*This Analysis provides a discussion of the factors underpinning the credit rating/s and should be read in conjunction with our Credit Opinion. The most recent ratings, opinion, and other research specific to this issuer are provided on Moodys.com. Click here to link.*

Analysis

GERMANY
Europe/M.East/Africa

*February 2006*



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# DVB Bank AG

## Ownership

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

The majority owner of DVB Bank AG (rated A2/P-1/C-) is DZ Bank Deutsche Zentral-Genossenschaftsbank (DZ Bank, rated A2/P-1/C-), which includes the bank in its list of subsidiaries which are covered by a letter of comfort. Since DVB transferred its role as a central bank of the Sparda Banks[1] to DZ Bank in 2004, we believe that DZ Bank's strategic interest in DVB is less clear than in the past. Nevertheless, we see DVB as a profitable equity investment for DZ Bank. In October 2005 DZ Bank emphasised its commitment to DVB by participating in a capital increase of DVB Bank. The capital increase provided gross proceeds of about €105 million to the bank to enable its further expansion. We do not expect any changes in the ownership structure of DVB in the medium term. However, it has to be noted in this context that any change in DVB's ownership structure would 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*[2] has endured in recent years, especially between 2000 and 2002, we believe that the BVR support mechanism still provides a considerable level of protection – especially for relatively small banks. Although DVB is large in comparison to the primary banks in the co-operative sector, it is small in comparison to the larger central banks, WGZ-Bank Westdeutsche Genossenschafts Zentralbank (WGZ, rated A2/P-1/C) and DZ Bank, and the sector as a whole.

1. *Co-operative banks which are focused on retail banking (only individuals no businesses) and which operate in larger regions than Raiffeisen or Volksbanken.*
2. *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.*

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## Strategy and Franchise

### ESTABLISHED LENDER TO THE AVIATION AND SHIPPING INDUSTRIES

DVB started its transformation into a specialised lender and corporate finance partner for its targeted sectors in the transport industry with the acquisition of an aircraft finance portfolio from Long-Term Credit Bank of Japan in 1998 and of Nedship Bank N.V.[3] from Rabobank in 2000.

Around 96% of DVB's loan portfolio now derives from its core business segments of Shipping (52.9%), Aviation (28.5%), Land Transport (8.9%) and Transport Infrastructure (5.7%) and Group Investment Management (Corporate Finance) (2%). Markets outside Germany account for more than 90% of its customers and exposure. In addition, DVB owns a worldwide network of branches and representative offices in the major centres for ship financing and aviation.

Since 2004 DVB has intensified its efforts to become a fully integrated corporate finance house for its selected industries through strengthening its corporate finance and capital market activities (through its DVB Capital business unit). This has entailed extending the bank's customer lending relationships into higher-margin products and services, such as structured finance, syndication, advisory services, mezzanine lending and equity sourcing. We view this revenue diversification positively and note that DVB's corporate finance activities are developing successfully; however, their contribution to recurring profitability still has some room for improvement.

Nonetheless, in 2004 and 2005 DVB made considerable progress in generating commission income in corporate finance and, if the bank continues to strengthen its customer penetration without taking undue risk, it could improve its risk profile. However, we would take a cautious view of any larger positions of unsecured credit exposure or equity positions.

### CONNECTIVITY OF DVB'S THREE CORE BUSINESSES NEEDS TO BE EXPLORED

As at the end of 2004, DVB completed its transformation process from an unfocused commercial bank with a central bank role attached to it into an internationally focused niche player. This process encompassed the following actions:

- Selling ReiseBank (not rated) and CashExpress to DZ-Bank[4] in 2003.
- Terminating its role as a central bank for the Sparda Banks between 2002 and 2004, specifically transferring its liquidity clearing functions to DZ Bank.
- Complementing its research capabilities through building an aviation research team.
- Broadening product and services capabilities for its core customers.
- Exploring new asset classes within transport and related industries: container financing through its Container Business Unit and, more recently, engine financing through the formation of a dedicated Aero Engine Finance Unit.

In recent years DVB has made considerable investments in a new IT platform and implemented 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 efficiency gains in the short-to-medium term, especially in terms of controlling costs, loan underwriting and improving management information systems.

In this context, we believe that DVB has not yet fully explored the synergies from the combination of specialised finance expertise in the various fields of international transport and translated them into stronger recurring profitability. However, we got more comfort about DVB's potential in further penetrating its selected customer groups[5] and improving its risk-weighted recurring profitability with commission income in view of competition from larger, more diversified and financially stronger banking groups or specialised and established competitors. We acknowledge DVB's efforts and its first success in achieving its targeted cost/income ratio of no more than 50%, besides a continuing diversification into new products and asset classes. Compared to other specialised lenders, like ship financing or mortgage banks, this cost-to-income ratio might appear relatively high. However, we believe that it will be difficult for the bank to achieve the very low cost-to-income ratios of secured long-term lenders who specialise in financing only one asset class.

Having said that, DVB's application of modern management tools to all areas of its business, specifically RORAC (return on risk-adjusted capital) calculations and internal Basel II-compliant rating tools, better support an efficient portfolio management across its industry sectors and business lines.

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*3. DVB announced in 2004 that Nedship Bank N.V. remained a 100% subsidiary of DVB but it was renamed DVB Bank N.V. with effect from 1 March 2004.*

*4. 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.*

*5. The number of core customers varies from one business segment to another, but in aggregate ranges between 500 and 700 worldwide.*

## Financial Fundamentals

### ASSET QUALITY HAS SHOWN CONSIDERABLE RESILIENCE IN DIFFICULT YEARS

DVB's loan portfolios in its core businesses of shipping and aviation – excluding the "old" DVB German corporate loans, which are being managed down – have been demonstrating considerable resilience in the current depressed market environment, thanks primarily to the bank's good level of diversification in the various sub-segments of these two industries and also by geographical areas. Additionally, more than 95% of DVB's loan portfolio in these segments is collateralised and the quality of the collateral is sound, as confirmed by the absence of any actual losses of principal in the core businesses over recent years.

Strong collateral has helped DVB avoid losses, despite its exposure to larger bankruptcies between 2001 and 2003, especially in the aviation industry. In the past years, little loan-loss provisioning has been required in DVB's ship-financing business, which is indicative of the bank's strong expertise in its core business fields. Although these industries are highly volatile, the bank has been able to withstand the challenges thanks to a successful strategy through which it prioritises the assets and contractual covenants in its credit decisions, thus taking less comfort from the credit-worthiness of the airline or ship owner.

However, given the high level of volatility and positive correlation within the aviation and shipping segments, we remain somewhat cautious about the potential impact of a "worst-case" scenario in one or both of these industries on DVB's financial fundamentals. On the other hand, with many airlines having experienced their most difficult times following September 11$^{th}$ 2001 and shipping having also undergone negative cycles since then, we have found growing evidence of strong credit risk management capabilities at DVB which balance this inherent volatility in its operating environment.

Especially the bank's unique and in depth market know-how in the transport industries, given through its highly experienced research teams, should enable the bank to identify business opportunities regardless of distinctive economic indicators. We believe that DVB has inherent market know-how in the transport business, which may allow the bank to do profitable business through all business cycles.

### RISK-ADJUSTED PROFITABILITY AND ECONOMIC CAPITALISATION HAVE IMPROVED, BUT RISK-ABSORPTION CAPACITY REMAINS VULNERABLE

DVB's main targets for the last 2 years were to concentrate on generating more fee-driven services, strengthening the bank's Tier 1 capital base and making progress on achieving its targeted cost-to-income ratio.

Results for the 2004 financial year and the first 6 months of 2005 show continued improvement in the profitability and efficiency ratios, whilst regulatory capital levels benefited from the gain incorporated in the sale of ReiseBank AG and CashExpress GmbH to DZ Bank, which took effect on 31 December 2003.

Although the divestments had an overall negative impact on the bank's earnings, especially on the earnings structure, as ReiseBank was the main contributor to fee income, DVB was able to grow commission income from its core businesses in 2004 and 2005. It has also started to align its business model with financial ratios comparable with those of other specialised banks, mortgage banks and ship-financing banks.

In 2004 and the first half of 2005, DVB achieved significant growth in assets with a negative impact on its regulatory capitalisation levels, specifically the total capital ratio, which fell to 8.8% at 30 June 2005 from 10.7% at year-end 2004, while the core capital ratio was 5.6% (vs. 6.7% at end-2004) – all ratios according to German regulatory guidelines (KWG). However, through DVB's capital increase, which took place in October 2005, the bank should be able to stabilise its capital levels, although on a relatively low level.

We view DVB's risk-absorption capacity as having clearly improved, given the increased level of core profitability and reserves (retained earnings, § 340 f and g HGB). However, the bank's financial robustness and flexibility would benefit from a higher economic capitalisation, in particular since it remains vulnerable due to the highly cyclical markets. In this context, continuing strong portfolio growth, incited by higher margins and DVB's anti-cyclical behaviour, and a strengthening of the US dollar against the euro could again put pressure on its regulatory capital levels. This problem occurs mainly as the bank's assets are denominated in US dollar and DVB's funding is based in the EURO-markets. However, the bank is therefore aiming to further diversify its funding structure and will target mainly Asian markets to attract a new investor base.

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

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

DVB is wholesale-funded, with a significant share of short-term borrowing, making it inherently more vulnerable than a deposit-funded bank. In addition, it has ceased providing liquidity clearing functions for the Sparda Banks, which are typically highly liquid retail banks that provided DVB with relatively stable inter-bank deposits until the end of 2004. Nonetheless, DVB had made preparations for an eventual cash outflow and increased its capital market funding over the period.

In addition, DVB holds a considerable amount of liquid securities and has access to committed undrawn back-up facilities.

## Related Research

**Analysis:**

DZ Bank Deutsche Zentral-Genossenschaftsb. AG, November 2004 (90275)

**Banking Statistical Supplement:**

Germany, December 2005(96133)

**Banking System Outlook:**

Banking System Outlook: Germany, December 2004 (90648)

*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 (Consolidated)

| | 31/12/2004 | 31/12/2003 | 31/12/2002 | 31/12/2001 | 31/12/2000 |
|---|---|---|---|---|---|
| **Summary Balance Sheet (EUR million)** | | | | | |
| Cash & central bank | 101 | 216 | 310 | 202 | 121 |
| Due from banks | 1,139 | 1,362 | 1,134 | 2,560 | 1,844 |
| Securities | 591 | 563 | 810 | 1,126 | 899 |
| Gross loans | 6,957 | 6,547 | 6,685 | 6,858 | 6,244 |
| Loan loss reserves (LLR) | - | - | - | - | - |
| Insurance assets | 0 | 0 | 0 | 0 | 0 |
| Fixed assets | 84 | 12 | 82 | 31 | 21 |
| Other assets | 379 | 366 | 276 | 195 | 343 |
| Total assets | 9,250 | 9,065 | 9,296 | 10,972 | 9,472 |
| Total assets (USD million) [1] | 12,621 | 11,379 | 9,743 | 9,719 | 8,918 |
| Total assets (EUR million) | 9,250 | 9,065 | 9,296 | 10,972 | 9,472 |
| Demand deposits | 110 | 188 | 367 | 1,034 | 1,065 |
| Savings deposits [2] | 2,672 | 1,921 | 1,729 | 1,677 | 1,431 |
| Due to banks | 2,683 | 3,781 | 4,855 | 5,418 | 4,709 |
| Market funds | 2,753 | 2,178 | 1,489 | 1,953 | 1,521 |
| Insurance liabilities | 0 | 0 | 0 | 0 | 0 |
| Other liabilities | 104 | 100 | 123 | 187 | 111 |
| Total liabilities | 8,322 | 8,168 | 8,563 | 10,268 | 8,836 |
| Subordinated debt | 224 | 226 | 206 | 211 | 142 |
| Shareholders' equity | 458 | 425 | 358 | 329 | 329 |
| Total capital funds | 929 | 898 | 733 | 704 | 635 |
| Total liabilities & capital funds | 9,250 | 9,065 | 9,296 | 10,972 | 9,472 |
| Derivatives - notional amount | 17,673 | 14,215 | 9,316 | 11,104 | 15,500 |
| Derivatives - replacement value | 555 | 484 | - | - | - |
| Contingent liabilities | 1,317 | 1,264 | 1,533 | 1,679 | 1,549 |
| Risk weighted assets (RWA) | 7,574 | 7,197 | - | - | - |
| Assets under management (EUR million) [3] | - | - | - | - | - |
| Number of employees | 359 | 406 | 950 | 940 | 906 |
| **Summary Income Statement** | | | | | |
| +Interest income | 407 | 385 | 443 | 530 | 413 |
| -Interest expense | 307 | 287 | 354 | 452 | 366 |
| =Net interest income | 100 | 98 | 89 | 78 | 48 |
| +Trading income | (1) | 4 | 5 | 6 | 8 |
| +Fee & commission income | 47 | 88 | 93 | 98 | 90 |
| +Insurance income (net) | 0 | 0 | 0 | 0 | 0 |
| +Dividend income and other operating income | 16 | 4 | 10 | 10 | 17 |
| =Operating income | 162 | 194 | 197 | 192 | 163 |
| -Personnel expenses | 46 | 68 | 73 | 66 | 60 |
| -Other operating expenses | 62 | 68 | 78 | 78 | 65 |
| = Operating funds flow | 54 | 58 | 45 | 48 | 39 |
| -Amortisation/depreciation | 8 | 13 | 15 | 17 | 11 |
| (Total operating expenses) | 117 | 149 | 166 | 160 | 135 |
| =Preprovision income (PPI) | 45 | 45 | 30 | 32 | 28 |
| -Loan loss provisions | 11 | 21 | 20 | 16 | 0 |
| +Impairment of goodwill, fixed assets and investments [4] | (0) | 14 | 30 | 14 | 2 |
| +Result of subsidiaries and associates | 4 | 0 | 0 | 0 | 0 |
| +Non-recurring items | (0) | 3 | (6) | (19) | 0 |
| =Pretax income | 38 | 41 | 34 | 10 | 31 |
| -Taxes | 6 | (31) | 2 | 6 | 11 |
| =Net income | 33 | 72 | 33 | 5 | 19 |
| -Minority interests | 0 | 0 | 28 | 0 | 0 |
| =Net income (group share) | 32.51 | 71.59 | 4.82 | 4.51 | 19.14 |
| **Growth Rates (%)** | | | | | |
| Gross loans | 6.26 | (2.06) | (2.52) | 9.83 | 85.25 |
| Total assets | 2.04 | (2.48) | (15.28) | 15.84 | 37.77 |
| Customer deposits (demand and savings) | 31.97 | 0.60 | (22.68) | 8.60 | 42.62 |
| Net interest income | 2.19 | 10.16 | 14.19 | 63.55 | 37.23 |
| Fee and commission income | (46.62) | (5.01) | (5.49) | 9.18 | 23.59 |
| Operating expenses | (21.49) | (10.35) | 3.59 | 18.62 | 24.12 |
| Preprovision income | 0.14 | 48.80 | (3.81) | 12.05 | 4.47 |
| Net income | (54.59) | 1,384.57 | 7.04 | (76.47) | 23.22 |
| **Income Statement in % Average Risk Weighted Assets** | | | | | |
| Net interest income | 1.36 | 1.36 | - | - | - |
| Trading income | (0.01) | 0.05 | - | - | - |
| Fee and commission income | 0.64 | 1.23 | - | - | - |
| Insurance income | - | - | - | - | - |
| Operating income | 2.20 | 2.70 | - | - | - |
| Operating expenses | 1.58 | 2.07 | - | - | - |
| Preprovision income | 0.61 | 0.63 | - | - | - |
| Loan loss provisions | 0.15 | 0.29 | - | - | - |
| Extraordinary profit | (0.00) | 0.04 | - | - | - |
| Net income | 0.44 | 0.99 | - | - | - |

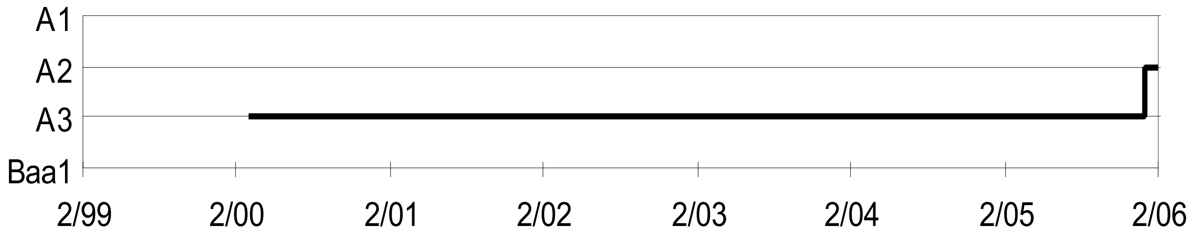
## DVB Bank AG (Consolidated)

| | 31/12/2004 | 31/12/2003 | 31/12/2002 | 31/12/2001 | 31/12/2000 |
|---|---|---|---|---|---|
| **Liquidity, Funding (including sub debt) & Balance Sheet Composition** | | | | | |
| Avg. liquid assets % avg. total assets | 21.68 | 23.93 | 30.30 | 33.03 | 38.55 |
| Avg. gross loans % avg. total assets | 73.73 | 72.07 | 66.82 | 64.09 | 58.81 |
| Avg. customer deposits % avg. total funding | 29.22 | 24.82 | 25.38 | 27.17 | 27.68 |
| Avg. interbank funds % avg. total funding | 38.62 | 50.98 | 54.25 | 52.86 | 56.58 |
| Avg. market funds (excl. interbank) % avg. total funding | 29.47 | 21.65 | 18.18 | 18.13 | 14.40 |
| Avg. sub debt % avg. total funding | 2.69 | 2.55 | 2.20 | 1.84 | 1.34 |
| Avg. liquid assets % avg. customer deposits | 81.21 | 104.53 | 127.80 | 129.71 | 148.45 |
| Avg. gross loans % avg. customer deposits | 276.14 | 314.76 | 281.79 | 251.68 | 226.47 |
| Avg. market funds reliance [5] | 6.91 | (5.70) | (20.52) | (25.49) | (69.26) |
| Avg. RWA % avg. total assets | 80.65 | 78.40 | - | - | - |
| **Breakdown of Operating Income in %** | | | | | |
| Net interest income % operating income | 61.76 | 50.49 | 45.27 | 40.59 | 29.16 |
| Trading income % operating income | (0.55) | 2.03 | 2.39 | 2.89 | 5.04 |
| Fee & commission income % operating income | 29.07 | 45.49 | 47.31 | 51.25 | 55.15 |
| Insurance income % operating income | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other operating income % operating income | 9.73 | 1.98 | 5.03 | 5.27 | 10.65 |
| **Profitability** | | | | | |
| Yield on avg. earning assets (%) | 4.71 | 4.51 | 4.62 | 5.42 | 5.59 |
| Cost of interest bearing liabilities (%) | 3.67 | 3.39 | 3.73 | 4.71 | 4.77 |
| Net interest margin (%) [6] | 1.16 | 1.15 | 0.93 | 0.80 | 0.64 |
| Recurring earning power (Pre-prov. inc. [PPI] % avg. assets) | 0.49 | 0.49 | 0.30 | 0.31 | 0.34 |
| Risk-weighted recurring earning power (PPI % avg. RWA) | 0.61 | 0.63 | - | - | - |
| Post-provision income % avg. assets | 0.38 | 0.27 | 0.10 | 0.15 | 0.34 |
| Post-provision income % avg. risk weighted assets | 0.47 | 0.34 | - | - | - |
| Return on average assets (%) | 0.35 | 0.78 | 0.32 | 0.04 | 0.23 |
| Return on avg. RWA (%) | 0.44 | 0.99 | - | - | - |
| Post-provision income % tier 1 capital | 6.75 | 5.00 | - | - | - |
| Return on equity (period end) (%) | 7.10 | 16.85 | 1.35 | 1.37 | 5.82 |
| Net interest income coverage of loan loss provisions | 9.28 | 4.75 | 4.47 | 4.81 | - |
| Loan loss provisions % preprovision income | 23.87 | 45.75 | 65.55 | 51.39 | - |
| Pre-tax income % operating income | 23.72 | 21.03 | 17.48 | 5.34 | 18.72 |
| Internal capital growth (%) | 7.65 | 18.32 | 0.10 | 0.00 | 4.71 |
| Dividend payout ratio (%) | - | 8.44 | 93.50 | 100.00 | 56.42 |
| **Efficiency** | | | | | |
| Cost/income ratio (op. expenses % op. income) [7] | 72.13 | 76.75 | 84.56 | 83.57 | 82.77 |
| Adjusted cost/income ratio (incl. non-operating items) | 72.14 | 68.34 | 72.40 | 86.21 | 81.28 |
| Operating expenses % average assets | 1.28 | 1.62 | 1.64 | 1.57 | 1.65 |
| Operating income / employee (EUR thousand) | 451.77 | 478.17 | 206.87 | 204.22 | 180.34 |
| Operating expenses / employee (EUR thousand) | 325.85 | 366.99 | 174.94 | 170.67 | 149.28 |
| PPI / employee (EUR thousand) | 125.92 | 111.19 | 31.93 | 33.55 | 31.07 |
| **Asset Quality and Risk Measurement** | | | | | |
| Problem loans % gross loans | - | - | - | - | - |
| LLR % problem loans | - | - | - | - | - |
| LLR % gross loans | - | - | - | - | - |
| Loan loss provisions % gross loans | 0.16 | 0.32 | 0.30 | 0.24 | - |
| Problem loans % (shareholders' equity + LLR) | - | - | - | - | - |
| Replacement value % shareholder's equity | 121.08 | 114.01 | - | - | - |
| **Capital Adequacy (Period End)** | | | | | |
| Tier 1 ratio (%) | 6.70 | 6.80 | 5.80 | 5.00 | 5.70 |
| Total capital ratio (%) | 10.70 | 11.10 | 10.40 | 9.50 | 10.20 |
| Shareholders' equity % total assets | 4.95 | 4.69 | 3.85 | 3.00 | 3.48 |
| Equity participations % shareholders' equity | 24.66 | 0.31 | 0.64 | 1.52 | 0.30 |

*[1] Historical exchange rates are applied accordingly for USD and EUR figures.*
*[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] Includes goodwill amortisation (pre-IFRS).*
*[5] Avg. [(market funds-liquid assets) % (earning assets-liquid assets)]*
*[6] Although not part of net interest income calculation, the NIM includes dividend income.*
*[7] Cost/income ratio excludes goodwill amortisation, which is included together with net non-operating income in the adjusted cost/income ratio.*

## Rating History

**Long-term Bank Deposits**

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