

Reprinted from RatingsDirect

Research

Outlooks on DZ BANK AG and Various Cooperative Banks Revised to Stable; Ratings Affirmed

Publication Date: 24-Aug-2004
Credit Analyst: Bernd Ackermann, Frankfurt (49) 69-33-999-153;
Stefan Best, Frankfurt (49) 69-33-999-154;
Harm Semder, Frankfurt (49) 69-33-999-158;
Karlo Fuchs, Frankfurt (49) 69-33-999-156

FRANKFURT (Standard & Poor's) Aug. 24, 2004--Standard & Poor's Ratings Services said today it revised to stable from negative its outlooks on DZ BANK AG Deutsche Zentral-Genossenschaftsbank (DZ BANK) and on other rated members of the German cooperative banking sector.

At the same time, it affirmed its 'A-' long-term and 'A-2' short-term counterparty credit and certificate of deposit ratings on DZ BANK--including its subsidiaries Deutsche Genossenschafts-Hypothekenbank AG, DZ Bank International S.A., and DZ Bank Ireland PLC--and on cooperative sector member banks, Westfälische Landschaft Bodenkreditbank AG and Deutsche Apotheker- und Ärztebank eG. In addition, it affirmed its 'BBB+' long-term and 'A-2' short-term ratings on DVB Bank AG and VR Leasing AG.

"The rating actions mainly reflect the expectation of a continued turnaround of DZ BANK's operating profitability following progress in the restructuring of its loan portfolio, improving cost structures, and the benefits of recent strategic initiatives to strengthen cooperation within the sector," said Standard & Poor's credit analyst Bernd Ackermann. "Moreover, it reflects the expectation that the sector's earnings improvements will be sustained as Standard & Poor's views the German cooperative banking sector as a single economic group."

The ratings on DZ BANK and rated member banks of the cooperative banking sector are based on the German cooperative banking sector's system of solidarity and its comprehensive protective scheme, which has prevented insolvencies of member institutions for more than 70 years. The ratings are also based on the sector's important market position, particularly in the domestic retail banking market; its stable funding sources; and overall sound capitalization.

The ratings are constrained, however, by the sector's moderate profitability due to its high cost base and still high loan-loss provisions (LLPs). As the largest member, DZ BANK's still weak financial profile--reflected by remaining weaknesses in asset quality despite recent improvements, modest operating profitability, and weak capitalization--also continues to be a negative factor in Standard & Poor's assessment of the sector's financial strength. Recent results, however, indicate improvements for both DZ BANK and the member banks.

The downward trend in earnings of the cooperative banking sector was halted in 2003, owing to the improved operating profits of the local cooperative banks and the turnaround at DZ BANK. Nevertheless, LLPs of the sector are still at a high level, and synergies from consolidation within the sector are not yet filtering through. In addition, asset quality problems have put strains on both earnings and the sector's protective scheme due to problems at the cooperative sector's member banks as whole. This has prompted the cooperative banking association to increase the members' contributions to the protective scheme to the maximum level allowable under their statutes in 2004 to replenish its funds. Initiatives have also been implemented to improve the credit-risk management of DZ BANK and member banks.

After two years of operating losses, DZ BANK's profitability demonstrated a significant turnaround in 2003, and first-half 2004 numbers suggest further improvements. This is mainly the result of continued progress in the bank's restructuring process and a stabilizing economic environment. As a result, the turnaround is being driven by a significant drop in credit-loss provisions and ongoing cost-cutting, and most recently also by rising revenues.

Asset quality remains a key weakness of DZ BANK, but increasingly benefits from the cleanup of the legacy corporate loan portfolio of the former DG Bank. A more focused lending approach and revised pricing policies should contribute to further gradual enhancement in the future.

Capitalization is weak and likely to improve only gradually in the medium term due to DZ BANK's still low level of profitability and its limited ability to retain earnings. Substantial efforts were required to absorb DZ BANK's very high LLPs between 2000 and 2002, which have strained its financial flexibility considerably.

"The stable outlook reflects Standard & Poor's expectation that DZ BANK's progress in its restructuring process has improved the bank's business and risk profile, thus reducing concerns about setbacks in a still difficult operating environment," said Mr. Ackermann. Standard & Poor's expects that DZ BANK will further strengthen its business ties with other members and gradually improve its weak financial profile. Furthermore, it also reflects the expectation that recent earnings improvements of the German cooperative sector will be sustainable, and that improvements in uniform risk management and monitoring should help to reduce severe asset quality problems of individual institutions. "While Standard & Poor's considers the sector's progress in implementing planned restructuring initiatives to be slow, further progress could have positive rating implications if this were to result in improving cost structures and stronger asset quality," added Mr. Ackermann. The stable outlook on DZ BANK also reflects the expectation that the solidarity within the sector to support troubled institutions will remain unchanged.

Ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. It can also be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search. Alternatively, call one of the following Standard & Poor's numbers: London Ratings Desk (44) 20-7176-7400; London Press Office Hotline (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5916; or Moscow (7) 095-783-4017. Members of the media may also contact the European Press Office via e-mail on: media_europe@standardandpoors.com.

ANALYST E-MAIL ADDRESSES

bernd_ackermann@standardandpoors.com

stefan_best@standardandpoors.com

harm_semder@standardandpoors.com

karlo_fuchs@standardandpoors.com

FIG_Europe@standardandpoors.com

This report was reproduced from Standard & Poor's RatingsDirect, the premier source of real-time, Web-based credit ratings and research from an organization that has been a leader in objective credit analysis for more than 140 years. To preview this dynamic on-line product, visit our RatingsDirect Web site at www.standardandpoors.com/ratingsdirect.

Standard & Poor's.

Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: 1221 Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280. Copyright 2000 by The McGraw-Hill Companies, Inc. Reproduction in whole or in part prohibited except by permission. All rights reserved. Information has been obtained by Standard & Poor's from sources believed to be reliable. However, because of the possibility of human or mechanical error by our sources, Standard & Poor's or others, Standard & Poor's does not guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions or the result obtained from the use of such information. Ratings are statements of opinion, not statements of fact or recommendations to buy, hold, or sell any securities.

The McGraw-Hill Companies