IKB: Interim announcement as of 31 December 2010

The interim announcement covers the period from the start of the financial year on 1 April 2010 to 31 December 2010.

Business development

Thanks to the strong economic development, the new business volume improved by 23% to € 2.7 billion in the first nine months of the 2010/11 financial year. The credit margins for new business increased. The credit volume was reduced by € 1.7 billion as a result of maturities and disposals in order to meet the EU conditions on reducing total assets. Commission business with customers also increased in the period under review.

Profit and loss (consolidated income statement as of 31 December 2010)

IKB is reporting a consolidated net loss of € 132 million in the first nine months of the 2010/11 financial year. This represented an improvement of € 483 million on the same period of the previous year (1 April to 31 December 2009: consolidated net loss of € 615 million). Consolidated net income of € 101 million is recorded in the third quarter (1 October to 31 December 2010), largely as a result of various extraordinary factors.

The fair value measurement of assets and liabilities had a significant impact on results as of 31 December 2010. Since the start of the 2010/11 financial year, the sustained financial and government debt crisis in the euro zone has led to a sharp increase in risk premiums for certain sovereign risks and banks in Europe. Emerging fears of inflation led to a rise in long-term interest rates towards the end of the reporting period. In IKB's consolidated results, these developments – and default risk-related remeasurement gains on liabilities in particular – were reflected in positive net income from financial instruments at fair value in the third quarter.

At the same time, the pronounced economic upturn in Europe, particularly in Germany, and the improved global economic outlook were reinforced, resulting in a substantial reduction in loan loss provisions. Results continue to be impacted by the expenses for the implementation of the EU conditions (deadline: 30 September 2011) and commission payments to SoFFin in the amount of € 96 million.

The consolidated net loss adjusted for extraordinary factors (primarily relating to fair value measurement, guarantee commission to SoFFin, IAS 39 AG 8 and IFRS 1 IG 60 A measurement) amounted to € 140 million, an improvement on the adjusted prior-year figure (€ -258 million).

in € million	1 April 2010 to 31 December 2010	1 April 2009 to 31 December 2009	Change
Net interest income	91.0	142.1	-51.1
Provisions for possible loan losses	79.1	297.1	-218.0
Net interest income (after provisions for possible loan losses)	**11.9**	**-155.0**	**166.9**
Net fee and commission income	-62.2	-31.6	-30.6
Net income from financial instruments at fair value	166.9	-411.0	577.9
Net income from investment securities	37.7	27.7	10.0
Net income from investments accounted for using the equity method	0.4	-0.5	0.9
Administrative expenses	217.2	216.3	0.9
Personnel expenses	*114.6*	*119.5*	*-4.9*
Other administrative expenses	*102.6*	*96.8*	*5.8*
Other operating result	-67.8	154.6	-222.4
Operating result	**-130.3**	**-632.1**	**501.8**
Tax expenses/income	1.9	-17.3	19.2
Consolidated net loss for the period	**-132.2**	**-614.8**	**482.6**
Minority interests	0.0	0.2	-0.2
Consolidated cumulative loss	**-132.2**	**-614.6**	**482.4**

Figures for the previous year have been restated.

Net interest income declined by € 51 million year-on-year to € 91 million as a result of measures aimed at restructuring the Bank and fulfilling the EU conditions. Proprietary trading and portfolio investments have been largely eliminated, while the credit portfolio has been reduced since the start of the year in accordance with the conditions. Net interest income continues to be negatively impacted by the extraordinary effects of amortisation in accordance with IFRS 1 IG 60 A and unwinding in accordance with IAS 39 AG 8 measurement, which totalled € -82 million.

Strong economic development, particularly in Germany, led to a reduction in **provisions for possible loan losses** of € 218 million to € 79 million.

As a result, **net interest income (after provisions for possible loan losses)** improved by € 167 million year-on-year to € 12 million (previous year: € -155 million).

Net fee and commission income fell by € 31 million year-on-year to € -62 million. This was attributable to the guarantee commission payable to SoFFin, which increased by € 47 million to € 96 million. Adjusted for this effect, net fee and commission income would have risen by € 16 million to € 33 million on the back of the upturn in client business.

Net income from financial instruments at fair value was positive at € 167 million (previous year: € -411 million). This development was primarily due to the following opposing extraordinary factors: Remeasurement losses on long-term investments and derivatives totalled € 177 million (€ +189 million), particularly as a result of the increase in risk premiums for the European government and corporate bonds used for refinancing at the ECB. The increase in IKB spreads at the end of the reporting period led to extensive default risk-related remeasurement gains on the liability side in the amount of € 319 million (€ -727 million), which was the main reason for the positive fair-value result as well as the positive consolidated net result in the third quarter 2010/11. Portfolio investments accounted for an income of € 29 million (€ +137 million).

Net income from investment securities improved by € 10 million to € 38 million. This was due in particular to positive changes in fair value and disposals of portfolio investments and long-term investments.

At € 217 million, **administrative expenses** were up slightly on the previous year (€ 216 million). Although personnel expenses fell by € 5 million year-on-year, other administrative expenses increased by € 6 million. This latter development was attributable to the consulting costs incurred in conjunction with the Bank's reorientation and internal process optimisation projects, as well as the continued costs of managing the crisis and implementing the restructuring measures required under the EU conditions.

The **other operating result** declined from € 155 million in the previous year to € -68 million. In the previous year, other operating income was largely dominated by income from the debt waiver by LSF6 Europe Financial Holdings, L.P., Dallas, USA, in exchange for a compensation agreement and the lower present values recognised in accordance with IAS 39 AG 8 as a result. By contrast, other operating income in the 2010/11 financial year was primarily impacted by a write-down in conjunction with real estate project development and the effect of the initial consolidation of a company.

The **operating result** for the first three quarters of the 2010/11 financial year improved by € 502 million year-on-year to € -130 million (previous year: € -632 million). The **consolidated net loss** after taxes amounted to € 132 million (previous year: net loss of € 615 million).

In the period under review, IKB AG recorded a net loss in accordance with the German Commercial Code (HGB) of € 116 million.

Net assets (balance sheet as of 31 December 2010)

Total assets amounted to € 34.2 billion as of 31 December 2010, down € 1.5 billion compared with 31 March 2010. On the asset side, loans and advances to customers declined by € 2.4 billion due to the reduction in customer lending as part of the implementation of the EU conditions and due to maturities. Loans and advances to banks increased by € 0.8 billion as a result of short-term money market trading. On the liability side, securitised liabilities fell by € 2.2 billion due to maturities, while short-term money market trading led to a € 1.1 billion increase in liabilities to banks.

The Tier 1 capital ratio of the IKB Group based on HGB figures amounted to 10.8% as of 31 December 2010 (31 March 2010: 10.4%), while the total capital ratio amounted to 15.7% (31 March 2010: 14.9%).

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 accepting revolving deposits from a number of customers, reducing the volume of non-strategic assets in particular in order to generate liquidity, and being selective with regard to entering into new lending business with an impact on the balance sheet. The markets are increasingly providing a range of opportunities for collateralised borrowing. In addition to establishing the conditions for collateralised borrowing IKB, with the update of its debt issuance programme in December 2010, established the conditions for uncollateralised borrowing.

Key events and transactions

Please see the 2010/11 half-yearly financial report for details of the significant events and transactions in the reporting period. The following current developments are also of material importance:

Repayment of all Rio portfolio loans

With the exception of a small number of exposures that were in the process of being wound up, IKB sold the portfolio investments on its balance sheet, which also contained some sub-prime risks, to the special-purpose entity Rio Debt Holdings in 2008. IKB partially financed the special-purpose entity by retaining the first loss pieces, meaning that it limited its own risk of further loss. The loans assumed by the special-purpose entity to finance the purchase price as a whole – including the first loss tranche held by IKB – with a total original volume of a good € 900 million have now been paid back ahead of schedule thanks to repayments and disposals at favourable conditions. Current income from the portfolio still held by the special-purpose entity will be divided up between IKB and Lone Star.

Implementation of EU conditions

IKB has already implemented the majority of the EU conditions and is continuing to press ahead with ensuring that the remaining conditions are fulfilled on time. The further active reduction in total group assets to € 33.5 billion by the end of September 2011 is particularly relevant at present. Total group assets had declined to € 34.2 billion as of 31 December 2010. As planned, the lending volume in the area of real estate finance in particular is currently being reduced further. The transfer of loans and derivatives from Luxembourg to Düsseldorf (EU condition: closure of IKB S.A., Luxembourg, effective 1 April 2011) is largely complete. IKB S.A. will become a settlement company effective 1 April 2011. The settlement company will retain the small number of holdings which have not been approved for transfer by the relevant customers.

Return of SoFFin guarantees

On 7 October 2010, SoFFin approved a limited buy-back of SoFFin-guaranteed bonds and a corresponding reduction in the guarantee volume. In this context, a total of € 400 million was returned ahead of schedule – € 100 million in each of the SoFFin-guaranteed issues maturing on 29 April 2011 and 27 January 2012 and a total of € 200 million in the SoFFin-guaranteed bond maturing on 13 March 2012. This meant that the guarantee fees payable to SoFFin were reduced by utilising available liquidity reserves.

Risks

The risks to the company as a going concern listed in the section of the 2010/11 half-yearly financial report on the risk situation at IKB still apply. For further details, please see the 2010/11 half-yearly financial report.

Outlook

For a detailed analysis of expected developments, please see the forecast report contained in the 2010/11 half-yearly financial report. All forecasts remain subject to uncertainty. The stability of the financial markets remains sustainably impaired following the crisis. As such, the possibility of further crises of confidence on the financial markets cannot be ruled out.

Over the coming months, a great deal will depend on the extent to which Europe succeeds in finding a convincing solution for the government debt issues affecting the euro zone. The outlook for the US economy is becoming slightly more positive, albeit cautiously, while there are fears of inflationary trends arising from emerging markets and raw material prices. These trends are intensified by the insecurities resulting from the unexpected social upheaval in a number of Arab nations. Depending on how things progress, this may have a significant positive or negative impact on IKB's net income from financial instruments at fair value in particular, and hence its consolidated result. IKB anticipates that loan loss provisions will remain calm, while lending and fee and commission business are expected to see a further recovery.

The majority of the Basel III provisions have been available in their finalised form since mid-December 2010. The corresponding impact study by the Basel Committee underlines the fact that banks around the world need to raise additional Tier 1 capital to a significant extent, particularly since various accompanying provisions (including IFRS 9) could have an impact on Tier 1 capital requirements. IKB is entering the transition and implementation period defined by Basel III with a high Tier 1 capital ratio at present. It is conceivable that the recognition of reserves from current income and stringent balance sheet management will become particularly important for banks in the long term if they are to meet the high Tier 1 capital requirements, meaning that business plans may have to be adjusted accordingly. IKB intends to review its own forecasts by the end of the financial year on the basis of the new requirements.

The fundamental organisational changes aimed at expanding IKB's business model have been initiated. The Bank has been recapitalised, risk management has been expanded, risks have been reduced and liquidity has been guaranteed. This has created the basic foundations for leveraging the opportunities emerging in the current and, in particular, the next financial year. Above all, IKB will be able to refocus its full attention on customer business once it has fulfilled the EU conditions (deadline: 30 September 2011). The burden resulting from implementing the EU requirements by this deadline, which involves the commitment of a high level of resources and significant non-personnel administrative expenses, will be successively lifted.

The positive economic development is also reflected in IKB's loan commitments for German companies. Loan commitments increased significantly in the third quarter of the financial year (1 September to 31 December 2010), with corporate finance for environmental investments and innovations enjoying particularly strong demand. Leasing transactions have picked up considerably, while the number of acquisition finance transactions is also on the rise.

Above and beyond this, IKB believes there are good prospects for a targeted and sustainable expansion of its activities in the area of consulting, hedging and credit products. Expanding the product range will help to intensify customer relationships and diversify the Bank's earnings structure. 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 planned sale of IKB by Lone Star could have various consequences for future economic development that cannot be specified in greater detail at present. However, a sale could speed up the implementation and further development of IKB's new business model. The Board of Managing Directors of IKB is supporting the current sales process.

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.

Düsseldorf, 28 February 2011

The Board of Managing Directors