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Analysis  
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## DVB Bank AG

### OWNERSHIP BY DZ BANK AND MEMBERSHIP OF CO-OPERATIVE FINANZVERBUND UNDERPIN RATINGS

DZ Bank Deutsche Zentral-Genossenschaftsbank (DZ Bank, rated A2/P-1/D) holds a majority stake in DVB (rated A3/P-2/C-) and includes the bank in its list of subsidiaries, which are covered by a letter of comfort. However, we believe that DZ Bank has a limited strategic interest in DVB, as DVB's role as the central bank of Sparda Banks has been reduced. In this context, any changes in the ownership structure have to be considered as a rating event.

DVB also benefits from a second layer of support: its membership in the Association of Co-operative Banks in Germany (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken* or *BVR*). Despite the strains that the *Garantiefond*<sup>1</sup> has endured in the recent years, especially 2000 and 2001, we believe that the BVR support mechanism still provides a considerable level of protection — especially for relatively small banks. DVB is relatively large in comparison to the primary banks in the co-operative sector, but small in comparison to the larger central banks, WGZ-Bank Westdeutsche Genossenschafts Zentralbank (WGZ, rated A2/P-1/C) and DZ Bank and the whole sector.

### Strategy and Franchise

#### SUCCESSFULLY DEVELOPING INTERNATIONAL TRANSPORT FRANCHISE

DVB's acquisition of an aircraft finance portfolio from Long-Term Credit Bank of Japan in 1998 and of Nedship Bank N.V. from Rabobank in 2000 has brought the bank closer to its goal to be a specialised lender and corporate finance partner for its targeted sectors in the transport industry.

Currently, more than 90% of DVB's customers and exposure is outside of Germany, and the bank owns a world-wide network of branches and representative offices in the major centres for ship-financing and aviation.

At the end of 2000, DVB established DVB Capital, its corporate finance and investment banking unit, building on the already existing corporate finance team. DVB Capital is the bank's attempt to extend its customer lending relationship into higher margin products and services, such as structured finance, syndication, advisory services and mezzanine lending. We view this step positively, and DVB Capital is developing successfully, but its contribution to pre-provision profits has not yet materialised.

That said, in 2003 DVB made further progress generating non-interest income in corporate finance, and if the bank continues to strengthen its franchise without taking undue risk it could improve its risk profile.

1. Garantiefond is a funded support fund which is also topped up by annual contributions from its members. The Garantieverbund is a further contractually defined support measure which invariably takes the form of a performance-guarantee in favour of a co-operative bank in difficulty.

## CHALLENGE TO BECOME AN INTEGRATED TRANSPORTATION FINANCE SPECIALIST

In 2003, DVB finalised its transformation process from an unfocused commercial bank with a central bank role attached to it, into an international focused niche player. This process included:

- Selling ReiseBank (not rated) and CashExpress to DZ-Bank<sup>2</sup>
- Reducing its role as a central bank; retaining only its liquidity clearing functions
- Complementing its research capabilities with the build-up of an aviation team

DVB has been making considerable investments in a new IT platform and is finalising new risk-management systems to better fit its international business profile. We view this development as an important step in the transformation process and expect some efficiency gains in the short-to-medium term, especially in terms of controlling costs, loan underwriting and improving management information systems.

However, DVB has so far achieved only limited synergies from the combination of specialised finance expertise in the various fields of international transport. In addition, the bank faces the challenge of further penetrating its selected customer group – the number of core customers varies between business segments, but in aggregate ranges between 500 and 700 worldwide – especially in view of competition from larger, more diversified and financially stronger banking groups or specialised and established competitors.

## Financial Fundamentals

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### ASSET QUALITY SHOWS CONSIDERABLE RESILIENCE

DVB's loan portfolios in its core businesses of shipping and aviation, excluding the "old" DVB German corporate loans which are being managed down, are showing considerable resilience in this depressed market environment. The main reasons are that DVB is well diversified in the various sub-segments of these two industries and also by geographical areas. Additionally, about 95% of DVB's loan portfolio in these segments is collateralised and the quality of the collateral is good.

Strong collateral helped DVB avoid losses despite its exposure to larger bankruptcies between 2001 and 2003, especially in the aviation industry. In the past four years no loan-loss provisions were required in DVB's ship-financing business, which is indicative of the very good expertise of DVB's core business fields. Although these industries are highly volatile, the bank was able to withstand the challenges with a successful strategy by prioritising in its credit decisions the asset and contractual covenants, thus taking less comfort from the creditworthiness of the airline or ship owner.

However, we are still concerned about the continuing depressed market conditions for the global aviation industry. In addition, we believe that DVB's unsecured exposures – including collateralised loans with high LTVs – represent in a few cases some concentration risk. Nevertheless, in light of growing evidence of improvement in the economic climate, there is a better environment for business in the shipping industry (higher demand for container ships).

### RISK-ADJUSTED PROFITABILITY AND ECONOMIC CAPITALISATION HAS IMPROVED, BUT RISK-ABSORBING CAPACITY REMAINS MODEST

DVB's main targets for 2003 were to concentrate on the generation of more fee-driven services, strengthening the bank's Tier 1 capital basis and further distancing the bank's headquarters from resources not directly linked to core businesses.

Results for the first nine months in 2003 indicate that the cost reduction will be achieved. In 2003, DVB terminated its work-intensive central bank functions especially in the area of mass payment transactions, securities trading and administration. We believe that the bank should be able to improve its regulatory capital due to the gain incorporated in the sale of ReiseBank AG and CashExpress GmbH to DZ Bank, which takes effect on 31 December 2003.

However, the divestments will have an overall negative impact on the bank's earnings, especially on the earnings structure, as ReiseBank was the main contributor to fee income. Mitigating this weakening of income diversification is the fact, that DVB is now better positioned to align its business model with the financial ratios comparable with other specialised banks, taking into consideration banks such as IKB Deutsche Industriebank AG (IKB, rated Aa3/P-1/B-), or mortgage banks and ship-financing banks.

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2. ReiseBank AG provides mainly foreign exchange services to retail clients at around 100 branches in Germany and neighbouring countries. CashExpress GmbH is a financial institution supporting Reisebank in its activities.

In transport finance, the bank will generate its earnings mostly in the short-and-medium term with lending activities in the shipping and aircraft areas. However, we expect that growing success in loan syndication and corporate finance will lead over time to more diversified earnings.

So far, the sale of non-core assets, the warehousing and syndication of loans, and prudent growth targets will continue to strengthen DVB's regulatory capitalisation levels; currently the bank's Tier 1 ratio is at around 5.7%, but the figure is closer to 6% if the capital gains from ReiseBank are included.

In this context, we believe that DVB's risk-absorbing capacity has improved, but remains modest in terms of the following:

- Some concentration risks in the loan portfolio
- Low level of capital-generating power through recurring earnings
- DVB is active in highly cyclical markets and the aviation industry at large is still in a difficult situation

In the short term, stronger portfolio growth, incentivised by higher margins and DVB's non-cyclical behaviour, could again put pressure on its regulatory capital levels.

DVB is aiming for the Advanced Approach under Basel II, and because of the high share of secured lending the bank expects a positive impact on its regulatory capital levels in the future.

## **DVB'S WHOLESALE FUNDING IS STABILISED BY THE CO-OPERATIVE SECTOR**

DVB is wholesale funded, with a significant share of short-term borrowing. This is inherently more vulnerable compared to a deposit funded bank. However, this factor is balanced by the fact that DVB retains the liquidity-clearing functions for the Sparda Banks, which are normally highly liquid retail banks that provide DVB with relatively stable interbank deposits. In addition, DVB holds a considerable amount of liquid securities and has access to committed undrawn back-up facilities.

## **Related Research**

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### **Analysis**

[DZ Bank Deutsche Zentral-Genossenschaftsbank AG, 03 October 2003 \(#79629\)](#)

### **Banking Statistical Supplement**

[Germany, August 2003 \(#79207\)](#)

### **Banking System Outlook**

[Banking System Outlook: Germany, November 2003 \(#80113\)](#)

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.*

## DVB Bank AG

	31/12/02	31/12/01	31/12/00	31/12/99	31/12/98
<b>Summary Balance Sheet (EUR million)</b>					
Cash & central bank	310	202	121	1,013	140
Due from banks	1,134	2,560	1,844	1,226	3,061
Securities	810	1,126	899	1,199	877
Net loans	6,685	6,858	6,244	3,370	2,434
Loan loss reserves (LLR)	--	--	--	--	--
Insurance assets	0	0	0	0	0
Fixed assets	29	31	21	14	15
Other assets	328	195	343	53	37
Total assets	9,296	10,972	9,472	6,875	6,565
Total assets (USD million) [1]	9,743	9,719	8,918	6,903	7,661
Demand deposits	367	1,034	1,065	964	1,042
Savings deposits [2]	1,729	1,677	1,431	786	828
Due to banks	4,855	5,418	4,709	3,970	3,579
Market funds	1,489	1,953	1,521	688	770
Insurance liabilities	0	0	0	0	0
Other liabilities	123	187	111	137	63
Total liabilities	8,563	10,268	8,836	6,545	6,280
Subordinated debt	206	211	142	63	44
Shareholders' equity	358	329	329	177	151
Total capital funds	733	704	635	330	285
Total liabilities & capital funds	9,296	10,972	9,472	6,875	6,565
Derivatives - notional amount	9,316	11,104	15,500	10,300	8,385
Derivatives - replacement value	--	--	--	--	--
Contingent Liabilities	1,533	1,679	1,549	824	609
Risk weighted assets (RWA)	--	--	--	--	--
Assets under management (EUR million) [3]	--	--	--	--	--
Number of employees	950	940	906	796	784
<b>Summary Income Statement</b>					
+Interest income	443	530	413	265	190
-Interest expense	354	452	366	231	166
=Net interest income	89	78	48	35	23
+Trading income	5	6	8	11	13
+Fee and commission income	93	98	90	73	60
+Insurance income (net)	0	0	0	0	0
+Other operating income	10	10	17	17	16
=Operating income	197	192	163	136	112
-Personnel expenses	73	66	60	49	47
-Other operating expenses	78	78	65	54	45
= Operating funds flow	45	48	39	33	21
-Amortisation/depreciation	15	17	11	6	6
(Total operating expenses)	166	160	135	109	97
=Preprovision income (PPI)	30	32	28	27	15
-Risk provisions	20	16	0	6	8
+Other non operating adjustments [4]	30	14	2	1	-1
+Extraordinary profit / loss	-6	-19	0	0	0
=Pretax income	34	10	31	22	7
-Taxes	2	6	11	7	2
=Net income	33	5	19	16	5
-Minority interests	28	0	0	0	0
=Net income (group share)	5	5	19	16	5
<b>Growth Rates (%)</b>					
Net loans	-2.52	9.83	85.25	38.50	61.48
Total assets	-15.28	15.84	37.77	4.72	23.16
Customer deposits (demand and savings)	-22.68	8.60	42.62	-6.38	35.78
Net interest income	14.19	63.55	37.23	47.82	-9.30
Fee and commission income	-5.49	9.18	23.59	22.47	12.83
Operating expenses	3.59	18.62	24.12	12.54	7.95
Preprovision income	-3.81	12.05	4.47	74.81	-48.38
Net Income	7.04	-76.47	23.22	212.30	2,042.95

[1] USD figure uses the historical exchange rate against the EUR (against the DEM prior to 1999).

[2] Full disclosure may not be available for all years. The amount is then included in "demand deposits".

[3] As reported by the bank

[4] This may include value adjustments of securities.

[5] Avg. [(market funds-liquid assets) % (earning assets-liquid assets)]

# DVB Bank AG

	31/12/02	31/12/01	31/12/00	31/12/99	31/12/98
<b>Income Statement in % Average Risk Weighted Assets</b>					
Net interest income	--	--	--	--	--
Trading income	--	--	--	--	--
Fee and commission income	--	--	--	--	--
Insurance income	--	--	--	--	--
Operating income	--	--	--	--	--
Operating expenses	--	--	--	--	--
Preprovision income	--	--	--	--	--
Risk provisions	--	--	--	--	--
Extraordinary profit	--	--	--	--	--
Net income	--	--	--	--	--
<b>Liquidity, Funding (including sub debt) &amp; Balance Sheet Composition</b>					
Avg. liquid assets % avg. total assets	30.30	33.03	38.55	55.93	65.93
Avg. net loans % avg. total assets	66.82	64.09	58.81	43.18	33.13
Avg. customer deposits % avg. total funding	25.38	27.17	27.68	28.42	28.63
Avg. interbank funds % avg. total funding	54.25	52.86	56.58	59.28	61.67
Avg. market funds (excl. interbank) % avg. total funding	18.18	18.13	14.40	11.45	9.30
Avg. sub debt % total funding	2.20	1.84	1.34	0.84	0.78
Avg. liquid assets % avg. customer deposits	127.80	129.71	148.45	207.73	241.64
Avg. net loans % avg. customer deposits	281.79	251.68	226.47	160.38	121.41
Avg. market funds reliance [5]	-20.53	-25.51	-69.29	-130.47	-204.45
Avg. RWA % avg. total assets	--	--	--	--	--
<b>Breakdown of Operating Income in %</b>					
Net interest income % operating income	45.27	40.59	29.16	25.55	20.93
Trading income % operating income	2.39	2.89	5.04	8.11	11.67
Fee and commission income % operating income	47.31	51.25	55.15	53.65	53.04
Insurance income % operating income	0.00	0.00	0.00	0.00	0.00
Other operating income % operating income	5.03	5.27	10.65	12.69	14.36
<b>Profitability</b>					
Yield on avg. earning assets (%)	4.68	5.50	5.80	4.57	3.54
Cost of interest bearing liabilities (%)	3.73	4.71	4.77	3.62	2.94
Net interest margin (%)	0.99	0.88	0.86	0.77	0.64
Recurring earning power (PPI % avg. assets)	0.30	0.31	0.34	0.40	0.26
Risk-weighted recurring earning power (PPI % avg. RWA)	--	--	--	--	--
Return on average assets (%)	0.32	0.04	0.23	0.23	0.08
Return on avg. RWA (%)	--	--	--	--	--
Return on equity (period end) (%)	1.35	1.37	5.82	8.77	3.29
Net interest income coverage of risk provisions	4.47	4.81	--	5.49	2.90
Risk provisions % preprovision income	65.55	51.39	0.00	23.46	52.48
Internal capital growth (%)	0.10	0.00	4.71	4.92	3.29
Dividend payout ratio (%)	93.50	100.00	56.42	52.05	0.00
<b>Efficiency</b>					
Cost/income ratio (operating expenses % operating income)	84.56	83.57	82.77	80.18	86.27
Operating expenses % average assets	1.64	1.57	1.65	1.62	1.63
Operating income / employee (EUR thousand)	206.87	204.22	180.34	170.73	143.15
Operating expenses / employee (EUR thousand)	174.94	170.67	149.28	136.88	123.49
PPI / employee (EUR thousand)	31.93	33.55	31.07	33.85	19.66
Total assets / employee (EUR million)	9.78	11.67	10.45	8.64	8.37
<b>Asset Quality and Risk Measurement</b>					
Problem loans % net loans	--	--	--	--	--
LLR % problem loans	--	--	--	--	--
LLR % net loans	--	--	--	--	--
Risk provisions % net loans	0.30	0.24	--	0.19	0.33
Problem loans % (shareholders' equity + LLR)	--	--	--	--	--
Replacement value % shareholder's equity	--	--	--	--	--
<b>Capital Adequacy (Period End)</b>					
Tier 1 ratio (%)	5.80	5.00	5.70	4.50	5.20
Total capital ratio (%)	10.40	9.50	10.20	8.60	8.80
Shareholders' equity % total assets	3.85	3.00	3.48	2.58	2.30
Equity participations % shareholders' equity	0.64	1.52	0.39	0.57	0.67

[1] USD figure uses the historical exchange rate against the EUR (against the DEM prior to 1999).

[2] Full disclosure may not be available for all years. The amount is then included in "demand deposits".

[3] As reported by the bank

[4] This may include value adjustments of securities.

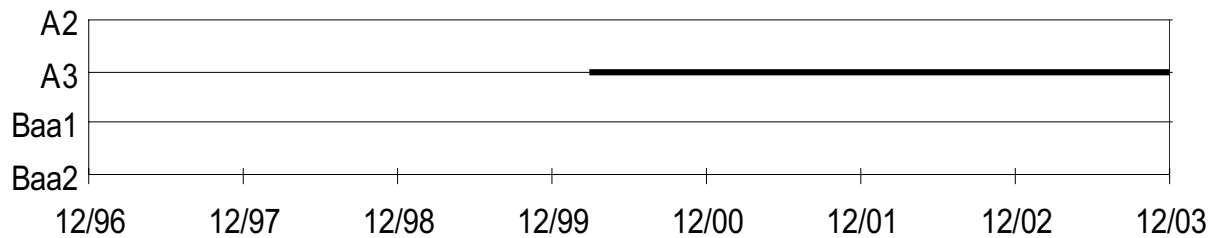
[5] Avg. [(market funds-liquid assets) % (earning assets-liquid assets)]

Description	Coupon (%)	Currency	Face Amount (mil)	Maturity	Moody's Rating
<b>DVB Bank AG</b>					
Flt. Rt. German Notes	—	EUR	300	2005	A3
Euro Medium Term Notes	4.280	EUR	5	2006	A3
Euro Medium Term Notes	3.125	EUR	250	2006	A3
Flt Rt Euro Medium Term Notes	—	EUR	200	2006	A3
Euro Medium Term Notes	3.500	EUR	10	2007	A3
Flt Rt Euro Medium Term Notes	—	EUR	10	2008	A3
Flt Rt Euro Medium Term Notes	—	EUR	375	2008	A3
Flt Rt Euro Medium Term Notes	—	EUR	350	2009	A3
Sub. German Bonds	6.000	EUR	58	2011	Baa1
Euro Debt Issuance Program	—	EUR	3,000	—	A3/Baa1/P-2
Long-Term Bank Deposit Rating	—	—	—	—	A3
Bank Financial Strength Rating	—	—	—	—	C-
Short-Term Bank Deposit Rating	—	—	—	—	P-2



## Rating History

## Long-term Bank Deposits



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