PRESS RELEASE

APRIL 17, 2024

Morningstar DBRS Confirms Landesbank Baden-Württemberg LT Issuer Rating at A (high), Trend Remains Stable

BANKING ORGANIZATIONS

DBRS Ratings GmbH (Morningstar DBRS) confirmed the credit ratings on Landesbank Baden-Württemberg (LBBW or the Bank), including Issuer Ratings at A (high) / R-1 (middle). Morningstar DBRS also confirmed the Senior Non-Preferred Debt rating at 'A', the Subordinated Debt Rating at A (low) and the Critical Obligations Ratings (COR) at AA / R-1 (high). The trend on all credit ratings remains Stable. The credit ratings and the trend are all in line with the broader Sparkassen-Finanzgruppe (SFG). LBBW's Intrinsic Assessment (IA) is 'A' and its Support Assessment is SA1. For a complete list of credit ratings, please see the table at the end of this press release.

KEY CREDIT RATING CONSIDERATIONS

LBBW's ratings reflect its membership in the Sparkassen-Finanzgruppe (SFG) and in the Institutional Protection Scheme (IPS) of the SFG. Each member of the IPS, including LBBW, is generally rated at the floor level, which is currently A (high) with a Stable trend.

The 'A' Intrinsic Assessment (IA) is supported by LBBW's solid franchise mostly in commercial banking with a regional focus on Southern Germany. In particular, the Bank is the leading provider of commercial real estate (CRE) loans in Germany. In its function as a Landesbank, LBBW also acts as a central institution and clearing bank for the savings banks in its designated regions of Baden-Württemberg, Rhineland-Palatinate and Saxony. LBBW's liquidity and funding profile is skewed towards wholesale funding, as the Bank's retail deposit franchise is rather small. However, in our view, LBBW's well-established covered bond franchise and its membership in the SFG with access to the savings banks liquidity add to the Bank's resilience. In addition, LBBW has solid capital ratios with cushions well above minimum requirements, which we expect to be maintained over the medium-term. The IA also considers the improvement in earnings as a result of the higher interest rate environment. However, relative to European peers profitability remains on the weaker side. Asset quality metrics have softened somewhat, but performance is still strong, especially in light of the Bank's large CRE exposure, which, in our view, is attributable to prudent underwriting. We expect pressure in the CRE market to persist for some time, however, which could lead to elevated loan loss provisions, albeit at a manageable level.

The Stable trend takes into consideration that 2024 earnings will likely weaken from higher levels, as margins have peaked, while wage inflation and higher credit costs may still prevail for some time. However, we expect economic indicators to improve along with lower rates in 2025, and combined with the Bank's own growth initiatives, earnings should return to a path of steady, albeit modest, improvement.

CREDIT RATING DRIVERS

LBBW's Issuer Ratings benefit from the SFG's IPS, and therefore a change in SFG's ratings would lead to a change in LBBW's credit ratings.

The Bank's Intrinsic Assessment (IA) would be upgraded if the Bank improves its profitability on a sustainable basis, while maintaining solid asset quality. A significant deterioration in asset quality or a material decline in profitability would lead to a downgrade of the IA.

CREDIT RATING RATIONALE

Franchise Combined Building Block (BB) Assessment: Strong / Good

LBBW provides universal banking services to primarily corporate clients, with a focus on the regions of Baden-Württemberg, Rhineland-Palatinate and Saxony. The Bank holds a strong market share in its core regions and has market leading positions in a number of products, including commercial real estate (CRE) finance in Germany, particularly after the acquisition of Berlin Hyp in 2022. As a Landesbank, the Bank also performs central banking and clearing functions for the savings bank associations in these regions. Among the Landesbanken, LBBW has also become the main provider for rates, currency and commodity risk management services for the savings banks. LBBW is an institution incorporated under German public law with legal capacity (rechtsfähige Anstalt des öffentlichen Rechts, AöR) and is a member of the Sparkassen Finanzgruppe and therefore part of the Group's joint liability scheme. LBBW is designated as an 'other systemically important institution' within Germany, given its position as a major counterparty in the German capital markets.

Earnings Combined Building Block (BB) Assessment: Good / Moderate

LBBW's earnings metrics improved significantly in 2023, however, profitability remains weaker than European peers. This is due to various factors such as a competitive German banking market, the specific roles Landesbanken play, and a relatively high proportion of wholesale funding. In 2023, LBBW reported a profit before tax of EUR 1,374 million down from EUR 1,873 million a year earlier, when results benefitted from badwill of EUR 972 million related to the acquisition of Berlin Hyp. On an operating basis (excluding badwill), the Bank's net profit before tax increased by 52.5% (YOY) to EUR 1,374 million in 2023 from EUR 901 million in the previous year, underpinned by a 22.6% YOY increase in net interest income (NII), which more than offset a decrease in net fee and commission income by 6.2%, while administrative expenses increased by 12.2% and loan loss provisions increased by 6.1%. 2024 earnings are expected to weaken due to a combination of margin pressure, wage inflation and elevated provisioning needs. The Bank's strategy to improve efficiency through selective revenue growth while keeping costs tightly managed is expected to result in a gradual decline in its cost-to-income ratio and an improved return on equity (ROE), thereafter, but also depends on the overall economic environment.

Risk Combined Building Block (BB) Assessment: Strong / Good

As expected, LBBW's asset quality metrics weakened somewhat over the course of 2023, but have remained relatively resilient, especially given the large exposure to CRE. The NPL ratio as calculated by Morningstar DBRS was 1.3% at end-2023 compared to 0.9% at end-2022. Cost of risk as calculated by Morningstar DBRS remained relatively stable at 17 basis points (bps) in 2023 compared to 19 bps in 2022, as loans to customers increased. Geographically, LBBW mainly operates in stable, mature economies. Most of LBBW's loan exposure is to Germany and Western Europe, followed by North America. LBBW's corporate loan book shows a well-balanced sector mix, as the traditionally high exposure to the automobile industry has been reduced in recent years to reflect structural changes in the industry. However, LBBW's CRE concentration is very high at 49% of loans to customers and 21% of total assets. The portfolio has been resilient so far, but the operating environment remains challenging, characterised by weak economic growth and still elevated interest rates. We reiterate our view, that potential asset quality deterioration will remain manageable given LBBW's strong underwriting standards, and solid buffers stemming from solid loan loss reserves and loan collateralisation.

Funding and Liquidity Combined Building Block (BB) Assessment: Strong / Good

We view LBBW's funding and liquidity profile as sound. The high reliance on wholesale funding, is a reflection of the Bank's business model, with a relatively limited retail customer base. However, we see this as mitigated by a well- matched asset/liability profile and good access to the covered bond market, which we consider a stable source of funding. In addition, LBBW has a solid liquidity position with Liquid Assets (cash, deposits with central banks, and securities) accounting for 24% of total assets. The Bank also has access to the savings banks liquidity pool and benefits from the confidence derived from its membership in the Sparkassen-Finanzgruppe. At end-2023, the Liquidity Coverage Ratio (LCR) was 150.5% and the Net Stable Funding Ratio (NSFR) was 109.7%, well above minimum requirements.

Capitalisation Combined Building Block (BB) Assessment: Good

LBBW strengthened its capital ratios in 2023 by retaining profits, reducing risk-weighted assets (RWAs) through methodological changes, and through securitisation. The Bank reported a fully loaded CET1 ratio of 14.6% at and a total capital ratio of 20.1% end-2023 up from 14.1% and 20.0% a year before, respectively. LBBW maintained cushions well over minimum requirements. LBBW's SREP requirement for CET1 increased significantly by 178 bps in the course of 2023 to 10.56% (as of March-2024) due to the incorporation of new requirements such as a countercyclical capital buffer of 0.64%, an AT1 shortfall buffer of 1.03% and a buffer for systemic risks of 0.1%. The healthy capital cushions should protect the Bank in case of increased pressure on asset quality. This is particularly important given the Bank's limited access to capital markets due to its ownership structure.

Further details on the Scorecard Indicators and Building Block Assessments can be found at https://www.dbrsmorningstar.com/research/431300.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

ESG Considerations had a relevant effect on the credit analysis.

Governance (G) Factors

The subfactor Corporate Governance is relevant to the rating of Sparkassen-Finanzgruppe, and this is reflected in the franchise grid grades for the group.

Morningstar DBRS views certain weaknesses in the group structure as relevant from a corporate government perspective. Notably, the Landesbanken are majority or part-owned by German Federal States. State governments, in our view, have limited capabilities to effectively supervise the banks' activities. In the past, Landesbanken have taken outsized risks, resulting in high costs to tax payers and the Sparkassen. Sparkassen associations, while part-owners of some Landesbanken, have had only limited influence over the risk taking by the Landesbanken. The ownership mix and the parliamentary process involved in decision making, have also made it difficult at times to swiftly react to challenges. In 2020, the ECB requested better pre-emptive risk controls within the IPS and more transparent processes in case of a recapitalisation, which was addressed in 2023. In addition, aggregate financial information for the Group is limited.

There were no Environmental or Social factors that had a significant or relevant effect on the credit analysis.

A description of how Morningstar DBRS considers ESG factors within the Morningstar DBRS analytical framework can be found in the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (23 January 2024) https://dbrs.morningstar.com/research/427030/morningstar-dbrs-criteria:-approach-to-environmental,-social,-and-governance-risk-factors-in-credit-ratings

Notes:
All figures are in Euros unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (22 June 2023) https://dbrs.morningstar.com/research/415978/global-methodology-for-rating-banks-and-banking-organisations In addition Morningstar DBRS uses the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (23 January 2024) https://dbrs.morningstar.com/research/427030/morningstar-dbrs-criteria:-approach-to-environmental,-social,-and-governance-risk-factors-in-credit-ratings in its consideration of ESG factors.

The credit rating methodologies used in the analysis of this transaction can be found at: https://dbrs.morningstar.com/about/methodologies.

The sources of information used for these credit ratings include Morningstar Inc. and Company Documents, LBBW 2018-2023 Annual Reports, LBBW 2023 Results Presentation, LBBW 2023 Press Release, LBBW H1 2023 Disclosure Report. Morningstar DBRS considers the information available to it for the purposes of providing these credit ratings to be of satisfactory quality.

Morningstar DBRS does not audit the information it receives in connection with the credit rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. Morningstar DBRS's outlooks and credit ratings are under regular surveillance.

For further information on Morningstar DBRS historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: https://registers.esma.europa.eu/cerep-publication. For further information on Morningstar DBRS historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see https://data.fca.org.uk/#/ceres/craStats.

The sensitivity analysis of the relevant key credit rating assumptions can be found at: https://www.dbrsmorningstar.com/research/431301.

These credit ratings are endorsed by DBRS Ratings Limited for use in the United Kingdom.

Lead Analyst: Sonja Forster, Vice President - European Financial Institution Ratings
Rating Committee Chair: William Schwartz, Senior Vice President - Global Fundamental Ratings, Credit Practices
Initial Rating Date: April 21, 2022
Last Rating Date: April 19, 2023

For more information on this credit or on this industry, visit dbrs.morningstar.com.

Ratings

Landesbank Baden-Wuerttemberg

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
17-Apr-24	Long-Term Issuer Rating	Confirmed	A (high)	Stb	EU U
17-Apr-24	Short-Term Debt	Confirmed	R-1 (middle)	Stb	EU U

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
17-Apr-24	Short-Term Deposits	Confirmed	R-1 (middle)	Stb	EU U
17-Apr-24	Short-Term Issuer Rating	Confirmed	R-1 (middle)	Stb	EU U
17-Apr-24	Long-Term Critical Obligations Rating	Confirmed	AA	Stb	EU U
17-Apr-24	Short-Term Critical Obligations Rating	Confirmed	R-1 (high)	Stb	EU U
17-Apr-24	Senior Non-Preferred Debt	Confirmed	A	Stb	EU U
17-Apr-24	Long-Term Deposits	Confirmed	A (high)	Stb	EU U
17-Apr-24	Long-Term Senior Debt	Confirmed	A (high)	Stb	EU U
17-Apr-24	Subordinated Debt	Confirmed	A (low)	Stb	EU U
17-Apr-24	LBBW EUR 10,000,000,000 Commercial Paper Programme 2019	Confirmed	R-1 (middle)	Stb	EU U
17-Apr-24	LBBW EUR 5,000,000,000 Negotiable European Commercial Paper Programme 2022	Confirmed	R-1 (middle)	Stb	EU U

Contacts

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