

09

# Group Financial Report

30 September 2009

 Finanzgruppe

 Bayern LB



<b>BayernLB Group as at 30 September 2009</b>	4
<b>Business performance as at 30 September 2009</b>	6
Earnings	6
Banking supervisory capital	8
Net assets and financial position	9
Segment reporting	10
Outlook	12
<b>Administrative bodies</b>	14

*Note:*

*This Group financial report as at 30 September 2009 has been prepared with great care. The information is presented voluntarily for our customers and the public. The report does not contain all the information and data required under IAS 34 (Interim Financial Reporting) nor does it fully comply with the disclosure and valuation standards of IFRS. The results have not been audited or reviewed for correctness.*

# BayernLB Group at a glance as at 30 September 2009

## Income statement

EUR million	1 Jan – 30 Sept 2009	1 Jan – 30 Sept 2008
Net interest income	1,934	1,949
Risk provisions for the credit business	-1,292	-333
Net commission income	325	452
Gains or losses on fair value measurement	754	-1,017
Gains or losses on investments	291	-1,185
Administrative expenses	-1,554	-1,773
<b>Operating profit/loss</b>	<b>613</b>	<b>-1,674</b>
Restructuring expenses	-246	-66
<b>Earnings before taxes</b>	<b>367</b>	<b>-1,740</b>

## Balance sheet figures

EUR billion	30 Sept 2009	31 Dec 2008
Total assets	394.9	421.7
Credit volume	297.7	314.6
Equity and subordinated capital	28.9	23.1

## Banking supervisory ratios under the German Banking Act (KWG)

EUR billion	30 Sept 2009	31 Dec 2008
Core capital	18.4	15.8
Own funds	25.9	24.2
Risk positions (SolV)	171.3	197.7
Core capital ratio	10.7%	8.0%
Own funds ratio (at Group level)	15.1%	12.3%

## Current ratings

	Long-term	Short-term	Pfandbriefs*
Fitch Ratings	A+	F1+	AAA
Moody's Investors Service	A1	Prime-1	Aaa

\* Applies to public-sector pfandbriefs and mortgage-backed pfandbriefs

## Quarterly comparison

The table below is a comparison of the performance in the third quarter to the first and second quarters of 2009:

	Q3 2009 EUR million	Q2 2009 EUR million	Q1 2009 EUR million
Net interest income	665	695	574
Risk provisions for the credit business	-588	-566	-138
<b>Net interest income after risk provisions</b>	<b>77</b>	<b>129</b>	<b>436</b>
Net commission income	97	113	115
Gains or losses on fair value measurement	363	225	166
Gains or losses on hedge accounting	-18	-4	35
Gains or losses on investments	26	-3	268
Income from companies valued at equity	2	-10	0
Administrative expenses	-523	-478	-553
Other income	-7	69	89
<b>Operating profit/loss</b>	<b>16</b>	<b>40</b>	<b>557</b>
Restructuring expenses	0	-20	-226
<b>Earnings before taxes</b>	<b>16</b>	<b>20</b>	<b>331</b>

*Calculations may result in the figures in the table being rounded up or down by ± one unit.*

# Business performance as at 30 September 2009

## Earnings

EUR million	1 Jan – 30 Sept 2009	1 Jan – 30 Sept 2008
Net interest income	1,934	1,949
Risk provisions for the credit business	-1,292	-333
<b>Net interest income after risk provisions</b>	<b>642</b>	<b>1,616</b>
Net commission income	325	452
Gains or losses on fair value measurement	754	-1,017
Gains or losses on hedge accounting	13	29
Gains or losses on investments	291	-1,185
Income from companies valued at equity	-8	7
Administrative expenses	-1,554	-1,773
Other income	151	197
<b>Operating profit/loss</b>	<b>613</b>	<b>-1,674</b>
Restructuring expenses	-246	-66
<b>Earnings before taxes</b>	<b>367</b>	<b>-1,740</b>

The financial market crisis, which primarily affected the monetary sector in the beginning, has developed into a financial crisis that now massively impacts on the real economy – both domestic and international. The global recession is weighing on financial institutions through sharply rising risk provisions caused by an increasing number of corporate bankruptcies and higher unemployment. The BayernLB Group has also been unable to avoid the consequences of these events and has seen risk costs leap – particularly in the Eastern and South Eastern regions of Europe.

On capital markets a slight recovery can be seen. For example, BayernLB succeeded in placing a benchmark bond on the international market, other than the Pfandbrief or government-backed segments, for the first time since its state guarantee was lifted in 2005. The bond issue with a volume of over EUR 1 billion was oversubscribed two and a half times allowing the books to be quickly closed. Despite such positive signals, it is not yet safe to assume that the crisis is over.

Compared to the same period the year before, the Group's **operating earnings** swung by nearly EUR 2.3 billion to a profit of EUR 613 million. The banking supervisory **core capital ratio** likewise rose to 10.7 percent. This provides a solid foundation to bear any future storms that may occur. The rise in the core capital ratio is due in part to the recapitalisation measures provided by the Free State of Bavaria but also to the 13.4 percent decrease in risk positions to EUR 171.3 billion.

Customer-related business was satisfactory despite the difficult market environment.

**Net interest income** amounted to EUR 1,934 million, virtually unchanged from the year before period (–0.8 percent). Net interest income rose at the Group retail banking subsidiaries as they were able to take advantage of noticeably higher customer deposits to benefit from the favourable refinancing structure. The funding situation, in contrast, remained difficult due to the market conditions on the money and capital markets in effect since the beginning of 2009. Nonetheless, BayernLB has consciously accepted the higher funding costs resulting from this in order to ensure it has adequate liquidity on hand at all times.

As a result of the weak economic conditions, **risk provisions for loans** in the first nine months of 2009 rose by almost EUR 1 billion compared to the year before period to EUR 1,292 million. Hypo Group Alpe Adria (HGAA) and MKB, which operate in Eastern and South Eastern Europe, accounted for over half of this amount. Risk provisions at HGAA more than doubled and it alone accounts for around 44 percent of the entire BayernLB Group's risk provisioning requirements. Risk provisions in the other Group units on the whole were well below pro-rated estimates.

Declining commission income in the loan business together with fees paid to SoFFin, the German financial stabilisation fund, for BayernLB's EUR 5 billion state-backed bond issue in January 2009 weighed on **net commission income** which slipped to EUR 325 million (–28.1 percent).

**Gains from fair value measurement** amounted to EUR 754 million in the first nine months of 2009 (previous year: EUR –1,017 million). This result can be broken down into net trading income of EUR 694 million (previous year: EUR –585 million) and fair value option gains totalling EUR 60 million (previous year: EUR –432 million). Net trading income mainly includes earnings from customer-related interest rate derivative and foreign exchange transactions (EUR 529 million) and write ups in the credit portfolios affected by the financial market crisis (EUR 165 million). The increase over the year before period from transactions exercising the fair value option and their related hedging transactions resulted in large part from a decrease in credit linked assets.

For the first nine months of 2009, **gains or losses on investments** amounted to EUR 291 million (previous year: EUR –1,185 million). As in the first half, tighter credit spreads in the assets held for sale category continued to contribute to the positive results. The gains or losses on investments item was also boosted by the impact of the credit default swap (umbrella) that was part of the hedging transaction with the Free State of Bavaria. The aim of the hedge transaction is to offset losses from the ABS portfolio.

Administrative expenses fell by 12.3 percent or EUR 219 million to EUR –1,554 million. BayernLB accounted for around 70 percent of the cost reductions with the other 30 percent spread among the Group's strategic subsidiaries. This result means that BayernLB is ahead of the cost reductions targets contained in its Hercules restructuring plan. The Bank will continue however to systematically implement the plan in order to achieve the targeted reductions in operating and personnel expenses.

The EUR 46 million decrease in the **other result** to EUR 151 million was primarily driven by writedowns in the real estate portfolio of one of the subsidiaries. Restructuring expenses were essentially accounted for in the first half of 2009. For this reason, restructuring expenses remained unchanged at EUR –246 million. This compares with EUR –66 million in the first nine months of the year before.

**Earnings before taxes** amounted to EUR 367 million and were thus approximately EUR 2.1 billion higher than in the same period the year before.

### Banking supervisory capital

The banking supervisory **core capital ratio** was significantly higher at 10.7 percent and thus was 2.7 percentage points higher than at the end of 2008. This provides a solid foundation to bear any future storms that may occur. The rise in the core capital ratio is due in part to the recapitalisation measures provided by the Free State of Bavaria but also to the 13.4 percent decrease in risk positions to EUR 171.3 billion.

The G20 meeting in Pittsburgh resulted in the announcement of goals aimed at better fortifying banks to deal with future crises. These goals indicate that the present bank supervisory regime will be tightened up in the future. The changes are likely to include a narrower definition of core capital and the addition of a leverage ratio to the supervisory regime. The BayernLB Group is prepared for this and will react to the forthcoming changes by continuing to implement the de-risking and deleveraging strategy that it has already embarked on.

For example, the BayernLB Group would still have a very solid core capital ratio even without taking its hybrid capital into account. In such a case, the core capital ratio would only fall by 0.5 percentage points to 10.2 percent. The leverage ratio is roughly the ratio of core capital to total assets and indicates a financial institution's degree of gearing, although the actual risk structure is not taken into account. The BayernLB Group has managed to significantly reduce this factor (capital leveraging) from 37 at the end of December 2008 to 21 now.

## Net assets and financial position

### Assets

EUR million	30 Sept 2009	31 Dec 2008
Cash reserves	2,705	3,796
Loans and advances to banks	81,001	89,638
Loans and advances to customers	196,002	202,567
Risk provisions	-4,282	-3,439
Portfolio hedge adjustment	712	546
Assets held for trading	41,360	47,349
Positive fair values from derivative financial instruments (hedge accounting)	4,566	3,929
Investments including interests in companies valued at equity	58,138	62,561
Investment property	3,628	3,517
Property, plant and equipment	1,812	1,951
Intangible assets	2,323	2,213
Tax assets	4,656	4,659
Other assets	2,274	2,378
<b>Total assets</b>	<b>394,896</b>	<b>421,666</b>

Calculations may result in the figures in the tables being rounded up or down by  $\pm$  one unit.

### Liabilities and equity

EUR million	30 Sept 2009	31 Dec 2008
Liabilities to banks	100,862	142,480
Liabilities to customers	104,701	91,307
Securitised liabilities	113,471	117,479
Liabilities held for trading	32,977	34,054
Negative fair values from derivative financial instruments (hedge accounting)	2,373	3,086
Provisions	3,360	3,112
Tax liabilities	4,637	4,902
Other liabilities	3,617	2,160
Subordinated capital	10,478	11,821
Equity	18,419	11,265
• Equity excluding minority interests	15,893	8,693
• Minority interests	2,526	2,573
<b>Total liabilities and equity</b>	<b>394,896</b>	<b>421,666</b>

Calculations may result in the figures in the tables being rounded up or down by  $\pm$  one unit.

**Total assets** have decreased by EUR 26.8 billion since the end of 2008 to EUR 394.9 billion. BayernLB is thus well underway towards meeting the expected requirement from the EU Commission to significantly reduce total assets. On the asset side, the decrease occurred particularly in loans and advances to banks and foreign customers as well as in assets held for trading and investments. Loans to domestic customers, in contrast, rose by 7 percent to approximately EUR 114 billion, thereby indicating BayernLB's commitment to financing the German economy. On the liabilities side, liabilities to banks fell by EUR 41.6 billion to EUR 100.9 billion.

As a result of the capital measures by the Free State of Bavaria, **equity** grew by EUR 7.2 billion to EUR 18.4 billion. **Subordinated capital** decreased by EUR 1.3 billion to EUR 10.5 billion as tranches expired.

### Segment reporting

Segment reporting reflects the business structure of the BayernLB Group. Results are reported for six segments altogether. In addition to each segment's operating profit, the earnings include the earnings of the consolidated subsidiaries and units allocated to each segment. The segment report is based on the monthly management reports to the Board of Management. As from 1 July 2009 the segments were reorganised to reflect the new strategy and resizing of the BayernLB Group.

The former segments Corporates and Financial Markets plus business with financial institutions (from the former Financial Institutions & Sovereigns segment) have been consolidated into the new **Corporates & Markets** segment.

The **Real Estate / Public Sector & Savings Bank** segment is composed of the former separate Real Estate and Savings Banks segments plus the public sector business from the former Financial Institutions & Sovereigns segment. In addition, the Bayerische Landesbodenkreditanstalt (BayernLabo) is also allocated to this segment.

The Group strategic subsidiaries DKB, SaarLB, and Banque LBLux plus the Bayerische Landesbausparkasse (LBS Bayern) have been added to the existing Mittelstand segment to create the new **Mittelstand & Retail Customers** segment.

The new **Eastern Europe** segment is made up of the Group subsidiaries MKB and HGAA which operate primarily in Eastern and South Eastern Europe.

The **Restructuring Unit** segment contains the Credit Investments Portfolio (CIP) and selected portfolios transferred from the Business Areas that no longer form part of the core business under the new restructuring project and which are to be disposed of as quickly as possible in order to free up capital and liquidity resources.

The **Central Areas and Others** segment includes the Central Area operations Corporate Center, Financial Office, IT & Operations, and Risk Office as well as all other activities under the Others heading that are not allocated to other segments.

The contributions of each of the segments to the EUR 613 million operating profit in the first nine months of 2009 are shown below:

EUR million	Corporates & Markets	Real Estate / Public Sector & Savings Banks	Mittelstand & Retail Customers	Eastern Europe	Restructuring Unit	Central Areas and Others	Consolidation	Group
Net interest income	204	266	716	794	122	-136	-32	<b>1,934</b>
Risk provisions for the credit business	-77	-27	-143	-708	-337	0	0	<b>-1,292</b>
Net commission income	93	43	-29	170	60	-11	0	<b>325</b>
Gain/loss on fair value measurement	286	6	112	110	275	-11	-24	<b>754</b>
Result from hedge accounting	71	0	-104	51	-5	0	0	<b>13</b>
Gains or losses on investments	14	0	20	43	201	23	-9	<b>291</b>
Income from companies valued at equity	-1	0	0	-10	0	0	3	<b>-8</b>
Administrative expenses	-223	-154	-410	-641	-61	-67	0	<b>-1,554</b>
Other income	13	20	50	30	-1	7	31	<b>151</b>
<b>Operating profit/loss</b>	<b>380</b>	<b>153</b>	<b>213</b>	<b>-161</b>	<b>253</b>	<b>-194</b>	<b>-31</b>	<b>613</b>
Restructuring expenses	-41	-23	-8	0	-20	-154	0	<b>-246</b>
<b>Earnings before taxes</b>	<b>339</b>	<b>130</b>	<b>205</b>	<b>-161</b>	<b>233</b>	<b>-347</b>	<b>-31</b>	<b>367</b>
Return on equity (RoE) in %	11.6	16.0	7.2	-7.2	6.8			<b>6.3*</b>
Cost-income ratio in %	33.4	45.9	55.0	55.5	13.6			<b>48.9</b>

\* BayernLabo's results and share in Group equity are not included in the return on equity (in percent) at Group level.

The three segments Corporates & Markets, Real Estate / Public Sector & Savings Banks, and Mittelstand & Retail Customers all reported operating profits that were satisfactory or good. RoE ranged from 7.2 to 16.0 percent which can be considered as good, particularly in the given market situation.

Although net interest income and net commission income rose, higher risk provisions led to a negative operating profit in the Eastern Europe segment. HGAA's results were responsible for this. MKB's operating profit in contrast was not only positive for the first nine months of 2009 but also higher than in the same period of the year before.

The Restructuring Unit is also marked by high risk provisions, however it was able to report a satisfactory operating profit driven by good results from the fair value measurement and the investments items. In addition to the ABS portfolio, the Restructuring Unit also includes other loan and securities portfolios classified as non-core portfolios under the new strategy.

The results of the Central Areas and Others segment were mainly affected by refinancing expenses for the Group's participations.

## Outlook

In spite of a tough business environment, the overall performance of the customer-related business was satisfactory in the first nine months of 2009. In regard to its Hercules restructuring project, BayernLB is well on the way to implementing the targeted measures. As things currently stand, the Bank's earnings are expected to be both good and higher-than-planned after adjusting for restructuring expenses and the negative impact from HGAA described below.

Moreover, the ongoing dialogue with the European Commission regarding the state aid received by BayernLB has been constructive. The Commission has already confirmed the fundamental strategic policy decision to focus the business areas on specific customers and regions. Nonetheless, negotiations on the list of requirements the Commission will impose as part of the approval have not yet taken place. As a result, the full impact of the forthcoming negotiations with the EU Commission on the restructuring of BayernLB Group cannot be estimated or quantified at this time.

In addition, events in the fourth quarter can be expected to heavily weigh on the income statement. Besides a considerable increase in risk provisions in the core business, the performance of HGAA will have a particular impact on the fourth quarter of 2009.

HGAA's credit portfolio is currently being examined as part of a so-called asset screening by an external auditing firm. Even though the examination has not been completed yet, it can already be seen that risk provisions will have to be sharply increased as a result of the difficult economic situation in the countries of Eastern and South Eastern Europe at this time. The amount of the additional risk provisions required will be determined by the end of the 2009.

HGAA is expected to report a significant loss for the year as a result of the increase in risk provisions. To ensure HGAA is adequately capitalised, a capital injection by means of a capital increase will be indispensable.

Based on the newly recognised need for additional risk provisions and taking into account the forecast for the performance of the economy, a new long-term forecast for HGAA will have to be produced. As it can be assumed that the value of HGAA derived from the revised forecast will be lower than its current carrying amount on the Group's books, a goodwill impairment charge can be expected to be taken at the end of the year.

The higher risk provisions and expected goodwill impairment (which among other things are due to the changed cash generating units in the new segmentation) can be expected to have a significant negative impact on the BayernLB Group's earnings in the fourth quarter. Due to the uncertainties mentioned above a final quantification of the impact is not yet possible. However, it can be expected that as a result of these effects, the Group will report a consolidated net loss of over EUR 1 billion. Due to the BayernLB Group's solid capital base, which also is sufficient to buffer and support the ongoing transformation process, the projected loss for the Group will not require any additional capital at the BayernLB level.

# Administrative bodies of BayernLB

## Board of Administration (since 1 August 2009)

### **Georg Fahrenschoen**

Chairman  
State Minister  
Bavarian State Ministry of Finance  
Munich

### **Professor Dr. Georg Crezelius**

Professor  
University of Bamberg  
Bamberg

### **Dr. Dr. Axel Diekmann**

Partner  
Verlagsgruppe Passau GmbH  
Passau

### **Gerd Häusler**

Director  
RHJ International  
Zurich

### **Joachim Herrmann**

State Minister  
Bavarian State Ministry of the Interior  
Munich

### **Diethard Irrgang**

Chairman of the General Staff Council  
BayernLB  
Munich

### **Hans Schaidinger**

Lord Mayor  
Regensburg

### **Siegmund Schiminski**

Chairman of the Board of Management  
Sparkasse Bayreuth  
Bayreuth

### **Dr. Klaus von Lindeiner-Wildau**

Member of the Executive Board (retired)  
Wacker Chemie GmbH  
Independent Consultant  
Munich

### **Klaus Weigert**

Deputy Secretary  
Bavarian State Ministry of Finance  
Munich

### **Martin Zeil**

State Minister  
Bavarian State Ministry of Economic  
Affairs, Infrastructure, Transport  
and Technology  
Munich

## Board of Management (including allocation of tasks from 1 September 2009)

### **Dr. Michael Kemmer**

Chairman  
Corporate Center Central Area<sup>1</sup>  
Group Risk Control Division

### **Stefan Ermisch**

Deputy Chairman  
Financial Office Central Area  
IT & Operations Central Area

### **Stefan W. Ropers**

Corporates & Markets Business Area

### **Dr. Ralph Schmidt**

Risk Office Central Area<sup>2</sup>  
Restructuring Unit Central Area

### **Dr. Edgar Zoller**

Real Estate / Public Sector &  
Savings Banks Business Area  
(central bank for the  
savings banks function)  
Bayerische Landesbodenkreditanstalt<sup>3</sup>  
Corporate Center Central Area<sup>1</sup>

### **Jan-Christian Dreesen**

Mittelstand & Retail Customers  
Business Area  
Bayerische Landesbausparkasse<sup>3</sup>

<sup>1</sup> The Legal Services, Compliance Center and Prevention of Money Laundering and Financial Crime Division comes under Dr. Edgar Zoller. The Compliance Office and the officers responsible for money laundering, financial crime and data protection report directly to the Board of Management but are assigned to the Legal Services division in organisational terms.

<sup>2</sup> Not including Group Risk Control Division

<sup>3</sup> Institutions of the Bank

Bayerische Landesbank  
Brienner Strasse 18  
80333 Munich  
Germany  
[www.bayernlb.com](http://www.bayernlb.com)

