FitchRatings

Banks
Wholesale Commercial Banks
Germany

IKB Deutsche Industriebank AG

Ratings

Foreign Currency	
Long-Term IDR	BBB-
Short-Term IDR	F3
Viability Rating	bbb-
Government Support Rating	ns
Sovereign Risk (Germany)	
Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA
Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Fitch Downgrades IKB Deutsche Industriebank to 'BBB-'; Stable Outlook (December 2022)

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Key Rating Drivers

Profitability Constrains Ratings: IKB Deutsche Industriebank AG's (IKB) Viability Rating (VR) is one notch below the 'bbb' implied VR, because its weak earnings and modest profitability prospects (scored 'bb+') have a high importance to the bank's credit profile. IKB's ratings also reflect its stable asset quality, underpinned by resilient, good-quality mid-cap corporate ('Mittelstand') borrowers, adequate capitalisation, and satisfactory funding and liquidity profile.

Lower Growth Expectations: Fitch Ratings expects IKB's business profile to remain stable during the upcoming recession, due to the resilience of its Mittelstand portfolio. However, more selective new business and temporarily increased regulatory capital requirements are constraining IKB's growth opportunities and revenue generation.

Healthy Underwriting Standards but Concentration: IKB has improved its risk profile over the past 12 months by tightening its underwriting standards and focusing on higher-quality corporates. It has implemented various measures to address regulatory findings after a review of its risk-management framework in 2021, including the calibration of its risk-bearing capacity and market risk models. It also reduced market risks in its securities portfolio in 2022.

Resilient Asset Quality: IKB's asset quality is a rating strength, thanks to the bank's focus on higher-quality Mittelstand clients. We believe it will be challenging to prevent a deterioration of asset quality in a recessionary environment. However, we expect the rise in the impaired loan ratio to be gradual and contained below 3% over the next two years. This is because we view IKB's exposure to cyclical and energy-intensive sectors as manageable.

Valuation Losses: Fitch expects IKB to incur an operating loss (as calculated by Fitch) in 2022 due to write-downs and disposal losses in its securities portfolio amid rising interest rates and widening spreads. Lower new lending volumes will constrain earnings as revenues rely heavily on interest income. IKB also benefits from low costs due to lean processes and adequate franchise in its structuring-heavy public development loan (PDL) business, as large German competitors are reluctant (for strategic and cost reasons) to dedicate resources to this business.

Capital Weakened but Adequate: In 2022, IKB released sizeable reserves that count as common equity Tier 1 (CET1) capital under German GAAP, to offset the write-downs and disposal losses in its securities portfolio. These losses have also been partly offset by unrealised gains in its derivative portfolio, which are not reflected in its German GAAP income statement.

IKB's capitalisation and leverage score is constrained by concentration in corporate lending. In addition, we have lowered the score to 'bbb' to reflect the reduced capital available for loss absorption, despite various mitigating measures already taken, such as profit retention and risk reduction. We believe IKB will restore comfortable capital buffers and maintain a CET1 ratio above 13% in the near to medium term. Its fully phased CET1 ratio was 14.9 % at end-June 2022.

Satisfactory Funding and Liquidity: IKB's underdeveloped capital market funding is balanced by its sound corporate and retail deposit base and its secured central bank funding capacity. IKB also benefits from maturity-matched funding from 'AAA' rated German state-owned development banks (predominantly KfW) for its entire PDL portfolio. We expect its liquidity profile to remain adequate despite sizeable liquidity outflows over the next 12 months, when a sizeable volume of ECB funding (targeted longer-term refinancing operations, TLTRO) matures.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

IKB's ratings have sufficient headroom at the current levels, but would come under pressure should there be extended structural operating losses and a decline of the CET1 ratio below 12% without clear recovery prospects. A material and structural deterioration in the impaired loan ratio to above 3% without a credible plan to reduce it would also put pressure on the ratings.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

A rating upgrade would require a sustainable earnings recovery, with an operating profit/risk-weighted assets (RWAs) ratio converging toward 1% and an extended record of operations with the current reduced risk appetite. An upgrade would also require maintaining good asset quality metrics through the recession and reasonable capital buffers.

Other Debt and Issuer Ratings

Rating level	Rating
Long-term deposits: long term	BBB-
Short-term deposits: short term	F3

Source: Fitch Ratings

The bank's 'F3' Short-Term IDR is the only option mapping to its 'BBB-' Long-Term IDR.

IKB's deposit ratings are aligned with its IDRs. The bank's preferred resolution strategy is liquidation. Therefore, we do not expect the bank to be subject to a minimum requirement for own funds and eligible liabilities and to build or maintain buffers of junior and senior non-preferred debt in excess of 10% of RWAs.

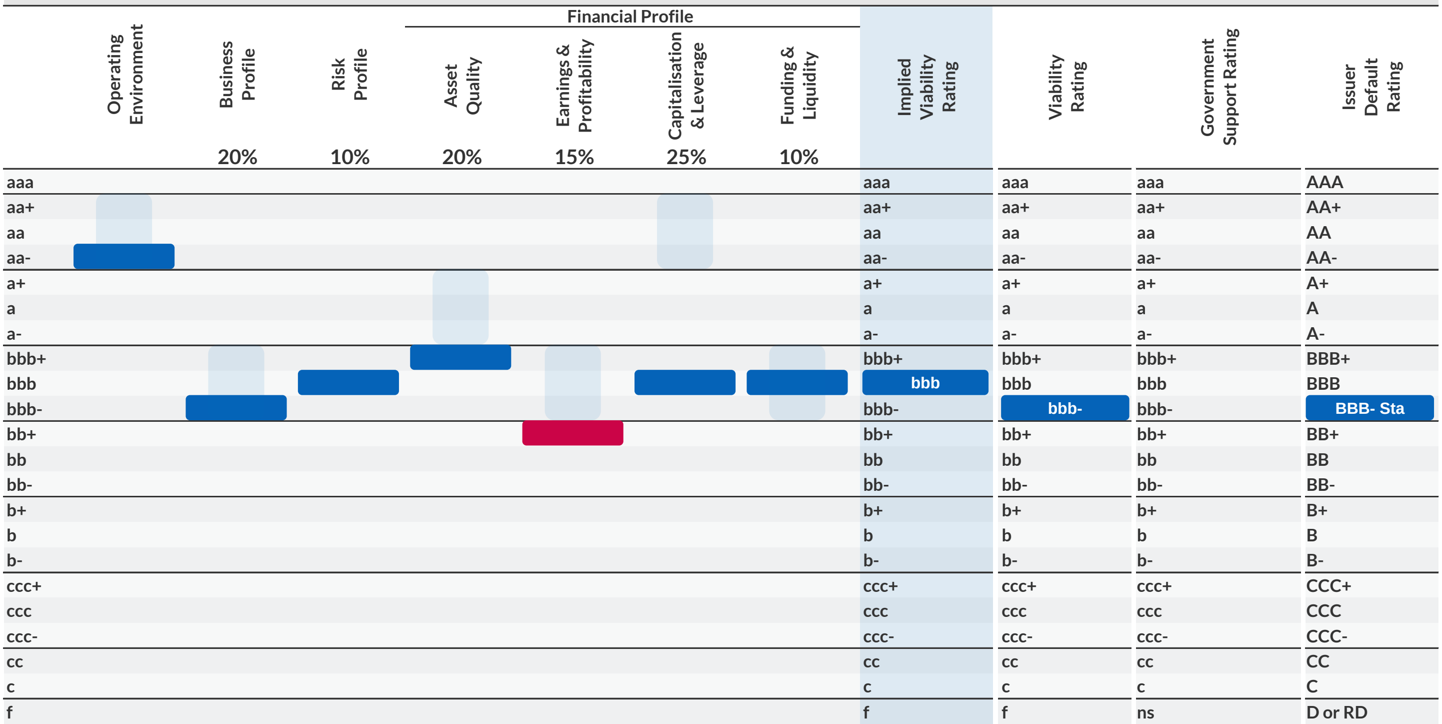
IKB's deposit ratings are sensitive to changes in its IDRs.

Ratings Navigator

IKB Deutsche Industriebank AG

ESG Relevance:

Banks
Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

The asset quality score of 'bbb+' has been assigned below the 'a' category implied score, due to the following adjustment reason: concentrations (negative).

The earnings and profitability score of 'bb+' has been assigned below the 'bbb' category implied score, due to the following adjustment reason: historical and future metrics (negative).

The capitalisation and leverage score of 'bbb' has been assigned below the 'aa' category implied score, due to the following adjustment reason: risk profile and business model (negative) and regulatory capitalisation (negative).

Company Summary and Key Qualitative Factors

Operating Environment

Fitch forecasts economic contraction during the winter due to the severe energy shock triggered by the war in Ukraine, while growth is further weakened by slower growth in China, Germany's second-largest export market. Fitch forecasts GDP growth of 1.8% in Germany in 2022, followed by a 0.5% contraction in 2023 and a 1.9% recovery in 2024. Inflation is expected to peak in 2022, with Fitch's year-end inflation forecast reaching 12.2% in 2022, before declining to 4.1% in 2023 and 2.3% in 2024.

The German government has implemented various measures since February 2022 to mitigate the energy shock for households and corporates, including energy subsidies of up to EUR200 billion (5.3% of projected 2022 GDP) until early 2024. However, energy prices are likely to remain higher for longer. In combination with the deteriorating credit conditions, this is likely to financially affect Mittelstand companies, although they remained resilient in 2022. In particular, we expect asset quality pressure in energy-intensive sectors such as chemicals, papers and metals manufacturing.

Business Profile

IKB focuses on long-term lending for investment purposes to Mittelstand companies with more than EUR100 million annual revenue and is less engaged in short-term working-capital financing. It follows a regional coverage model to ensure close proximity to about 500 core customers.

The bank was acquired in 2008 by Lone Star Funds, a private equity vehicle, and has since been extensively restructured to overcome legacies from the 2007–2009 financial crisis. The bank was loss-making until mid-2019 and has since completed its restructuring, eliminating legacy legal risks. It has also regained its historic corporate banking focus, helped by its simplified business model and more cost-efficient operations than most domestic competitors.

IKB has acceptable margins and competitiveness in key lending products despite its small market shares and intense competition in the German corporate banking market, which constrain its pricing power. The bank focuses on traditional senior, mostly unsecured, lending (44% of its loan book at end-1H22) and has a long record of providing bespoke financial solutions, structuring, arranging and syndication. PDLs, which are provided by German public development banks and passed through to borrowers via commercial banks, account for the remaining 56% of IKB's loan book. While lending margins in the PDL business are lower than those earned in traditional lending, the business' complex range of products makes it particularly advisory-heavy.

In the past, IKB earned a sizeable portion of its revenue from its large securities portfolio (30% of interest income in 2021). We expect the portion of income from securities to decline after the bank reduced its securities holdings by 20% in 1H22.

Risk Profile

IKB's lending business bears moderate credit risk and relies on sound underwriting standards. IKB has also tightened its underwriting standards in 1H22 by focusing on better-rated borrowers. As a result, business origination in 1H22 declined to EUR1.2 billion (1H21: EUR1.7 billion) with a lower contribution from both commercial and PDLs, and the bank revised downwards its new business target for 2022 – originally, this was EUR3 billion. As a result, we expect the banks to remain cautious with regard to its underwriting standards in 2023 as the bank takes a more selective approach to new business.

IKB has spent substantial resources to review its risk-management framework, particularly model calibration and stress testing, following an audit by the German banking supervisor. The bank has also reduced the volume of its liquidity portfolio to EUR2.8 billion at end-1H22 (end-2021: EUR3.5 billion) to reduce market risk and improve its risk-bearing capacity. In the context of the reduction, it reclassified securities in a volume of EUR862 million previously held to maturity as current assets. Due to rising interest rates and widening credit spreads, the reclassification led to a valuation loss, net of derivative close-outs, of EUR355 million, which the bank offset by releasing over half of its reserve for general banking risks. IKB expects gains from interest-rate swaps on the liquidity portfolio to reduce the loss to EUR167 million once the derivatives are closed out.

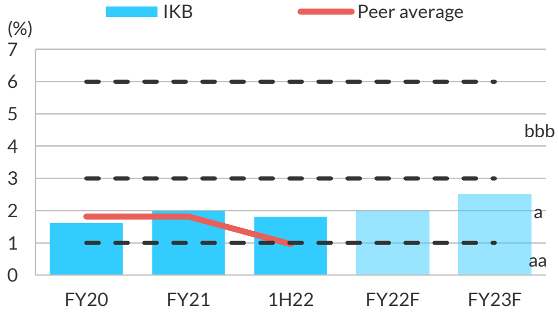
At end-1H22, the bank was compliant with all requirements. both in the normative and in the economic perspective.

Financial Profile

Asset Quality

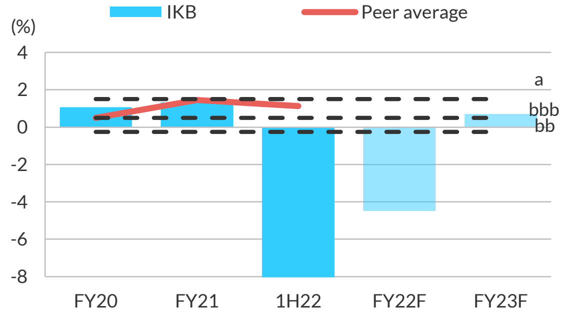
IKB's asset quality metrics were resilient in 1H22, but we expect a moderate deterioration in IKB's cyclical Mittelstand portfolio due to the combination of high energy prices, lower demand and worse credit conditions. However, we expect the four-year average impaired loans ratio to remain below 3%. Selective business origination, sound risk management, adequate risk-adjusted pricing, reasonable diversification by industry and a high share of lower-risk PDLs should mitigate credit losses and the likely negative rating migration over the next quarters. At the same time, concentration risk from large loans in IKB's portfolio remains high. IKB is not exposed to Russia or Ukraine, and its share of corporate loans in low rating classes has so far remained moderate.

Impaired Loans/Gross Loans



Source: Fitch Ratings, Fitch Solutions

Operating Profit/Risk-Weighted Assets



Source: Fitch Ratings, Fitch Solutions

Earnings and Profitability

IKB's pre-tax profit declined to EUR30 million in 1H22, driven by lower revenue and higher-than-expected administrative expenses, primarily triggered by higher provisions on legacy pension schemes. The bank has revised down its profit forecast for 2022 to EUR60 million (from EUR85 million) to reflect the more challenging environment.

In 1H22, write-downs and disposal losses in the securities portfolio led to an operating loss as calculated by Fitch (ie excluding the release of capital reserves from the operating income). The loss, which we view as non-recurring, highlights IKB's exposure to spread volatility and interest rates rises. We believe the bank will gradually restore its profitability, but to a lower level than previously anticipated, notably because the reduction of its securities holdings will weigh on net interest income.

Moreover, the increased regulatory capital requirements will also constrain the bank's ability to originate new business in the short term. In addition, the upcoming recession is likely to weigh on German corporates' investment activities. This could constrain IKB's new business generation, given its focus on long-term investment lending. This combined pressure on new business volumes is likely to weigh on the bank's earnings, despite rising interest rates on corporate loans.

IKB's costs increased by 10% in 1H22 yoy, driven by project costs and higher provisions on legacy pension schemes, and the latter will also weigh on earnings in 2023 and 2024. On an economic basis (not reflected in local GAAP accounts) the bank's pension fund net asset value increased by EUR78 million in 1H22.

We believe it is possible for IKB's costs to decline even in an inflationary environment given the bank's strong record in reducing expenses, including staff costs. However, we expect loan-impairment charges to rise in the next two years from their current low levels.

Capital and Leverage

IKB's fully phased in CET1 ratio dropped to 14.9 % at end-1H22 (end-2021: 16.6%). The decline was driven by the above-mentioned release of reserves for general banking risks, which are recognised as CET1 capital under German GAAP.

IKB also started making use of transitional provisions for the calculations of its regulatory capital ratios, which result in an additional 190bp relief over regulatory requirements. This option under the Capital Requirements Regulation (CRR) ceases at end-2022 and transitional provisions are not included in the fully phased-in capital ratios.

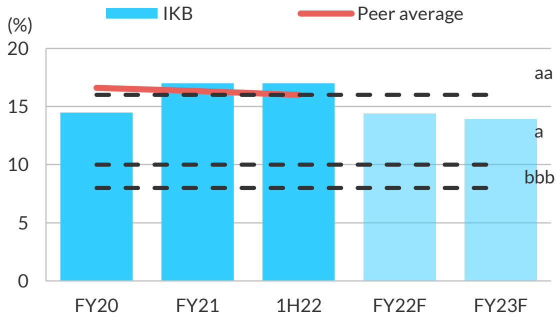
The German banking supervisor's temporary additional regulatory charges on IKB's CET1 (225bp), Tier 1 (300bp), and total capital (400bp) ratio requirements make IKB's Tier 1 capital requirement the most binding, at 13.02% of RWAs.

These requirements are measured against IKB's transitional capital ratio. To mitigate the decline in capital buffers, the bank has retained the EUR152 million dividend initially accrued on its 2020 profit and has stopped pay-outs.

RWAs have also declined by about 2% in 1H22 as a result of lower loan volumes and positive rating migration. The bank's high share of unsecured loans results in an above-average RWA density of 50%. The latter decreased from 68% at end-2019 due to an increased share of PDL business, which carries low risk-weights. The bank expects positive effects from Basel IV, due to a lower loss-given-default standard parameter. The output floor will not be a constraint.

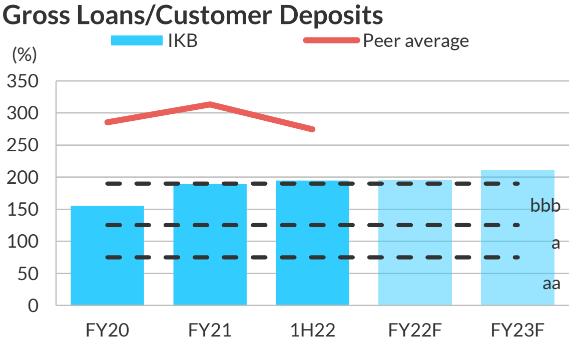
IKB targets a fully phased-in CET1 ratio above 13% at end-2022, but we believe that the temporary capital surcharge, in combination with higher provisions for credit costs and negative rating migration, could restrict IKB's financial flexibility – potentially into next year.

CET1 Ratio



Source: Fitch Ratings, Fitch Solutions

Gross Loans/Customer Deposits



Source: Fitch Ratings, Fitch Solutions

Funding and Liquidity

About 30% of IKB's funding stems from retail and corporate deposits covered by the voluntary deposit protection fund of German private commercial banks. The bank's membership in this fund helps the bank to attract deposits at low costs, compensating for its underdeveloped capital market access, which is still constrained by the bank's history of volatile profitability until 2019. The deposit base has been sticky, with only moderate corporate deposit outflows.

In addition, more than a third of IKB's funding arises from maturity-matched programmes from 'AAA' rated German public development banks (predominantly KfW) for its entire PDL portfolio, for which IKB does not carry funding risk or asset-liability mismatches.

The third large funding pillar is secured interbank lending, primarily TLTRO funding from the ECB. We expect some changes in the funding mix in 2023, as TLTRO funding is likely to be partly replaced.

IKB's liquidity is underpinned by EUR1.3 billion of unencumbered assets, although its liquid assets have declined during 9M22, due to maturing subordinated debt, lower institutional deposits and negative market value changes.

Additional Notes on Charts

The forecasts in the charts in this section reflect Fitch's forward view on the bank's core financial metrics per Fitch's Bank Rating Criteria. They are based on a combination of Fitch's economic forecasts, sector outlook and company-specific considerations. As a result, Fitch's forecasts may materially differ from the guidance provided by the bank to the market. To the extent Fitch is aware of material non-public information with respect to future events, such as planned recapitalisations or merger and acquisition activity, Fitch will not reflect this information in its published forecasts. However, where relevant, such information is considered by Fitch as part of the rating process.

Financials

Financial Statements

	30 Jun 22 6 months - interim (EURm)	31 Dec 21 Year end (EURm)	31 Dec 20 Year end (EURm)	31 Mar 20 Year end (EURm)
Summary income statement				
Net interest and dividend income	98	219	166	201
Net fees and commissions	13	26	21	40
Other operating income	-328	71	61	88
Total operating income	-217	316	247	329
Operating costs	97	197	157	241
Pre-impairment operating profit	-314	119	90	89
Loan and other impairment charges	0.0	12	20	30
Operating profit	-314	107	71	59
Other non-operating items (net)	344	-2	-7	-50
Tax	n.a.	18	-10	1
Net income	30	86	73	8
Summary balance sheet				
Assets				
Gross loans	8,908	9,002	8,942	9,714
- Of which impaired	161	179	144	154
Loan loss allowances	139	154	169	185
Net loans	8,770	8,847	8,774	9,530
Interbank	3,263	2,999	2,044	2,199
Derivatives	n.a.	7	19	20
Other securities and earning assets	3,025	3,672	3,492	4,123
Total earning assets	15,058	15,525	14,329	15,871
Cash and due from banks	125	228	2,313	344
Other assets	240	238	272	388
Total assets	15,423	15,991	16,913	16,603
Liabilities				
Customer deposits	4,581	4,758	5,758	6,140
Interbank and other short-term funding	8,568	8,625	8,528	7,669
Other long-term funding	804	828	927	1,112
Trading liabilities and derivatives	n.a.	2	17	22
Total funding and derivatives	13,953	14,213	15,229	14,944
Other liabilities	260	253	237	285
Total equity	1,210	1,525	1,447	1,374
Total liabilities and equity	15,423	15,991	16,913	16,603

In 2020, IKB changed its financial year-end to 31 December from 31 March, using a transitional nine-month period to 31 December 2020
Source: Fitch Ratings, Fitch Solutions, IKB Deutsche Industriebank AG

Key Ratios

	30 Jun 22	31 Dec 21	31 Dec 20	31 Mar 19
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	-8.0	1.3	1.1	0.5
Net interest income/average earning assets	1.3	1.5	1.4	1.3
Non-interest expense/gross revenue	-44.7	62.5	63.5	73.1
Net income/average equity	4.5	5.8	6.9	0.6
Asset quality				
Impaired loans ratio	1.8	2.0	1.6	1.6
Growth in gross loans	-1.0	n.a.	-8.0	-3.0
Loan loss allowances/impaired loans	86.3	86.2	117.1	119.8
Loan impairment charges/average gross loans	0.0	0.1	0.3	0.3
Capitalisation				
Common equity Tier 1 ratio	17.0	17.0	14.5	12.0
Fully loaded common equity Tier 1 ratio	14.9	16.6	14.3	12.0
Tangible common equity/tangible assets	7.1	8.8	8.5	8.2
Basel leverage ratio	6.4	8.2	7.5	7.1
Funding and liquidity				
Gross loans/customer deposits	194.5	189.2	155.3	158.2
Liquidity coverage ratio	244.0	274.0	271.0	235.0
Customer deposits/total non-equity funding	32.8	33.5	37.9	41.2

In 2020, IKB changed its financial year-end to 31 December from 31 March, using a transitional nine-month period to 31 December 2020
Source: Fitch Ratings, Fitch Solutions, IKB Deutsche Industriebank AG

Support Assessment

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	a+ to a-
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	ns
Government ability to support D-SIBs	
Sovereign Rating	AAA/ Stable
Size of banking system	Negative
Structure of banking system	Neutral
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Negative
Government propensity to support bank	
Systemic importance	Negative
Liability structure	Neutral
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

IKB's Government Support Rating (GSR) of 'no support' reflects our view that extraordinary sovereign support for EU banks is possible but cannot be relied on due to the Bank Recovery and Resolution Directive and the Single Resolution Mechanism's resolution tools and mechanisms. It is likely that senior creditors will be required to participate in losses, if necessary, instead of, or ahead of, the group receiving sovereign support.

Environmental, Social and Governance Considerations

Overall ESG

5	
4	
3	
2	
1	

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Environmental (E)

General Issues	Score	Impact	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1		n.a.	n.a.
Energy Management	1		n.a.	n.a.
Water & Wastewater Management	1		n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1		n.a.	n.a.
Exposure to Environmental Impacts	2		Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality

E Scale: 5, 4, 3, 2, 1

Social (S)

General Issues	Score	Impact	Sector-Specific Issues	Reference
Human Rights, Community Relations, Access & Affordability	2		Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile
Customer Welfare - Fair Messaging, Privacy & Data Security	3		Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile
Labor Relations & Practices	2		Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)
Employee Wellbeing	1		n.a.	n.a.
Exposure to Social Impacts	2		Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile

S Scale: 5, 4, 3, 2, 1

Governance (G)

General Issues	Score	Impact	Sector-Specific Issues	Reference
Management Strategy	3		Operational implementation of strategy	Business Profile (incl. Management & governance)
Governance Structure	3		Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage
Group Structure	3		Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)
Financial Transparency	3		Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)

G Scale: 5, 4, 3, 2, 1

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.