

# Danske Bank AT1: An Investor Perspective

January 2017

René Kallestrup, PhD, Partner

## Disclaimer

This information is issued by Capital Four AIFM A/S ('Capital Four'). It was produced by and the opinions expressed are those of Capital Four as of the date of writing and are subject to change. This document has been prepared solely for information purposes and for the use of the recipient. It does not constitute an offer or an invitation by or on behalf of Capital Four to any person to buy or sell any security or investment product. Any reference to past performance is not necessarily a guide to the future. The information and analysis contained in this publication have been compiled or arrived at from sources believed to be reliable but Capital Four does not make any representation as to their accuracy or completeness and does not accept liability for any loss arising from the use hereof. This document may not be reproduced either in whole, or in part, without the written permission of Capital Four. Capital Four is licensed, regulated and supervised by the Danish Financial Services Authorities.

## AT1 Structure: Four Key Points

	1. PRINCIPAL RISK	2. COUPON RISK	3. EXTENSION RISK	4. PRICING
Credit Risk	Bond is written down	No coupon payment (totally disc. coupons)	Not called at first or subsequent call dates	Find Fair Value
Quantitative factors	Distance to trigger	Distance to coupon restriction trigger (MDA)	Back-end spread & call history	Relative value vs. other fundamental variables
Qualitative factors	Potentially subordinated to shareholders (Risk transfer from AT1s to equity)	Assess risk of no coupon (no vote at shareholder meetings)	Reputation: Assess risk of a perpetual bond	Equity vs credit markets

## 1. Principal Risk: Quantitative Factors

Risk of hitting the contractual trigger

Danske Bank	
CET1 ratio (end of 3Q16)	Trans. 15.8%/FL 15.6%
Distance to trigger	8.80pp/8.60pp (DKK 70-72bn)
Comfortable distance to trigger	Positive
Discretionary write-up feature	Positive, issuer can choose to respect the traditional investor hierarchy

DKKbn	2008	2009	2010	2011	2012	2013	2014	2015	9M16
Impairments	12.1	25.7	13.8	13.2	12.5	5.4	3.7	-0.1	0.1
REA	960.1	834.2	844.2	906.0	819.4	852.3	865.8	833.6	814.3
Impairments/REA (bps)	126	308	164	146	153	64	43	-1	1

# 1. Principal Risk: Qualitative Factors

Danske Bank Risk Report 2015

IRB Exposure at Default (EAD) FY2015 of DKK 1,691.6bn

PD Scale	PD	Corporate EAD
1	IG	3
2	IG	20
3	iG	98
4	IG	197
5	IG	225
6	0.47	143
7	1.27	93
8	4.94	33
9	16.84	5
10	62.85	27
11	100.00	19
Total		861
Risk Report 2015		

Risk of rating migration -> will need to take provisions

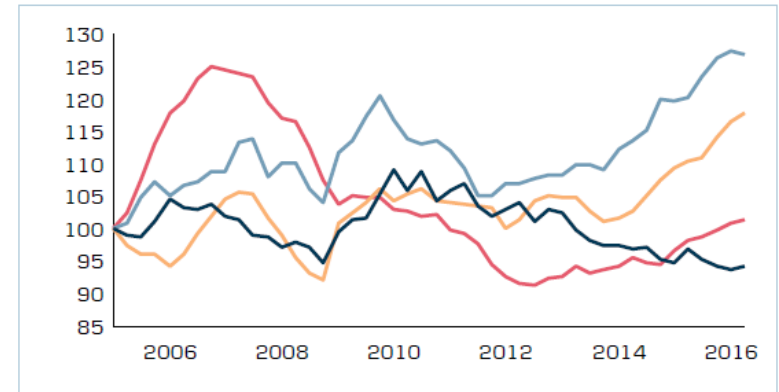
\* CET1 capital (FL) of 128.6bn

\* Corporate Clients: DKK 861bn EAD (50% of total)

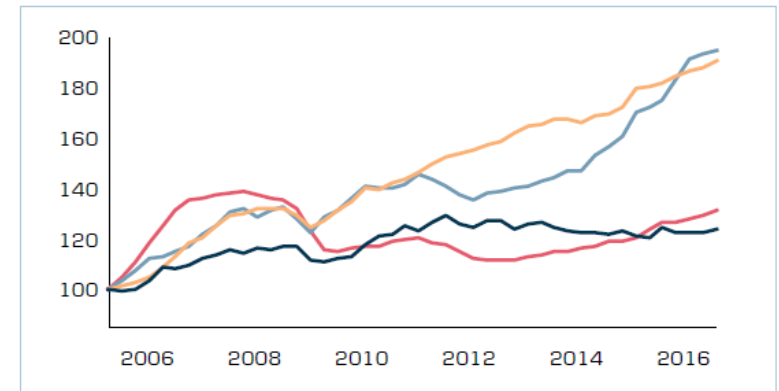
- Exposure to Commercial Property: 258bn

- DKK 408.5bn (in Denmark), DKK 187.3bn (in Sweden), DKK 108.8bn (Norway)

House prices/nom. GDP (index 2005 = 100)



Property prices (index 2005 = 100)

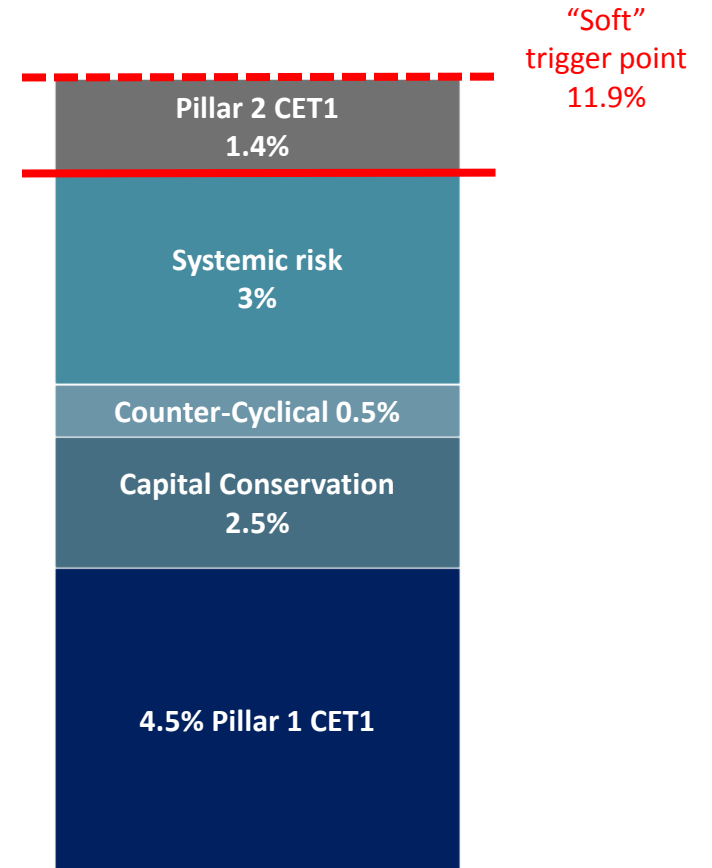


— Denmark — Sweden — Norway — Finland

## 2. Coupon Risk: Quantitative Factors

Danske Bank	
CET1 ratio (end of 3Q16)	Trans. 15.8%
CET1 ratio target by 2019	14%
Distance to MDA in 2017	6.5pp (vs 3Q16) (DKK 53bn)
Distance to MDA in 2019	3.5pp (vs target) (DKK 29bn)
Distance to "soft" trigger in 2019	2.1pp (vs target) (DKK 17bn)
Comfortable distance to MDA	Positive

Coupon  
cancellation  
trigger point  
(MDA)  
10.5%



## 2. Coupon Risk: Qualitative Factors

Coupon payments are fully discretionary

New EU rules puts AT1 coupon in front of both bonuses and dividend payments in case of a breach of the MDA trigger point

- Will these rules be adopted in Denmark?
- Change docs for existing AT1s?

REA, CET1, profit and distribution (DKK bn, %)

	2008	2009	2010	2011	2012	2013	2014	2015	9M2016
REA	960	834	844	906	819	852	865	834	814
CET1 ratio	8.1%	9.5%	10.1%	11.8%	14.5%	14.7%	15.1%	16.1%	15.8%
Net profit**	1.0	1.7	3.7	1.7	4.7	7.1	13.0	17.7	14.3
Distributed to shareholders	5.9	0	0	0	0	2.0	10.5***	17.1***	-
Total assets	3,544	3,098	3,214	3,424	3,485	3,227	3,453	3,293	3,549

Other factors:

- Risk floors (Basel IV)
- Trading book RWAs

### 3. Extension Risk: Quantitative Factors

Perpetuity risk – the instrument is not called at first call date

#### Old style Tier 1

DANBNK EUR 4.878 cMay17  
-> EUR003M + 1.620% (STEP)

SAMBNK FLT (Danske s. 2006) cQ  
-> French 10y + 0.30% (NON-STEP)

#### New style AT1 (NON-STEP)

DANBNK EUR 5.75 cApr20 (S/A)  
-> EUSA6 + 4.640%

DANBNK FLT cNov21 (Q)  
-> CIBOR + 4.75%

DANBNK EUR 5.875 cApr22 (S/A)  
-> EUSA5 + 5.471%





### 3. Extension Risk: Qualitative Factors

Early redemption requires the prior approval of the Danish FSA



## 4. Pricing: Quantitative Factors

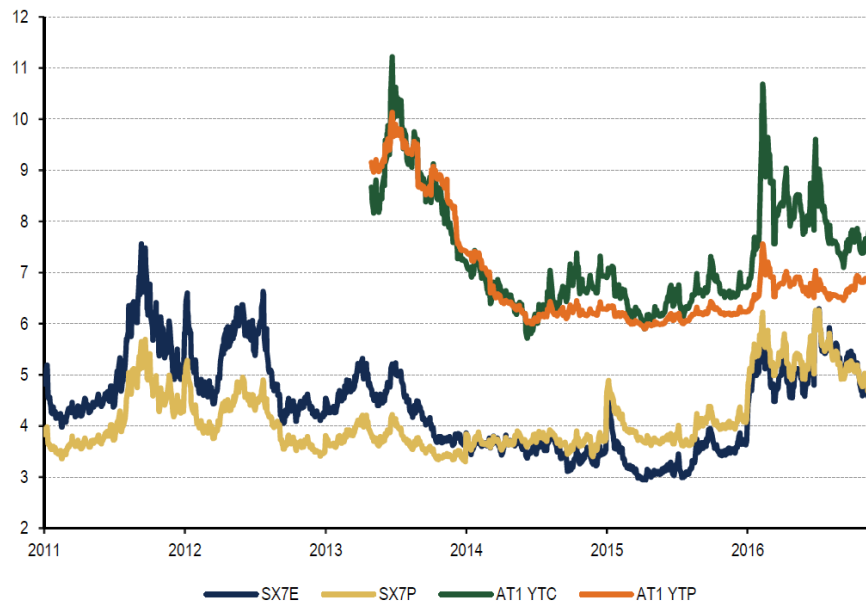
Danske Bank: Back-end mispriced

Danske Bank	Price Nov16	Price Today	Issue spread	Δ Back-end	I-Spread to call at issuance	CDS	Δ Spread (adjusted for curve, xccy, etc.)	Δ Spread/ Δ Issue Spread
DANBNK EUR 5.75 c20	102.56	104.00	EUSA6Y +4.64%	0.83%	5.01%	3y: 0.90%	0.13% - 0.40%	<b>-32%</b>
DANBNK EUR 5.875 c22	103.00	104.75	EUSA5Y +5.47%		5.14%	5y: 1.30%		
DANBNK DKK FRN c21	100.00	101.10	3M CIBOR +4.75%	0.72%	4.75%	4.5y: 1.20%	0.39% - 0.10% - (0.18% + Liquidity Premium)	<b>Wrong price @ issuance (since corrected)</b>
DANBNK EUR 5.875 c22	103.00	104.75	EUSA5Y +5.47%		5.14%	5y: 1.30%		

## 4. Pricing: Qualitative Factors

AT1s are offering more yield than bank stocks – NOT among Scandi banks!

Chart 55: European banks: dividend yields vs. AT1 yields



Source: BofA Merrill Lynch Global Research

### Danske Bank

Dividend paid (16' vs 16')	DKK 8.1bn vs. 7.9bn
Share buy-back	DKK 9.0bn vs. 5.0bn
Total distribution	DKK 17.1bn vs. 12.9bn
Total Dividend & Buyback 16'	8.3% (3.9% dividend yield)
Total Dividend & Buyback 15'	7% (4.3% dividend yield)
Average AT1 yield	4.2-4.8%