Daiwa Capital Markets

DZ Bank AG

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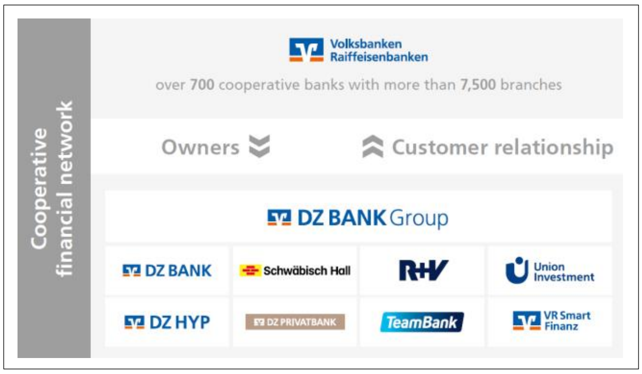
	Sr. Unsecured	Short-term	Outlook
Moody's	**Aa2**	**P-1**	**Stable**
Fitch	**AA**	**F1+**	**Stable**
S&P	**A+**	**A-1**	**Stable**

Source: Moody's, Fitch, S&P

Background and ownership

DZ Bank AG (DZ Bank) acts as the holding company for DZ Bank Group and serves as the central institution and commercial bank to the German cooperative financial network (*Volks- und Raiffeisenbanken*). The latter comprises almost 700 local cooperative banks that are DZ Bank's main shareholders (94.7% of total shares). The group consolidates specialised institutions that operate through a number of recognisable brands, which in turn provide a range of financial products and services, such as banking, insurance, home savings, and investment solutions, among other things. The business of all DZ Group entities is mostly focused on the German market and it forms the second largest private banking group in Germany in terms of total assets, standing at EUR644.5bn as at FY23. As of end-2023, the German cooperative financial network held a domestic market share of 25% in terms of private household deposits and its consumer home finance provider had a 31% market share. DZ Bank AG offers its products and services through a handful of own branches and indirectly through the cooperative banking network, which it seeks to strengthen in terms of market position and competitiveness.



Source: Company reports; Simplified view

Main activities

DZ Bank AG provides a range of products and services aimed at local cooperative banks as well as large corporates, SMEs and institutional investors through for following four business segments:

- **Retail banking –** DZ Bank offers local cooperative banks and their retail customers a range of financial products and services, such as its own interest rate products, derivatives, investment certificates, depositary for securities, exchange-traded funds (ETFs), and equities.
- **Corporate banking –** Through 12 regional branches that look after both direct customers and those at the joint venture business with cooperative banks at the regional level. The division also overlooks the customer relationship management for multinational corporates, the cooperative financial network and clients in the agriculture and healthcare sectors. The international business of corporate clients is supported with foreign payments processing, import and export credit guarantees and financing, and currency hedging.
- **Capital markets –** This segment provides advisory and sales in relation to investment and risk management products, including interest-rate, credit, equities, and currency asset classes to institutional customers, cooperative banks and corporate clients. DZ Bank also manages the cash pooling for the cooperative banks as well as procurement of liquidity by issuing securities.
- **Transaction banking –** Through this business line, DZ Bank offers payments processing, card processing, customer-centric solutions, as well as capital markets, securities, depositary and advisory services.

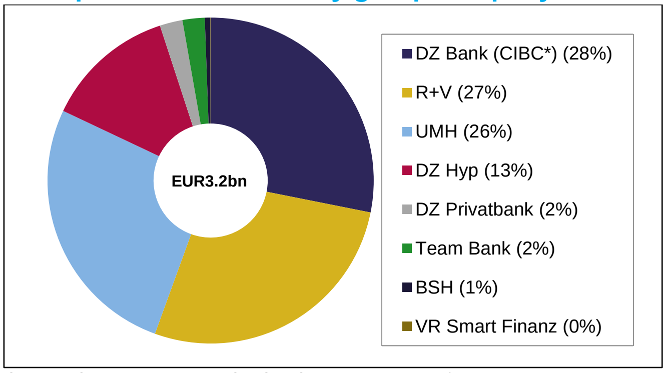
DZ Bank AG – Key Data (Consolidated Financials)			
Key Ratios (%)	FY23	FY22	FY21
CET 1 ratio	15.5	13.7	15.3
NPL ratio	1.9	1.5	1.7
Coverage ratio	59.2	65.5	57.5
Loan/ deposit ratio	128.3	127.7	140.8
Cost-income ratio	56.4	63.5	58.9
RoRAC	17.1	11.6	15.7
Balance Sheet (EURbn)			
Total assets	644.6	628.4	627.3
Total customer loans	204.8	203.6	195.7
Total customer deposits	159.6	159.4	138.9
Total liabilities	613.5	600.7	598.6
Debt securities	103.7	82.3	79.6
Total equity	31.1	27.6	28.6
Income Statement (EURm)			
Total revenues	8,093	6,800	7,201
o/w NII	*4,333*	*3,322*	*2,785*
Operating expenses	-4,597	-4,447	-4,265
Loan loss provisions	-362	-304	120
Profit before tax	3,189	2,252	3,096
Net income	2,234	1,341	2,176

Source: Company reports; Bloomberg

Financial strength indicators

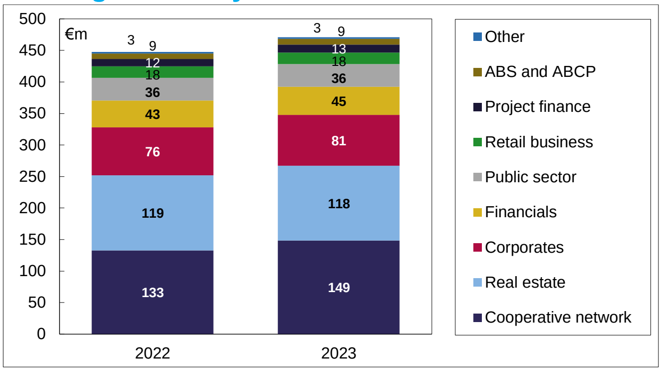
Profitability – Consolidated revenues as of FY23 amounted to EUR8.1bn (+19% yoy), of which 54% comprised of net interest income (NII), 35% net fee and commission income and 11% from the insurance business. Due to the bank's role as central institution within the wider group, DZ Bank aggregates a number of unrelated income streams that give it a diversified earnings profile. NII in particular benefitted from volume growth within the corporate banking business, money market and capital market business. For 2024, and in line with the group's strategy, corporate banking remains a key area of revenue growth for the bank. Overall, DZ Bank manages its cost base well, as reflected in the adequate cost-to-income ratio of 56.4%, despite ongoing inflationary pressure and business expansion. FY23 net income was EUR2.2bn (+67% yoy), translating to a return on risk-adjusted capital (RoRAC) of 17.1% (FY22: 11.6%).

FY23 profit before taxes by group company



Source: Company reports; CIBC = Central institution & corporate bank

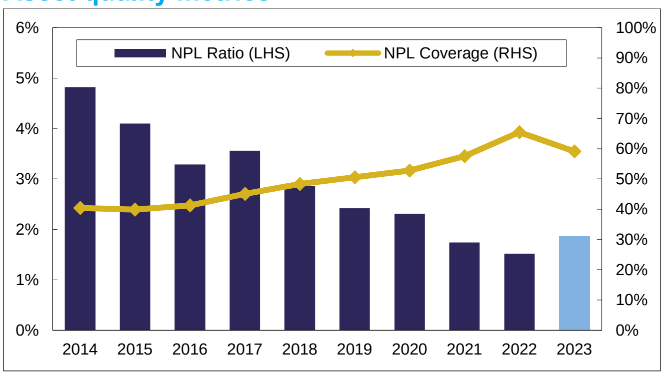
Lending volume by asset classes



Source: Company reports

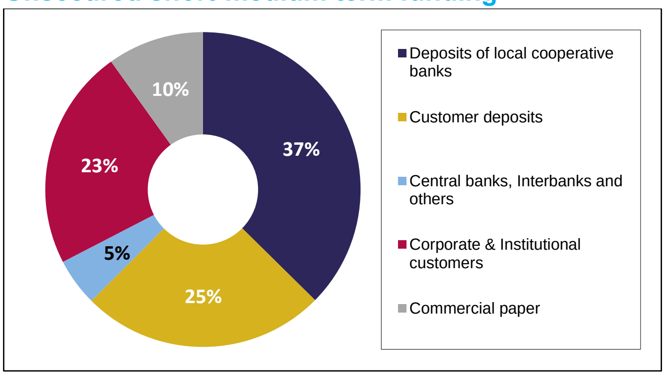
Asset quality – Total assets at FY23 grew modestly to EUR645bn (+2.6% yoy), and comprised of customer loans (32% of total), interbank lending (20%), investments held by insurance companies (18%), cash and equivalents (16%) and other investments (7%). Loans to customers are predominantly domestic (87%) and only partially extended to foreign entities (13%). A significant portion of these lending activities (60% of customer loans) can be considered low risk as they are either backed by residential properties or linked to home savings loans extended by DZ's building society. The elevated level of intrabank lending is reflective of DZ Banks' central role, with 92% of these exposures extended to affiliated banks. Prudent underwriting standards have ensured robust asset quality metrics, with non-performing loans remaining at a modest 1.86% as a proportion of total loans (five-year average: 1.97%). Reserve coverage was adequate at 59%. Loan loss provisions (LLPs) increased to EUR362m (+19% yoy) but remained in line with the average observed over the past decade. Potential headwinds to asset quality may emerge from a weakening economic environment, as most exposures are domestically focused, as well as downward pressure on the residential and commercial real estate sectors.

Asset quality metrics



Source: Company reports; Bloomberg

Unsecured short-medium term funding



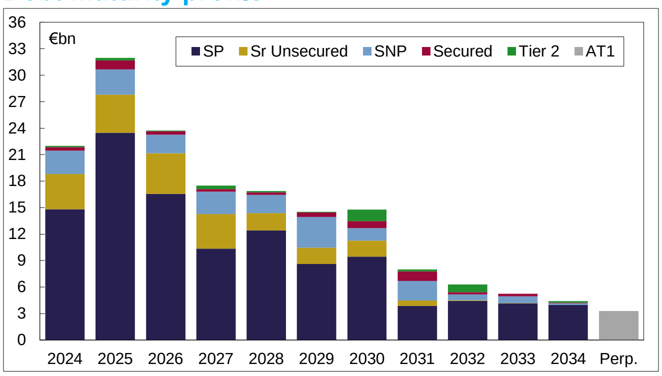
Source: Company reports

Funding & Liquidity – Total liabilities, excluding equity, amounted to EUR613bn at FY23, comprising interbank deposits (28% of total), customer deposits (26%), debt securities (17%), and insurance liabilities (17%). DZ Bank's funding composition is skewed towards market-based funding, which in turn exposes the group to potential market volatility. This partial reliance on market funding is reflected in the above average loan-to-deposit ratio of 128%. Nevertheless, the issuer's strong external credit ratings support frequent bond issuances that demonstrate good access to capital markets. The comparatively low customer deposit base is only partially made up of retail clients, with the remainder being corporate and institutional clients that are considered less sticky and more confidence sensitive. With regards to interbank deposits, these largely stem from the bank's role as central institution to the German cooperative financial network. This treasury-like function, available to affiliated banks, makes up 41% of the interbank deposit base. Another component recognised under interbank deposits is residual funding from the ECB's discontinued TLTRO programme. These exposures have decreased significantly over the past years and stand at just EUR472m compared to EUR11bn at FY22. The liquidity position is well managed and backed by a EUR130bn pool of high quality, unencumbered assets. Liquidity metrics such as the LCR (146%) and NSFR (127%) are comfortably above the minimum requirement of 100%.

ESG activities and funding

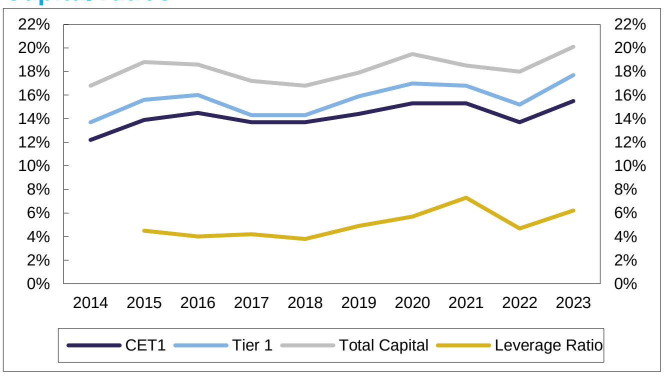
In March 2023, DZ Bank published an enhanced set of ESG targets as part of its group-wide sustainability drive. In particular, it has set specific climate targets and decarbonisation pathways in five CO2-intensive industries (energy, automotive, steel, cement and aviation) that account for a significant share of global CO2 emissions. The sectors in scope account for 13% of the total lending volume. The overall aim is to almost completely reduce the CO2 intensity of its lending business and own investments in the identified sectors by 2050. Overall, interim targets foresee a reduction of the CO2 intensity of 14% by 2025 and 36% by 2030. Business activities in the energy sector already exemplify this strategic approach. Thus, the majority of the portfolio consists of project financing for renewable energies. At FY23 the loan volumes committed amounted to EUR7.4bn (FY22: EUR6.5bn) and thus ahead of the EUR7.1bn target set for renewal energy commitments by 2026. Among other things, the DZ Bank Group aims to achieve a group-wide proportion of women on the board of managing directors of 30% by 2030 (currently 25%). In terms of ESG-themed bonds in issue, DZ Bank group has 10 green bonds outstanding for a combined EUR4.57bn. Of these, eight are covered bonds (EUR4bn) and the rest are senior non-preferred securities issued by DZ Bank AG.

Debt maturity profile



Source: Bloomberg; view excludes periods with <EUR1bn debt maturing

Capital ratios



Source: Company reports; Bloomberg

Capitalisation – The capital position is robust overall, with a CET1 ratio of 15.5% (+180bps yoy) and Tier 1 ratio of 17.7% (+250bps). The jump in the ratio was partially driven by higher retained earnings and RWA management but mostly due to the application of IFRS 17 accounting from 2023 at DZ Bank's insurance company, R+V Versicherung. The capital position was further strengthened in the year by several AT1 issuances for a total of EUR1.1bn. The CET1 ratio sits comfortably above the minimum SREP requirements of 9.9% (+570bps buffer) and 420bps above its own internal minimum threshold. DZ Bank's MREL requirement sits at 25.1%, which it meets with a large stock of MREL eligible funds, bringing its total ratio to 42.4% of RWA. Due to the large MREL surplus and high capitalisation rate, the bank has low funding requirements over the short term from a regulatory perspective.

Rating agencies' views

Moody's (Jan-24): DZ Bank's ratings consider its overall sound solvency profile, based on good asset quality; a strong capitalization yet only moderate profitability, and its overall sound liquidity profile, with a high share of liquid assets mitigating its very high dependence on market funding. DZ BANK benefits from a degree of diversification across business activities which are only partly correlated, such as banking, asset management and insurance, but also shows some risk concentrations that could result in a more rapid deterioration of asset quality in an adverse scenario.

Fitch (Apr-24): In April 2024, Fitch ratings affirmed the ratings of Genossenschaftliche FinanzGruppe (GFG), its central institution DZ Bank AG Deutsche Zentral-Genossenschaftsbank, and around 700 local bank members of GFG's mutual support scheme. The ratings reflect the group's leading and highly diversified business profile, underpinned by its strong domestic retail and small SME banking franchise, strong risk-adjusted capitalisation and low leverage, sound asset quality, a record of profitability that is considerably better than most German peers, as well as its outstanding funding profile by international standards.

S&P (Aug-23): S&P's long-term issuer credit rating of DZ Bank AG is 'A+' and the short-term issuer credit rating is 'A-1' with a stable outlook. The rating agency listed the following key considerations contributing to its assessment. Key strengths: i) Role as the central institute of the German cooperative banking sector, which makes it integral to the sector's identity and a core group member; ii) Benefits from mutual support within the sector and a comprehensive protection scheme; iii) Good market position in German corporate banking and diversification through its subsidiaries. Key risks: i) Weaker risk profile and capitalization than its owners, the local cooperative banks; ii) Intense competition and margin pressure in German corporate banking; iii) Earnings sensitivity to capital market conditions in its insurance and asset management subsidiaries.

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