FitchRatings

Banks
Trading & Investment Banks
Germany

IKB Deutsche Industriebank AG

Key Rating Drivers

Financial Profile Sustainably Improved: IKB Deutsche Industriebank AG's (IKB) Issuer Default Ratings (IDRs) and Viability Rating (VR) primarily reflect the bank's niche franchise and business model focusing on unsecured public development loans (PDLs) and lending to German mid-cap companies. The ratings also reflect IKB's strongly improving financial profile after over a decade of restructuring, as well as its adequate capitalisation, funding and liquidity. Fitch Ratings expects the recent improvements in IKB's earnings and capitalisation to be largely sustained.

Pandemic Drives Negative Outlook: The Negative Outlook on IKB's Long-Term IDR reflects the agency's view that the economic and financial market fallout from the coronavirus crisis will exert manageable but uncertain pressure on the bank's asset quality and profitability.

Restructuring Successfully Completed: IKB's franchise rests on decades of relationships with the majority of larger German mid-caps, helped by its cooperation with KfW as a key PDL provider. Over 10 years of restructuring has simplified IKB's processes, business model and product offering, ensuring acceptable margins and competitiveness. IKB's modestly diversified business model in terms of product offering, foreign diversification and ability to generate fee income unrelated to its lending business constrain our assessment of its company profile.

Asset Quality Likely to Weaken: The robust non-performing loan (NPLs) ratio of 2.0% at end-September 2020 after years of strong domestic economic environment positively influences our view of IKB's asset quality. However, our assessment is constrained by the bank's focus on unsecured mid-cap lending, which entails large single loans relative to its equity. As IKB is exposed to sectors vulnerable to the pandemic, we expect its NPL inflows and NPL ratio to rise in 2021 when state support recedes and damages from the pandemic materialise.

Pandemic Weighs on Profitability: Our base case assumes a four-year average operating profit/risk-weighted assets (RWAs) of at least 0.5% through the crisis. IKB's well above-average cost efficiency mitigates the strong competitive pressure prevailing in German corporate banking. The negative outlook on the bank's earnings and profitability score reflects the risk of higher credit losses in the event of a deeper than expected recession or slower recovery.

Adequate Capitalisation: IKB's common equity Tier 1 (CET1) ratio of 13.3% at end-September 2020 provides a reasonable buffer over its regulatory requirement. We expect sizeable RWAs relief from Internal Ratings-Based Approach related model changes in 2021. This will mitigate the impact on IKB's capitalisation from weakening asset quality as a result of the pandemic.

Stable Funding, Sound Liquidity: German state-owned development banks fund with matching maturities IKB's entire PDL book, for which the bank consequently does not carry funding or asset-liability management risk. IKB funds its commercial loan book mainly with corporate and retail deposits as well as central bank and bilateral repos, given its underdeveloped access to the capital markets. Liquidity is sound and has been robust during the pandemic.

Rating Sensitivities

Economic Recovery: We could revise the Negative Outlook to Stable if the operating environment stabilises and IKB manages the challenges arising from the crisis, limiting risks to its asset quality and profitability, while maintaining its current capital levels.

Unexpectedly High Credit Losses: We could downgrade IKB's VR if we expect its four-year average NPL ratio to exceed 5% and the four-year average operating profit/RWAs ratio to decline durably below 0.5% without credible prospects to restore robust asset quality and profitability in the medium term. This could happen if the impact of the pandemic is materially worse than expected, without credible medium-term prospects to restore the financial metrics.

Ratings

Foreign Currency	
Long-Term IDR	BBB
Short-Term IDR	F3
Viability Rating	bbb
Support Rating	5
Support Rating Floor	No Floor
Sovereign Risk	
Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA
Outlooks	
Long-Term Foreign Currency IDR	Negative
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Publishes IKB Deutsche Industriebank AG's 'BBB' IDR; Outlook Negative (January 2021)

Fitch Affirms Germany at 'AAA'; Outlook Stable (November 2020)

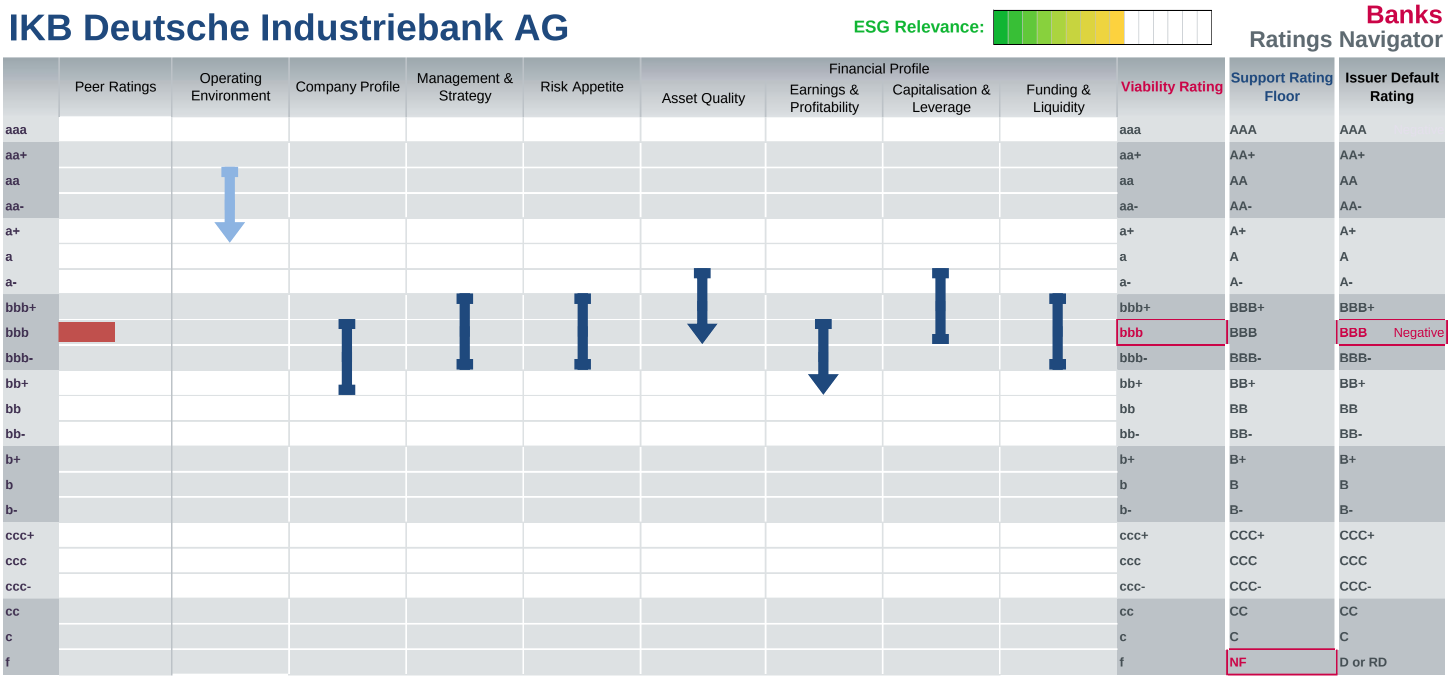
Fitch Ratings 2021 Outlook: Western European Banks (December 2020)

Analysts

Markus Glabach
+49 69 768076 195
markus.glabach@fitchratings.com

Caroline Lehmann, CFA
+49 69 768076 176
caroline.lehmann@fitchratings.com

Ratings Navigator



Significant Changes

Pandemic Likely to Moderately Weaken IKB's Credit Profile

We lowered the operating environment score for German banks to ‘aa-’/Negative from ‘aa’/ stable in April 2020 as the pandemic exacerbates banks’ vulnerability to a rapid and severe deterioration of their asset quality and, even more, of their earnings. The negative trend signals we could lower the operating environment score further if there are signs that the German economy will suffer in the longer term from the crisis, or if the domestic banking sector is unable to sustainably restore acceptable profitability. Restoring profitability is likely to require greater pricing discipline and consolidation to remove excess capacity from the sector.

Germany has launched comprehensive fiscal measures in the form of large programmes to support companies and households affected by the crisis. Together with regulatory forbearance for the classification of crisis-driven loan payment holidays and NPLs, these programmes have strongly mitigated negative rating migration, RWA inflation, and provisioning needs in 2020.

However, German corporates and SMEs’ credit quality (and banks’ asset quality) is likely to deteriorate in 2021 despite the state’s support measures, because some vulnerable borrowers will not fully recover, and many others are likely to emerge markedly weaker from the crisis.

German GDP deteriorated much less in 2020, and is likely to recover slightly faster in 2021, than that of other large western European countries. Fitch expects, in its December 2020 Global Economic Outlook, German GDP to contract by 5.6% in 2020 and recover by 5% in 2021.

New Joint-Venture with Hypoport Could Moderately Diversify Earnings Mix

IKB intends to acquire (pending regulatory approval) for an undisclosed price 30% of Fundingport GmbH, a subsidiary of Hypoport SE, a German technology platform that serves the financial and property sectors. Fundingport’s brokerage platform matches renewable energy project developers with banks, investors, utilities and due diligence providers. The joint venture will allow IKB’s clients to access financing offers from third-party lenders via the platform.

This new distribution channel should diversify IKB’s earnings to some extent by generating additional commission income without associated interest income. However, net interest income from corporate lending will continue to dominate the bank’s business model, earnings and risk profile. The joint venture is neutral to our assessment of IKB's company profile.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧ Positive	⇩ Negative
⇳ Evolving	▫ Stable

Brief Company Summary

Specialist in German Mid-Cap Lending and Public Development Loans

IKB has simplified its business model through more than a decade of restructuring, e.g. by selling its leasing subsidiary and streamlining its previously fragmented client base. Its private equity ownership has helped to achieve a rigorous client-tiering and prioritise business development efforts. By streamlining its processes and lean product offering, the bank has achieved a more efficient cost base than its direct competitors. It has maintained acceptable margins and competitiveness in key lending products despite its small market shares and limited pricing power that results from the intense competition.

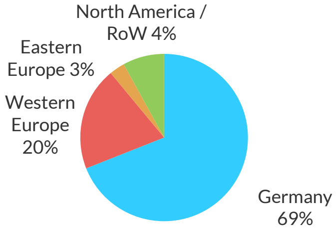
IKB's moderate franchise rests on decades of established relationships with the majority of Mittelstand companies with turnover above EUR250 million and on its close cooperation with KfW as the main provider of pass-through development loans to these companies. IKB's focus on structuring and transmitting PDLs results in a leading expertise in this important advisory-heavy market for German corporates. IKB's adequate risk/return profile is underpinned by its lean processes, its regional coverage model, but also its larger competitors' reluctance (for cost reasons) to devote more resources to the structuring-intensive part of the PDL market.

Change of Financial Year to Calendar Year

IKB will change its financial year (currently 1 April to 31 March) to the calendar year, using a transitional nine-month period ending on 31 December 2020. The change aims to reduce complexity for accounting, tax and supervisory matters and improve comparability with peers.

Credit Exposure Breakdown by Country

End-September 2020



Source: Fitch Ratings, IKB

Summary Financials and Key Ratios

	30 Sep 20 6 months - interim	31 Mar 20 Year end	31 Mar 19 Year end
Summary income statement (EURm)			
Net interest and dividend income	107	201	196
Net fees and commissions	14	40	37
Other operating income	19	88	35
Total operating income	140	329	268
Operating costs	80	241	271
Pre-impairment operating profit	60	89	-3
Loan and other impairment charges	13	30	36
Operating profit	47	59	-39
Other non-operating items (net)	-4	-50	-66
Tax	0.3	0.6	-64
Net income	42	8	-41

Source: Fitch Ratings, Fitch Solutions, IKB

Summary Financials and Key Ratios

	30 Sep 20 6 months - interim	31 Mar 20 Year end	31 Mar 19 Year end
Summary balance sheet (EURm)			
Gross loans	9,061	9,714	10,018
- Of which impaired	183	154	149
Loan loss allowances	172	185	194
Net loans	8,889	9,530	9,823
Interbank	4,855	2,199	1,268
Derivatives	18	20	55
Other securities and earning assets	3,726	4,123	4,406
Total earning assets	17,488	15,871	15,553
Cash and due from banks	0.6	344	25
Other assets	334	388	539
Total assets	**17,823**	**16,603**	**16,116**
Customer deposits	6,452	6,140	5,750
Interbank and other short-term funding	8,695	7,670	7,352
Other long-term funding	974	1,112	1,256
Trading liabilities and derivatives	25	22	61
Total funding	16,146	14,944	14,418
Other liabilities	261	285	281
Total equity	1,416	1,374	1,417
Total liabilities and equity	**17,823**	**16,603**	**16,116**
Ratios (annualised as appropriate)			
Profitability			
Operating profit/risk-weighted assets	0.9	0.5	-0.3
Net interest income/average earning assets	1.3	1.3	1.2
Non-interest expense/gross revenue	57.1	73.1	101.2
Net income/average equity	6.1	0.6	-2.9
Asset quality			
Impaired loans ratio	2.0	1.6	1.5
Growth in gross loans	-6.7	-3.0	1.3
Loan loss allowances/impaired loans	93.8	119.8	130.3
Loan impairment charges/average gross loans	0.3	0.3	0.4
Capitalisation			
Common equity Tier 1 ratio	13.5	12.0	12.1
Tangible common equity/tangible assets	7.2	8.2	8.7
Basel leverage ratio	7.6	7.1	7.3
Net impaired loans/common equity Tier 1	0.8	-2.2	-3.3
Funding and liquidity			
Loans/customer deposits	140.4	158.2	174.2
Liquidity coverage ratio	309.0	235.0	318.0
Customer deposits/funding	40.0	41.2	40.1

Source: Fitch Ratings, Fitch Solutions, IKB

Key Financial Metrics – Latest Developments

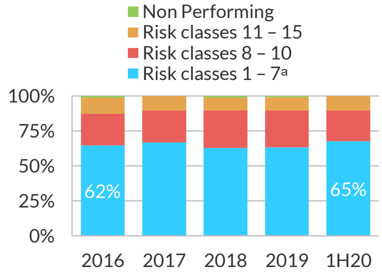
Pandemic Drives Increase in Impaired Loans

The outlook on IKB's asset quality score is Negative, as we expect the pandemic to weigh on its asset quality over the next two years. The pandemic is likely to lead to a strong increase in the number of insolvencies in Germany in 2021 despite the government's extensive intervention, which has so far contained the deterioration of corporate cashflows and by guaranteeing KfW's emergency loans. Asset quality remained resilient in 1H20 and more time will be needed for the asset quality implications of the crisis to become clearer.

The economic downturn will affect IKB's unsecured midcap lending and is likely to inflate NPLs as the bank is exposed to cyclical industries (e.g. basic metals and construction equivalent to 65% of the bank's CET1 capital at end-September 2020) and some sectors we consider to be more affected by the pandemic, including automotive (62%), real estate (51%) and retail (21%). Additionally, single-name concentrations resulting from IKB's larger ticket sizes are only partly mitigated by the bank's sound risk management, selective business origination, adequate risk-adjusted pricing, reasonable industry diversification and high share of lower-risk PDLs.

Credit Exposure

Breakdown by risk classes



[a] Investment grade
Source: Fitch Ratings, IKB

Loan Impairment Charges (LICs) and Margin Pressure Will Weigh on Profitability

We expect LICs to intensify earning pressure in 2021 and 2022. IKB booked low LICs of EUR13 million in 6M20 (an annualised 28bp of total loans) as credit risks have not yet materialised. IKB front-loaded discretionary provisions to provide a substantial cushion against Covid-19 related losses in FY19/20, which ended in March 2020.

We expect the bank's pre-impairment profits to remain a sufficient first line of defence. Our base case assumes IKB can achieve a recurring four-year average operating profit/RWAs of at least 0.5% through the crisis, in line with its earnings and profitability score of 'bbb-'. However, a deeper-than-expected recession or a slower economic recovery could lead to higher than anticipated credit losses and net annual losses in the next two years. This is reflected in the negative outlook on IKB's earnings and profitability score.

IKB was loss-making until mid-2019 due to the completion of the last stage of its restructuring. Since then, the restructuring has been completed and legacy legal risks eliminated. Therefore, we view the efficiency improvement and return to profitability achieved during 2020 as sustainable. The execution of the business plan benefits from an experienced and credible management team and a solid record of cost-cutting based on stringent cost management, streamlined processes and a small number of products. The management team was recently expanded from two members to four. We expect further significant cost relief over the next few years, some of which has already been contractually secured.

Capital Buffers Adequate to Navigate Pandemic Crisis

The trend on IKB's capitalisation and leverage score is stable because our sensitivity analysis indicates robust revenues and manageable credit losses through the pandemic, with only moderate pressure on capitalisation.

The fully-loaded CET1 ratio of 13.3% at end-September 2020 was adequate for IKB's risk profile and provides a sizeable buffer over its Supervisory Review and Evaluation Process (SREP) requirement. However, our assessment of capitalisation is constrained by loan concentrations and a corporate loan book that is more cyclical than those of large universal banking models. Our assessment also factors in our expectation that sizeable regulatory RWA relief driven by IRBA-related model changes will mitigate the impact on IKB's capitalisation from weakening asset quality as a result of the pandemic.

IKB's high Basel III leverage ratio of 7.6% at end-1H20 reflects its high share of unsecured loans, which results in a fairly high RWAs density of 56% and makes a high leverage ratio necessary to maintain adequate risk-adjusted ratios. The RWAs density decreased from 68% at end-2019 due to a balance sheet reduction and increased share of new business in low risk-weighted PDLs. The bank expects positive effects under Basel IV, resulting from the reduction in the Loss Given Default -standard parameter, while the output floor is not a limiting factor for IKB.

Stable Funding and Good Liquidity

IKB's funding mainly consists of deposits, repos and maturity-matched funding from AAA-rated German state-owned development banks (predominantly KfW) for the entire PDL portfolio (30% of IKB's balance sheet at end-September 2020), for which IKB consequently does not carry funding or asset-liability management risk. Excluding the back-to-back funded PDL book, IKB's pro-forma loan-to-deposit ratio of 57% is only about half of the actual 140% at end-September 2020. IKB's history of volatile profitability still constrains its underdeveloped capital market access and debt issuance franchise. However, its completed restructuring and stabilised financial performance should soon enable IKB to access market funding on acceptable terms.

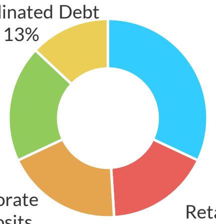
IKB is a member of German banks' voluntary private depositor protection scheme, which covers liabilities to non-banks (including non-retail customer deposits), in theory up to 15% of IKB's equity per depositor. This helps the bank to attract institutional and retail deposits at low costs and compensate for its lack of capital market access.

IKB's corporate and institutional deposits are moderately concentrated. According to management, a significant number of relationships with depositors pre-date the bank's restructuring. IKB originates retail deposits via its own online platform that is independent from its corporate franchise. Retail deposits are price sensitive, although the bank's active depositor management results in adequate stability and retention.

ECB funding (predominantly TLTRO) rose to EUR3 billion at end-September 2020 from EUR1.2 billion at end-2019. This strong increase reflects IKB's opportunistic take-up of TLTRO III, whose conditions the ECB further eased in 2Q20 to tackle the impact of the pandemic. This large TLTRO III take-up has strongly inflated IKB's excess liquidity, leading to an exceptionally high Liquidity Coverage Ratio (LCR) of 309% at end-September 2020 as its unencumbered liquidity reserve rose to EUR3.1 billion (17% of total assets) from EUR1.8 billion at end-2019. We expect the LCR to gradually normalise as IKB deploys some excess liquidity for new lending and debt management.

Funding Breakdown

Total funding: EUR16.2bn at end-1H20



Source: Fitch Ratings, IKB

Sovereign Support Assessment

The Support Rating and Support Rating Floor reflect our view that, due to the EU's Bank Recovery and Resolution Directive, IKB's senior creditors can no longer rely on full extraordinary support from the German sovereign if the bank becomes non-viable.

Support Rating Floor:			NF
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem	✓		
Structure of banking system		✓	
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)	✓		
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support			✓
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	

Environmental, Social and Governance Considerations

The highest level of ESG credit relevance is a score of '3'. ESG issues are credit-neutral or have only a minimal credit impact on IKB, either due to their nature or to the way in which they are being managed by IKB. For more information on our ESG Relevance Scores, visit www.fitchratings.com.

FitchRatings **IKB Deutsche Industriebank AG**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

IKB Deutsche Industriebank AG has 5 ESG potential rating drivers

- IKB Deutsche Industriebank AG has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
not a rating driver	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
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; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
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	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
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	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

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.

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.

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