IKB: Interim announcement as of 31 December 2011

The interim announcement covers the period from the start of the financial year on 1 April 2011 to 31 December 2011.

Business development

Since the start of the 2011/12 financial year, the sovereign debt crisis within the eurozone dominated trends on the capital markets. Up until the end of December 2011, there was a strong upturn of volatility on the markets. This was also the case with risk premiums, particularly for banks and specific eurozone states, which rose in parallel due to their high level of reciprocal dependencies. Added to this was a typical symptom of the crisis – a further decline of what were already low interest rates for German government bonds. Only after massive intervention on the part of the European Central Bank (ECB) and the announcement of further action did the markets calm somewhat over the Christmas period. However, the resolutions of the EU Summits did not generate any calming effect. The consequent worsening of the economic situation in Europe and the general international environment had an increasing impact on the German economy. Nevertheless, at the moment a period of pronounced weakness for Germany is not probable, while the danger of a recession for other eurozone countries is high. The future economic trend depends directly on the outcome of the European sovereign debt crisis. This remains highly uncertain, at least for the next few months.

IKB's new business volume in the first nine months of the 2011/12 financial year amounted to € 2.5 billion (previous year: € 2.7 billion). Since the autumn, the credit markets have lost momentum, particularly for acquisition finance.

Credit margins for new business were again increased against the previous year. Against the figure on 31 December 2010, the credit volume declined by € 3.5 billion to € 31.4 billion. This also reflects the implementation of requirements to reduce volume stipulated by the EU anti-trust authorities as of 30 September 2011.

Profit and loss (IFRS consolidated income statement as of 31 December 2011)

Largely as a result of a high negative net income from financial instruments at fair value, IKB reported a consolidated net loss of € 431 million for the first nine months of the 2011/12 financial year. On a year-on-year basis, this represents an increase of the net loss by € 276 million (1 April to 31 December 2010: consolidated net loss of € 155 million). The main reason for the negative net income from financial instruments is the escalation of the eurozone sovereign debt crisis. After adjustment for extraordinary factors, an adjusted consolidated net loss of € 13 million was generated for the nine-month period (previous year: consolidated net loss of € 143 million).

The further escalation of the sovereign debt crisis resulted in sharp fair value losses for non-current assets, obligations and derivatives up to the autumn and further losses subsequently. This negatively impacted the net income from financial instruments at fair value and led to a consolidated net loss.

Despite the European sovereign debt crisis, the German economy continued to expand in the current financial year. The impact of this development on German SMEs is also reflected in IKB's provision for possible loan losses, which declined year-on-year by € 77 million to € 3 million. In the third quarter of the 2011/12 financial year, net additions totalled € 33 million (previous year: € 41 million).

Table: Income statement for the first nine months of the 2011/12 financial year (1 April 2011 to 31 December 2011)

€ million	**1 Apr to 31 Dec 2011**	**1 Apr to 31 Dec 2010**	**Change**
Net interest income	114.2	88.1	26.1
Provisions for possible loan losses	2.6	79.1	-76.5
Net interest income (after provisions for possible loan losses)	**111.6**	**9.0**	**102.6**
Net fee and commission income	-49.1	-62.2	13.1
Net income from financial instruments at fair value	-313.7	147.2	-460.9
Net income from investment securities	-8.8	37.7	-46.5
Net income from investments accounted for using the equity method	0.7	0.4	0.3
Administrative expenses	216.8	217.2	-0.4
Personnel expenses	*121.5*	*114.6*	*6.9*
Other administrative expenses	*95.3*	*102.6*	*-7.3*
Other operating result	44.9	-67.8	112.7
Operating result	**-431.2**	**-152.9**	**-278.3**
Tax expenses/income	0.1	1.9	-1.8
Consolidated net/cumulative loss for the period	**-431.3**	**-154.8**	**-276.5**

Figures for the previous year adjusted.

Net interest income increased by € 26 million year-on-year to € 114 million. In the Credit Products segment, net interest income rose, despite the reduction in the credit volume. The earnings contribution from the Treasury and Investments segment declined overall as against the previous year, largely as a result of the low interest level and the reduction in investments.

The non-recurring effect from the write-down of the adjustment item in accordance with IFRS 1 IG60A no longer applies in the current financial year.

The compensation agreements in connection with the debt waivers previously announced by KfW Bankengruppe, Frankfurt/Main and by LSF6 Europe Financial Holdings, L.P. (LSF6 Europe), Delaware, Dallas/USA, as well as some profit participation certificates and silent partnership contributions were measured at the present value of the repayment obligations in accordance with IAS 39 AG8. The year-on-year change in the present value also includes a share of interest (unwinding) which is recognised in interest expense. This unwinding declined year on year by € 20 million to € 24 million.

Provisions for possible loan losses decreased by € 77 million to € 3 million. This was driven primarily by lower additions to individual loans loss provisions and provisions. In addition, reversals were higher than in the equivalent period of the previous year.

Net fee and commission income improved by € 13 million year-on-year to € -49 million. This was due primarily to the guarantee commission payable to the SoFFin being € 16 million lower at € 80 million.

Net income from financial instruments at fair value amounted to € -314 million (previous year: € +147 million). This negative figure reflects the acute sovereign debt crisis in the eurozone to the end of 2011. Expansion of credit spreads for certain eurozone public-sector issuers was a key factor resulting in the high fair value losses. At the same time, lower interest rates considerably impacted non-current assets, liabilities and derivatives in the form of fair value losses. Although there were remeasurement gains on the Bank's liabilities as a result of increased risk premiums for IKB, these did not compensate the remeasurement losses mentioned above.

Net income from investment securities declined by € 47 million to € -9 million. This is a result of the abovementioned negative changes in fair value and losses on the disposal of portfolio investments and non-current assets.

Administrative expenses remained unchanged year-on-year at € 217 million. Personnel expenses rose by € 7 million, due in particular to the increase in the average headcount resulting from the realignment of the Bank. Other administrative expenses were reduced year on year by € 7 million.

The **other operating result** improved year-on-year from € -68 million to € 45 million. This was primarily attributable to positive effects from the measurement of liabilities in accordance with IAS 39 AG8, which resulted from the need to adjust expectations of future business development to reflect the financial and government debt crisis in particular. The prior-year comparative figures were primarily impacted by write-downs on a real estate project and the derecognition of the difference between the purchase price of a company and the fair value of the net assets acquired.

For the first nine months of the 2011/12 financial year, this resulted in an **operating result** and a consolidated net loss for the period of € 431 million (previous year: consolidated net loss for the period of € 155 million). After adjustment for extraordinary factors, an adjusted consolidated net loss of € 13 million was generated for the nine-month period (previous year: consolidated net loss of € 143 million).

Net assets (balance sheet as of 31 December 2011)

Total assets declined slightly by € 0.2 billion between 31 March 2011 and 31 December 2011, amounting to € 31.2 billion as of the reporting date. 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 liabilities side, there was a decrease in securitised liabilities in particular, while the volume of refinancing via liabilities to banks and customers increased.

As at 31 December 2011, the IKB Group had a **Tier I ratio** based on HGB data of 10.4% (31 March 2011: 11.2%) and an **overall capital ratio** of 14.0% (31 March 2011: 15.9%) in accordance with the quarterly notification submitted to Deutsche Bundesbank. Following Bundesbank notification, current developments meant that it was necessary to recognise further valuation allowances on receivables from the Republic of Greece in accordance with the German Commercial Code (HGB). After updating its ratios accordingly, the IKB Group had a Tier I ratio of 10.0% and an overall capital ratio of 13.6% as at 31 December 2011.

Financial position

The liquidity situation at IKB is stable. This was driven in particular by the diversification of the funding mix. Since March 2011, IKB has been accepting revolving deposits from a number of customers, including via the “IKB direkt” private customer online platform. The Bank is also reducing its volume of non-strategic assets in order to generate liquidity and being selective when it comes to entering into new lending business with an impact on the balance sheet.

Key events and transactions

Please see the 6-month 2011/12 report for details of the significant events and transactions in the reporting period. The following current developments are also of material importance:

Status of implementation of EU conditions

The final report on the implementation of the EU conditions was submitted by the German government to the EU Commission to the end of 2011. The implementation period for the ruling expired on 30 September 2011. IKB implemented the measures set out in the restructuring plan on time to the extent they were permitted by law and could be carried out. Accordingly, IKB assumes that the conditions were met by the deadline.

SoFFin guarantees

After the early buyback of € 0.8 billion, IKB repaid the remaining € 1.2 billion SoFFin-guaranteed bond maturing on 27 January 2012 on schedule. As a result, IKB’s SoFFin guarantee volume decreased to its current level of € 6.1 million. The maximum guarantee volume was € 12 billion.

The outstanding SoFFin-guaranteed bonds have the following maturities:

- € 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.

Results of the special audit

No report from the special audit has been received. Please refer to the details provided in the 2010/11 Annual Report.

Risks

For details of the risks to which the Bank is exposed, please see the 6-month 2011/12 report. There the fact was emphasised that the duration and severity of the ongoing government debt crisis in the eurozone remains the main risk. This statement continues to apply. To the end of the year, capital markets have evidenced an extremely high level of risk aversion. It was only the massive intervention on the part of the ECB and the announcement of further comprehensive support actions in the new year which prevented the situation from worsening further.

European debt crisis

The Greek government bonds held by IKB in the amount of € 211 million (€ 200 million original nominal volume plus € 11 million cumulative rise in an inflation-linked bond) are currently measured at a fair value of € 38 million in accordance with IFRS. The Bank classified these bonds as problem exposures and on a precautionary basis in accordance with HGB wrote down these bonds by 70% of the higher of their nominal and settlement amount.

According to the current state of knowledge, the rescue measures for Greece involving private creditors have not triggered a so-called credit event. This includes the first-to-default instruments held by IKB, some of which relate to Greece (nominal volume of € 149 million), which are carried at a fair value of € 51 million.

Outlook

For a detailed analysis of expected developments, please see the forecast report in the 6-month report. The current situation remains dominated by uncertainty with regard to the outcome of the government debt crisis in the euro member states, economic development in the USA and the possibility of an economic slowdown in Germany, all of which could lead to a high degree of earnings volatility, also in the business development at IKB. There is also a degree of uncertainty concerning the current restructuring of the German banking sector.

IKB still considers the government debt crisis in the eurozone to be a serious but ultimately temporary phenomenon. It is uncertain as to how long the EU governments will require to find a convincing solution and calm the markets. Based on the current situation, however, it must be assumed that the economic development in the eurozone, particularly in the “problem countries” will lead to recession, especially as the corresponding banking systems will have to reduce the high level of debt. For Germany, the economic development appears muted, without there being a credit squeeze for business. However, it is probable that the economic situation would be completely different if a country in the eurozone defaulted. This would mean an end to the cautious easing on capital markets which the ECB has achieved by its interventions so far in 2012.

Due to the ongoing impact of the crisis, IKB’s profit expectations are delayed and its business model will show positive results with a time lag. The future earnings structure will feature a stronger proportion of commission income from consulting, derivatives and capital market business. Profitable new lending business will lead to a stabilisation of net interest income in the medium term. The expenses arising from the guarantee commission owed to SoFFin will diminish.

The Group’s administrative costs will be reduced on a sustained basis following a temporary flare-up owing to investments in infrastructure and the costs of meeting the EU conditions. IKB plans to reduce the headcount by approximately 200 and is examining the efficiency of all important business processes. Negotiations have been initiated with the Works Council.

To limit its refinancing costs and ensure its liquidity, IKB will continue to diversify its refinancing structure. The key components of this are secured financing, actively using programme loans and global loans from government development banks and broader deposit business with corporate and retail clients.

IKB is maintaining its target of returning to operating profitability in the medium term. This will also create the scope to strengthen its Tier I capital. Furthermore, servicing the compensation agreements in the total amount of € 1,151.5 million and the value recovery rights of the hybrid investors mean that the Group and IKB AG will probably not report any, or only minimal, profit for several financial years to come.

Düsseldorf, 20 February 2012

The Board of Managing Directors