

**Credit Opinion: DVB Bank AG**

**DVB Bank AG**

Frankfurt, Germany

**Ratings**

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A1/P-1
Bank Financial Strength	C
Senior Unsecured	A1
Subordinate -Dom Curr	A2
Other Short Term -Dom Curr	P-1
<b>Parent: DZ BANK AG Deutsche Zentral-Genossenschaftsb.</b>	
Outlook	Stable(m)
Bank Deposits	Aa3/P-1
Bank Financial Strength	C-
Senior Unsecured -Fgn Curr	Aa3
Senior Unsecured -Dom Curr	Aa3
Subordinate -Dom Curr	A1
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	P-1

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**Key Indicators**

**DVB Bank AG**

	[1]2007	2006	2005	2004	2003	Avg.
Total assets (EUR billion)	11.40	11.10	10.86	9.28	9.07	[2]0.22
Total capital (EUR billion)	1.38	1.24	1.12	0.93	0.90	[2]12.01
Return on average assets	1.21	0.81	0.57	0.38	0.78	0.57
Recurring earnings power [3]	1.22	0.98	0.55	0.74	0.49	0.61
Net interest margin	1.72	1.57	1.17	1.12	1.15	1.18
Cost/income ratio (%)	48.12	53.77	65.23	56.79	76.75	67.42
Problem loans % net loans	--	0.27	0.17	0.37	--	0.27
Tier 1 ratio (%)	6.30	6.80	6.80	6.70	6.80	6.58

[1] As of June 30. [2] Compound annual growth rate. [3] Preprovision income % average assets.

**Opinion**

**SUMMARY RATING RATIONALE**

Moody's assigns a bank financial strength rating (BFSR) of C to DVB Bank AG (DVB), which translates into a Baseline Credit Assessment of A3. The rating derives from DVB's focused and well executed strategy of being a specialised lender to the transport finance industry, and its improving, but moderate, risk-adjusted profitability and economic capitalisation. The BFSR also takes into account the bank's established position in cyclical and competitive industries.

DVB's long-term global local currency (GLC) deposit rating is A1, based on the bank's own Baseline Credit Assessment of A3 and on Moody's assessment of a very high probability of group support from the Association of German Co-operative Banks (Bundesverband der Deutschen Volksbanken und Raiffeisenbanken or BVR), and a low probability of systemic support.

Under Moody's joint default analysis (JDA) methodology, our support assessment - as highlighted above - gives DVB's GLC deposit rating a two-notch uplift from its A3 Baseline Credit Assessment. The short-term rating is Prime-1.

### **Credit Strengths**

- Solid franchise and market expertise as a transport finance specialist in the international transport industry
- Asset quality has demonstrated considerable resilience to the difficult operating environment, furthermore coupled with a degree of comfort because of predominance of secured lending
- Financial fundamentals increasingly reflect the bank's successful transformation into a specialised lender, with acceptable risk-weighted returns and efficiency

### **Credit Challenges**

- Risk-adjusted profitability and economic capitalisation have improved, but risk-absorption capacity remains somewhat vulnerable, in particular given the possibility of a more severe downturn scenario in the shipping or aviation industries
- In addition to the inherent industry concentration, some single risks exist, represented by unsecured exposures or investments in equity or mezzanine finance
- DVB's liquidity profile is modest, since the bank's funding predominantly relies on wholesale funds

### **Rating Outlook**

The outlook on all ratings is stable.

### **What Could Change the Rating - Up**

We acknowledge that DVB has, over time, successfully completed its transformation process into a specialised corporate finance bank, including the elimination of all legacy risks in its German transport and corporate finance portfolio. This should result in a further strengthening of its financial fundamentals in the medium term, which would justify a higher BFSR. We view positively DVB's increased expansion into advisory activities - including the bank's active management of collateralised assets - mezzanine and equity financing, but we caution that undue growth in unsecured credit exposure could limit the upside potential for the BFSR.

### **What Could Change the Rating - Down**

DVB's BFSR is vulnerable to event risk, which would most likely be linked to a more severe downturn scenario in the shipping or aviation industries.

As at end September 2007, DVB's total assets were about EUR 12.3 billion, which is up 11% y-o-y. Net income rose by 57% to EUR 98.6 million while the cost-to-income ratio fell to 48.7% at the end of September 2007.

## **DETAILED RATING CONSIDERATIONS**

Detailed considerations for DVB Bank AG's currently assigned ratings are as follows:

### **Bank Financial Strength Rating**

Moody's assigns a C BFSR to DVB Bank AG, in line with Moody's bank financial strength rating scorecard. Key positive elements driving the BFSR include its solid franchise and market expertise in the international transport industry and its ample geographical diversification. The BFSR also takes into account the bank's improving cost efficiency and low risk profile, demonstrated in particular by its sound asset quality. Key elements constraining the BFSR are the improving but still modest profitability indicators, and the strong dependence on wholesale funding.

Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

DVB has a focused and well executed strategy of being a specialised lender to the transport finance industry. DVB has a well established market position in shipping and aviation finance and is also an important player in land transport finance, primarily on rail and roads. For the past several years the bank has built up client relationships and extensive sector know-how and is a well-known player in the international transport industry; it is active in lending, structured finance and advisory services. In addition DVB uses its sector expertise to establish itself as a service provider to its transport finance clients and as an asset manager in investment funds, focusing on investments in the shipping, aviation, cruise, rail rolling stock and intermodal equipment.

DVB's franchise value is somewhat constrained by the cyclical nature of its core business lines and the highly competitive and fragmented market of aviation and ship finance. The volatile characteristics of the aviation and shipping industry could potentially affect the bank's risk-return profile and render the bank's financial fundamentals somewhat less predictable, particularly when compared to those of banks with more diversified earnings spread over a greater number of businesses and industries. However, based on DVB's experience in - and deep knowledge of - the transport sector, we consider the bank to be well positioned to withstand negative cyclical developments. DVB's returns have proved to be stable in recent years, and continue to grow in line with its better entrenched position as a transport finance specialist.

DVB's activities are of a global nature and well diversified in geographical terms. The bank has significant operations in many major markets and owns a worldwide network of branches and representative offices in the major centres for aviation and ship finance. Markets outside Germany account for more than 90% of its customers and exposure. The overall score for franchise value is C.

#### Factor 2: Risk Positioning

Trend: Neutral

DVB's has a sound risk profile. DVB displays good risk management practices, supported by an improved IT platform and updated risk management systems.

The nature of bank's business determines the existence of notable credit risk concentration. From an industry point of view, the shipping industry - accounting for more than half of the portfolio - is, by far, the largest concentration. Borrower concentration is also high compared to less specialised banks. However, these concentrations are mitigated by the secured nature of DVB's lending practices. More than 95% of DVB's loan portfolio is collateralised and the quality of the collateral is sound, as confirmed by the virtual absence of any actual losses of principal in the core businesses over recent years.

Market risk is confined almost exclusively to interest rate risk and foreign exchange, as equity and trading risks are minimal. The vast majority of derivatives represent interest rate swaps and FX forwards used for hedging. DVB's scorecard outcome for risk positioning is C-.

#### Factor 3: Regulatory Environment

This factor does not address bank-specific issues; instead, it evaluates whether regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. According to Moody's country regulatory environment assessment, Germany has an advanced regulatory environment.

#### Factor 4: Operating Environment

Trend: Neutral

This factor is common to all German banks. Moody's assigns a B score for the overall operating environment. However, DVB's profits largely derive from outside the home country, we consider a blended operating environment score for each sub-factor reflecting the bank's overall operating environment based on its profit mix. The adjusted overall operating environment is still B, which is positively affected by the bank's operations in the USA, UK, Norway and Japan but outweighed by the negative impact of Korea, Greece and Hong Kong.

#### Quantitative Rating Factors (50%)

#### Factor 5: Profitability

Trend: Improving

DVB's revenues are dominated by net interest income derived from its lending operations. In the first nine months of 2007 net interest income increased to EUR 134 million (+30.5% y-o-y), reflecting higher lending volumes, while the average interest margin declined, reflecting in particular margin pressure in the aviation sector. Margins might

come under further pressure when the cycle turns downward in shipping or in some parts of this sector, but based on DVB's expertise and position we consider the bank to be well equipped to anticipate negative trends in the market well in advance. Based on its well-established client relationships, DVB should also be less vulnerable to margin pressure than other more opportunistic players that enter the aviation or shipping market. Other factors weighing on average lending margins are currently higher funding costs caused by the overall financial market turmoil.

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. 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. A constantly growing proportion of interest and commission income is in particular generated from the bank's fund management activities and its own shipping and aviation sector investment funds. We view this revenue diversification positively and note that DVB's corporate finance activities are developing successfully as demonstrated in recent periods. However, some of these higher margin activities, in particular equity and mezzanine finance, also entail higher risks than pure secured lending.

The bank's recurring earning power and profitability have clearly improved in 2006 and the first nine months of 2007 and, on a risk-weighted basis, are now roughly in line with other German banks, although still lagging behind its European peers. The overall score for profitability is D.

#### Factor 6:

Liquidity

Trend: Neutral

DVB's liquidity position is modest, reflecting the bank's dependence on wholesale funding, with interbank and capital market funding dominating. However, to improve its liquidity, DVB holds a portfolio of liquid securities, predominantly bank bonds, and has access to committed un-drawn back-up facilities. DVB's liquidity position is further enhanced by the bank's access to funding provided by the members of the co-operative banking sector, which are typically highly liquid retail banks. Moreover, since DVB is a member of the co-operative banking sector (BVR) it could in our opinion rely on short-term funds provided by BVR members in case of need. The D+ score for liquidity reflects in our view the more modest liquidity position of the bank.

#### Factor 7: Capital Adequacy

Trend: Neutral

DVB's total capital ratio was 9.5% as of end September 2007, down from 9.7% at year-end 2006, while the core capital ratio was 6.2%, down from 6.8% - all ratios are in accordance with German regulatory guidelines of the German Banking Act (Kreditwesengesetz or KWG). Although risk-weighted capital ratios appear quite tight they have to be seen against the background that they should benefit from a decline in risk-weighted assets under Basel II. DVB is applying the Advanced Approach and expects a clear improvement of its capital ratios from 2010 onwards. However, continuing strong portfolio growth could again put pressure on its regulatory capital levels.

We view DVB's economic capital position and consequently its risk-absorption capacity as adequate, given the increased level of core profitability and reserves. However, the bank's financial robustness and flexibility would benefit from a higher economic capitalisation, particularly since it remains vulnerable due to the highly cyclical markets. The score for the bank's capital adequacy is C+.

#### Factor 8: Efficiency

Trend: Improving

We acknowledge DVB's efforts and its success in achieving its targeted cost-to-income ratio of no more than 50% (48% as of end-June 2007), together with a continuing diversification into new products and asset classes. However, compared to other specialised lenders, such as ship financiers or mortgage banks, this cost-to-income ratio might appear relatively high, and it will be difficult for the bank to achieve the very low cost-to-income ratios of those secured long-term lenders specialising in financing only one asset class. We expect the current level of efficiency to be maintained over the coming periods. Based on the three-year average figure, DVB scores C for efficiency.

#### Factor 9: Asset Quality

Trend: Neutral

The score for Asset Quality highlights one of the strengths of the bank. DVB's loan portfolios in its core businesses of shipping and aviation have been demonstrating considerable resilience even in times of a 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, strong collateral has helped DVB to avoid losses, despite its exposure to sectors with larger bankruptcies between 2001 and 2003, especially in the aviation industry. 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.

In the past years, loan-loss provisioning requirements in DVB's ship financing business have been modest, which is indicative of the bank's strong expertise in its core business fields. In aviation loan loss provisions have been somewhat higher in recent years, but a reversal of loan loss provisions was possible in the first nine months of 2007. 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 relying to a lesser degree on the creditworthiness of the airline or ship owner. However, we would take a cautious view of any larger positions of unsecured exposure or equity positions. The bank scores B for Asset Quality

### **Global Local Currency Deposit Rating (Joint Default Analysis)**

Moody's assigns a global local currency (GLC) deposit rating of A1 to DVB Bank AG.

The GLC deposit rating is supported by DVB's Baseline Credit Assessment of A3, as well as by the ratings of its underlying support providers:

- The C- BFSR of its major shareholder (DZ Bank Deutsche Zentral-Genossenschaftsbank AG), which translates to a Baa1 Baseline Credit Assessment;
- The creditworthiness of the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), sector;
- Germany's Aaa local-currency deposit ceiling (LCDC).

The bank thus receives a two-notch uplift from its Baseline Credit Assessment, bringing the GLC rating to A1.

Based on DVB's membership of the BVR Moody's assesses the probability of co-operative sector support for the bank in the event of a stress scenario as very high. The bank's membership of the FinanzVerbund provides DVB with two forms of sector-specific support: the Garantiefonds (a support fund that is maintained by annual contributions from member banks) and the Garantie-Verbund (a further contractually defined support agreement, which invariably takes the form of a performance guarantee in favour of a co-operative bank in difficulty).

Moody's assessment of parental support for DVB's is low. Although DZ Bank holds a 93.21% stake in DVB, we see only limited indications that support would be provided, since there is no strategic fit of the two banks' business models and only limited management involvement from DZ Bank and no reference to the parent's brand name or logo.

The probability of systemic support is judged to be low. This is based on DVB's small national market share and minimal importance to the German paying system. Germany is characterised as a medium support country.

### **Notching Considerations**

In line with Moody's notching guidelines published in April 2007, DVB's dated subordinated debt is rated at A3, i.e. one notch below the bank's senior debt rating.

### **Foreign Currency Deposit Rating**

Moody's foreign currency deposit ratings for DVB are A2/Prime-1, stable.

### **Foreign Currency Debt Rating**

Moody's foreign currency debt ratings for DVB are A2/Prime-1, stable.

About Moody's Bank Ratings

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-



<b>Factor: Franchise Value</b>						<b>C</b>	<b>Neutral</b>
<b>Market Share and Sustainability</b>			<b>x</b>				
<b>Geographical Diversification</b>	<b>x</b>						
<b>Earnings Stability</b>					<b>x</b>		
<b>Earnings Diversification [2]</b>							
<b>Factor: Risk Positioning</b>						<b>C-</b>	<b>Neutral</b>
<b>Corporate Governance [2]</b>							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
<b>Controls and Risk Management</b>		<b>x</b>					
- Risk Management			<b>x</b>				
- Controls	<b>x</b>						
<b>Financial Reporting Transparency</b>		<b>x</b>					
- Global Comparability	<b>x</b>						
- Frequency and Timeliness		<b>x</b>					
- Quality of Financial Information			<b>x</b>				
<b>Credit Risk Concentration</b>	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
<b>Liquidity Management</b>			<b>x</b>				
<b>Market Risk Appetite</b>	<b>x</b>						
<b>Factor: Operating Environment</b>						<b>B</b>	<b>Neutral</b>
<b>Economic Stability</b>			<b>x</b>				
<b>Integrity and Corruption</b>		<b>x</b>					
<b>Legal System</b>	<b>x</b>						
<b>Financial Factors (50%)</b>						<b>C-</b>	
<b>Factor: Profitability</b>						<b>D</b>	<b>Improving</b>
<b>PPP % Avg RWA</b>				0.88%			
<b>Net Income % Avg RWA</b>				0.67%			
<b>Factor: Liquidity</b>						<b>D+</b>	<b>Neutral</b>
<b>(Mkt funds-Liquid Assets) % Total Assets</b>					46.52%		
<b>Liquidity Management</b>			<b>x</b>				
<b>Factor: Capital Adequacy</b>						<b>C+</b>	<b>Neutral</b>
<b>Tier 1 ratio (%)</b>			6.77%				
<b>Tangible Common Equity % RWA</b>		6.54%					
<b>Factor: Efficiency</b>						<b>C</b>	<b>Improving</b>
<b>Cost/income ratio</b>			58.60%				
<b>Factor: Asset Quality</b>						<b>B</b>	<b>Neutral</b>
<b>Problem Loans % Gross Loans</b>	--	--	--	--	--		
<b>Problem Loans % (Equity + LLR)</b>	--	--	--	--	--		
<b>Lowest Combined Score (15%)</b>						<b>D+</b>	
<b>Economic Insolvency Override</b>						<b>Neutral</b>	
<b>Aggregate Score</b>						<b>C</b>	
<b>Assigned BFSR</b>						<b>C</b>	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information

[2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral

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