

ISSUER COMMENT

HSH Nordbank's Significant De-risking Progress Is Credit Positive

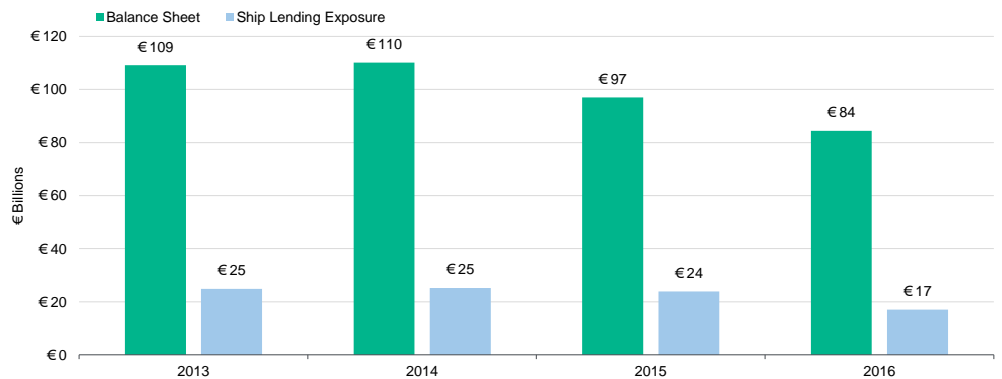
 From [Credit Outlook](#)
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Last Thursday, German Landesbank and leading ship lender [HSH Nordbank AG](#) (Baa3/Baa3 developing, b3¹) published year-end 2016 results that showed a reduction in non-core assets and a net increase in risk provisions on its large impaired ship finance portfolio. HSH's continued de-risking strategy is credit positive for the troubled ship lender, reducing threats from loan losses to its improved risk-weighted capitalization, as reflected in the bank's improved common equity Tier 1 ratio to 14.1% from 12.3% as of December 2015. Additionally, these efforts will make the bank more attractive to potential buyers in a privatization process as HSH tries to avoid an imposed wind-down and adverse effects on asset recoveries.²

As Exhibit 1 shows, HSH last year reduced its balance sheet by €12.6 billion to €84.4 billion, predominantly by reducing its shipping book to €17.0 billion from €23.9 billion at year-end 2015. The disposals of non-core assets and maturities of legacy assets largely drove this reduction. The shipping segment benefitted from the sale of €5.0 billion of nonperforming loans at a 52% haircut to [hsh portfoliomanagement AoR](#) (Aa1 stable). HSH plans to sell another €3.2 billion of nonperforming loans to the market in 2017, €1.6 billion of which it sold in January. We expect HSH to fully utilize its €10 billion credit guarantee in 2017. In 2016, the available headroom under the guarantee for additional risk charges fell by €1.8 billion to €100 million, with €900 million of the reduction of taking place in the fourth quarter.

EXHIBIT 1

HSH Nordbank Has Reduced Its Credit-Risky Shipping Exposure, € Billions


Note: Balance sheet size is measured in total assets; ship lending exposure is measured in exposure at default.

Sources: HSH Nordbank and Moody's Investors Service

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! THIS REPORT WAS REPUBLISHED ON 6 APRIL 2017 TO CORRECT THE TIMING OF THE SALE MENTIONED IN THE SECOND PARAGRAPH.

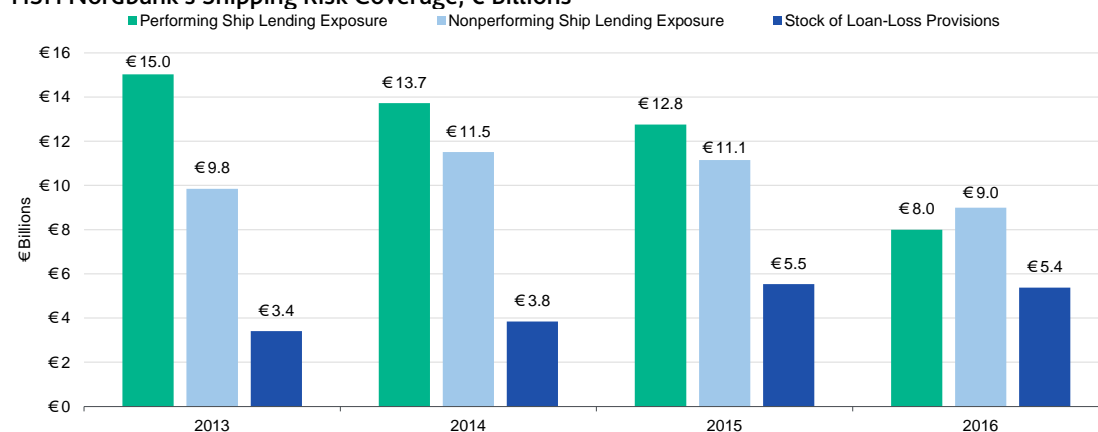
¹ The bank ratings shown in this report are HSH's deposit rating, senior unsecured debt rating and baseline credit assessment.

² In January, HSH's public-sector owners formally announced the start of HSH's privatization process. In accordance with the European Commission's 2016 state-aid decision, the German states of Hamburg and Schleswig-Holstein intend to sell at least 75% of their shares in HSH in an open, transparent and competitive bidding process. The owners are allowed to retain up to 25% of their shares in HSH for up to four years after the sale's completion.

HSH's overall nonperforming exposure ratio decreased to 17.5% in 2016 from 18.8% in 2015, while within its shipping portfolio the ratio rose to 52.9% from 46.4%. At the same time, HSH's nonperforming exposure coverage ratio improved significantly, both for its entire portfolio and its shipping exposures (see Exhibit 2). The bank charged €1.6 billion of loan-loss provisions in 2016, materially lower than €3.0 billion in 2015 but sufficient to increase the coverage ratio to 60% in shipping, which is near the top of the 20%-64% range reported by German ship lenders thus far for 2016.

EXHIBIT 2

HSH Nordbank's Shipping Risk Coverage, € Billions



Sources: HSH Nordbank and Moody's Investors Service

We maintain that HSH's [large underperforming legacy assets must be sold separately to ensure that the entity can change hands](#) because the bank in its current shape will not be able to compete successfully as a private bank. In light of the ongoing challenges on shipping loans, the improved coverage ratios on the bank's nonperforming shipping assets increase HSH's chances of selling its legacy assets.

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