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ISSUER COMMENT

SpareBank 1 SR's Increased Problem Loans and Impairments Signify Credit-Negative Risks in Oil-Related Exposures

From Credit Outlook

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Last Wednesday, SpareBank 1 SR-Bank ASA (A1/A1 negative, baa2[1]) released its half-year 2016 results, which showed a significant increase in problem loans and related impairments driven mainly by exposures to the oil sector (the bank is located in the city of Stavanger, Norway's oil hub). The bank's performance signifies the challenges that it faces in its oil sector exposures as well as other oil-dependent industries and services, which are currently facing difficulties owing to declining petroleum sector investments and low oil prices. To some extent, this credit-negative development is balanced against the bank's increased pre-provision income and capital metrics, which strengthen its loss-absorbing capacity.

SpareBank 1 SR's half-year 2016 net profit fell approximately 15% from a year earlier, mainly because of higher impairment losses on loans and guarantees. The increase in impairments largely was due to losses on four individual commitments in the oil-services sector, and NOK93 million of collective impairment losses out of total provisions of NOK455 million during the first six months of the year, up from NOK132 million a year earlier. The bank expects to carry out loan write-downs of similar magnitudes in the second half of the year, which would take full-year loan impairments up to NOK900 million, more than double the NOK420 million reported for 2015.

Concurrently, the bank's stock of nonperforming loans and doubtful commitments increased from a year earlier by around 88% to approximately NOK2.1 billion (or 1.34% of gross loans[2]) in June 2016, compared with NOK1.1 billion (or 0.75% of gross loans) in June 2015 (see exhibit). The increase was predominantly the result of companies in the oil sector experiencing financial difficulties. The Norwegian Petroleum Directorate expects investments in the petroleum sector to decline by 10% in 2016 following a 16% reduction in 2015. As a result, the level of economic activity in the Stavanger area is likely to decrease further, affecting other sectors including real estate, building and construction, and hospitality.

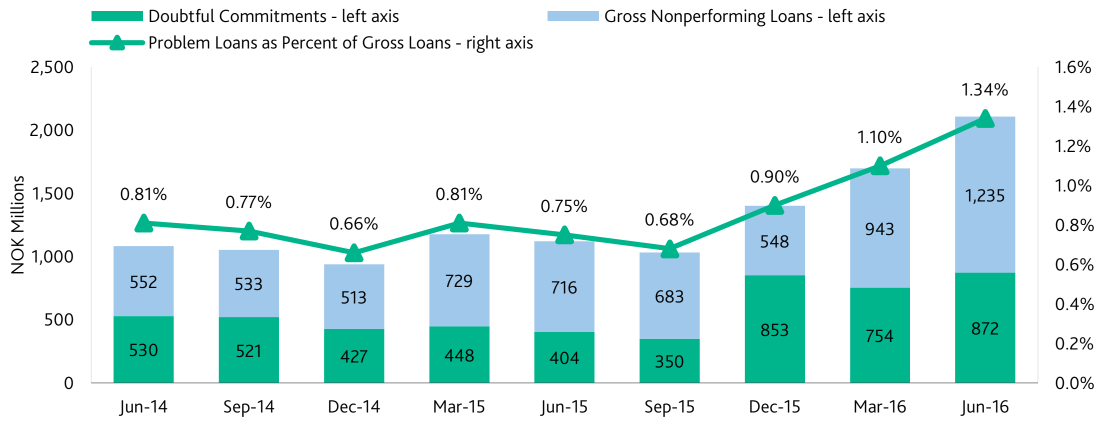
What is Moody's Credit Outlook?

Published every Monday and Thursday morning, Moody's Credit Outlook informs our research clients of the credit implications of current events.

1 The bank ratings shown in this report are SpareBank 1 SR's deposit rating, senior unsecured debt rating and baseline credit assessment.

2 Excluding any gross loans transferred to covered bond companies.

SpareBank 1 SR's Problem Loans



Source: The bank

SpareBank 1 SR is one of the highest exposed Norwegian banks to these sectors, with oil-related borrowers in June 2016 comprising around 11.1% of its loan book (exposure at default of 8.6% including loans in covered bond companies). Loans to the offshore industry (offshore service vessels, rigs and seismic vessels) account for around 6.5% of gross loans, while oil service companies are 3.2%, and exploration and production companies are 1.4%. The bank calculates its approximately NOK2 billion exposure to 17 rigs as having the highest average weighted probability of default in its overall portfolio, at 5.1%, constituting the most risky asset on its balance sheet. In addition, the bank is also exposed to the commercial real estate sector (14.8% of gross loans in June 2016), a significant part of which is located in the county of Rogaland, where reduced oil investments have led to vacancy rate increases.

Despite the elevated risks that SpareBank1 SR will continue to face through these oil-related exposures, the bank during the first half of 2016 increased its pre-provision income by around 9% year on year as a result of higher corporate lending margins and cost containment. The bank also increased its common equity Tier 1 (CET1) ratio to 13.5% in June 2016 from 12.3% a year earlier, and aims to raise it to 14.5% by year-end. Such improvements reinforce the bank's balance sheet and strengthen its loss-absorbing capacity.

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