

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A3/P-2
Bank Financial Strength	C-

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Key Indicators

Sparebanken Oest (Consolidated Financials)[1]

	[2]9-10	[2]12-09	[2]12-08	[3]12-07	[3]12-06	Avg.
Total Assets (NOK billion)	23.81	21.97	25.18	22.03	21.34	[4]2.78
Tangible Common Equity (NOK billion)	1.85	1.56	1.09	1.55	1.43	[4]6.51
Total Assets (EUR million)	2,978.42	2,650.42	2,587.10	2,775.45	2,598.55	[4]3.47
Tangible Common Equity (EUR million)	230.94	188.76	111.64	195.12	174.72	[4]7.22
Total Assets (USD million)	4,066.15	3,802.66	3,596.19	4,057.85	3,426.59	[4]4.37
Tangible Common Equity (USD million)	315.28	270.82	155.19	285.28	230.39	[4]8.16
PPI / Avg RWA	3.92%	3.55%	-1.99%	2.34%	1.15%	[5]1.82%
Net Income / Avg RWA	3.27%	2.42%	-2.95%	1.66%	0.86%	[5]0.91%
(Market Funds - Liquid Assets) / Total Assets	53.70%	50.18%	52.10%	48.05%	55.81%	[6]51.97%
Core Deposits / Average Gross Loans	40.86%	43.11%	44.18%	45.49%	41.32%	[6]42.99%
Tier 1 Ratio	13.12%	14.15%	8.39%	13.13%	13.61%	[5]11.89%
Tangible Common Equity / RWA	14.98%	13.33%	8.40%	12.15%	12.41%	[5]12.24%
Cost / Income Ratio	35.53%	41.01%	835.71%	49.23%	68.64%	[6]206.02%
Problem Loans / Gross Loans	1.68%	1.52%	1.63%	1.00%	1.12%	[6]1.39%
Problem Loans / (Equity + Loan Loss Reserves)	14.95%	14.11%	22.19%	10.10%	10.73%	[6]14.42%

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] Basel II & IFRS reporting periods have been used for average calculation [6] IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of C- to Sparebanken Øst, which translates into a baseline credit assessment (BCA) of Baa2, which reflects the bank's good regional franchise in south-eastern Norway (encompassing the Greater Oslo area). However, the rating is constrained by high credit risk concentrations, a reliance on market funding as well as future profitability challenges arising from intense market competition.

The global local currency (GLC) deposit rating of A3 for Sparebanken Øst is supported by the bank's Baa2 BCA and the Aaa local currency deposit ceiling of Norway, which we consider the underlying support provider. As a result of Sparebanken Øst's position in its region and the region's importance to the national economy of Norway, Moody's assesses a high probability of systemic support for the bank in the event of a stress situation. Consequently, Sparebanken Øst's GLC deposit rating benefits from a two-notch uplift from its BCA.

Credit Strengths

- Good regional market position in south-eastern Norway and improved earnings from core banking operations

- Open-architecture model allows for a product range suited to its customers
- Over 70% of lending to retail customers, of which most are mortgages
- Improved capital levels

Credit Challenges

- Further minimising the risks related to its financial investments
- Maintaining asset quality across the economic cycle and in light of slower economic growth in Norway
- Reducing credit risk concentrations in terms of largest borrowers and exposure to property management
- High reliance on wholesale funding
- Containing efficiency as an independent savings bank
- Developing risk management practices

Rating Outlook

The outlook on all ratings is stable. On 28 October 2010, Moody's changed the outlook on Sparebanken Øst's ratings to stable from negative, chiefly reflecting the bank's de-risking of its balance sheet, especially in its investment portfolio and in its syndicated loan exposures to Icelandic and eastern European financial institutions, coupled with good capital levels and improved performance in the latest quarters.

What Could Change the Rating - Up

Upward pressure on the bank's ratings could arise from (i) a continuation of the focus on core business and reduced asset allocation to the investment portfolio; (ii) an improvement in profitability; and/or (iii) sustaining the persistently low problem loan level.

What Could Change the Rating - Down

The BFSR would be negatively affected by a deterioration in financial flexibility, particularly adverse developments in asset quality. In addition, further erosion of the bank's market position, any increase in its overall risk profile (e.g. in the form of investment in less liquid financial securities) or deteriorating liquidity could exert downward pressure on the rating.

Recent Results and Company Events

Sparebanken Øst reported pre-tax profit of NOK357 million in Q1-Q3 2010, up by 15% compared to the corresponding figure in Q1-Q3 2009. The improvement was supported by a substantial reduction in loan loss provisions (write-back of NOK9 million in Q1-Q3 2010 vs. write-down of NOK16 million in Q1-Q3 2009). However, the good profit was also inflated by dividends from the bank's holding in Eksportfinans as well as one-off positive effects from the merger between electronic payment services providers Nordito (Norway) and PBS (Denmark) (NOK80 million) and a change in the Norwegian pension legislation (NOK29 million).

Regarding core banking earnings, they were negatively affected by lower volume growth in 2009 as well as compressed deposit and retail lending margins due to strong competition and higher cost of funding.

The bank reported a Tier 1 ratio of 13.1% at end-September 2010 (according to the standardised method under Basel II rules).

DETAILED RATING CONSIDERATIONS

Detailed considerations for Sparebanken Øst's currently assigned ratings are as follows:

Bank Financial Strength Rating

Sparebanken Øst's C- BFSR is supported by the bank's good local franchise and its satisfactory capitalisation and asset quality. Norway's operating environment and regulatory practices are also positive drivers. However, the rating is constrained by financial investments that display a higher risk profile in the current market environment, which could potentially result in further losses. In addition, Sparebanken Øst has a high reliance on market funding, which accounts for over 60% of its total funding. Moreover, efficiency will remain a challenge since being a smaller independent bank means that Sparebanken Øst will find it relatively difficult to achieve critical mass or economies of scale. Intense competition in the Norwegian market and slower growth are also likely to exert pressure on the bank's profitability.

The C- BFSR is in line with the outcome of Moody's bank financial strength scorecard.

Qualitative Factors (50% weighting)

Factor 1: Franchise Value

Trend: Neutral

Sparebanken Øst enjoys a good market position in the lower Buskerud county of south-eastern Norway. In recent years, the bank has established an online mortgage bank, DinBANK.no, as an additional distribution channel. The bank also introduced YoungBank.no as a brand to target young customers.

The bank offers clients a wide product range via an open-architecture model as well as more recently via companies established with other independent savings banks. Sparebanken Øst owns 15% of Frende Holding, which offers life and non-life insurance products. In addition, Sparebanken Øst, along with the savings banks behind Frende Forsikring and Fondsfinans (a Norwegian securities house), established Norne Securities, a securities company, which became operational in winter 2009 and of which it owns 10.12%.

We view these initiatives positively; Sparebanken Øst's cooperation with other small independent savings banks could over time create small-scale acquisition opportunities, especially in the context of the June 2009 regulation on savings bank's equity certificates (EC), which facilitate mergers between savings banks.

Overall, we positively view the bank's attempt to widen its operating area, but caution that the capital region remains increasingly competitive as large domestic and foreign banks are keen to gain a presence there. Therefore, we caution that the bank's franchise could come under pressure, especially outside of its key operating areas, where it benefits from local knowledge of customers' needs and the economy.

Although we acknowledge Sparebanken Øst's strong presence in the local market in which it operates, the C- score for franchise value is constrained by the bank's lack of geographic diversification.

Factor 2: Risk Positioning

Trend: Neutral

At YE2009, the bank's largest owner, MP Pensjon, had control of 10% of the ECs, with no other EC-holders having ownership above 10%. The 20 largest EC holders together own 45% of the ECs.

Although risk management practices are adequate for the level and type of risk in the bank, they lack the sophistication of other larger players in the Nordic region. We also expect to see better risk management in relation to securities investments. Following Finanstilsynet's critical remarks regarding Sparebanken Øst's investment strategy, risk management, controls and the board's role in January 2009, the bank has implemented remedial steps. Furthermore, high risk concentrations in the loan portfolio (see Asset Quality, below) remain a constraining factor for the score on risk management.

Since the beginning of 2009, the bank's strategy has been to run off its riskier investment portfolio, whose changes in fair value of financial assets resulted in a loss of NOK490 million in 2008. In 2009, realised losses on the bond portfolio totalled NOK82 million. At YE 2009 the bank reported financial investments worth NOK355 million in the high risk category according to its internal risk classification, down from NOK496 million at YE 2008.

In addition, the bank's exposures to Icelandic and Eastern European banks largely contributed to the loan loss provision of NOK245 million booked in 2008. Since 2008, almost NOK150 million was provisioned in relation to Icelandic banks and the bank reported loans to financial institutions in the high risk category decreased to NOK6 million from NOK438 million in 2008.

The bank's shareholdings on the balance sheet were NOK321 million at YE 2009, representing around 20% of Tier 1 capital. The largest shareholding is in Eksportfinans (4.84%), for which the bank also provides a guarantee of NOK46.6 million via a portfolio hedge agreement together with the other owners. The bank's net exposure to interest-rate risk was well below the NOK30 million limit (equivalent to around 2% of Tier 1 capital). Its foreign currency risk is also low; its net currency position was NOK15.4 million (total gross limit is NOK100 million). In addition, we note that the ownership in the insurance business increases its exposure to market volatility.

Sparebanken Øst scores C for risk positioning, with its high credit risk concentration its main constraining factor.

Factor 3: Regulatory Environment

For a discussion of the regulatory environment, please see Moody's latest Banking System Outlook on Norway.

Factor 4: Operating Environment

Trend: Neutral

The score for the operating environment takes into account the economic stability, integrity and corruption in the country as well as the legal system. The score for Norway's operating environment is B. For further discussion of the operating environment, please see Moody's latest Banking System Outlook on Norway.

Quantitative Factors (50% weighting)

Factor 5: Profitability

Trend: Weakening

For years Sparebanken Øst has been reliant on net interest income, which represented more than 65% of its core operating income in 2009. An increase of approximately 10% year-on-year in 2009 was primarily supported by lower funding costs, improved corporate lending margins as well as the good performance of its car financing subsidiary. Going forward, we believe growth in net interest income will remain subdued as an increase in volumes will remain limited due to intense competition.

Commission income has been a limited but a stable source of additional income, representing around 10% of the bank's operating income in 2009.

Value adjustments in the securities portfolio contributed positively to core income in 2009, a turnaround after years of negative adjustments. Exposures have been significantly reduced and we do not foresee negative valuation effects to the extent of those reported in 2008 going forward, although some volatility remains.

The ongoing derisking of the bank's exposures was also reflected in the reduction in loan loss provisions, which stood at NOK25 million, significantly down from NOK245 million in 2008. The bank has now provisioned for the bulk of its exposure to Icelandic and Eastern Europe financial institutions, hence our expectation that no such high provisioning levels will be seen in the future.

The score for profitability is B+, reflecting the good performance in 2009. However, we keep a weakening trend on the score due to our view that the bank's net profitability is dependent upon the success of ongoing efforts to contain the volatility of its investments and our expectations that growth in net interest income will be challenging.

Factor 6: Liquidity

Trend: Neutral

Deposits represented around 35% of Sparebanken Øst's total funding as of YE 2009, which falls below those of larger Moody's-rated savings banks in Norway. In 2009, its deposit base decreased by some 4% compared with a decrease in gross loans by almost 5% year-on-year.

With a deposits-to-gross loans ratio at 44%, the bank is reliant on market funding; around 45% of its total funding is in the form of bonds in the domestic market and some 15% are syndicated loans from foreign banks. The maturity profile of funding has shortened throughout the financial crisis, with NOK2.3 billion (around 18% of market funding) set to mature in 2010.

In April 2009, the bank established its wholly-owned covered bond company, Sparebanken Øst Boligkreditt A/S. During the year, covered bonds were mainly used in the (now phased out) government swap arrangement, whereby these instruments were exchanged for government bonds. We view this new funding tool positively, as it will address the bank's relatively less diversified funding.

Compared with its Norwegian savings bank peers, Sparebanken Øst has a relatively large proportion of liquid assets on its balance sheet, around 22% at YE 2009, which partly reflects the bank's higher dependence on market funding. The bank's total securities portfolio consists of the fixed-income securities of financial institutions and Norwegian companies as well as government bonds and covered bonds totalling NOK4.1 billion at YE 2009. We caution that Sparebanken Øst's fixed-income investments have showed some volatility in recent years.

The D+ score for liquidity, although lower than that of its European counterparts, is in line with that of the other rated Norwegian banks.

Factor 7: Capital Adequacy

Trend: Neutral

Sparebanken Øst reported a Tier 1 ratio of 14.2% and a total capital ratio of 17.1% at YE 2009 as calculated under Basel II's standardised approach. The substantial improvement from 8.4% and 11.5%, respectively at YE 2008 is largely attributable to the bank's NOK182 million rights issue in April 2009 as well as the decrease in risk-weighted assets associated with ongoing de-risking of the bank's balance-sheet. In addition, the bank has increased its capital adequacy targets and now aims to keep its Tier 1 ratio above 11% and its capital ratio above 13%. We view these developments favourably and note that Sparebanken Øst compares well with its rated Norwegian peers (as has been the case in the past few years).

However, we note that hybrid capital, which we assess as less loss-absorbing than pure equity, makes up 15% of the bank's Tier 1 capital, which is the maximum amount that can be included in Tier 1 in Norway. In addition, these instruments could be excluded from Tier 1 capital according to the Basel Committee's propositions as they are currently presented.

We regard capitalisation as a positive rating factor and believe the current levels provide a good buffer to absorb potential losses. The score for capital adequacy is A.

Factor 8: Efficiency

Trend: Neutral

Cost efficiency significantly improved in 2009, with the bank's cost-to-income ratio at a low 42%, which is a strong recovery from 2008 when the ratio was adversely affected by weak financial results. This improvement resulted chiefly from an increase in operating income. Operating expenses increased by 6% from 2008, mainly as a result of higher payroll expenses. Although we acknowledge an improvement in the bank's cost efficiency ratio, we caution that it is likely to remain under pressure from intense competition and higher funding costs. Additionally, while the bank avoids the fixed costs of product manufacturing through taking minority shares in its product development companies, going forward cost containment might prove to be more difficult as an independent bank.

The unadjusted score of E reflects the very low operating income in 2008. However we have adjusted the score to C, which we think more appropriately reflects the bank's efficiency.

Factor 9: Asset Quality

Trend: Weakening

Operating in only one region means that the bank has significant single-borrower concentration as measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision income. There is also some industry concentration: property management and construction account for some 15% of the total loan portfolio and is a source of potential vulnerability; also in addition, exposures are largely concentrated in a limited geographic area. The largest exposures also include a number of real estate-related entities.

Nevertheless, the relatively high proportion of retail loans (75% of lending including loans transferred to Sparebanken Øst Boligkreditt A/S) brings some stability in the loan book. In addition, the majority of retail lending is in the form of mortgages. Around 90% of mortgages are within an 80% LTV.

At YE 2009, problem loans (defined as gross loans in default and non-performing loans that are not in default) accounted for 1.5% of gross loans, slightly down from 1.6% at YE 2008.

Sparebanken Øst's problem loan coverage by loan loss reserves is around 60% of problem loans, which we consider satisfactory given the high share of retail mortgage lending. We caution that the sustained increase in house prices in Norway may have underrated the level of provisioning by inflating collateral value. We further note that at YE 2009, some 10% of the bank's retail mortgages were part of Sparebanken Øst Boligkreditt A/S's covered pool.

The economic environment in Norway, and in eastern Norway, is still satisfactory, but slower economic growth, fewer exports and weaker domestic demand are challenges for the corporate sector. In terms of retail loans, household indebtedness has also increased in recent years and makes customers more vulnerable to an increase in interest rates, but we take comfort in still low unemployment levels in Norway.

The score for asset quality is B, reflecting good asset quality over the past three years. However, given the outlook of slow economic growth we see the trend weakening.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A3 to Sparebanken Øst. The rating is supported by the bank's Baa2 BCA and the Aaa local currency deposit ceiling of Norway, which we consider the underlying support provider. As a result of Sparebanken Øst's importance to its region and the region's importance to the national economy of Norway, Moody's assesses a high probability of systemic support for the bank in the event of a stress situation. Consequently, there is a two-notch uplift for the GLC deposit rating from the bank's BCA.

Foreign Currency Deposit Rating

The A3 foreign currency deposit rating is unconstrained given that Norway has a country ceiling of Aaa.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honour its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognise the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. AAaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Sparebanken Oest

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C	
Factor: Franchise Value						C-	Neutral
Market Share and Sustainability		x					
Geographical Diversification					x		
Earnings Stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						C	Neutral
Corporate Governance [2]	--	--	--	--	--		
- Ownership and Organizational Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management			x				
- Risk Management			x				
- Controls		x					
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management			x				
Market Risk Appetite		x					
Factor: Operating Environment						B	Neutral
Economic Stability			x				
Integrity and Corruption		x					
Legal System	x						
Financial Factors (50%)						C+	
Factor: Profitability						B+	Weakening
PPI / Average RWA- Basel II		3.55%					
Net Income / Average RWA- Basel II	2.42%						
Factor: Liquidity						D+	Neutral
(Mkt funds-Liquid Assets) / Total Assets					50.11%		
Liquidity Management			x				
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio - Basel II	11.27%						
Tangible Common Equity / RWA- Basel II	10.86%						
Factor: Efficiency						C	Neutral
Cost / Income Ratio			55.00%				
Factor: Asset Quality						B	Weakening
Problem Loans / Gross Loans		1.38%					
Problem Loans / (Equity + LLR)		15.47%					
Lowest Combined Score (15%)						D+	
Economic Insolvency Override						Neutral	
Aggregate Score						C+	
Assigned BFSR						C-	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral



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