

Semi-annual Report

First Half of 2016



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Information about Merkur Cooperative Bank

Main Office

Merkur Cooperative Bank
Vesterbrogade 40, 1
DK-1620 Copenhagen
CVR number: 24255689
Place of Domicile: Copenhagen

Board of Directors:

Morten Gunge (Chair)
Henrik Tølløse (Vice-chair)
Klaus Loehr-Petersen
Jakob Brochmann Laursen
Annette Hartvig Larsen
Lene Diemer
Carsten Juul
Henrik Kronel
Søren Sivesgaard

Executive Board:

Lars Pehrson, CEO
Asbjørn Andersen, CFO and COO

Audit Committee

Henrik Tølløse (Chair)
Jakob Brochmann Laursen
Carsten Juul

Auditing

Beierholm, State-Certified Auditing Firm

Branches:

Aalborg, Bispensgade 16,1 DK-9000 Aalborg

Copenhagen, Vesterbrogade 40,1 DK-1620 Copenhagen

Odense, Mageløs 12,1. tv DK-5000 Odense C

Aarhus, Sct. Clemens Torv 17,1 DK-8000 Aarhus

Statement by the Executive Board and the Board of Directors

We have today processed and approved the semi-annual report for 1 January through 30 June 2016 for Merkur Cooperative Bank.

The semi-annual report has been prepared in accordance with the Danish Financial Business Act, including the executive order on financial reporting for credit institutions, investment companies, etc. We consider the accounting policies appropriate for the semi-annual report to provide a true and fair review of the cooperative bank's assets and liabilities, financial position and performance.

We consider that the management's review includes a fair review of the development in the cooperative bank's activities and finances, as well as a description of the most significant risks and uncertainties that might affect the cooperative bank.

The external auditors have not revised the semi-annual report nor performed a review.

Copenhagen, 26 August 2016

Executive Board:

Lars Pehrson, CEO

Asbjørn Andersen, CFO and COO

Board of Directors:

Morten Gunge (Chair)

Henrik Tølløse (Vice-chair)

Klaus Loehr-Petersen

Jakob Brochmann Laursen

Annette Hartvig Larsen

Lene Diemer

Carsten Juul

Henrik Kronel

Søren Sivesgaard

Management's Review for the first half of 2016

Profit for the first half of 2016 amounted to DKK 11.5m and is thereby a substantially better result than last year. Net income from interest and fees has grown nicely and impairments have fallen by 40%, thereby displaying a continued downward trend. The capital base has been strengthened substantially during the first half of the year through new share capital amounting to DKK 31.3m. Following a long run-up, we now see loans growing, which is resulting in increasing interest income. Several years' focus on increased lending is now bearing fruit.

Economic developments in Denmark are positive, and some of the areas that Merkur is involved in are even experiencing an especially favourable period. This is the case for e.g. organics, where the sale of organic products is rising markedly, meaning that the financial situation for organic farming is far better than the rest of the farming industry, which is still dogged by low prices and high levels of debt. This is a good example of the importance of choosing business models that are oriented toward the future.

The extremely low interest-rate level has continued to drop, which undermines our revenue base and, together with new regulations, contributes to making banking difficult. Merkur, just like other banks, must therefore continuously focus on streamlining and digitalisation in order to meet customer expectations with fewer available resources.

Nevertheless, it should be mentioned that we, as expected, from 2016 no longer have to contribute substantially to the Guarantee Fund (formerly the Deposit Guarantee Fund), since the fund has now attained its stipulated size. This allows us to save DKK 4m annually compared to previous years.

Financial Developments

During the first half of 2016, Merkur had a net customer intake of 1,016 new customers, which is more than a doubling in comparison with the first half of 2015. This demonstrates the great interest in the cooperative bank, while external events, such as the case with the Panama Papers, simultaneously bring new customers to Merkur. The overall customer total is now 27,294. During the six-month period, gross customer intake has been 1,754. This is also a considerably higher number than in the same period in 2015, when the gross intake was 1,392.

Deposits have grown by 8.7% (DKK 201m) since the beginning of the year, and by 6.5% (DKK 110m) since 30 June 2015. Merkur's deposit surplus and liquidity has thus increased further.

Loans as well show a very satisfactory increase of 7.7% (DKK 110m) since the beginning of the year, and if one views the past 12-month period, there has been an impressive growth of 14.3% (DKK 192m). We expect loans to continue to grow in the second half of 2016 and expect to reach the budgeted target of 10% growth for the year as a whole.

The case remains, however, that customers in Denmark in general wish to reduce their debt levels and prepare to meet the future with savings on hand. This entails higher deposit rates and a higher rate of debt repayment than we saw before the financial crisis. This also means that more lending is necessary in order to keep abreast of the repayments on existing loans, which again makes the increase in loans even more remarkable. Better utilisation of the large deposit surplus continues to be decisive for whether Merkur can achieve its goals, and at the end of the first half of the year, we can establish that we are well on our way.

Merkur's share capital has shown an especially positive development during the first half of the year with growth of DKK 31.9m for the first half of 2016, and a total growth of DKK 39.7m (21.7%) over 12 months. Half of the increase – DKK 20m – is due to an investment by Villum Fonden (Villum Foundation). Villum Fonden, which is the principal owner behind the famous Velux windows, is largely active in the same sectors as Merkur and is, like us, interested in moving society toward a higher degree of sustainability over the long term. Villum Fonden sees an investment in Merkur's share capital as an effective way of supporting such a development, in that the increased capital basis allows us to activate approx. DKK 150m of our deposit surplus in the form of new loans.

In addition to Villum Fonden, we have attracted a record amount of nearly DKK 20m from a large number of existing and new shareholders over the past 12-month period. The number of shareholders has increased by 296 to a total of 5,776 after the first half of the year. The total capital base, as of 30 June 2016, amounts to DKK 308.8m, after deductions, compared to DKK 278.6m at the close of 2015.

As of 30 June 2016, the capital ratio has thus increased to 17.4% compared to 16.6% at year's end. Merkur is therefore adhering to its capital plan for the period, which runs into the year 2019. Success has also been achieved in reducing a number of risks, which make up part of Merkur's ICAAP ratio. These risks can now be calculated as 9.7%, and we have thereby increased the difference between the ICAAP ratio and the capital ratio from 6.0% to 7.7%.

By virtue of its large deposit surplus, Merkur is extremely well padded when it comes to liquidity. The deposit surplus also represents a great potential for lending to good projects.

	30 June 2016	Excess cover relative to statutory minimum
Actual capital ratio (Formerly termed solvency ratio)	17.4%	+ 8.8 percentage points relative to the statutory minimum of 8.625%.*
Calculated ICAAP ratio and excess solvency coverage	9.7%	7.7 percentage points relative to actual solvency ratio.
Calculated ICAAP ratio and excess solvency coverage, incl. capital conservation buffer.	10.3%	7.1 percentage points relative to actual solvency ratio.
Liquidity	DKK 1,154m	+ DKK 835m (261.2 %)

* The minimum requirement in 2016 has been raised by 0.625%, which is the first part of the phasing in of a so-called capital conservation buffer, which in 2019 is to be 2.5%. In 2016, EU regulations furthermore allow authorities to introduce an add-on of 1.0%, as a so-called countercyclical buffer, which would bring the minimum capital requirement to 9.625%. This option has not been exercised.

By far the greater part of Merkur's deposits – 77.0% - are either fully covered (pension accounts, etc.) or within the Guarantee Fund's cover limit of approx. DKK 750,000.

The six-month period resulted in a profit of DKK 11.5m after tax, compared to DKK 3.2m for the first half of 2015.

Income from interest has increased by 4.6%, or DKK 2.1m, compared to the first half of 2016 despite a decrease of DKK 1.0m in income from the bond holdings. Interest expenses have fallen by 24.5% compared to the same period in 2015, which was effected by the falling interest rate level for deposits, despite the increase in deposits. Net interest rate income has increased by 7.9%, or DKK 3.2m. This should be seen in relation to a decrease in net interest income of 5.5% during the same period in 2015.

Net income from fees and commissions has risen by 6.3% (DKK 1.0m), compared to the first half of 2015, to a total of DKK 16.5m. The increase was realised despite the fact that the very high level of loan conversion activity in 2015 could not be replicated this year. In return, income has increased from e.g. investments, company pensions, etc. The total net income from interest and fees thus constitutes DKK 60.3m, an increase of 7.5%, or DKK 4.2m, compared to the same period in 2015. This is a very positive development compared to the previous year.

Value adjustments have been positive by DKK 9.0m, compared to DKK 2.7m as of 30 June 2015. Value increases on Merkur's shares in the credit institutions and sector companies with which we collaborate constitute DKK 1.3m. The foreign currency gains in connection with foreign transfers constitute DKK 1.1m and bonds have contributed with a positive adjustment of DKK 7.8m, as a consequence of the fall in interest rates that occurred in the run-up to and in connection with the British EU referendum. Merkur has chosen to realise a large part of these capital gains, which occurred in connection with a reorganisation of our portfolio's long-term securities toward short-term ones, since we wish to be prepared for potential future interest rate hikes.

Total costs, as of 30 June 2016, constituted DKK 47.8m; compared to DKK 44.1m in the same period for the previous year; that is, an increase of 8.2%. The increase of DKK 3.6m, can first and foremost be attributed to expenses paid toward wages (DKK 3.2m), as a result of investing in more manpower, especially in the form of customer advisors.

Earnings per cost unit (1 DKK), excluding value adjustments for bonds, impairments and the expenses related to the Guarantee Fund have fallen from DKK 1.35, as of 30 June 2015, to DKK 1.29, as of 30 June 2016.

This is not a satisfactory development, the cause of which primarily lies with investments in personnel, as well as decreasing interest income from liquidity. We expect this financial ratio to improve during the second half of the year, if growth in loans continues.

The financial developments of the two six-month periods in 2015 and the first half of 2016 can be summarised in the following manner:

DKK 1,000

	H1 2015	H2 2015	H1 2016
Net interest rate income	40,492	40,773	43,673
Other income	15,847	16,780	16,826
Net income from interest and fees etc.	56,339	57,553	60,499
Value adjustments etc.	+2,711	-4,158	8,964
Costs	44,141	45,571	47,770
Losses and impairments	11,881	2,152	7,190
Result before taxes	3,028	5,683	14,503

Impairments on loans in the first half of 2016 constituted DKK 7.2m, compared to approx. DKK 11.9m in the first half of 2015. Of the DKK 7.2m, DKK 2m constitute an impairment on a property previously acquired by foreclosure. Impairments often occur in the first half of the year, when customers' accounts are compiled, so this is a normal pattern. Finally, DKK 0.6m have been provided to cover any potential loss in connection with the renovation of Merkur's facilities.

Supervisory Diamond

In light of the financial crisis, the Danish Financial Supervisory Authority (DFSA) has introduced a number of benchmarks, which can give an indication of whether a financial institution is beginning to take on risks that are too large.

The five benchmarks can be configured in a pentagon, hence the term "diamond", and are the following:

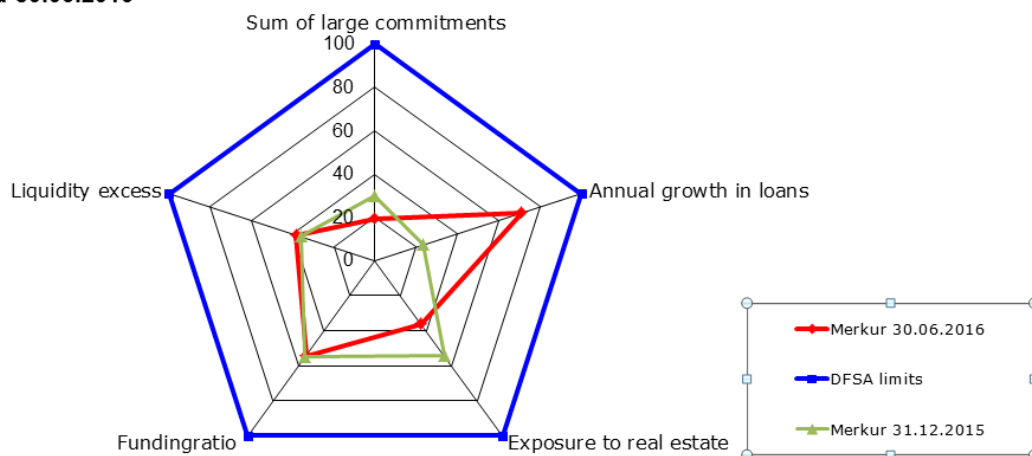
1. The sum of large commitments should not exceed 125% of a bank's capital base. Large commitments are defined as commitments whose individual sizes are in excess of 10% of the capital base.
2. The ratio between loans measured in proportion to working capital (deposits + Tier 1 capital + Tier 2 capital*) should at most be 1:1. This ratio is defined as the funding ratio.
3. The bank should have excess liquidity coverage of at least 50% more than required by law.
4. The bank should at most have an exposure to the real estate sector of 25% of the loan and guarantee portfolio. It must be underscored that the real estate sector, naturally, includes many other elements than the speculators who have received so much attention in connection with foreclosing, and in other ways crisis-struck, banks.
5. The annual growth rate for loans should not exceed 20%.

* issued bonds with a remaining maturity of more than 1 year and debt to the Danish Central Bank may also be calculated as part of this category, but this is currently not relevant for Merkur.

It must be emphasised that exceeding the benchmarks, in and of themselves, does not entail a breach of legislation – non-adherence to the benchmarks will merely lead to different degrees of increased attention and reactions on the part of the DFSA.

At the end of the first six months of 2016, Merkur meets all five benchmarks.

DFSA Diamond 30.06.2016



SUPERVISORY DIAMOND IN NUMBERS

	30 JUNE 2016	31 DEC. 2015	Diamond's threshold values
Sum of large commitments	24.1%*	37.3%	Max. 125%
Ratio between loans measured in proportion to working capital (funding ratio)	54.3%	55.2%	Max. 100%
Excess liquidity coverage	261.2%	279.7%	Min. 50%
Exposure to the real estate sector	12.2%	13.6%	Max. 25%
Growth rate for loans	14.3%	4.7%	Max. 20%

* This includes an exposure to Merkur's IT provider BEC of 13.6%, in the form of a guarantee deposit etc. In the adjusted supervisory diamond, which enters into force from 1 January 2018, the exposure to joint IT providers is excluded.

Share price

The price per share compared to year's end has risen from DKK 174.86 to DKK 180.75, an increase of 3.37% in six months. This represents a very positive development, and lies within the target rate of return for which we are aiming.

Important events in H1

The most important event of the first six-month period has been the DKK 20m investment in Merkur's share capital by Villum Fonden. This signifies a significant boost in terms of capital, which is supporting the current growth in loans, in line with the foundation's intentions. The substantial effort undertaken to increase loans is now bearing fruit simultaneously with the positive development of share subscriptions among our customers.

Uncertainties relating to recognition and measurement

Management believes that there are no uncertainties relating to recognition and measurement, other than that the drawing-up of financial accounting values always requires a certain degree of estimation.

Recognition and measurement in this six-month period have not been affected by unusual circumstances.

Events after the balance sheet date

No events have occurred after the end of the financial period that would affect the evaluation of the semi-annual report.

Accounting Policies

Accounting policies are consistent with the 2015 annual report.

Outlook for the remainder of 2016

Merkur expects growth in the second half of 2016, in both deposits and loans. The growth in loans for 2016, as a whole, is expected to be 10-12%. The expectation in the annual report for 2015 of approx. 10% ought therefore to be achievable, even to the upside.

We expect that the level of impairments is stabilising at around 0.5% of loans and guarantees, which we deem as a normal level. We therefore expect to remain within the annual report's expectations of impairments on the scale of DKK 10-11m in 2016. This estimate is associated with great uncertainty, as it depends on, among other things, the general economic developments in our surrounding society. Developments in individual commitments may also affect the overall picture, not least in a situation where total impairments are limited.

The continued drop in interest rate levels and Denmark's Central Bank's reduction of the so-called current-account limit (the option for banks to place money at currently 0% interest) actualize deliberations on further reduction of the deposit rate. Likewise, it may become relevant for customers with large deposits in some situations to pay a negative deposit rate. In the event, the justification for such a step would be to compensate for the cooperative bank's loss by placing liquidity with the central bank or the market in general.

In view of the profit for the first half of the year being positively affected by value adjustments on bonds, which cannot be expected for the second half of the year, we maintain the annual report's estimate for a total profit for 2016 of DKK 15-18m

Income statement January-June 2016
In 1,000 DKK

note	Period ended June 30 2016	Period ended June 30 2015
1 Interest income	47,129	45,068
2 Interest expense	3,456	4,576
Net interest income	43,673	40,492
Dividends from shares etc.	92	60
3 Fee and commission income	17,696	16,459
Fee and commission expense	1,187	922
Net interest and fee income	60,274	56,089
4 Securities and foreign exchange income	8,964	2,711
Other operating income	220	250
5 Staff costs and administrative expenses	44,923	39,871
Depreciation	414	412
Other operating expenses	2,433	3,858
Operating result before provisions and tax	21,688	14,909
6 Provisions for bad and doubtful debts	7,190	11,881
Result from holdings in associated undertakings	5	0
Profit before tax	14,503	3,028
Computed tax of the period's result	2,988	-140
Net profit after tax	11,515	3,168

Balance sheet**ASSETS (IN 1,000 DKK)**

	June 30 2016	Dec. 31 2015	June 30 2015
Cash in hand and demand deposits with central banks	14,693	169,291	257,695
Due from credit institutions + deposits with central banks	286,676	35,760	141,260
Loans and advances	1,541,011	1,430,950	1,348,795
Bonds at fair value	979,465	871,982	808,510
Bonds at amortized cost	49,877	49,836	49,795
Shares etc.	49,540	46,646	46,401
Holdings in associated undertakings	648	642	631
Intangible assets	0	0	0
Real estate (investment properties)	4,000	5,260	15,260
Real estate in the use of the bank	12,952	10,688	8,342
Other tangible assets	2,233	1,622	1,978
Actual tax assets	3,524	1,506	1,722
Deferred tax assets	1,941	1,941	2,699
Assets in temporary possession	6,250	8,250	9,506
Other assets	45,274	51,787	52,377
Prepayments and accrued income	2,339	1,807	2,166
TOTAL ASSETS	3,000,423	2,687,968	2,747,137

EQUITY AND LIABILITIES (IN 1,000 DKK)

Due to credit institutions and central banks	136,501	71,911	82,422
Deposits	2,501,144	2,300,360	2,347,874
Current tax liabilities	2,988	0	0
Other liabilities	22,810	22,522	28,401
Total debt	2,663,443	2,394,793	2,458,697
Provisions for obligations:			
Provision for pensions and similar liabilities	137	137	111
Provisions for deferred taxes	0	0	0
Provisions for potential losses on guarantees	228	0	0
Provisions for other obligations	625	0	0
Total provisions for obligations	990	137	111
Subordinated debt:			
Subordinated debt	43,871	43,730	52,098
Net capital:			
Share capital	147,603	129,848	124,963
Share premium account	74,746	61,205	57,668
Revaluation of real property	859	859	859
Other reserves	4,708	4,708	4,708
Brought forward from previous years incl. result of period	64,203	52,688	48,032
Total net capital	292,119	249,308	236,231
TOTAL LIABILITIES	3,000,423	2,687,968	2,747,137
OFF-BALANCE SHEET ITEMS:			
Guarantees etc.	529,020	480,866	480,928
TOTAL OFF-BALANCE SHEET ITEMS	529,020	480,866	480,928

STATEMENT OF CAPITAL (1,000 DKK)**Statement of capital June 30, 2016**

	June 30 2016	Dec. 31 2015	June 30 2015
Share capital, beginning of year	129,848	122,053	122,053
Capital increase	17,755	7,795	2,910
Share capital, end of period	147,603	129,848	124,963
Value of shares, end of period			
Value of shares, relative to 100	181	175	171
Share premium account, beginning of year	61,205	55,664	55,664
Share premiums from shares issued	13,541	5,502	2,004
Other comprehensive income	0	39	0
Share premium account, end of period	74,746	61,205	57,668
Other reserves, beginning of year	4,708	4,708	4,708
Other reserves, end of period	4,708	4,708	4,708
Revaluation reserves			
Beginning of the year	859	859	859
Revaluation reserves, end of period	859	859	859
Profit brought forward, beginning of year	52,688	44,864	44,864
Increased through net profit of year	11,515	7,824	3,168
Profit brought forward, end of period	64,203	52,688	48,032
Composition of net capital, end of period			
Share capital	147,603	129,848	124,963
Share premium account	74,746	61,205	57,668
Other reserves	4,708	4,708	4,708
Revaluation reserves, real estate	859	859	859
Brought forward from prior years	52,688	44,864	44,864
Appropriated from net profit for the period	11,515	7,824	3,168
Total net capital	292,119	249,308	236,231

NOTES (in 1,000 DKK)	Period ended June 30 2016	Period ended June 30 2015
Note		
1 Interest income		
Credit institutions and central banks	12	66
Loans	45,471	42,357
Bonds	1,605	2,611
Other interest income	41	34
Total interest income	47,129	45,068
of which repo transactions	0	0
2 Interest expenses		
Credit institutions and central banks	640	973
Deposits	1,698	2,827
Subordinated debt	1,116	774
Other interest expenses	2	2
Total interest expenses	3,456	4,576
of which repo transactions	0	0
3 Fees and commission income		
Securities trade and securities in account	1,858	1,246
Payment handling	3,081	2,525
Loan business, fees and charges	1,976	2,554
Guarantee commission	5,496	4,652
Other charges, fees and commission income	5,285	5,482
Total fees and commission income	17,696	16,459
4 Securities and foreign exchange income		
Bonds (mark-to market valuation)	7,822	-483
Shares	1,346	2,625
Value adjustments investment properties	-1,260	0
Foreign exchange income	1,056	569
Total securities and foreign exchange income	8,964	2,711
5 Staff costs and administrative expenses		
Salaries and remuneration of board of directors, executive board and shareholders committee:		
Executive board	710	698
Board of directors	392	375
Total	1,102	1,073
Staff costs:		
Salaries	20,577	18,184
Pension costs	2,320	2,130
Financial services employer tax	3,283	2,674
Total	26,180	22,988
Other administrative expenses	17,641	15,810
Total staff costs and administrative expenses	44,923	39,871

Average number of employees (full time equivalents) for the period was 89.6

6 Impairments

	Individual impairments	Collective impairments		
	June 30 2016	June 30 2015	June 30 2016	June 30 2015
Impairments of the period	9,529	16,197	1,326	1,024
Reversal of impairments from previous years	5,649	5,177	94	176
Direct write offs	1,123	1,026	0	0
Income from prior years write offs and interest from impairments	1,045	2,525	0	0
Net impairments from income statement	3,958	9,521	1,232	848
Write offs, previously impaired	2,778	2,043		0

7 Financial highlights

	June 30 2016	June 30 2015	June 30 2014	June 30 2013	June 30 2012
Net interest and fee income	43,673	40,492	55,575	50,858	50,205
Market value adjustments	8,964	2,711	2,934	984	2,348
Staff and administrative expenses	44,923	39,871	36,720	32,355	31,986
Impairments on loans etc.	7,190	11,881	13,446	17,515	15,987
Result from holdings in ass. undertakings	5	0	0	0	0
Profit of the period	11,515	3,168	3,425	-2,155	1,492
Deposits	2,501,144	2,347,874	2,149,584	1,926,211	1,764,249
Loans	1,541,011	1,348,795	1,287,862	1,198,051	1,172,517
Net capital	292,119	236,231	216,500	191,745	183,392
Total assets	3,000,423	2,747,137	2,546,189	2,244,847	2,073,744

8 FINANCIAL RATIOS	June 30	June 30	June 30	June 30	June 30
Profit	2016	2015	2014	2013	2012
Income/cost ratio DKK	1.26	1.05	1.07	0.95	1.04
Income/cost ratio DKK, before impairments and bank packages	1.29	1.35	1.46	1.49	1.50
Return on equity before tax (%)	5.4	1.3	1.9	-1.5	1.1
Return on equity after tax (%)	4.3	1.4	1.6	-1.2	0.8
Development in % of the value of shares, 12 months from 20. July the preceding year	5.70	2.86	3.91	-1.99	-4.81
Solvency					
Capital ratio (BIS Ratio)	17.4	16.2	15.1	13.8	14.3
Core capital ratio	15.0	13.5	13.0	11.7	12.1
Market risks					
Interest-rate risk (%)	-0.6	0.5	2.9	0.9	1.3
Currency position (%)	1.0	0.9	1.3	1.0	0.6
Currency risk (%)	0.0	0.0	0.0	0.0	0.0
Liquidity					
Loans + impairments in % of deposits	63.8	59.9	62.3	64.8	68.6
Excess cover in % relative to the statutory liquidity requirement	261.2	306.3	304.5	281.7	248.1
Credit risk					
Impairment ratio of the period	0.2	0.5	0.8	1.0	1.0
Accumulated impairment ratio	2.5	3.0	3.0	3.0	2.3
Sum total large-scale commitments in % of capital base	24.1	40.8	36.1	20.6	75.1
Growth in % in loans of the period	7.7	-1.3	-0.3	3.5	-0.9
Loans relative to equity	5.3	5.7	6.0	6.2	6.4