

Research Update:

# Denmark-Based Skibskredit 'BBB+' Rating Affirmed On Resilient Earnings And Risk Profile; Outlook Stable

July 21, 2021

## Overview

- Denmark's Skibskredit's business remained solid during the pandemic, with predictable and stable earnings over the past 10 years compared with those of peers.
- The high level of capitalization, prudent underwriting standards, and sustained improvement of asset quality balance the concentrated portfolio in the volatile and cyclical shipping industry.
- Although the institution lacks full access to the central bank, we consider its funding and liquidity metrics robust, given its large liquidity holdings and prefunding strategy.
- We affirmed our 'BBB+/A-2' long- and short-term ratings on Skibskredit.
- The stable outlook indicates our expectations that, over the next two years, the entity will maintain strong capitalization levels, supported by growing profitability, prudent underwriting, and conservative funding and liquidity management.

## Rating Action

On July 21, 2021, S&P Global Ratings affirmed its 'BBB+/A-2' long- and short-term issuer credit ratings on Denmark's Skibskredit A/S (DS). The outlook remains stable.

## Rationale

**We believe that downturns in the cyclical business of shipping, including with the pandemic, have shown DS' business model to be resilient.** The financial institution has a sound and stable operational track record, with strong efficiency and predictable earnings. However, we also factor in our assessment of DS' narrow franchise and concentrated business model, focusing on financing for select Danish and international shipping companies (of which there are less than 100).

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**Our combined view of DS' capital and risk position remain a rating strength.** This assessment incorporates our forecast of a risk-adjusted capital (RAC) ratio well above our 15% threshold for a very strong assessment over the next two years, at about 20%. The RAC ratio calculated as of December 2020 was 23.8%, mainly due to a sharp decline in business activity related to COVID-19, which lowered S&P Global Ratings-adjusted risk-weighted assets by 17%. However, for this year and next, we project a sharp recovery, with lending volumes and profitability reaching pre-COVID-19 levels.

**We consider that the stronger-than-peers' credit loss experience is due directly to DS' prudent underwriting and provisioning policy.** Specifically, we expect the cost of risk to remain near 15-20 basis points, slightly below the previous 15-year average of 22. Moreover, following DS' exit of the offshore business and focus on workout of deteriorated positions, nonperforming loans (NPL) declined 60% from 2016-2020, and we expect this trend to continue, leading to an NPL ratio of 5.6% by 2022 from 7.2% as of December 2020. Nevertheless, we believe the limited diversification by business and low granularity of the portfolio remain tail risks.

**Although DS' funding metrics are significantly better than its domestic peers', we consider funding below average, because the entity does not have direct access to central bank funding.** However, its euro-dominated bonds are eligible for repurchase transactions at the European Central Bank.

**The stand-alone credit profile (SACP) is 'bbb', to which we apply a one-notch upward adjustment.** We expect DS will continue demonstrating superior funding metrics and a stronger resilience to abrupt market dislocations, which partly offsets DS' lack of access to central bank funding. Its large liquidity holdings and prefunding strategy result in lower earnings buffers compared with those of peers, but very stable risk adjusted earnings over the shipping industry's credit cycle. The upward adjustment is also explained by the greater earning predictability through the credit cycle, on high operating efficiency and prudent underwriting standards.

## Outlook

The stable outlook reflects S&P Global Ratings' view that DS' high-quality underwriting policy will allow it to continue navigating cycles in the various shipping segments, with predictable earnings, a declining NPL ratio, and low realized losses through the cycle in the next 24 months. We also anticipate the financial institution will maintain its strong capital position. Moreover, we expect DS will continue prefunding its lending and maintain strong liquidity buffers against adverse scenarios.

## Downside scenario

A negative rating action could stem from a worsening risk profile. This could follow, for example, increased risk appetite with DS taking up clients with weaker credit quality or the underwriting of new business with lower standards. A further reduction of its client base or significantly deteriorating conditions in the shipping industry could exacerbate DS' portfolio risk concentration and, in turn, weaken its creditworthiness. In addition, a marked worsening of the entity's funding and liquidity metrics could prompt us to remove our positive adjustment for the institution's superior performance relative to that of peers.

## Upside scenario

We consider the likelihood of a positive rating action on DS remote. This is because we already incorporate a notch of positive adjustment due to its stance compared with peers on earnings predictability and funding profile.

## Ratings Score Snapshot

Issuer Credit Rating	BBB+/Stable/A-2
SACP	bbb
Anchor	bbb+
Business Position	Weak (-2)
Capital and Earnings	Very Strong (+2)
Risk Position	Adequate (0)
Funding and Liquidity	Below Average and Strong (-1)
Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	+1

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- As Near-Term Risks Ease, The Relentless Profitability Battle Lingers For European Banks, June 24, 2021
- Banking Industry Country Risk Assessment Update: May 2021, May 26, 2021
- EMEA Financial Institutions Monitor 2Q2021: Another Challenging Year, April 23, 2021
- Sudden Managerial Changes At Danske Bank A/S Shouldn't Derail Its Focus On Its Strategic Plan, April 19, 2021
- Leading Nordic Banks Keep Calm And Carry On Despite COVID-19 Stress, Feb. 23, 2021
- SLIDES: Nordic Banks: Strong Fundamentals And Digital Preparedness Shield Against COVID-19 Stress, Feb. 18, 2021

## Ratings List

### Ratings Affirmed

#### Danmarks Skibskredit A/S

Issuer Credit Rating	BBB+/Stable/A-2
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceld/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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