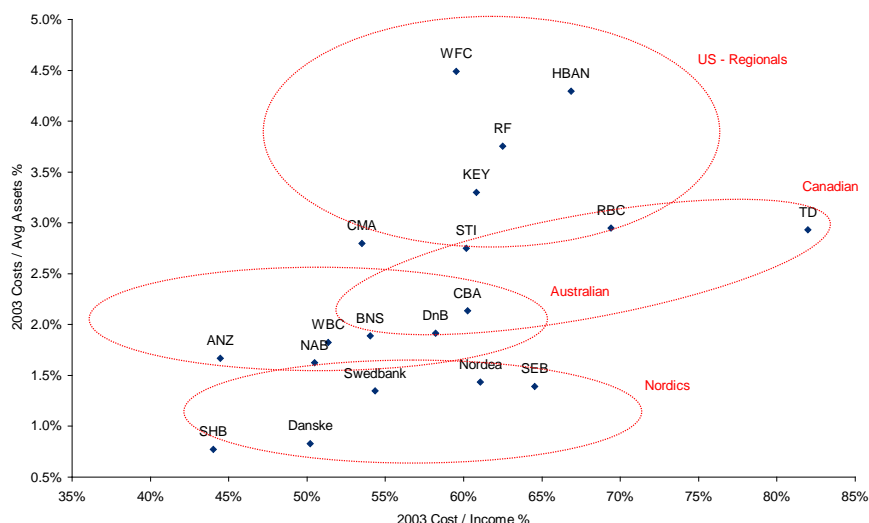
Figure 29. Danske 2003& 2013 Cost/Income vs Cost to Avg Assets by Bank



Source: Citi Research, Company reports

Danske had one of the best cost/income ratios in 2003 – only SHB was better in Scandinavia while regional and many global peers lagged far behind

Figure 30. 2003 Cost / Income vs Cost to Avg Assets by Banks



Source: Citi Research, Company Reports

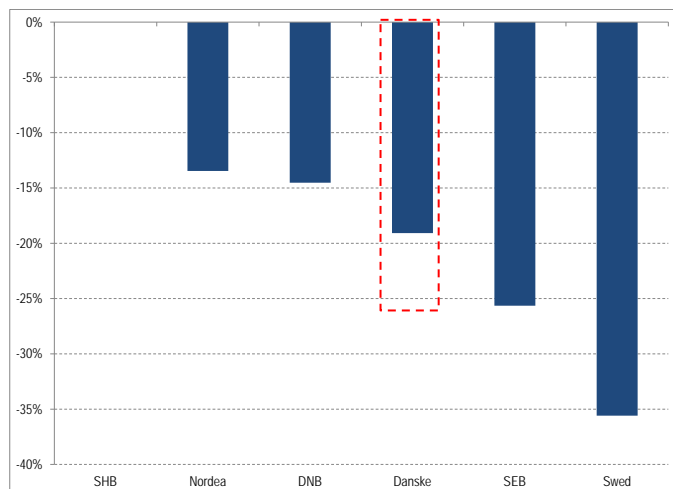
Danske ranks middle of its peer group for FTE reduction from peak levels and lead the Nordic peers in absolute branch reductions from peak.

Headcount versus Branch Reductions

While most Nordic banks, like their European peers have been active in cutting costs through branch and headcount (FTE) reductions, trends have varied. Danske Bank leads the Nordic peers for branch reductions. It has aggressively reduced its number of branches by almost 60% from its peak in 2007, similar to SEB at 57% (albeit the latter includes business divestments as well as organic reduction).

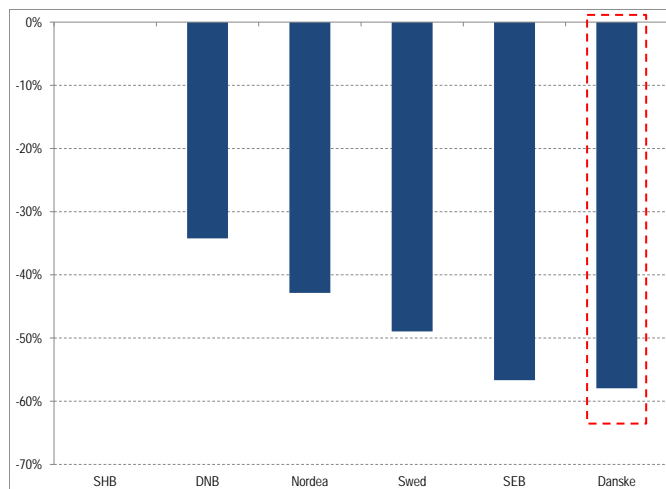
However, Danske Bank only ranks in the middle of the peer group for FTE reduction from peak levels. Danske's total FTEs peaked in 2008 at 23,624 and declined 19% by end-2013. By contrast, Swedbank's FTE's are down 36% from its 2008 peak and SEB is down 26%. DNB, a bank that has enjoyed a much better economic and profit environment relative to Danske, has reduced almost as much headcount from peak levels as its more challenged Copenhagen headquartered cousin.

Figure 31. Nordic Banks – FY13 Number of FTE From Peak Level



Source: Company Reports

Figure 32. Nordic Banks – FY13 Number of Branch From Peak Level



Source: Company Reports

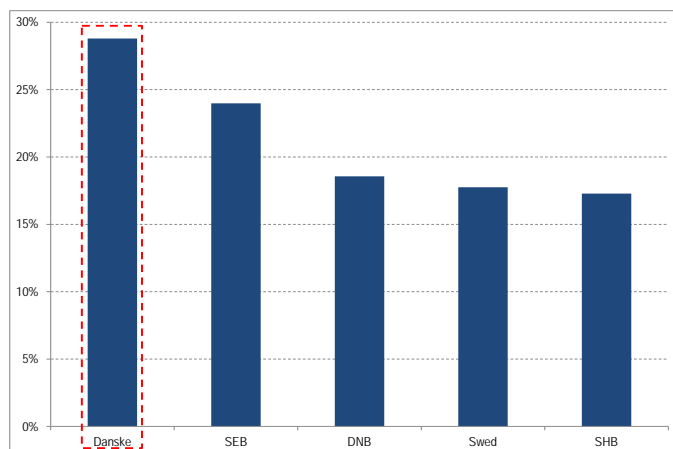
Danske has the highest number of employees in group functions relative to Nordic banks. A new American COO from outside banking is being brought in to accelerate efficiency gains

A possible reason for the relatively higher costs at Danske, and lower headcount versus branch reduction, is an over-staffed corporate centre/group function. The proportion of employees in group functions is highest at Danske relative to Nordic peers. Danske has almost 29% of its employee base in group functions compared to 17% of SHB and 18% for Swedbank at 2013-end.

Some of the difference in the size of Nordic banks' group functions may be due to different external reporting formats. However, Danske has been actively trying to right size this aspect and has seen the largest (21%) decline in group function employee base from its peak vs other Nordic peers and there is clearly more to come on this front.

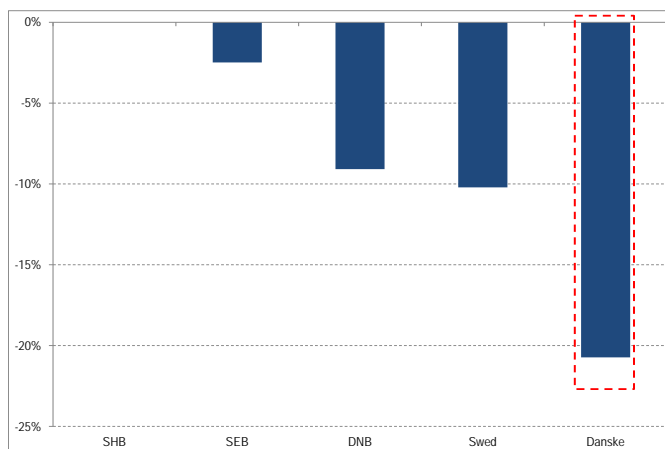
On 7 March 2014, Danske announced the appointment of a new Group COO Jim Ditmore, who was the Chief Technology Officer at Allstate Insurance, headquartered in Chicago. Appointing an outsider — an American insurance executive to work in a Copenhagen-headquartered banking group — we see as a signal of Danske's aspiration to rethink operational and IT fundamentals.

Figure 33. Nordic Banks – FY13 FTE in Group Functions % Total FTEs



Source: Company Reports; Danske's Group Functions FTE is from reporting segment Other; DNB is from support functions and operations; SEB is from business support; SHB is from division Other; Swed is from Total Group Functions

Figure 34. Nordic Banks – FY13 FTEs in Group Function From Peak



Source: Company Reports; Danske's Group Functions FTE is from reporting segment Other; DNB is from support functions and operations; SEB is from business support; SHB is from division Other; Swed is from Total Group Functions

Headline 2013 costs of DKr24.3bn are about DKr23bn excluding restructuring costs; management appear confident of meeting their 2015 cost target of "below DKr23bn"

Danske has guided to 2015 costs of "below DKr23 billion" in 2015E. Headline costs in 2013 of DKr24.3 billion included severance payment of DKr0.8bn and branch closure charges of DKr0.5bn (Citi estimated). Excluding these costs, underlying costs are already at DKr23bn. Further severance payments are likely during 2014-15 but the underlying costs should also decline along with average FTE declines.

Figure 35. Danske – Adjusted Expenses FY2012-13

	2013	2012
Expenses	24.3	24.6
Severance payments	0.8	0.7
Rebranding		0.2
Estimated Branch closure expenses	0.5	
Write down, rights to names *		0.5
Adjusted Expenses	23.0	23.2
Adjusted costs/income ratio (%)	57.5	50.8
Cost/income ratio (%)	60.7	53.9

Source: Company Reports; * Expenses for 2012 include a charge of DKK 0.5 billion related to name rights because of the rebranding of Sampo Bank as part of the Group's decision to market all its banking operations under the Danske Bank brand name. Branch closure expenses is estimated based on the difference between FY13 and FY12 other expenses (DKK 6.5bn vs DKK 6.0bn)

"No Sacred Cows"

Management have said there are "no sacred cows" — we think Danske should unwind the recent mistakes: exit all of Ireland, sell Baltics and divest Nordic retail banking outside Denmark

Danske Bank has expanded via a series of acquisitions, initially at home in Denmark, from the late 1990s increasingly in neighbouring Nordic countries and then the coup de grace of expanding into Ireland (acquisition announced late 2004, completed 2005). We believe that the new management of Danske Bank should take the group back to its core business: Danish banking, supplemented with a pan-Nordic corporate and investment banking franchise. Following the announcement in 3Q13 that all of Ireland, including Retail, has been designated non-core, we believe that other non-Nordic businesses (for example Northern Ireland) will be divested.

Figure 36. Danske Bank – Major M&A Activities

1990	Den Danske Bank creation via 3-way Danish bank merger
1995	Sale of Baltica Forsikring, 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 (Finland, Baltics)

Source: Company Reports

We believe that Danske Bank should focus on Danish universal banking and pan Nordic corporate and investment banking

Danske Bank remains a leading bank in its original home market with about 30% market share for both loans and deposits. However, outside Denmark the group has relatively low market shares, typically in the single digits. Retail banking is usually a domestic business, with lower cross-border synergies than wholesale banking, and earning competitive returns is usually difficult with low market shares. We believe that Danske Bank can operate a credible pan-Nordic corporate and investment banking franchise built around offices in the major Nordic cities but we don't think they should invest in its small Retail/SME franchises outside Denmark.

Figure 37. Danske Market Share Across Countries

	Denmark	Finland	Sweden	Norway	N. Ireland	Ireland	Estonia	Latvia	Lithuania
Lending Market Share	27%	10%	5%	4%	20%	4%	7%	2%	6%
Deposits Market Share	28%	11%	5%	6%	na	2%	14%	1%	6%
Branches	159	45	39	32	53	0	13	1	12

Source: Company Reports; Deposit Market Share for Ireland, Estonia, Latvia and Lithuania is as of FY12.

Nordea has double-digit market shares in all four Nordic countries and in 3 of the 4 is a number one or two bank — Danske is big in Denmark, small elsewhere

Benchmarking to Nordea

Nordea is a marked contrast to Danske Bank. Nordea's pan-Nordic franchise has a relatively high market shares in all four core Nordic markets, with a particularly strong market share in Finland and Denmark and a competitive position in Sweden and Norway. Not surprisingly, Nordea's profitability in its four core Nordic markets is stronger than Danske's: in three of the four countries, Nordea has a 20%+ pre-tax ROE on allocated capital. On cost/income ratios, the comparison is less clear cut: Danske and Nordea have similar CIRs in Denmark, Nordea is better in Finland and Norway but (surprisingly) weaker in Sweden.

Figure 38. Nordea Market Share Across Countries, 2013

	Denmark	Finland	Norway	Sweden	Estonia	Latvia	Lithuania	Russia
Loans:								
Household Mortgage Lending	17%	30%	11%	15%	15%	19%	12%	<1%
Consumer Lending	20%	31%	7%	8%	9%	2%	10%	<1%
Corporate Lending	24%	35%	13%	14%	22%	17%	13%	1%
Deposits:								
Household Deposits	23%	30%	8%	16%	6%	6%	3%	<1%
Corporate Deposits	27%	43%	12%	16%	13%	8%	11%	1%

Source: Company Reports

Figure 39. Danske Profitability By Country

FY 2013										
(DKK millions)	Personal Banking + Business Banking								Non Core	Total
	Denmark	Finland	Sweden	Norway	N.Ireland	Ireland	Baltics	Other		
Total income	17,186	3,525	2,692	2,918	1,737	247	814	(277)	121	28,963
GOP*	7,837	510	1,359	1,183	604	(85)	411	(241)	(182)	11,396
Loan impairment charges	3,082	1	31	352	434	76	(242)	(19)	1,233	4,948
Profit Before Tax*	4,506	483	1,258	787	161	(153)	618	(210)	(1,415)	6,035
Loans and advances	911,295	141,600	174,618	119,832	49,311	17,411	18,500	5,505	36,211	1,474,283
Deposits ,end of period	282,731	91,871	78,567	70,436	52,922	11,401	21,561	4,809	4,885	619,183
Allocated capital*	45,504	7,030	10,871	7,105	2,340	1,125	1,354	610	8,567	84,506
Pretax RoE	9.9%	6.9%	11.6%	11.1%	6.9%	-13.6%	45.7%	-34.5%	-16.5%	7.1%
LLR	0.34%	0.00%	0.02%	0.29%	0.88%	0.44%	-1.31%	-0.35%	3.41%	0.34%
C/I	54.4%	85.5%	49.5%	59.5%	65.2%	134.5%	49.5%	13.0%	250.4%	60.7%

FY 2012										
(DKK millions)	Banking Activities								Non Core	Total
	Denmark	Finland	Sweden	Norway	N.Ireland	Ireland	Baltics	Other		
Total income	16,997	3,516	3,478	3,111	1,712	507	761	507	402	30,991
GOP	7,751	509	1,756	1,261	595	(175)	384	441	162	12,684
Loan impairment charges	3,918	366	414	219	1,425	661	(431)	64	4,921	11,557
Profit Before Tax	3,833	143	1,342	1,042	(830)	(836)	815	377	(4,759)	1,127
Loans and advances	953,487	152,178	184,000	141,463	45,509	24,046	18,576	17,394	29,359	1,566,012
Deposits ,end of period	292,283	100,877	77,625	68,198	50,769	22,563	19,910	7,189	642	640,056
Allocated capital	44,709	7,095	10,757	7,876	2,028	1,459	1,277	1,809	1,347	78,357
Pretax RoE	8.6%	2.0%	12.5%	13.2%	-40.9%	-57.3%	63.8%	20.8%	-353.3%	1.4%
LLR	0.41%	0.24%	0.23%	0.15%	3.13%	2.75%	-2.32%	0.37%	16.76%	0.74%
C/I	54.4%	85.5%	49.5%	59.5%	65.2%	134.5%	49.5%	13.0%	59.7%	59.1%

Source: Company Reports and Citi Research Estimates; *Estimated numbers. FY2013 GOP is estimated assuming same C/I ratio as FY12; Profit Before Tax equals to GOP + Loan impairment charges; Allocated capital has grown in proportion to loan growth. Both Profit Before Tax and allocated capital are adjusted with a factor so that the total matches with reported numbers.

Nordea has 20%+ pre-tax ROEs in three of the four Nordic countries, Danske has 7%-12% pre-tax ROEs in these countries

Figure 40. Nordea Retail Banking Profitability By Country

(EUR millions)	Denmark	Finland	Sweden	Norway	Baltics
Total income	1,514	1,111	1,528	1,063	172
GOP	718	466	657	598	88
Loan impairment charges	310	57	53	22	23
Profit Before Tax	408	409	604	576	65
Loans and advances	65	48	65	44	9
Deposits, end of period	32	31	34	18	4
Allocated capital	2,981	1,956	2,758	2,407	676
Pretax RoE	13.7%	20.9%	21.9%	23.9%	9.6%
LLR	0.48%	0.12%	0.08%	0.05%	0.27%
C/I	52.6%	58.1%	57.0%	43.7%	48.8%

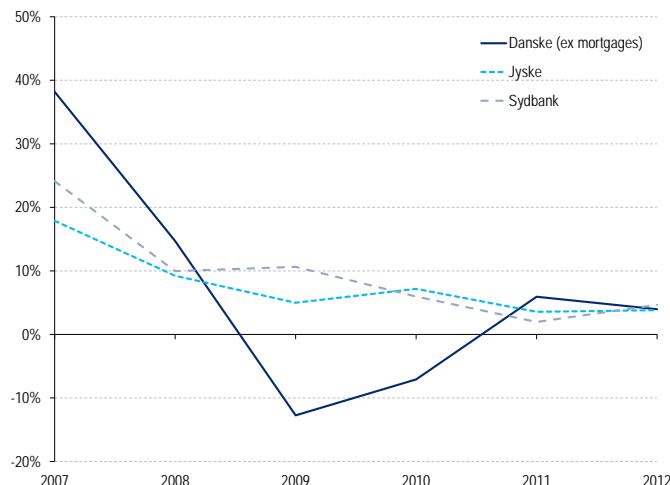
Source: Company Reports

Benchmarking to Local Peers

Danske Bank's Danish banking business had a larger downturn than local peers such as Jyske Bank and Sydbank in the 2009-10 downturn but by 2011 returns at all the larger Danish banks had begun to converge. Driven by declining loan losses as the Danish economy and housing market improves, Danske's Danish ROEs should improve further in 2013-14 relative to the 2009-12 period. Danske Bank's Sweden and Norway businesses are similar profitability to their Danish business but are low return versus Nordea.

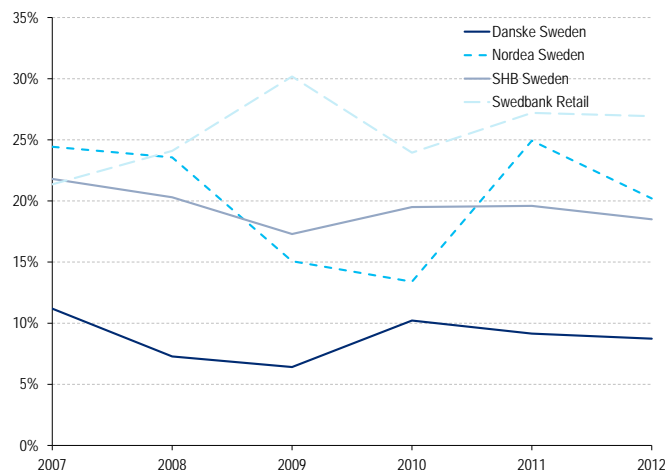
In Sweden, the best-in-class retail banks such as Swedbank or SHB have ROEs twice as high as Danske Bank. Given that SEB has historically been smaller in retail banking and this remains a growth focus, and this division is also co-incidentally run by the former Head of Danske's Swedish operations, we believe that SEB may be interested should Danske consider carving out and selling its Swedish retail bank.

Figure 41. Danske Denmark vs Peer ROEs



Source: Citi Research, Company Reports; 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; ROE of Danske Denmark ex Mortgage is calculated based on Pretax ROE assuming 30% tax rate. Adjusted for 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.

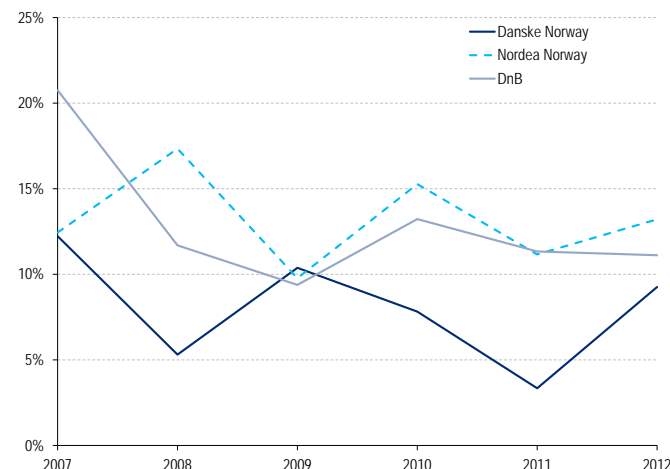
Figure 42. Danske Sweden vs Peer ROEs



Source: Company Reports, Citi Research Estimates

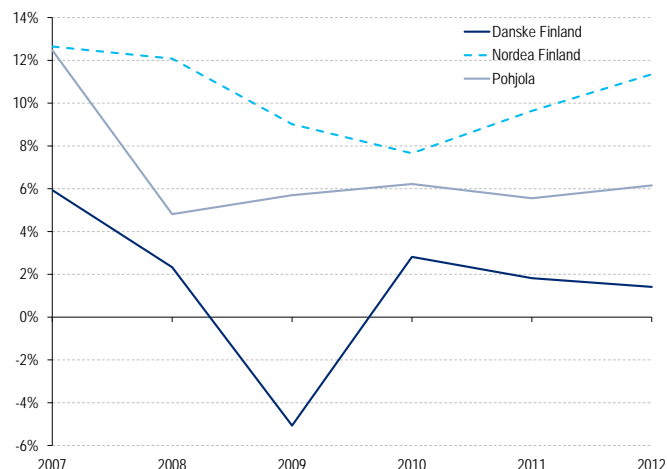
Danske Sweden is based on Banking Activities Sweden (2007-2009) or Retail Banking Sweden (2010-2012) segment reported; Nordea Sweden is based on Nordea's Sweden Banking segment; SHB Sweden is based on Banking Sweden. Swedbank Retail is the Swedish Banking segment (04-07) or Retail segment (08-12) of Swedbank. ROE of Danske Sweden and SHB Sweden is calculated based on Pretax ROE assuming 30% tax rate.

Figure 43. Danske Norway vs Peer ROEs



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.

Figure 44. Danske Finland vs Peer ROEs



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 and includes goodwill amortisation costs..

Our updated Danske Bank group and divisional forecasts are set out overleaf.

Figure 45. Danske Bank — Group Profit and Loss Account, 2011-16E (DKr in Millions)

	2011	% Chg	2012	% Chg	2013	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg
Net interest income	23,537	-1%	24,788	5%	22,245	-2%	23,479	6%	24,453	4%	25,375	4%
Net fee income	8,298	-2%	8,782	6%	9,525	7%	10,254	8%	10,646	4%	11,182	5%
Net trading income	7,325	-8%	8,901	22%	5,818	-45%	7,101	22%	7,447	5%	7,811	5%
Insurance Income	569	NM	2,263	298%	1,088	-50%	1,624	49%	1,717	6%	1,824	6%
Other Income	3,648	-5%	2,951	-19%	1,329	3%	1,400	5%	1,457	4%	1,516	4%
Total income	43,377	-6%	47,685	10%	40,005	-12%	43,859	10%	45,719	4%	47,707	4%
Operating expenses	-25,987	0%	-26,588	2%	-24,344	-1%	-23,404	-4%	-22,610	-3%	-22,360	-1%
Operating Income	17,390	-14%	21,097	21%	15,661	-25%	20,455	31%	23,109	13%	25,347	10%
Prov. loan losses (Net)	-13,185	-5%	-12,529	-5%	-4,187	-45%	-3,030	-28%	-2,786	-8%	-2,250	-19%
Profit before tax, Non-Core	0		0		-1,415		-1,140		-338		-52	
Income Before Tax	4,205	-35%	8,568	104%	10,059	18%	16,285	62%	19,985	23%	23,045	15%
Taxes	-2,482		-3,819		-2,944		-4,397		-5,396		-6,222	
- Implied Tax Rate	59%		45%		27.0%		27.0%		27.0%		27.0%	
Net Attributed Group Income	1,723	-53%	4,749	176%	7,115	51%	11,888	67%	14,589	23%	16,823	15%
Minority Interest	-11		-4		0		0		0		0	
Available Income to Shareholder	1,712	-53%	4,745	177%	7,115	51%	11,888	67%	14,589	23%	16,823	15%
Per Share Data (DKr)												
EPS	1.95	-60%	5.05	160%	7.11	41%	11.88	67%	14.58	23%	16.82	15%
OLD EPS	1.95		5.05		7.11		11.42		14.23		16.10	
Dividend	0.0	NM	0.0	0%	2.0	0%	4.0	100%	6.0	50%	8.0	33%
Payout ratio	0.0%		0.0%		28.1%		33.7%		41.1%		47.6%	
BVPS per share	135.7	-2%	138.0	2%	145.6	6%	155.5	7%	166.1	7%	176.9	7%
Tangible BVPS per share	111.6	3%	116.9	5%	125.0	7%	135.6	9%	147.0	8%	158.6	8%
Number of shares (avg)	879	16%	939	7%	1,001	7%	1,000	0%	1,000	0%	1,000	0%
Operating Ratios												
Net interest margin (Citi Calculation)	0.71%		0.72%		0.66%		0.73%		0.75%		0.76%	
Cost / income ratio	60%		56%		61%		53%		49%		47%	
Provision charge / customer loans (bps)	71		67		23		17		15		12	
ROA	0.05%		0.14%		0.21%		0.37%		0.45%		0.50%	
Return on Equity	1.5%		3.6%		5.0%		7.9%		9.1%		9.8%	
Return on Tangible Equity	1.8%		4.3%		5.9%		9.1%		10.3%		11.0%	
Capital Ratios (DKr in bn)												
Total capital	162	8%	174	8%	182	4%	194	7%	202	4%	211	4%
Tier 1 capital	145	16%	159	10%	162	1%	173	7%	182	5%	191	5%
Risk-weighted assets	906	7%	819	-10%	852	4%	852	0%	870	2%	893	3%
Total capital ratio (B2)	17.9%		21.3%		21.4%		22.7%		23.3%		23.6%	
Tier 1 ratio (B2)	16.0%		19.4%		19.0%		20.3%		20.9%		21.4%	
Fully Loaded B3 CT1	10.6%		12.5%		12.8%		13.8%		14.4%		15.0%	
Balance Sheet Summary (DKr bn)												
Lending - general public	1,847	0%	1,895	3%	1,791	-5%	1,791	0%	1,829	2%	1,877	3%
Total deposits	849	-1%	929	9%	939	1%	960	2%	984	2%	1,019	3%
Total assets	3,424	7%	3,485	2%	3,227	-7%	3,227	0%	3,294	2%	3,382	3%
Shareholders' equity	126	20%	138	10%	146	5%	156	7%	166	7%	177	7%

Source: Company Reports and Citi Research Estimates

Figure 46. Danske Bank — Divisional Profit and Loss Account, 2012-16E (DKr in Millions)

	2012	2013	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg
PERSONAL BANKING									
Net interest income	11,672	11,160	-4%	11,249	1%	11,587	3%	11,934	3%
Net fee income	3,730	4,250	14%	4,760	12%	4,903	3%	5,148	5%
Net trading income	819	659	-20%	758	15%	796	5%	836	5%
Other income	608	667	10%	700	5%	735	5%	772	5%
Net income from insurance	0	0	0%	0	0%	0	0%	0	0%
Total income	16,829	16,736	-1%	17,467	4%	18,021	3%	18,690	4%
Operating expenses	-12,430	-12,103	-3%	-11,740	-3%	-11,388	-3%	-11,160	-2%
Profit before credit losses	4,399	4,633	5%	5,728	24%	6,633	16%	7,530	14%
Credit loss expenses	-2,749	-1,935	-30%	-1,230	-36%	-1,236	0%	-1,050	-15%
Profit before tax	1,650	2,698	64%	4,498	67%	5,397	20%	6,480	20%
Loans	871,759	823,953	-5%	815,713	-1%	832,028	2%	848,668	2%
Cost/ Income	74%	72%		67%		63%		60%	
NII/ Loans	1.34%	1.35%		1.38%		1.39%		1.41%	
Provisions/ Loans	0.32%	0.23%		0.15%		0.15%		0.13%	
BUSINESS BANKING									
Net interest income	9,243	8,908	-4%	9,220	4%	9,496	3%	9,971	5%
Net fee income	2,149	1,937	-10%	1,995	3%	2,075	4%	2,179	5%
Net trading income	479	763	59%	649	-15%	674	4%	701	4%
Other income	481	497	3%	517	4%	538	4%	559	4%
Net income from insurance	0	0	0%	0	0%	0	0%	0	0%
Total income	12,352	12,105	-2%	12,380	2%	12,783	3%	13,410	5%
Operating expenses	-5,466	-5,574	2%	-5,463	-2%	-5,353	-2%	-5,300	-1%
Profit before credit losses	6,886	6,531	-5%	6,918	6%	7,430	7%	8,111	9%
Credit loss expenses	-3,825	-1,779	-53%	-1,400	-21%	-1,250	-11%	-1,000	-20%
Profit before tax	3,061	4,752	55%	5,518	16%	6,180	12%	7,111	15%
Loans	641,133	614,118	-4%	626,400	2%	645,192	3%	671,000	4%
Cost/ Income	44%	46%		44%		42%		40%	
NII/ Loans	1.44%	1.45%		1.47%		1.47%		1.49%	
Provisions/ Loans	0.60%	0.28%		0.23%		0.20%		0.15%	
CORPORATES & INSTITUTIONS									
Net interest income	1,918	2,306	20%	2,421	5%	2,542	5%	2,644	4%
Net fee income	1,118	1,218	9%	1,279	5%	1,343	5%	1,410	5%
Net trading income	8,341	4,894	-41%	5,628	15%	5,910	5%	6,205	5%
Other income	19	17	-11%	18	5%	19	5%	20	5%
Net income from insurance	0	0	0%	0	0%	0	0%	0	0%
Total income	11,396	8,435	-26%	9,346	11%	9,813	5%	10,279	5%
Operating expenses	-4,307	-4,588	7%	-4,359	-5%	-4,315	-1%	-4,315	0%
Profit before credit losses	7,089	3,847	-46%	4,988	30%	5,498	10%	5,964	8%
Credit loss expenses	-1,160	-473	-59%	-400	-15%	-300	-25%	-200	-33%
Profit before tax	5,929	3,374	-43%	4,588	36%	5,198	13%	5,764	11%
Loans	161,112	154,406	-4%	157,494	2%	162,219	3%	168,708	4%
Cost/ Income	38%	54%		47%		44%		42%	
NII/ Loans	1.19%	1.49%		1.54%		1.57%		1.57%	
Provisions/ Loans	0.72%	0.30%		0.26%		0.19%		0.12%	
DANSKE CAPITAL									
Net interest income	-25	-38	52%	-40	5%	-42	5%	-44	5%
Net fee income	1,945	2,186	12%	2,295	5%	2,410	5%	2,531	5%
Net trading income	-3	16	0%	17	5%	18	5%	19	5%
Other income	0	0	0%	0	5%	0	5%	0	5%
Net income from insurance	0	0	0%	0	0%	0	0%	0	0%
Total income	1,917	2,164	13%	2,272	5%	2,386	5%	2,505	5%
Operating expenses	-982	-1,033	5%	-1,043	1%	-1,054	1%	-1,085	3%
Profit before credit losses	935	1,131	21%	1,229	9%	1,332	8%	1,420	7%
Credit loss expenses	0	0	0%	0	0%	0	0%	0	0%
Profit before tax	935	1,131	21%	1,229	9%	1,332	8%	1,420	7%
Loans	211	296	40%	314	6%	333	6%	353	6%
Cost/ Income	51%	48%		46%		44%		43%	
NII/ Loans	-11.85%	-12.84%		-12.72%		-12.60%		-12.48%	
Provisions/ Loans	0.00%	0.00%		0.00%		0.00%		0.00%	

Source: Company Reports and Citi Research Estimates

Figure 47. Danske Bank — Divisional Profit and Loss Account, 2012-16E (DKr in Millions)

	2012	2013	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg
DANICA PENSION									
Profit before tax	2,171	1,088	-50%	1,624	49%	1,717	6%	1,824	6%
OTHER ACTIVITIES									
Net interest income	-30	-91	203%	629	NM	869	38%	869	0%
Net fee income	-76	-66	-13%	-75	14%	-85	13%	-85	0%
Net trading income	926	-514	-156%	50	NM	50	0%	50	0%
Other income	177	148	-16%	165	11%	165	0%	165	0%
Net income from insurance	0	0	0%	0	0%	0	0%	0	0%
Total income	997	-523	-152%	769	-247%	999	30%	999	0%
Operating expenses	-1,457	-1,046	-28%	-800	-24%	-500	-38%	-500	0%
Profit before credit losses	-460	-1,569	241%	-31	-98%	499	NM	499	0%
Credit loss expenses	54	0	-100%	0	0%	0	0%	0	0%
Profit before tax	-406	-1,569	286%	-31	-98%	499	NM	499	0%
NON-CORE									
Net interest income	305	115	-62%	104	-10%	93	-10%	84	-10%
Net fee income	26	5	-81%	5	-10%	4	-10%	4	-10%
Net trading income	-8	1	-113%	1	-10%	1	-10%	1	-10%
Other income	0	0	0%	0	-10%	0	-10%	0	-10%
Net income from insurance	0	0	0%	0	0%	0	0%	0	0%
Total income	323	121	-63%	109	-10%	98	-10%	88	-10%
Operating expenses	-275	-303	10%	-248	-18%	-186	-25%	-140	-25%
Profit before credit losses	48	-182	-479%	-140	-23%	-88	-37%	-52	-42%
Credit loss expenses	-4,849	-1,233	-75%	-1,000	-19%	-250	-75%	0	-100%
Profit before tax	-4,801	-1,415	-71%	-1,140	-19%	-338	-70%	-52	-85%
Loans	44,537	36,211	-19%	28,969	-20%	23,175	-20%	18,540	-20%
Cost/ Income	85%	250%		228%		190%		158%	
NII/ Loans	0.68%	0.32%		0.36%		0.40%		0.45%	
Provisions/ Loans	10.89%	3.05%		3.07%		0.96%		0.00%	

Source: Company Reports and Citi Research Estimates

Danske Bank A/S

Company description

Danske Bank A/S is a Danish banking group that encompasses Danske 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%. We estimate an underlying sustainable ROE in 2017 of 10.1% 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%. 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 DKK175 per share, equivalent to 1.1x 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.

Notes

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.

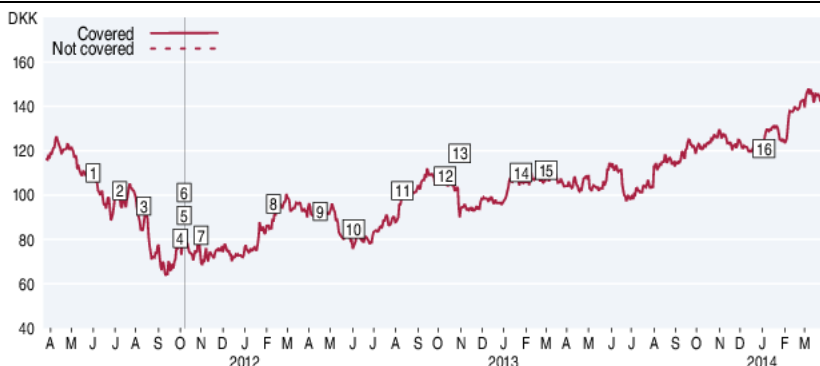
IMPORTANT DISCLOSURES

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	1-Jun-11	*2M	*125.00	107.10
2	8-Jul-11	*2H	125.00	98.25
3	11-Aug-11	*1H	*115.00	86.60
4	3-Oct-11	1H	*100.00	79.30
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	100.00	77.00

* Indicates change

	Date	Rating	Target Price	Closing Price
7	1-Nov-11	1	*95.00	69.45
8	10-Feb-12	*2	95.00	88.00
9	17-Apr-12	2	*100.00	91.75
10	4-Jun-12	*1	100.00	76.90
11	10-Aug-12	*2	100.00	98.60
12	10-Oct-12	2	*110.00	106.50

	Date	Rating	Target Price	Closing Price
13	31-Oct-12	2	*105.00	90.00
14	25-Jan-13	2	*110.00	106.70
15	1-Mar-13	*1	*140.00	108.10
16	3-Jan-14	1	*150.00	124.20

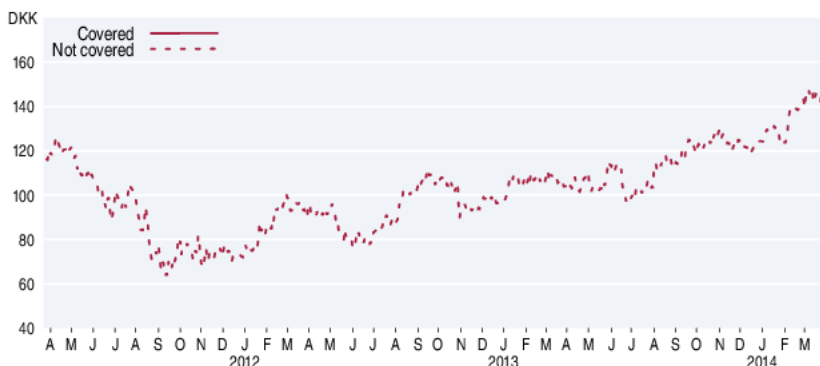
Rating/target price changes above reflect Eastern Standard Time

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 Danske Bank A/S.

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