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Research

Deutsche Verkehrsbank AG

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Credit Rating
A-/Stable/A-2

Rationale

The ratings on Deutsche Verkehrsbank AG (DVB) are fully based on the bank's membership of the German cooperative banking sector and the sector's system of solidarity, which is underpinned by a comprehensive protection scheme. The ratings are also based on the sector's important market position--particularly in domestic retail banking--and its overall sound profitability levels. While member banks are not linked by a cross-guarantee scheme, strong solidarity has been demonstrated for more than 60 years, with the sector operating a system to protect the solvency of each bank, preventing losses for the banks' creditors and their member shareholders.

Although the ratings reflect Standard & Poor's view of the sector as a group, in the absence of a cross-guarantee system, distinctions are made between stronger and weaker members within the group. In a cohesive group these differences are slight however, and therefore the rating differences also are slight. Following asset quality problems until 1997 and the initiation of a comprehensive restructuring process, DVB's profitability and capital levels are still low, although existing problem loans seem to be adequately covered.

With total consolidated assets of euro (Eur) 9 billion (\$7.6 billion, at Eur0.85 to \$1) and 870 employees at Sept. 30, 2000, DVB is a wholesale commercial bank and acts as a central bank for a group of 16 local cooperative banks, which operate under the name Sparda Banken. Its fully owned subsidiary, Reise Bank, is mainly active in foreign currency exchange for retail customers. DVB is 67% owned by DG Bank Deutsche Genossenschaftsbank AG (DG Bank; no counterparty credit ratings assigned), the largest central bank of the cooperative sector, which in turn is owned by members of the cooperative sector. The 16 Sparda Banken had total assets of Eur33 billion at year-end 1999, and own 13% of DVB.

DVB's unfocused policy in corporate lending eventually led to a revision of the bank's strategy in 1997. As a former subsidiary of Deutsche Bahn AG (the German railway) until 1995, DVB has its roots in the transport sector, which has been singled out as the bank's core business segment. Within the DG Bank group, DVB will act as a center of competence for the transport sector. DVB broadened its market position through acquisitions, which serve as a basis for growth in the international transport sector, in which the bank has yet to establish a record. As a first step, DVB acquired a portfolio of mainly aircraft loans from Long-Term Credit Bank of Japan Ltd. of Eur1.4 billion and a team of 14 credit specialists in 1998. In December 1999, DVB announced the acquisition of Nedship Bank (Nedship; loan portfolio of Eur2.2 billion), a specialized ship financier, from May 31, 2000.

The bank's profitability has been improving since 1998, but is still unsatisfactory, impaired by comparatively low margins and a cost-to-income ratio of 76% at Sept. 30, 2000. Its pretax ROE (reduced by goodwill and hybrid capital) rose to 19.7%, compared with 13.5% in 1999, up from 4.4% in 1998, reflecting growth in revenues through acquisitions as well as the bank's high leverage. Commission income from Reise Bank's foreign currency business, which has contributed significantly to DVB's operating profit in the past, will come under pressure with the introduction of the euro in 2002 although Reise Bank has taken steps to diversify its

fee income to compensate for the loss of business. Financial flexibility is further weakened by a very low level of capitalization, with a Tier 1 capital ratio according to German regulations of 4.8% at Sept. 30, 2000, reflecting the bank's growth and its rehabilitation process. Following the acquisition of Nedship, DVB's economic capitalization deteriorated further because of the goodwill and funding of the acquisition. Standard & Poor's expects that capital levels will remain very low for some time.

Outlook

The outlook reflects Standard & Poor's expectation that the German cooperative sector will maintain its strong position in the domestic market, and cohesiveness and solidarity will continue to be demonstrated within the sector. Standard & Poor's will also monitor DVB's business expansion and its role within the sector and the DG group.

The Cooperative Banking Sector In Germany

The cooperative banking sector consisted of 1,966 local cooperative banks and three central banks (DG Bank, GZ-Bank, and WGZ-Bank) at June 30, 2000. GZ-Bank was established through the merger of SGZ Bank and GZB-Bank in 2000.

In contrast with the savings banks sector, the cooperative bank sector does not benefit from any public sector support. Central institutions provide services that cannot be carried out by the independent local cooperative banks, including payment and foreign transactions, securities business, technological support, and advisory functions. Furthermore, they act as commercial banks. The sector offers a complete range of financial services through specialized entities. The largest of these is R+V, one of the leading German insurance groups. Mortgage banking is conducted by four cooperative mortgage banks, the largest of which is Deutsche Genossenschafts-Hypothekenbank AG (DG HYP; A/Stable/A-1), and is complemented by the group's building savings bank, Bausparkasse Schwäbisch Hall AG (BSH), which has a market share of about 26% in this business. With Union Investment, the sector also operates the third-largest domestic retail fund manager.

Internal guidelines require local banks to place a percentage of customer deposits with their central bank. The central banks in turn are required to hold a certain amount of deposits with DG Bank. In addition, local cooperative banks are expected to do all their interbank business with their central bank. Consequently, only a few local banks have limited business relationships with noncooperative banks, largely for historical reasons.

Unlike in The Netherlands and France, the German cooperative banking sector is not linked by a cross-guarantee scheme. Instead, it has had a protective system in place for more than 60 years that is funded by annual contributions from the banks. This system aims to protect the solvency of the banks, and has been successful in preventing bankruptcies and losses for creditors and member shareholders. The interdependence of the member banks means that the incentive and willingness to prevent bankruptcies is very strong as regularly demonstrated in the past, particularly in connection with the restructuring of Berlin-based local banks, but also through the support of a bank, which, after its transformation into a joint-stock company, had already left the cooperative sector, but continued to carry the name Volksbank.

Standard & Poor's assigned long-term counterparty ratings of 'A+', 'A', and 'A-' to individual member banks, based on the cooperative banking sector's system of solidarity, its important market position (particularly in the domestic retail banking markets), and its overall sound, although decreasing, profitability levels. Although the ratings reflect Standard & Poor's view of the sector as a group, in the absence of a cross-guarantee system, distinctions are made between stronger and weaker members of the group. In a cohesive group, however, these differences are slight and the rating differences therefore will also be slight.

With total added business volume of Eur739 billion, the cooperative banking sector had a market share of 12.5% at June 30, 2000. With 17,828 outlets at year-end 1999, local cooperative banks, together with local savings banks, operate the largest branch network in Germany.

Consolidation reduced the number of local cooperative banks to 1966 at mid-year 2000, from 11,997 at year-end 1965. Consequently, the average balance sheet increased to Eur266 million from Eur58 million in 1985. The number of central banks reduced to three from 18 in 1985.

Local banks, whose business profiles are similar to those of savings banks, offer a full range of banking services but concentrate on retail customers and small businesses. They operate as cooperative banks (Volks- und Raiffeisenbanken), with 14.8 million members who are customers and shareholders of local banks. The cooperative banking sector serves more than 30 million clients and its strong position in domestic retail banking is reflected in its market shares: 19% of customer deposits (but almost 29% of savings deposits) and about 14% of customer loans (but 19% of loans to private customers) at year-end 1999.

The cooperative banks' profitability generally is sound by domestic standards, based on still healthy net interest margins and the banks' major strengths--proximity to and intimate knowledge of the local clientele. This is partly offset by high expense levels. To improve financial flexibility, however, cooperative banks also tend to build up taxed hidden reserves, since opportunities to strengthen capitalization are limited and pressure to improve shareholder value is almost nonexistent.

Low-cost customer deposits have been the basis for the local banks' above-average margins, but growing competition from larger banks and new entrants--such as direct banks targeting the retail banking market supported by technological developments, and the increased awareness and diminishing loyalty of customers--have forced the banks to pay interest rates that are closer to market levels. Furthermore, booming stock markets pose a risk for the banks' deposit base. Fees for standard services, which form an important revenue source for cooperative banks, also have come under pressure as competitors offer accounts free of charge. Substantial investments in IT and new products (direct banking) also puts pressure on the cost side and intensifies the need to form larger entities and to further centralize overhead functions to better exploit the cost saving potential. This requires closer cooperation among the central banks and leadership to restructure the sector and to safeguard its still-strong position, but consensus on strategically important decisions has been difficult to achieve. Further consolidations will continue to form larger entities, but it remains to be seen if the banks' managerial capacities are sufficient for them to cope with stronger competition, the partial loss of relatively stable revenues, and the high portion of fixed costs.

In May 1999, the Association of the German Cooperative Banks (BVR) reported its plans to restructure the sector against this background of shrinking interest margins, high expense levels, and increasing but still-manageable expenses caused by the recapitalization of troubled local cooperative banks by the guarantee fund, caused by the lack of adequate management resources at the local level. In particular, the Berlin-based cooperative banks suffer from severe asset quality problems and had to be restructured with support from the guarantee system. The plan foresees further consolidation among the local banks (down to 800), a reduction in EDP centers (to two, from five) and regional associations (to three, from 11), avoidance of competition among cooperative banks, standardization of products and harmonization of IT systems, management training, and the introduction of a common risk-management system at the local level to reduce payments of the guarantee fund.

The centralization and outsourcing of back-office functions--which has already started with the set up of a securities-processing bank, the combining of asset management activities, and the newly established processing center for residential mortgage loans--is key to improving the sector's efficiency and would allow local banks to focus on their function as distribution channels. Ultimately, the function of the three remaining central banks also would have to be reconsidered if the number of local banks is drastically reduced. Standard & Poor's believes that the current structure does not exploit the synergy potential, and views the BVR's plans as a positive move. While Standard & Poor's believes that the sector will maintain a solid market position, concerns remain about the scope and speed of its implementation.

Deutsche Verkehrsbank Financial Statistics¶					
	-Year ended Dec. 31-				
(Mil. Eur)	2000§	1999	1998	1997	1996
Assets	8,923	6,875	6,565	5,331	4,658
% change	29.79	4.72	23.16	14.45	(1.80)
Regulatory risk assets*	7,168	3,974	3,309	2,217	1,911
% change	80.36	20.09	49.25	16.04	(3.23)
Loans	6,308	3,370	2,433	1,507	1,496
% change	87.15	38.50	61.48	0.72	8.11
Customer deposits	1,753	1,750	1,869	1,377	1,293
% change	0.19	(6.38)	35.78	6.48	(20.71)
Total equity	321	177	151	151	150
% change	81.23	17.04	0.02	0.65	19.74
Adjusted common equity	143	177	151	151	150
% change	(19.12)	17.04	0.02	0.65	19.74
Adjusted total equity	143	177	151	151	150
% change	(19.12)	17.04	0.02	0.65	19.74
Revenues	114	138	113	120	93
% change	9.92	21.82	(5.61)	29.27	(11.64)
Noninterest expense	87	109	97	90	82
% change	6.32	12.54	7.95	8.75	(13.74)
Net operating income bef. loan loss prov. (LLP)	27	29	16	30	10
% change	23.44	76.67	(45.83)	193.70	9.82
LLP	3	7	9	N.A.	N.A.
% change	(39.05)	(19.47)	N.A.	N.A.	N.A.
Pretax income	24	22	7	1	7
% change	42.96	231.43	1,220.57	(92.58)	47.40
Net income	N.A.	16	5	0	4
% change	N.A.	213.63	2,003.25	(93.99)	(14.41)
ASSET COMPOSITION (%)					
Customer loans	70.69	49.02	37.07	28.27	32.12
Bond portfolio	8.64	13.66	9.74	10.58	14.46
Interbank assets	15.56	17.84	46.63	52.10	47.23
Other assets	5.11	19.48	6.56	9.05	6.19
¶Consolidated since 1997. §Period ended Sept. 30; ratios annualized where appropriate. *KWG definition of Tier 1 equity and risk assets. N.A.- Not available.					

Profile

With total consolidated assets of Eur9 billion and 870 employees at Sept. 30, 2000, DVB is a wholesale commercial bank with an exclusive focus on the transport sector. It also acts as a central bank for a group of 16 local cooperative banks, which operate under the name Sparda Banken. The parent company, DVB, has its headquarters in Frankfurt. Nedship, which has been fully consolidated since June 1, 2000, is DVB's largest subsidiary accounting for one-third of group assets. Other major subsidiaries include International Transport Finance Ltd., London (ITFL), and Reise Bank AG.

As a subsidiary of Deutsche Bahn AG (German Railway) until 1995, DVB has its roots in the transport sector, which has been singled out as DVB's core business segment. Within the DG Bank group, DVB acts as a center of competence. This includes all vehicles used for transportation by air, sea, railway, and road, as well as infrastructure projects (for example, airports) and advisory business with larger customers. In 1998, DVB acquired a portfolio of mainly aircraft loans from LTCB of Eur1.4 billion and a team of 14 credit specialists. In December 1999, DVB announced the acquisition of Nedship (total assets of \$2.5 billion), a specialized ship financier, effective May 31, 2000. Both acquisitions serve as a basis for further growth in the transport sector on an international scale. The transport sector is a huge and growing market that offers significant business opportunities for specialized banks. DVB estimates the annual investment needs at \$81 billion for aviation, \$47 billion for shipping, \$113 billion for road transport, and \$70 billion for rail transport.

DVB also acts as a central bank mainly for historical reasons. The cooperative banking sector has committed itself on a voluntary basis to the principle that the central institutions should only provide services that cannot be carried out at the lower levels. The retail-oriented Sparda Banken had total assets of Eur33 billion; a net income of Eur66 million (ROA of 0.2%); 5,900 staff; and a branch network of about 300 at year-end 1999. Its 1.8 million members are the owners of the banks. Customer deposits of Eur27 billion by far exceed customer loans of about Eur19 billion and a portion of this excess liquidity is placed with DVB as their central bank and clearing house accounting for the bulk of DVB's interbank liabilities. DVB in turn provides typical central bank functions for the Sparda Banken such as advisory, securities/custody, and payment services, and is integrated into DG Bank's and the sector's network.

Nedship is represented in major shipping centers. It had total assets of Eur2.5 billion and 83 staff at year-end 1999 and is exclusively active in international ship financing. It was 100% owned by Dutch Rabobank, whose plans to establish a joint venture with DG Bank that would combine both banks' international and investment banking operations eventually failed. Nedship will continue to operate as a separate legal entity and will not be a member of the German cooperative guarantee system. DVB issued a letter of comfort in favor of Nedship, however. With an international loan portfolio of Eur2.2 billion at the time of the acquisition, Nedship claims to rank among the 10-15 largest shipping banks worldwide.

While Nedship's traditional lending business is still dominant, the bank is in the early stages of developing corporate finance expertise, and intends to focus on the larger corporate ship owners. Although Nedship's loan portfolio is well-diversified by size, type of vessel, and geography, the implementation of the bank's strategy means that the bank has to withdraw from a number of relationships with smaller customers. The downturn in the cyclical shipping industry caused by overcapacities and the Asian crisis had a negative impact on asset quality and caused higher provisioning needs, which remained at manageable levels, however. Relief came from the improving charter rates since mid-year 1999. Profitability benefits from Nedship's low cost-to-income ratio of less than 30%, however, through the sale, Nedship will lose its funding advantage accruing from its former owner Rabobank. Its ROE remained unchanged at 8.8% in 1999, but was down from 13.6% in 1997, mainly reflecting higher loan loss provisions.

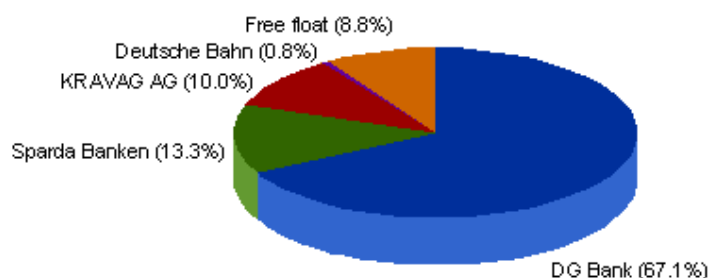
London-based ITFL, with an office in Tokyo, was established following the acquisition of the LTCB portfolio in 1998. ITFL is in charge of handling customer relationships in the Americas and Japan and processing loans to Japanese leasing companies.

Reise Bank was spun off DVB in 1996, and has total assets of Eur49 million, 316 staff, and about 60 outlets. Its core business is the exchange of foreign currency bills and travelers checks for retail customers and it claims to be the market leader in Germany, with a market share of 35%. DVB is in charge of DG Bank's wholesale (physical) foreign currency exchange and precious metals business, and it provides these services to about 1,200 local cooperative banks and other institutional clients. DVB and Reise Bank's foreign currency exchange business forms the bulk of the group's commission and trading income. Although profits from this business have been crucial to the restructuring of DVB, these activities are likely to lose importance for DVB as they are not considered essential in the medium term.

Ownership and Legal Status

Contrary to the cooperative banks (but like its majority owner DG Bank), DVB is a joint-stock company. It was listed by its former owner Deutsche Bahn AG in 1988, which, after its privatization, sold the largest portion of its majority stake to DG Bank in 1995. This gave DG Bank the opportunity to achieve a controlling stake and to close the ties with DVB and its affiliated Sparda Banken, which were originally established as cooperative banks for railway employees. Today, the ownership structure is as follows (see chart 1):

Chart 1
Ownership Structure at Dec. 2000



DVB's ownership structure reflects its close links to the cooperative banking sector, which holds 90% of the bank. KRAVAG is a specialized insurance group that focuses on the transport sector. Deutsche Bahn itself kept only a tiny share and the free float is 9% only. DVB, DG Bank, and the Sparda Banken are members of the guarantee system of the German cooperative banking sector. Two board members of DG Bank sit on DVB's supervisory board.

As a credit institution, DVB is subject to the provisions of the German Banking Act (Kreditwesengesetz, or KWG) and to the supervision of the Federal Banking Supervisory Authority (Bundesaufsichtsamt für das Kreditwesen or BAKred).

Strategy

Unfocussed corporate lending business had caused an increase in problem loans and eventually led to a revision of the bank's strategy in 1997. Under new management, DVB implemented a restructuring program with a focus on the transport business and geared toward the development of a 'competence center' within the DG group and for the cooperative sector. DVB will follow a niche strategy as a specialist, and aims to become a leading wholesale financial institution in the transport sector, servicing the upper tier of domestic and international customers. Existing relationships, which do not fit into DVB's strategy, will be discontinued and no new business outside the transport sector will be undertaken. Correspondingly, DG Bank will not actively seek new business in this area.

DVB's main activities are:

- Structured finance and corporate advisory in the transport sector (shipping, aviation, and land transport);
- Acting as a Central bank for the Sparda Banken, which provides DVB with a stable funding base;
- Performing treasury functions, including exchange of and trading with foreign currency and precious metals for institutional customers; and
- Foreign currency exchange and payment services for retail customers (Reise Bank).

Although DVB was mainly a domestic corporate lender with expertise in the railway sector, the acquisition of an international aircraft and a smaller ship loan portfolio of Eur1.4 billion from LTCB in 1998 provided an opportunity to implement the new strategy. This was because they allowed for the reduction of nonstrategic businesses while keeping the negative impact on profitability at bay. A number of these transactions were arranged or coarranged by LTCB.

With the acquisition of Nedship, DVB also gained an international presence in ship financing. Although Nedship is still in the process of building expertise in corporate finance, it may benefit from the know-how of former LTCB specialists. DVB's key challenge is to manage successfully the integration process and to maintain and use its expertise and customer relationships for new transactions, thereby gaining market shares while maintaining prudent underwriting standards. DVB has therefore hired a senior manager with longstanding experience in the shipping industry as the new CEO of Nedship. While expansion is limited by the low level of capital, qualitative growth is needed to better use the bank's facilities and to reduce its cost-to-income ratio, which was still 76% in 2000. Having improved its name recognition, DVB aims to increasingly act as advisor and arranger to diversify its revenues. To this end, DVB established a special unit in London to combine its corporate finance activities for the whole transport sector.

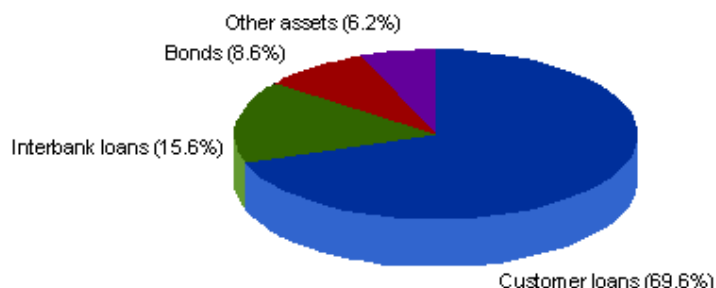
Another challenge for DVB is the introduction of the euro as legal tender in 2002, because DVB and Reise Bank will lose portions of commissions and trading profits from its foreign currency exchange business. On the wholesale level, DVB aims to leverage off its leading market position and to benefit from economies of scale, offering its services to those institutions that do not plan to continue in this costly business. Reise Bank will have to close a number of outlets and focus on Eastern Europe, non-EMU currencies, and other services to reduce the inevitable loss of revenues.

Asset Quality

DVB's asset quality had been impaired by the weak quality of DVB's traditional corporate loan portfolio (that is, excluding the portfolio acquired from LTCB in 1998), which caused an unsustainable level of loan loss provisions until 1997, when DVB completed a reevaluation of its portfolio, established a work-out division, and significantly raised provisions to cover remaining risks in the portfolio. In 1998, provisioning needs, already at a low level, further declined in 1999. With the strategic reorientation in place, DVB will wind-down nonstrategic relationships over time and focus exclusively on the transport sector.

After a period of moderate growth until 1997, total assets rose by 23% in 1998, reflecting the acquisition of a loan portfolio acquired from LTCB, and by 30% at Sept. 30, 2000, reflecting the consolidation of Nedship. Customer loans accounted for 70% of total assets at Sept. 30, 2000, up from 28% at year-end 1997. Interbank placings represented 16% of total assets down from 52% at year-end 1997. Bonds remained at 9% of total assets (see chart 2).

Chart 2
Asset Composition at Sept. 30, 2000



At Sept. 30, 2000, the group's exposure to the transport sectors amounted to Eur6 billion, up from Eur2.6 billion at year-end 1999, mainly reflecting the acquisition of Nedship in 2000. With the acquisition of Nedship's international portfolio of Eur2.2 billion, shipping loans represented 55%. Aviation (Eur1.6 billion) accounted for 27% as a result of DVB's acquisition of a portfolio from LTCB in 1998. The remaining 18% was evenly split between DVB's traditional business areas of rail and road transport. Exposures in the nontransport sectors of Eur0.7 billion (consisting of a mixed portfolio of corporate loans, particularly to domestic midsize clients, which caused significant problems in the past) will be wound down. DVB has been improving its risk management concerning the loan-approval process, surveillance, work-out, and internal ratings, and has implemented new credit guidelines reflecting its strategy, but needs to further develop portfolio management tools. New business will focus on cash-flow-based medium and long-term collateralized transactions in the transport sector, with limits concerning loan-to-value (LTV) ratios, maturities, and objects.

In 1998, DVB acquired a portfolio from LTCB, the bulk of which consisted of aircraft financing and a smaller portion of ship loans because LTCB had to liquidate assets in the course of its restructuring. LTCB's asset quality problems relate to its domestic portfolio, however, and were not caused by its overseas business. DVB and its advisors undertook a due diligence on asset quality and legal documentation, while the ongoing surveillance after the closing of the transaction confirmed the sound quality of the portfolio.

The shipping loan portfolio is well diversified by type of vessels, with a focus on tankers, bulk carriers, and containers with an average loan-to-value ratio of 64%, reflecting the upward trend since mid-year 1999. Market rates in most shipping segments have shown pronounced volatility in the past, leading to higher LTV ratios in times of stress, however. Although findings from the due diligence undertaken by an external auditing firm on Nedship's accounts were confirmed by DVB's ongoing evaluation of the portfolio, it includes a significant but manageable amount of higher risk exposures for which Nedship had to increase its loan loss provisions in recent years. Under new management Nedship targets larger, more creditworthy customers utilizing its higher underwriting capacity.

DVB's function as a central bank acting as liquidity clearer for the local Sparda cooperative banks is demonstrated by its interbank business. Interbank loans represented 16% of total assets, with 36% due from local banks and DG Bank at Sept. 30, 2000. Within the sector's guarantee system, these interbank loans rank pari passu with other obligations to noncooperative lenders, and therefore enjoy the same protection. Other bank exposures include domestic public sector and large commercial banks. DVB's bond portfolio acts as a liquidity reserve and mainly includes securities eligible for repo transactions with the central bank.

Risk provisions, according to German accounting rules, which do not fully reflect trends in the basic quality of the bank's loan portfolio, were high, particularly in 1997 and 1994, when they exceeded operating income before risk provisions. DVB disclosed the level of risk provisions for the lending business for 1998 and 1999, however, which compares very favorably with earlier years.

Table 1 Risk Provisions			
	-Year-ended Dec. 31-		
(Mil. Eur)	2000†	1999	1998
Loan loss provisions (LLP)	3	7	9
LLP/average loans (net)	0.09	0.24	0.44
LLP/Revenues	2.82	5.08	7.68
†At Sept. 30, 2000.			

While DVB seems to have made adequate loan loss provisions (LLP) for existing problem loans in its work-out portfolio, as demonstrated by the significant decline since 1998, new problems may emerge in a still-difficult economic environment that has seen a record number of domestic corporate insolvencies that is not expected to decline substantially in 2001. This has to be seen in light of the bank's very low level of capitalization and profitability. Furthermore, the success of DVB's strategic move into sophisticated structured finance transactions such as international aircraft and ship financing will strongly depend on the successful integration and expertise of former LTCB and Nedship specialists and DVB's commitment to maintaining prudent lending criteria.

Deutsche Verkehrsbank Ratio Analysis¶					
	-Year ended Dec. 31-				
(%)	2000§	1999	1998	1997	1996
PROFITABILITY					
Revenues/avg. assets	1.92	2.05	1.90	2.40	1.97
Net interest income/avg. assets	0.84	0.71	0.62	0.67	0.69
Noninterest income/avg. assets	1.07	1.25	1.22	1.31	1.19
Noninterest expense/avg. assets	1.47	1.62	1.63	1.80	1.75
Net operating income before LLP/avg. assets	0.45	0.43	0.28	0.61	0.22
Net operating income after LLP/avg. assets	0.40	0.34	0.14	(0.11)	(0.00)
LLP/avg. assets	0.05	0.10	0.15	N.A.	N.A.
Pretax profits/avg. assets	0.40	0.33	0.11	0.01	0.14
Net income/avg. assets (ROA)	N.A.	0.23	0.08	0.00	0.08
Revenues/avg. risk assets*	2.72	3.79	4.10	5.81	4.77
Net income/avg. risk assets*	N.A.	0.43	0.18	0.01	0.20
Net interest income/revenues	44.03	34.38	32.59	28.06	34.85
Noninterest income/revenues	55.97	60.87	64.17	54.51	60.24
Noninterest expense/revenues	76.44	79.02	85.53	74.79	88.90
Net operating income before LLP/revenues	23.56	20.98	14.47	25.21	11.10
Net operating income after LLP/revenues	20.83	16.40	7.32	(4.72)	(0.07)
LLP/revenues	2.82	5.08	7.68	N.A.	N.A.
Pretax profits/revenues	20.83	16.02	5.89	0.42	7.34
Net income/revenues	N.A.	11.28	4.38	0.20	4.23
Net income/avg. adj. common equity (ROE)	N.A.	9.47	3.28	0.16	2.84
LIQUIDITY					
Total deposits/total liabilities	73.38	85.40	84.94	92.45	92.64
Loans/customer deposits	359.79	192.62	130.20	109.48	115.73
Loans (net)/assets	70.69	49.02	37.07	28.27	32.12
Net interbank deposits/total liabilities	(37.60)	(40.97)	(8.06)	(12.25)	(15.16)
CAPITAL					
Adjusted common equity/assets	1.61	2.58	2.30	2.84	3.23
Adjusted common equity/risk assets*	2.00	4.46	4.57	6.82	7.87
Adjusted common equity/loans	2.27	5.25	6.22	10.04	10.05
Tier 1 capital/risk-adj. assets*	4.78	4.46	4.57	6.82	7.88
Adjusted total equity/assets	1.61	2.58	2.30	2.84	3.23
Adjusted total equity/risk assets*	2.00	4.46	4.57	6.82	7.87
Adjusted total equity/loans(net)	2.27	5.25	6.22	10.04	10.05
Dividend payout ratio	N.A.	52.00	100.00	7,145.31	100.00
¶Consolidated since 1997. §Period ended Sept. 30; ratios annualized where appropriate. *KWG definition of Tier 1 equity and risk assets. N.A.- Not available.					

Profitability

Although DVB's operations were unprofitable between 1994 and 1997, there have been signs of a turnaround since 1998, mainly reflecting the acquisitions of the LTCB portfolio and Nedship whose results have been consolidated since June 2000.

Pretax profit tripled in 1999 and rose by 15% for the first nine months in 2000, reflecting lower risk provisions and stronger operating profits following the acquisitions. Profitability is still at low levels as the bank's consolidated cost-to-income ratio of 76% at Sept. 30, 2000, remained very high, however. Further improvement will now more strongly depend on developments in the historically volatile shipping markets, but also on a successful work-out of the nonstrategic loan portfolio and the ability to compensate the loss of the euro-related foreign currency business.

The group's nine-month results include, for the first time, Nedship's results between June and September because the acquisition became effective May 30, 2000, which makes comparisons with earlier years more difficult.

Net interest income accounted for 44% of revenues at Sept. 30, 2000 up from 34% in 1999 and net interest margin increased to 0.84% up from 0.71%, already reflecting the consolidation of Nedship since June. On a stand-alone basis, Nedship's interest income accounted for 92% of its revenues, with a net interest margin of 1.9% in 1999. Therefore, the group's interest margin will further increase but remain well below Nedship's historical levels because of DVB's low-yielding work-out portfolio, a stronger focus on higher rated customers and ongoing competition in the shipping and aviation financing business. Margins do not benefit from lower cost retail deposits because DVB as a wholesale and cooperative central bank has no access to retail customers.

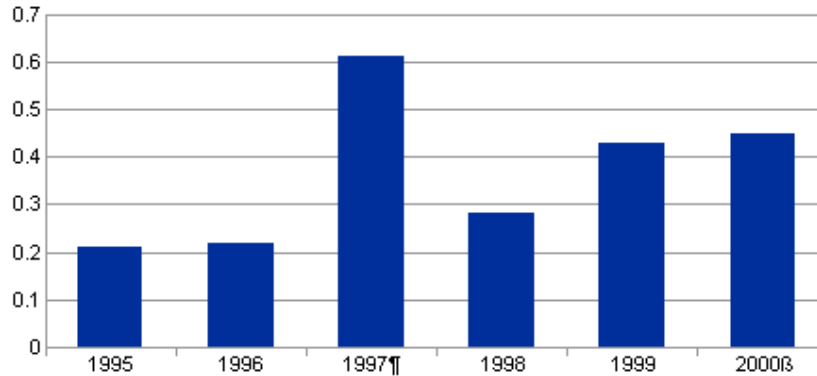
Net commission income represented 50% of revenues, and is mainly derived by DVB's subsidiary, Reise Bank, which accounts for 70%. The majority of Reise Bank's revenues are generated by the exchange of foreign currency for retail customers, but with the EMU, the bank will lose some of its business. The bank therefore aims to focus on Eastern European and non-European currencies, to broaden its product range, including fees from its ATM, travel business, and money transfers, and to streamline its branch network to counter the loss in revenues. DVB itself aims to generate fee income from arranging structured finance transactions.

Trading results accounted for only 6% of revenues, and mainly includes DVB's foreign currency exchange business on the wholesale level and smaller amounts of foreign currency and securities trading. This business is facing similar challenges, and DVB is aiming to provide its services for other institutions outside the cooperative sector.

Overall, DVB's revenues rose by 10% on an annualized basis by Sept. 30, 2000, as a result of the increased loan portfolio.

Although DVB reduced staff by 18% between 1994 and 1998, which explains the moderate growth in expenses by only 9% over a five-year period, a lack of revenue momentum caused an increase of the bank's unfavorable cost-to-income ratio, which stood at 85% in 1998. The ratio dropped to 79% in 1999 and to 76% for the first nine months of 2000, following DVB's acquisitions. DVB expects only moderate efficiency improvements in the short term because of investment needs for implementing a new IT system, building up its corporate finance activities, and winding down its nonstrategic domestic operations. Nevertheless, DVB's operating profit before risk provisions further improved by 23% on an annualized basis by Sept. 30, 2000.

Chart 3
Net Operating Income Before Loan Loss Provisions/Average Assets



‡1997 results distorted by extraordinary profits.

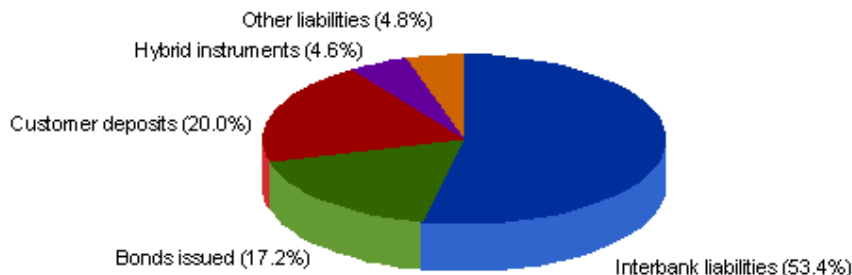
§Period ended Sept. 30, 2000.

Risk provisions continued to decline, absorbing only 5% of revenues in 1999 and, based on the bank's budgeted amount of only 3% by Sept. 30, 2000, compares very favorably with earlier years. Pretax ROE (reduced by goodwill and hybrid capital) rose to 19.7% by Sept. 30, 2000, from 13.5% in 1999 and 4.4% in 1998, but DVB's capitalization is very low. ROE was 9.5% in 1999, up from 3.3% in 1998. Based on published equity, pretax ROE was 12.7% at Sep. 30, 2000 and aims to exceed 15% in 2002, while maintaining very low capital ratios, however.

Asset-Liability Management

With the acquisition of Nedship, DVB had to change its funding strategy (to refinance the acquisition and Nedship's ongoing funding needs) and started to issue medium-term notes and commercial paper. Nevertheless, because of its role as a central bank and the lack of retail clients, DVB's major funding source remains interbank funds, which accounted for 53% of liabilities at Sept. 30, 2000 (see chart 4). While each local Sparda cooperative bank must hold its minimum reserve requirements directly with the Bundesbank, they place a certain percentage of customer deposits with DVB as their central bank. In addition, the Sparda banks do most of their interbank business with DVB, thereby providing their central bank with a stable funding base and covering its short-term funding needs. Furthermore, in times of stress, DG Bank as DVB's parent and central bank of the German cooperative sector would be able to provide funds to bridge liquidity gaps if needed.

Chart 4
Breakdown of Liabilities at Sept. 30, 2000



A significant portion of DVB's business is with affiliated banks and its parent. Because customer deposits of the local Sparda cooperative banks far exceed customer loans, a portion of their excess liquidity is also placed with DVB. At Sept. 30, 2000, DVB's deposits (mainly from local Sparda cooperative banks and a smaller amount from DG Bank) accounted for 35% of interbank liabilities and 19% of total liabilities. The amount of funds received from the Sparda banks has declined because of their growing customer lending business, which means that DVB has to strengthen its efforts to raise funds outside the sector. At the same time, DVB had placed Eur0.5 billion, or 36% of interbank placings, mainly with Sparda cooperative banks and DG Bank.

As a wholesale bank, deposits from DVB's corporate customers represented only 20% of liabilities at Sept. 30, 2000. In the past, the ratio of customer deposits to customer loans was close to 100% but, through the acquisition of the LTCB loan portfolio and Nedship, customer loans by far exceed deposits. Consequently, DVB significantly reduced interbank placings to free up funds, and increasingly tapped the capital markets to broaden its international investor base. Own bonds issued rose to 17% of liabilities, up from only 4% in 1997. DVB increasingly issues structured products, which significantly reduced funding costs.

Asset-liability management aims to ensure that DVB's liquidity ratio comfortably exceeds the regulatory minimum. In times of stress DVB has back-up lines in place and should also be able to raise funds from sector members. DVB is not a trading house, and market risk management focuses on the overall interest rate risk of the banking business. Interest rate risk is closely monitored and limited by daily scenario analysis on a present-value basis. Overnight shifts are used for potential price movements to control its limited foreign exchange and equity positions. DVB's overall risk appetite is in line with its limited ability to absorb adverse market movements.

Capital

DVB's capitalization is weak and does not adequately reflect the risks inherent in the bank's lending operations considering its business profile, the volatile and highly competitive shipping financing business, and the still-difficult economic environment for small and midsize domestic corporations. Economic capital strengths deteriorated further considering the goodwill from the Nedship acquisition and the quality of DVB's hybrid capital. Although DVB meets German regulatory capital requirements, the bank's low profitability levels (which in the past did not allow for earnings to be retained) and the lack of significant reserves, both a result of high provisioning needs in the past, have further reduced its financial flexibility. Although DVB is committed to improving its ROE in the medium term through earnings retention, capitalization will continue to be very low.

The acquisition of Nedship was only partially funded by a capital increase (Eur64 million), and to a larger extent through the issuance of weaker forms of capital such as hybrid Tier 1 capital (77.6 million) and Tier 2 instruments (Eur152 million), and debt. DVB reports regulatory capital ratios according to KWG, which, in contrast to BIS guidelines, does not require DVB to fully deduct the goodwill of almost Eur130 million from Tier 1 capital at once but allows banks to gradually increase the amount to be deducted equally from Tier 1 and Tier 2 capital over a period of 10 years. Therefore, its regulatory Tier 1 ratio slightly improved to 4.8% at Sept. 30, 2000 from 4.6% at year-end 1999. The acquisition of the LTCB portfolio in 1998 caused a decline to 4.6% from 6.8%.

Because Standard & Poor's does not include dated hybrid capital with a maturity of 10 years or Tier 2 capital in its calculation of adjusted common equity (considering the ability to absorb losses on a going-concern basis and permanence) and deducts goodwill from equity, DVB's ratio of adjusted common equity to risk assets declined to only 2% at Sept. 30, 2000, from 4.5% at year-end 1999.

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