IKB: Interim announcement as of 30 June 2011

The interim report covers the period from the start of the financial year on 1 April 2011 to 30 June 2011.

Business development

As in the same period of the previous year, the first quarter of the 2011/12 financial year was dominated by the government debt crisis in Europe. In the eurozone, there was uncertainly due to the potential for further rescue measures for Greece in particular, as well as the risk of potential contamination for major euro member states, leading to a further increase in the risk premiums for governments and banks alike.

The new lending volume was down slightly on the previous year at € 0.7 billion in the first quarter of the 2011/12 financial year (1 April to 30 June 2010: € 0.8 billion). The credit margins for new business and fee and commission business both increased in the period under review. The credit volume for the Bank as a whole declined by € 0.6 billion as against the last reporting date (31 March 2011) due to maturities and disposals. The economic upturn in Germany in particular was reflected in positive risk development in the period under review.

The operating performance of the core business segments improved again compared with the previous year despite the € 1.3 billion reduction in the average credit volume and substantial investments in infrastructure. Net interest income (after provisions for possible loan losses) in the two core business segments ("Credit Products" and "Advisory and Capital Markets") totalled € 55 million in the first quarter (up € 12 million year-on-year), while the operating result improved by € 20 million to € 30 million.

Profit and loss (IFRS consolidated income statement as of 30 June 2011)

The income statement for the first quarter of the 2011/12 financial year shows a consolidated net loss of € 83 million, an improvement of € 52 million compared with the same period of the previous year. IKB reported a net profit of € 7 million after adjustment for extraordinary factors. Net income from financial instruments at fair value was affected by the expansion of credit spreads for certain government issues in particular. The Greek government issues held by IKB were also measured at fair value in the consolidated financial statements. Their fair value had already been substantially reduced in the past, meaning that current income was only impacted in the amount of the additional remeasurement losses since the last balance sheet date. The narrowing of the IKB liability spreads also resulted in valuation losses for the individual liability items measured at fair value.

IKB's earnings continue to be impacted by the expenses for the implementation of the conditions imposed by the EU and commission payments to SoFFin. The expenses from commission payments will decrease successively in future as a result of the early return of SoFFin-guaranteed bonds and initial maturities, while the expenses relating to the EU conditions will be significantly lower in future as there is a good possibility that they will be met by 30 September 2011.

in € million	1 April 2011 to 30 June 2011	1 April 2010 to 30 June 2010	Change
Net interest income	39.2	39.6	-0.4
Provisions for possible loan losses	-11.5	16.8	-28.3
Net interest income after provisions for possible loan losses	**50.7**	**22.8**	**27.9**
Net fee and commission income	-15.8	-23.5	7.7
Net income from financial instruments at fair value	-42.6	-61.0	18.4
Net income from investment securities	-6.0	27.9	-33.9
Net income from investments accounted for using the equity method	1.5	-0.1	1.6
Administrative expenses	74.5	71.5	3.0
Personnel expenses	*40.2*	*36.8*	*3.4*
Other administrative expenses	*34.3*	*34.7*	*-0.4*
Other operating result	7.7	-22.8	30.5
Operating result	**-79.0**	**-128.2**	**49.2**
Tax expenses	4.3	7.4	-3.1
Consolidated net loss for the period	**-83.3**	**-135.6**	**52.3**

Figures for the previous year have been restated. The change is due to the adjustment of the amortisation charge for one of IKB's own issues. This meant that prior-year net interest income was reduced by € 0.4 million, from € 40.0 million to € 39.6 million, while the consolidated net loss for the period was increased by € 0.4 million, from € 135.2 million to € 135.6 million.

Net interest income was largely unchanged year-on-year at € 39 million. Net interest income in the Credit Products segment enjoyed stable development despite the reduction in the credit volume (due to the EU conditions). On balance, the earnings contribution from the Treasury and Investments segment declined compared with the previous year. The non-recurring effect from the write-down of the adjustment item in accordance with IFRS 1 IG60A, which impacted net interest income in the previous year, no longer applies in the current financial year due to the full reversal.

The strong economic situation led to income of € 12 million from **provisions for possible loan losses** compared with an expense of € 17 million in the previous year. This development in the period under review was largely attributable to the partial reversal of existing portfolio impairment losses.

As a result, **net interest income after provisions for possible loan losses** improved by € 28 million year-on-year to € 51 million (previous year: € 23 million).

Net fee and commission income improved by € 8 million year-on-year to € -16 million. This was due to the increase in net fee and commission income from operating credit and advisory business as well as the lower level of expenses from the guarantee commissions payable to SoFFin. Net fee and commission income adjusted for SoFFin commission increased by € 5 million to € 13 million in the period under review.

Net income from financial instruments at fair value improved by € 18 million, amounting to € -43 million after € -61 million in the previous year. The negative figure at the reporting date was primarily attributable to remeasurement losses on European government and corporate bonds carried at fair value due to the government debt crisis. IKB's exposure in Greece is measured at fair value. The already low prices of the relevant instruments fell to less than 50% as of the quarterly reporting date, resulting in further remeasurement losses. There were also less substantial remeasurement losses on own liabilities carried at fair value due to the reduction in the risk premiums listed for IKB on the market.

Net income from investment securities declined by € 34 million, from € 28 million in the previous year to € -6 million. This was primarily attributable to net remeasurement losses of € 8 million on portfolio investments compared with the gains of € 24 million in the previous year due to positive changes in value and disposals.

Administrative expenses were up € 3 million year-on-year at € 75 million (previous year: € 72 million) and were again dominated by the fulfilment of the EU conditions and investments in the realignment of the Bank's business model. Personnel expenses rose by € 3 million to € 40 million, while other administrative expenses remained essentially unchanged at € 34 million.

The **other operating result** improved by € 31 million to € 8 million. In the previous year, the other operating result was largely dominated by a write-down in conjunction with a real estate development project and a provision expense for costs relating to the winding-up of portfolio investments.

All in all, an **operating result** of € -79 million was generated (previous year: € -128 million). The operating result adjusted for extraordinary factors was positive at € 11 million, representing a year-on-year improvement of € 23 million. The **consolidated net loss** after taxes amounted to € 83 million (previous year: € 136 million). This resulted in a net profit after adjustment of € 7 million.

In the period under review, IKB AG recorded a net result in accordance with the German Commercial Code (HGB) of € -50 million.

Net assets (balance sheet as of 30 June 2011)

Total assets declined slightly by € 0.2 billion between 31 March 2011 and 30 June 2011, amounting to € 31.2 billion as of the reporting date and hence remaining below the target of € 33.5 billion to be achieved by September 2011 in accordance with the EU conditions. The downturn resulting from the further reduction in loans and advances to customers was partially offset by growth in other forms of investment. On the liability side, there was a decrease in securitised liabilities in particular, while the volume of refinancing via liabilities to banks and customers increased.

In accordance with the notification submitted to Deutsche Bundesbank, the Tier 1 capital ratio of the IKB Group based on HGB figures amounted to 11.2% as of 30 June 2011 (31 March 2011: 11.2%), while the total capital ratio amounted to 15.6% (31 March 2011: 15.9%).

Financial position

The liquidity situation at IKB is stable. This is thanks in part to the utilisation of the SoFFin guarantees and the diversification of the funding mix. Among other things, IKB is taking in revolving deposits from a number of customers, including via its "IKB direct" private customer platform since March 2011. The Bank is also reducing its volume of non-strategic assets in particular in order to generate liquidity and being selective when it comes to entering into new lending business with an impact on the balance sheet. In July 2011, further SoFFin guarantees in the amount of € 1.3 billion were returned early.

Key events and transactions

Please see the 2010/11 annual report for details of the significant events and transactions in the reporting period. In addition, the following current developments are of material importance:

Status of implementation of EU conditions

IKB has continued to work towards fulfilling the EU conditions since 31 March 2011. At € 31.2 billion as of 30 June 2011, total Group assets remained below the EU condition of € 33.5 billion to be achieved by September 2011. Based on these conditions and the reconciliation with the authorities in May 2011, IKB assumes that there will be no material obstacles preventing the fulfilment of the conditions on schedule as of 30 September 2011.

SoFFin guarantees

The SoFFin-guaranteed bond maturing on 29 April 2011 was repaid on schedule. Following the buyback and the early return of additional SoFFin guarantees in the amount of € 1.3 billion in July 2011, IKB's SoFFin guarantee volume decreased to its current level of € 7.3 billion.

The maturity structure of the bonds issued under SoFFin guarantees is currently as follows:

- € 1.2 billion maturing on 27 January 2012
- € 1.1 billion maturing on 13 March 2012
- € 2.0 billion maturing on 10 September 2012
- € 1.0 billion maturing on 1 February 2013
- € 2.0 billion maturing on 2 February 2015

Current rating situation

IKB terminated its contracts with rating agencies with effect from 30 June 2011, as a rating is no longer beneficial to the Bank and its investors and costs can be saved. In response to this, the rating agencies Fitch and Moody's withdrew their ratings with effect from 30 June and 14 July 2011 respectively, meaning that IKB does not currently have an external rating. With the withdrawal of their ratings, both agencies confirmed their most recent ratings for IKB.

Risks

For details of the risks to which the Bank is exposed, please see the 2010/11 annual report. Significant changes in the risk environment relate in particular to the rescue measures for Greece and the slump on the capital markets over recent weeks following an extremely nervous reaction to the global government debt crisis and fears of a downturn in the US economy.

Further rescue measures for Greece

On 22 July 2011, the governments of the euro member states resolved further comprehensive rescue measures for Greece that they intend to implement jointly. Banks will also make a contribution in the form of the voluntary exchange of Greek bonds for bonds with longer maturities and different conditions. Due to the involvement of the banking sector, the Institute of Public Auditors in Germany (IDW) has advised that it is necessary for banks to write down their Greek bonds accordingly insofar as their carrying amount is not already continuously adjusted to reflect market prices. This procedure should be applied by all banks holding Greek bonds maturing up to and including 2020, even if they are not participating in the bond exchange scheme. Greek bonds with longer maturities should be examined by the respective banks in order to determine the need to recognise write-downs in light of the package of measures agreed for Greece.

IKB measures its Greek bonds at fair value, meaning that it has recorded significant IFRS losses since the start of the crisis affecting the country even though the rescue package means that Greece is not expected to default. Based on current information, the final maturities of the Greek bonds held by IKB means that they do not qualify for any of the exchange schemes developed by the Institute of International Finance. The Greek bonds held by IKB (with a nominal volume of € 200 million) are reported on the consolidated balance sheet at a fair value of € 85 million.

According to current information, the rescue measures involving private creditors have not triggered a credit event for standard credit derivatives with respect to Greece. This includes the first-to-default instruments held by IKB (with a nominal volume of € 145 million), some of which refer to Greece and which are carried at a fair value of € 85 million.

Outlook

For a detailed analysis of expected developments, please see the forecast report in the 2010/11 annual report. All forecasts remain subject to uncertainty. The stability of the financial markets remains sustainably impaired, while there are growing doubts as to the capacity of governments in Europe and the USA to act. This loss of confidence has led to massive price fluctuations and losses on the capital and stock markets. The possibility that these developments will continue or that there will be further crises of confidence in the European and US economic areas cannot be excluded. In any case, the global economy has temporarily weakened once again.

If the financial and economic crisis persists or flares up again, IKB’s business development may be strained, potentially resulting in high earnings volatility depending on its intensity and duration. This applies to the Bank’s core business and, in particular, to its balance sheet items carried at fair value.

Results for the 2011/12 financial year could be impacted by a rise in the number of corporate defaults if the economic upturn in Germany tails off in the longer term. This also raises the question of whether there would be a further negative effect in terms of demand for loans and the propensity to invest. If the aforementioned scenarios occur on a more sustained basis, the previous earnings plans could be endangered. As such, there is a possibility that it could take longer to expand the higher-margin lending business and fee and commission business with customers.

The costs for the full implementation of the EU conditions will continue to have an impact this financial year. The structural reduction of administrative costs will continue, while the Bank will also invest in the development of its infrastructure and staff for more extensive services for SMEs. For the purposes of liquidity management, the early buyback of SoFFin bonds will reduce the cost of maintaining liquidity as well as expenses for commission payments to SoFFin.

Above and beyond this, IKB believes there are good prospects for an expansion of its activities in the area of consulting, hedging and credit products. Due to restructuring costs, however, it will take some time before the reorientation is also positively reflected in the income statement to a tangible extent. The recent slump on the capital markets has also put the brakes on the financing of company acquisitions, at least for the time being.

Thanks to its solid capital and liquidity resources, IKB believes that it is well positioned to make a success of its business model. The planned sale of IKB by Lone Star may serve to accelerate the implementation and further development of the business model, and hence continues to enjoy the support of IKB’s Board of Managing Directors. However, the current capital market turbulence affecting the M&A markets is not particularly beneficial for strategic sales processes.

Despite the current crisis on the capital markets, the Board of Managing Directors is maintaining its target of returning to operating profitability in the medium term. The earnings structure will see a growing share of fee and commission income and a lower overall income level than in the financial years prior to 2007/08, as total Group assets – and hence IKB's interest-bearing business in particular – will be greatly reduced. The need to service the compensation agreements with a total volume of € 1,151.5 million and the value recovery rights of the hybrid investors also mean that the Group and IKB AG will probably not report any, or only minimal, profit for several financial years to come.

IKB Deutsche Industriebank is a specialist bank for corporate financing in Germany and Europe. Its target groups are small and medium-sized enterprises as well as international enterprises and private-equity funds.

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