S&P Global Ratings

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Research Update:

Bank Norwegian Affirmed At 'BBB/A-2' On Risk-Adjusted Profitability; Outlook Still Negative On Growth Risks

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Overview

- Bank Norwegian is continuing its strong consumer lending growth across the Nordics, and the sale of nonperforming loans (NPLs) has supported the quality of its loan portfolio.
- The bank's strategic expansion is backed by customer deposits, which we consider to be more price sensitive than for Nordic universal banking peers.
- However, we consider Bank Norwegian to be an outperformer in terms of risk-adjusted profitability compared with consumer finance peers in Europe.
- We are consequently affirming our 'BBB/A-2' ratings on Bank Norwegian.
- The negative outlook reflects the risk that high loan growth or an aggressive capital payout policy could erode Bank Norwegian's very strong risk-adjusted capitalization.

Rating Action

On March 12, 2019, S&P Global Ratings affirmed its 'BBB/A-2' long-term and short-term issuer credit ratings on Norway-based consumer lender Bank Norwegian AS. The outlook remains negative.

Rationale

Bank Norwegian's strong lending growth is continuing across Norway, Sweden, Finland, and Denmark. To date, Bank Norwegian has demonstrated stable high-margin earnings, with steadily increasing net interest income, due to the rapid credit growth, reported at 17.4% in 2018 (22% adjusted for the sale of the NPL portfolio). The bank's continued expansion in each of its markets facilitates further earnings growth, in our view. In addition, we believe geographic diversification supports revenue stability, given the relatively low correlation among the Nordic consumer finance markets.

We understand that Bank Norwegian is now looking for opportunities to diversify its franchise outside Nordic markets in cooperation with its owner Norwegian Air Shuttle. It has announced a strategic investment in

Ireland-based Lilienthal Finance Ltd. to develop banking services across Europe. Although this project is still in a start-up phase, we consider that it could broaden Bank Norwegian's operations into new markets over the medium term.

As we expected, business in Denmark and Finland, which the bank entered in 2015 and 2017, has contributed to growth but also led to weaker asset quality metrics. NPLs peaked at 9.2% in the third quarter of 2018, due to the poor performance of loans in those two countries. Bank Norwegian's consequent sale of €160 million of NPLs in Finland in the last quarter of 2018 brought the reported NPL ratio down to 7.6%, roughly in line with the opening quarter of the year when the bank changed to IFRS9 accounting.

We observe that Bank Norwegian has financed its expansion primarily through customer deposits in each country and demonstrates rather balanced key funding metrics. The stable funding ratio is estimated at 119% and core deposits to loans at 93% as of year-end 2018. Although Bank Norwegian aims to broaden its funding profile with senior unsecured debt, we consider that its funding will remain less diversified than peers' in Norway. We understand that the customer deposits are almost fully covered by the Norway's deposit guarantee scheme: Norwegian krone (NOK) 2 million per depositor in Norway and €100,000 per depositor in foreign branches.

However, in our view, the deposit franchise remains more price- and confidence-sensitive than that of universal Nordic banks. We saw, for instance, that the reduction of the deposit rate in Finland by 100 basis points (bps) to 75bps led to significant outflows late last year. Also, an amendment in Norway's deposit guarantee scheme as of Jan. 1, 2019, has weighed on Bank Norwegian's non-domestic deposit base. We therefore consider Bank Norwegian's funding to be below average rather than average. As a result, we have revised our assessment of Bank Norwegian's stand-alone credit profile to 'bbb-' from 'bbb'.

That said, in our view, Bank Norwegian is an outperformer in its consumer finance peer group. In particular, it displays high risk-adjusted margins and cost efficiency, with its ability to generate capital by retaining earnings to support its growth plans. Its net interest margin was 9.2% in 2018, which is well above its peers'.

Bank Norwegian's earnings buffer also indicates a greater capacity for earnings to cover normalized losses than that of its European consumer finance peers. Moreover, Bank Norwegian's risk-adjusted capital (RAC) ratio was a very strong 17.1% at midyear 2018 and we project it at 17%-18% over 2019-2020, despite continued loan growth. We note Bank Norwegian's public commitment to maintain a 3% management buffer above the regulatory common equity tier 1 capital ratio requirement of 15.9% at the group level before undertaking share buybacks or dividends. We add one notch of uplift to the SACP to take this into account, resulting in the 'BBB' long-term rating on Bank Norwegian.

Outlook

The negative outlook stems from our expectation of further significant loan growth at Bank Norwegian in its competitive home markets, which could depress its margins and ultimately its capital position over the next two years.

We could lower the rating on Bank Norwegian if the bank followed a more aggressive growth strategy, jeopardizing its risk-adjusted profitability and asset quality, or if we observed a more aggressive capital policy leading the RAC ratio to fall below 15%. Furthermore, any negative spillover effects from the distressed owner Norwegian Air Shuttle on the bank's reputation and business momentum could lead us to lower the ratings.

We could revise the outlook to stable if the bank maintains a solid RAC ratio and, in our view, lending growth and business evolution has become more sustainable. This could lead us to incorporate the positive adjustment notch into Bank Norwegian's SACP, more specifically, in our business or risk position assessment. We anticipate that this would be indicated, for example, by normalization of loan growth and an improvement of asset-quality figures in Bank Norwegian's newer markets.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Negative/A-2	
SACP	bbb-	bbb
Anchor	a-	a-
Business position	Weak (-2)	Weak (-2)
Capital and earnings	Very strong (+2)	Very strong (+2)
Risk position	Weak (-2)	Weak (-2)
Funding and Liquidity	Below average and Adequate (-1)	Average and Adequate (0)
Support	(0)	(0)
ALAC support	(0)	(0)
GRE support	(0)	(0)
Group support	(0)	(0)
Sovereign support	(0)	(0)
Additional factors	(+1)	(0)

Related Criteria

- 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: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment Update: February, Feb. 22, 2019
- Nordic Banks Sport Strong Capital--And It's Not Likely To Soften, Oct. 17, 2018
- Nordic Bank Ratings Continue To Stand Tall, Aug. 16, 2018
- Banking Industry Country Risk Assessment: Norway, May 11, 2018
- DNB Bank, Eiendomskreditt, Bank Norwegian Ratings Affirmed On Stabilizing Domestic Risks; DNB Bank Outlook Now Positive, March 26, 2018

Ratings List

Ratings Affirmed

Bank Norwegian AS	
Issuer Credit Rating	BBB/Negative/A-2

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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.