IKB Deutsche Industriebank

IKB Deutsche Industriebank AG’s results for the first half of 2022: solid results in a challenging economic environment

- **Consolidated net income before tax of €30 million impacted by extraordinary effects**
- **Adjusted return on equity (ROE) after tax of 8.5%**
- **Structural reduction of the cost basis ongoing with underlying adjusted administrative expenses in 1H 2022 further reduced by €5 million to €68 million**
- **Adjusted cost income ratio (CIR) of 62%**
- **Resilient loan book: risk provisions of €0 million and NPL ratio (EBA definition) of 1.8%**
- **CET 1 ratio (fully phased) of 14.9%, pro-forma CET 1 ratio (Basel IV/CRR III) of 15.9%**
- **Leverage ratio of 6.4%**
- **Chairman of IKB’s Board of Managing Directors, Dr Michael Wiedmann: “We successfully navigated a challenging overall economic environment and continue to execute our strategy.”**

[Düsseldorf, 19 August 2022] Despite the macroeconomic uncertainties and high volatility in the capital markets, IKB achieved solid results in the first half of 2022. Consolidated net income before taxes amounted to €30 million (previous year: €48 million) and was particularly influenced by prudent new business origination, extraordinary effects on administrative expenses and benign risk costs.

The Russian assault on Ukraine led to a significant impact on the prices and availability of raw materials as well as the broader development of economic and inflationary dynamics. This resulted in a challenging business environment for IKB in the first half of 2022 with a substantial increase in interest rates and a widening of credit spreads. As a result, IKB has slightly adjusted its forecast and outlook for 2022.

“IKB has once again proven that even in difficult circumstances the bank continues to perform. Our figures for the first half-year are of course burdened by external factors such as increased pension costs due to inflation. Adjusted for these effects, our operations show that we are headed in the right direction with our strategy. With our clear focus on the upper midmarket we continue to remain a reliable partner to our customers in challenging economic times. Even though we are forced to adjust the short-term goals for the current year due to special effects beyond our control, we are confirming our medium-term targets such as a cost/income ratio of around 40% and a ROE of more than 10%." said IKB Dr Michael Wiedmann, Chairman of IKB's Board of Managing Directors.

Positive result in the first half of 2022

In the first half of 2022, new business volume amounted at €1.2 billion (prior year: €1.7 billion), reflecting selective lending practices due to the high economic uncertainty. The share of corporate loans as of total new lending stood at 66%.

In the first six months of 2022, IKB achieved consolidated net income before taxes of €30 million (prior year: €48 million). The forecast for consolidated net income before taxes for the 2022 financial year has been reduced from around €85 million to around €60 million. This is mainly due to higher projected administrative expenses as a result of inflation-driven increase in pension plan obligations as well as one-off expenses for unplanned regulatory project costs. Total administrative expenses amounted to €80 million in the reporting period or, adjusted for these extraordinary effects, €68 million (prior year: €73 million).

The increase in personnel expenses is primarily due to higher pension expenses under legacy pension obligations. In particular, inflation-induced adjustments to pension benefits for former employees in particular resulted in an increase in pension obligations. These adjustments are made over a period of three years for a third of the eligible former employees each year and will hence continue to impact IKB in the next two years. These effects resulted in additional expenses of €9 million in the reporting period. In economic terms, IKB's pension fund net asset value (CTA assets) has improved by €78m in HY 1 2022, mainly driven by a higher discount rate which has led to a decrease in pension liabilities which is not fully reflected under German GAAP whereas banks which report under IFRS are able to reflect this as a positive capital impact.

One-off expenses for unplanned project costs in connection with regulatory requirements added €2 million to administrative expenses, which amounted to €34 million. Adjusted for these costs, they amounted to €32 million, in line with prior year's expenses (€32 million).

Consolidated net income before taxes adjusted for the increased administrative expenses amounted to €42 million. The cost income ratio amounted to 72% in the reporting period, compared to 60% in the previous year; However, adjusted for one-off effects, it amounted to 62%. The return on equity stood at 6.2% (based on a Common Equity Tier 1 ratio of 12% calculated on the basis of average risk-weighted assets), compared to 8.8% in the prior year, or at 8.5% on an adjusted basis. At 1.77%, the net interest margin on the loan book remained stable year-on-year.

In the first half of 2022, net risk provisioning amounted to €0 million (prior year: positive €2 million). With the NPL ratio (EBA definition) at 1.8% (previous year: 1.9%), the share of non-performing assets remains low. This was primarily due to IKB's resilient loan book which is based on a stable customer portfolio and conservative approach to risk assessment. Portfolio loan loss allowances and single loan loss allowances stood at €139 million (31 December 2021: €154 million).

Net other income stood at -€1 million in the reporting period (prior year: -€3 million). IKB's investment portfolio incurred economic fair value losses of €167 million in the first half of the year which however differs from the amounts recognised through profit and loss. This was due to the reduction of the securities portfolio to €2.8 billion as of 30 June 2022 (31 December 2021: €3.4 billion). The reclassification of certain securities due to a change in the intended holding period triggered valuation changes. Also, the persistently high inflation, rising interest rates and widening credit spreads impacted valuations. The components recognised in profit and loss of the changes in fair value were reported within net other income and largely offset a partial release of reserves for general banking risks in the amount of €345 million (prior year: €0 million).

In addition, changes in the discount factor for pension plan obligations generated expenses of €7 million (prior year: expense of €15 million), while the proceeds from legal settlements of litigation initiated by the Bank resulted in substantial proceeds which are included in net other income.

Resilient loan book

IKB’s loan book of €9.2 billion contains public programme loans of €5.0 billion from the KfW Banking Group and other development banks which are fully funded by the respective development banks. This implies that for more than half of IKB’s loan book the funding is secured. IKB’s loan book mainly consists of loans to German companies in the upper mid-market segment, i.e. companies with annual revenues of €100 million or more. These companies generally show characteristics of good credit ratings and an attractive margin profile.

Solid equity and liquidity position

As of 30 June 2022, the CET 1 ratio (fully phased) stood at 14.9% for IKB Group and 15.1% for IKB AG. IKB has hence substantially exceeded the CET 1 forecast of over 13% (IKB AG: over 13.5%) for the 2022 financial year. Besides the profits generated during the period, this was also driven by the Bank’s amended dividend-distribution policy in relation to the retained earnings for the 2020 financial year. As the Bank currently has no intention to distribute any dividends in this respect, it now includes the net retained profit carried forward within its CET 1 capital. In addition, risk-weighted assets declined due to a selective approach to lending and effects from positive rating migration in the loan portfolio. A partial release of reserves for general banking risks to offset the valuation losses in IKB's securities portfolio had an opposing negative effect on CET1 capital. According to Basel IV/CRR III the CET 1 ratio was 15.9%.

At 6.4%, the IKB Group's leverage ratio exceeds the statutory minimum significantly. With a loan-to-deposit ratio of 90% as of 30 June 2022 – calculated as the loan book excluding public programme loans relative to the total of retail and business customer deposits and promissory note loans – IKB maintains a solid funding position (31 December 2021: 70%).

Outlook

The impact of the Ukraine war on prices and availability of raw materials as well as the broader development of economic and inflationary dynamics present a challenging business environment and resulted in a substantial increase in interest rates and a widening of credit spreads in the first half of 2022. As a result, IKB has slightly adjusted its forecast and outlook for 2022 reported in the annual report for 2021. Despite these ongoing macroeconomic challenges and its impact on the current fiscal year, IKB confirms its strategy and its medium-term targets.

In the 2022 financial year IKB expects a net interest and commission income slightly below the previous year. In view of its selective approach to lending, IKB assumes that new business volume will now be substantially lower than the initial forecast of €3 billion stated in the annual report for 2021.

Based on the challenging business environment in the first half of 2022, the Bank expects risk provisions for the 2022 financial year to amount to up to €25 million despite the net risk provisioning of €0 million in the current reporting period. Higher risk provisioning expenses may be necessary as a result of increased economic uncertainties and more stringent regulatory requirements.

Revising its forecast in the annual report for 2021, the Bank now projects substantially higher administrative expenses of around €148 million for the 2022 financial year mainly due to higher projected administrative expenses as a result of inflation-driven increases in pension plan obligations as well as one-off expenses for unplanned regulatory project costs. This corresponds to an increase of around €18 million compared to the prior forecast and includes increases in pension obligations recognised through profit and loss in the reporting period. IKB currently expects that under current conditions this effect will also result in higher administrative expenses in the first six months of the next two years.

In contrast to the initial forecast, the Bank hence projects a cost income ratio substantially above the prior figure of 54.5%. It is IKB aim to improve cost efficiency further to decrease administrative expenses to around €105 million in the medium term and to achieve a cost income ratio of around 40%.

IKB now projects consolidated net income before taxes of around €60 million (IKB AG: around €40 million) in the 2022 financial year. Consolidated net income will be lower than the prior forecast of around €85 million primarily as a result of the unexpected increase in administrative expenses. The Bank hence expects that its ROE after taxes will be significantly below the originally projected figure of 9%. In the medium term, however, an ROE of over 10% is still being targeted.

Contrary to the forecast contained in the annual report 2021, IKB expects now a higher CET 1 ratio (fully phased) for the Group of significantly above 13.0% (IKB AG: substantially over 13.5%). The improved expectations with respect to the CET 1 ratio are primarily due to the lower expected risk-weighted assets at year end 2022 as a result of lower new business volumes and positive rating migrations. However, the general macroeconomic uncertainties may lead to rating adjustments in the future.

In light of the current market and risk situation, IKB is currently not planning to distribute any dividend for the financial year 2022. It still plans to distribute regular dividends amounting to 60% to 80% of the Group's consolidated net income after taxes in the medium term.

The Bank projects a liquidity coverage ratio of consistently above 100% and a leverage ratio of around 7% for the 2022 financial year.

Table: Profit and loss statement for IKB for the first half of 2022 (Group, in accordance with German GAAP)

in € million	1 Jan. 2022 – 30 June 2022	1 Jan. 2022 – 30 June 2022 adjusted[1)]	1 Jan. 2021 – 30 June 2021
Net interest income	98	98	108
Net fee and commission income	13	13	14
Gross income	**111**	**111**	**122**
Administrative expenses	-80	-68	-73
Personnel expenses	*-46*	*-36*	*-41*
Other administrative expenses	*-34*	*-32*	*-32*
Operating profit before risk provisions	**31**	**43**	**49**
Net risk provisioning	0	0	2
Operating profit	**32**	**43**	**51**
Net other income[2)]	-1	-1	-3
Earnings before tax	**30**	**42**	**48**
Tax expense/income	0	0	-1
Net profit after tax	**30**	**42**	**47**

Any differences in totals are due to rounding effects.

1) Adjusted for inflation-induced pension plan expenses (€9 million) and one-off expenses for unplanned project costs in connection with regulatory requirements (€2 million).

2) This includes expenses of €436 million in relation to valuation changes of securities in the liquidity portfolio and a release of €345 million from the reserves for general banking risks.

Further details on the performance in the first half of 2022 can be found in the half year report 1H 2022 and the investor presentation at https://www.ikb.de/en/investor-relations/reports-and-presentations.

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