

Credit Opinion: Eksportfinans ASA

Global Credit Research - 09 Jan 2012

Oslo, Norway

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Issuer Rating	*Ba1
Senior Unsecured	*Ba1
Subordinate	*Ba2
Pref. Stock Non-cumulative	*B1 (hyb)
Commercial Paper	NP
Other Short Term	(P)NP

* Placed under review for possible downgrade on November 22, 2011

Contacts

Analyst	Phone
Kristin Dahlberg/London	44.20.7772.5454
Janne Thomsen/London	
Simon Harris/London	
Soline Poulain/London	

Key Indicators

Eksportfinans ASA (Consolidated Financials)[1]

	[2]9-11	[2]12-10	[2]12-09	[2]12-08	[3]12-07	Avg.
Total Assets (NOK billion)	226.4	215.5	225.3	296.9	218.7	[4]0.9
Total Assets (EUR million)	28,743.927	642.627	177.630	503.827	551.0	[4]1.1
Total Assets (USD million)	38,565.837	837.083	838.992	942.401	840,281.0	[4]-1.1
Tangible Common Equity (NOK billion)	3.5	2.0	1.8	-0.9	1.5	[4]23.2
Tangible Common Equity (EUR million)	448.3	257.5	212.0	-90.6	193.0	[4]23.5
Tangible Common Equity (USD million)	601.5	345.4	304.2	-125.9	282.2	[4]20.8
Net Interest Margin (%)	0.7	0.6	0.6	0.3	0.3	[5]0.5
PPI / Avg RWA (%)	2.3	2.9	2.4	-0.4	-1.9	[6]1.8
Net Income / Avg RWA (%)	1.7	2.1	1.7	-0.2	-1.4	[6]1.3
(Market Funds - Liquid Assets) / Total Assets (%)	37.3	36.0	27.3	38.3	45.1	[5]36.8
Tier 1 Ratio (%)	12.8	12.7	9.7	8.1	6.3	[6]10.8
Tangible Common Equity / RWA (%)	11.3	6.3	4.5	-1.9	3.8	[6]5.0
Cost / Income Ratio (%)	21.4	14.5	15.1	-840.8	-33.5	[5]-164.7
Problem Loans / Gross Loans (%)	1.1	0.6	0.1	0.0	0.0	[5]0.4

Source: Moody's

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

Opinion

SUMMARY RATING RATIONALE

On 22 November 2011, Moody's downgraded Eksportfinans ASA's issuer and debt ratings to Ba1/Not Prime from Aa3/Prime-1. All long-term ratings remain on review for further downgrade.

The rating action follows the decision by the Norwegian government (on 18 November 2011) to take over responsibility for the system of government-subsidised export lending - i.e. the 108-agreement scheme - which had been administered by Eksportfinans. The removal of the government-supported export loan monopoly leaves Eksportfinans without a viable business model as a credit provider to the Norwegian export industry. As a consequence of this decision, Eksportfinans' management immediately initiated a run-off process of the company.

The rating review focuses on (i) the implications of the run-off process on Eksportfinans' remaining operations, especially regarding risks to its liquidity and capitalisation and (ii) the remaining value of its balance sheet.

Moody's is particularly concerned about Eksportfinans' liquidity position given; (i) the possibility of various kinds of debt repayment triggers being activated following the significant changes in the company's business model, (ii) the risk of derivative positions being affected, (iii) the potential for funding shortfall arising due to asset and liability mismatches, (iv) the possible impact of capital market fluctuations on valuations in the structured funding portfolio or other events prompting a need for additional funding.

On 22 November 2011 the company's major shareholders, the Norwegian government (rated Aaa), DNB Bank (rated Aa3/Prime-1/C), Nordea Bank Norge (rated Aa2/Prime-1/C) and Danske Bank (rated A2/Prime-1/C) published a press release indicating their intention to provide capital support to Eksportfinans, if needed, although this has, so far, not translated into legal commitments.

Moody's note that Eksportfinans has received an alleged declaration of default from a Japanese bond holder.

Credit Strengths

- The government and large Nordic banks currently own approximately 80% of Eksportfinans' equity capital
- Loan quality is stable, reflecting sovereign and bank guarantees
- Liquidity reserves are sizeable

Credit Challenges

- Securing liquidity throughout the run-off process
- Avoiding any material changes to the current funding base such as repayment triggers, market fluctuations of the structured funding portfolio, and asset and liability mismatches
- Complying with the requirements on large exposures as stipulated in CRD

Rating Outlook

Eksportfinans' long-term ratings are on review for further downgrade.

What Could Change the Rating - Up

The risks associated with Eksportfinans' run-off status imply that upward pressure on the ratings is very unlikely unless the downside risks are mitigated.

What Could Change the Rating - Down

Downward pressure would be exerted on the ratings should the run-off process have any negative implications for Eksportfinans' remaining operations especially regarding its liquidity and capitalisation.

DETAILED RATING CONSIDERATIONS

Eksportfinans' Ba1 issuer and senior debt ratings and Not Prime short-term ratings are based on Moody's methodologies for Government Related Issuers (GRI). In line with those methodologies, Eksportfinans' Ba1 issuer and senior debt ratings are derived from (i) a baseline credit assessment of 11 (on a scale of 1 to 21, whereby 1 represents the lowest credit risk), (ii) the supporting government's rating (Norway rated Aaa), (iii) an estimate of the default correlation between the two entities (dependence), (iv) an estimate of the likelihood of extraordinary government support (support).

The main owners of Eksportfinans are three of the largest banking groups in the Nordic area: DNB Bank (40%) and Nordea Bank Norge (23%) and Danske Bank (8%). The Norwegian government holds a 15% direct stake in Eksportfinans and an indirect holding through its 34% stake in DNB.

Detailed considerations for Eksportfinans' currently assigned ratings are as follows:

Franchise Value

We believe the Norwegian government's decision to transfer the monopoly of government-supported loans from Eksportfinans has left the company without a viable business model and franchise for future operations. We note that the company will not grant new loans and its business will be gradually managed to exit the market.

Liquidity

Eksportfinans relies totally on market funding and is not permitted to collect deposits; it is therefore highly sensitive to market movements. Around half of long-term funds are structured issuances, most of which have triggers that might shorten the maturity of these issuances and could therefore affect liquidity. For short-term funding, Eksportfinans has US and Euro Commercial Paper programmes.

Eksportfinans has increased the current liquidity portfolio to NOK36.9 billion as of Q3 2011, up from NOK31.9 billion at year-end 2010 - this portfolio mainly comprises bonds from financial institutions. It should be noted that, that the liquidity portfolios can be used in repo transactions with banks - Eksportfinans has committed repo facilities from its three-largest owner banks amounting to USD2 billion with a maturity of 12 months, which can be extended.

Factors that significantly add to the negative outlook on Eksportfinans' liquidity position are related to the run-off status and the substantial change to the company's business model which may result in debt repayment triggers being activated and derivative portfolios being affected. On 19-December-2011 Eksportfinans received a purported declaration of default from a Japanese bond holder. Furthermore, according to Eksportfinans' management, under normal circumstances, the company could occasionally require access to external funding in order to mitigate mismatches between assets and liabilities.

We regard a credible and timely approach to managing run-off liquidity, including the provision of any external support, as essential to ensure an orderly run-off process for Eksportfinans.

Capital Adequacy

Eksportfinans reported a Tier 1 ratio of 12.8% and total capital ratio of 16.5% as of Q3 2011 (according to the Basel II Standardised Approach). This represents an improvement from 10.3% and 14.4%, respectively, at year-end 2010, and we expect that the reduction in the loan book will reduce risk-weighted assets. However, these levels are not sufficient to cover Eksportfinans' current largest exposures, in accordance with the European Union's Capital Requirement Directive (CRD). Given the size of those exposures, the institution will need to raise capital and/or reduce the size of those loans by January 2013.

Risk Positioning

Eksportfinans' risk positioning reflects (i) its high dependence on market conditions and fluctuations; (ii) large loan concentrations; (iii) earnings volatility due to fluctuations in the fair value of its own debt; (iv) the absence of a viable business model; and (v) liquidity and capital risks during the run-off process.

A significant part of Eksportfinans' market risk relates to structured funding, as currencies, interest rates, equity prices, credit spreads and commodity prices can affect the maturity of the issued bonds. We note that market risk in these instruments is hedged in relation to fluctuations of indices but not in relation to maturities.

Further market risk arises from Eksportfinans' large securities portfolios: (i) an unwinding portfolio of NOK26.1 billion as of Q3 2011, comprising a significant portion of asset-backed securities; and (ii) a "new" liquidity portfolio (NOK36.9 billion) consisting of more-liquid assets and subject to a stop-loss limit of 25 basis points of the portfolio value and covenants on counterparties' ratings. The unwinding portfolio is hedged by a Portfolio Hedge Agreement (PHA) with the main shareholder banks, which protects NOK5 billion of the portfolio value.

The inherent uncertainty regarding how to manage the liquidity and capital positions during the run-off process of Eksportfinans reflects negatively on the company's risk positioning.

Asset Quality

The asset quality of Eksportfinans' loan book has historically been strong, although problem loans increased slightly in Q1-Q3 2011; at present, they represent just over 1% of gross loans. Problem loans are defined as interest and principal (and excludes matured principal) on loans 90+ days overdue. The company's loan quality reflects the fact that most of the export lending is guaranteed by the shareholder banks and/or the Norwegian government through the Norwegian Government Guarantee Agency (Garanti-Instituttet for Eksportkreditt or GIEK). However, as a result of its niche business, Eksportfinans loan portfolio exhibits considerable industry and single-name concentration.

Shipping-related loans represented the largest industry concentration, accounting for almost 40% of the loan portfolio at year-end 2010. This exposure has increased rapidly since 2007; it grew by more than 24% in 2010 and by almost 10% year-to-date (YTD) 2011. Eksportfinans borrower concentration - measured as the 20 largest exposures - remains high in relation to its European peers.

Profitability

Profit before tax increased in Q3 2011 to NOK367 million, from NOK81 million in Q2 2011. The difference was almost exclusively due to fluctuations of instruments reported at fair value, as Eksportfinans reported a gain of NOK35 million in Q3 2011 compared with a loss of NOK214 million in Q2 2011. Over the same period, net interest income improved somewhat to NOK373 million from NOK346 million in the previous quarter, and costs remained fairly stable. Although the earnings trend in Q3 2011 is positive, Eksportfinans' profitability remains susceptible to market movements, due to the effects of unrealised gains and losses on financial instruments.

More than 50% of Eksportfinans' underlying income (excluding unrealised gains or losses on financial instruments) stemmed from interest income on export lending. We understand that no further loans will be

granted going forward.

Eksportfinans experienced significant volatility in its earnings due to the mark-to-market valuation of its own debt. Earnings volatility related to the securities holdings is now mitigated by the PHA (see "Risk Positioning").

Eksportfinans' earnings will no longer be supported by operational expansion, which weighs on its profitability score. The possible reduction of loans to comply with the CRD's large exposure provision may also hinder profitability.



© 2012 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its

own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Any publication into Australia of this document is by MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657, which holds Australian Financial Services License no. 336969. This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001.

Notwithstanding the foregoing, credit ratings assigned on and after October 1, 2010 by Moody's Japan K.K. ("MJKK") are MJKK's current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. In such a case, "MIS" in the foregoing statements shall be deemed to be replaced with "MJKK". MJKK is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO.

This credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be dangerous for retail investors to make any investment decision based on this credit rating. If in doubt you should contact your financial or other professional adviser.