HSH NORDBANK

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HSH Nordbank's first-half results strained by worsening shipping crisis

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- Group net income of EUR 70 million as of the end of June
- Progress made in the Core Bank's client business reflected in substantial growth in new business.
- Heavy strain exerted by further deterioration in shipping, substantial increase in loan-loss provisions
- No swift improvement expected in the difficult environment for banks and particularly shipping
- Chairman of the Management Board Paul Lerbinger: "We are continuing to resolutely pursue our business model of being a bank for entrepreneurs and will be doing everything we can to also cope with the additional challenges."

HAMBURG/KIEL - Against the backdrop of a further worsening of market and sector conditions, HSH Nordbank achieved Group net income after tax of EUR 70 million in the first half of the current year, down from EUR 338 million in the same period of the previous year. Net income before restructuring expense arising in connection with the realignment of the Bank, the cost of government guarantees and tax effects came to EUR 211 million, down from EUR 697 million in the previous year. In addition to a further escalation of the crisis afflicting the international shipping markets, which was the main reason for the substantial increase in loan-loss provisions, the effects of the euro crisis, which were reflected in the considerable depreciation of the European single currency against the US dollar in the second quarter, particularly exerted pressure on the results for the first half.

"In addition to the dual strain on our Bank - namely simultaneous implementation of the EU Commission's stipulations and realignment as a 'bank for entrepreneurs' - we have faced further major challenges over the last few months. HSH Nordbank's general situation is closely tied to current conditions in the financial markets and the macroeconomic development. The further worsening of conditions in the shipping industry in the wake of the global economic downturn and the depreciation of the euro have taken a heavy toll on our figures

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and will continue to exert pressure on us in the foreseeable future. Unfortunately, this conceals the progress which we have already achieved in realigning the Bank in the market," said Dr. Paul Lerbinger, Chairman of HSH Nordbank's Management Board.

Further progress made in client business - new business almost doubled
As announced, HSH Nordbank was able to further expand client business in its Core Bank on the basis of its new business model in the first half of 2012. In this way, it came a step closer towards achieving its objective of successfully establishing itself in target markets as a "bank for entrepreneurs" on a sustained basis with a focus on Small and Medium-sized Enterprises. Strategic realignment is bearing fruit: despite generally muted borrowing demand and uncertainty on the part of clients in the wake of the European debt crisis, the Bank was able to almost double the volume of new loans compared with the first half of 2011 to EUR 2.9 billion. Thanks to growing market acceptance of the new business model, the Bank will be additionally strengthening client relationships throughout the rest of the year and making use of opportunities in the market on a risk-conscious basis. "HSH Nordbank stands by its responsibility of supplying the regional economy with funding even in difficult times. This is being increasingly recognised and acknowledged by corporate clients in Northern Germany," Lerbinger explains.

However, it will take time for the growth in new business to show up in the main earnings parameters. For the time being, the favourable income contributions will continue to be overshadowed by the effects of the reduction in interest-bearing assets in accordance with the EU agreement, macroeconomic strain and the consequences of the generally low interest rates. Thus, at EUR 453 million, the **net interest income** recorded by the Bank as a whole was substantially lower than in the same period of the previous year (EUR 635 million). This item particularly came under pressure from the decline in interest-bearing loans and advances as well as lower market interest rates. Moreover, net interest income in the previous year had included non-recurring income from dividends on investments. **Net commission** income came to EUR 44 million, thus also falling short of the previous year (EUR 61 million). Lending commissions in particular reflect the lack of business from the units also to be wound down in accordance with EU requirements. In addition the absence of the contribution made by the private client business of the Bank's Luxembourg subsidiary, which had been sold in the previous year, duly made itself felt.

Net trading income, which dropped to EUR -210 million (previous year: EUR 1 million), mirrors the continued heavy volatility in the financial markets. The greatest influence had been exerted by the valuation losses on interest-rate/currency derivatives (euro/US-dollar basis swaps) as a result of the euro crisis. These are used for funding foreign-exchange business and play a crucial role in HSH Nordbank's ship financing business, which is denominated almost exclusively in US dollars. This was exacerbated by the negative effects arising from the remeasurement and redemption of the Bank's own liabilities, which had to be marked at a higher fair value due to the reduced risk premiums for German banks. **Net income from financial investments** climbed to EUR 152 million, up from EUR 118 million in the previous year. In this connection, the Bank benefited from the sale of non-strategic investments and fair-value remeasurement gains on securities. On the other hand, impairments on portfolios, which the Bank had recognised – allowing for heightened sovereign risks - exerted strain.

Administrative expenses reveal the effect of the Bank's strategic and organisational realignment on the basis of the EU decision announced in the second half of 2011. One major success factor in this respect involves adjusting structures and processes in the light of the Bank's reduced size in tandem with significantly lowered costs. The Bank has made considerable progress in this respect this year.

One main element of the planned savings entails staff reductions, which were agreed upon at the end of 2011 and for which implementation commenced at the beginning of 2012. As a result, staff numbers (expressed as full-time equivalents) have dropped by a further 248 in the group since the end of 2011, currently standing at 3,436. Allowing for the redundancies for which contracts have already been signed and the inflow of new employees that only take effect after the reporting date (30 June), half of the reduction in staff numbers planned for the period until the end of 2014 has already been achieved. This forms the basis for a substantial decline in personnel expenses over the next few years.
Adjusted for the numerous companies which were consolidated for the first time in 2011, administrative expenses fell by EUR 22 million in the first half of the year; before this adjustment, a marginal increase to EUR 385 million was recorded.

Total expenditure for the provision of public guarantees decreased in the first half of the year to EUR 157 million (previous year: EUR 211 million). Of this, the bulk was accounted for by the second-loss guarantee issued by the states of Hamburg and Schleswig-Holstein. Due to the partial repayment of EUR 3 billion in 2011, which reduced the outstanding amount to EUR 7 billion, fee expenses for this guarantee dropped to EUR 141 (171) million. Total expenditure to date for the guarantee provided by the two states stands at EUR 1.725 billion. Expenditure of only EUR 16 million (previous year: EUR 40 million) arose in connection with guarantees of the Financial Market Stabilisation Fund (SoFFin).
In July 2012, the Bank repaid its final SoFFin-backed bond of EUR 3 billion on schedule. All told, HSH Nordbank has paid more than EUR 300 million over the entire term for the SoFFin facility, utilisation of which peaked at up to EUR 17 billion.

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Substantial increase in loan-loss provisions due to persistent shipping crisis - relief thanks to the effect of the guarantee

Loan-loss provisions were materially influenced by the escalation of conditions in international shipping, for which HSH Nordbank is one of the most important providers of finance. Contrary to original expectations, the crisis afflicting the sector has continued to worsen over the past few years due to softer growth in China, which has placed a damper on this country's ability to play its role as the main driving force for the global economy. On top of this, trading volumes between Europe and Asia have contracted substantially. As well as this, ship prices continued to drop in the second quarter accompanied by an unexpectedly large number of new ship deliveries. The muted sentiment in this sector and the unfavourable outlook are also reflected in declining orders for new ships and the rising number of reasonably young ships being scrapped. Moreover, the euro crisis is causing the US dollar to appreciate against the single currency, additionally resulting in an increase in loan-loss provisions in euro terms.

"The shipping industry, which is of great significance for Hamburg and the rest of Northern Germany - as well as the banks which finance it - face immense challenges. Despite the fact that the crisis afflicting international shipping is proving to be more protracted than originally hoped and we - like other banks - are feeling the effects in the form of a sharp rise in risk-related costs more severely than expected, we remain committed to our role as a reliable long-term partner to the maritime industry," Paul Lerbinger stressed.

As a result of the higher strain from restructuring commitments in the shipping portfolios, HSH Nordbank's loan-loss provisions rose to EUR -111 million in the first half of the year, compared with EUR 317 million in the same period of the previous year, in which it had been possible to release loan-loss provisioning. The figures reported already include the relief on the face of the balance sheet provided by the second-loss guarantee. This effect also includes items, strain from which is recorded within net trading income and net income from financial investments. All told, risk provisioning dropped by EUR 346 million in the first half of the year as a result of the securing action; this includes an additional premium of EUR -84 million imposed by the EU on the guarantee.

The relief provided for the Bank still does not involve any effective payment obligations for the federal states. Such obligations would not arise unless the actual loss sustained by the guaranteed portfolio were to exceed the first-loss tranche of EUR 3.2 billion borne by the Bank. However, the actual losses on the portfolio, which has been guaranteed since April 2009, stood at only around EUR 233 million at the end of June 2012, EUR 13 million more than at the end of the first quarter. Utilisation of the second-loss guarantee recorded on the face of the balance sheet increased unexpectedly sharply in the first half of the year due to necessary impairments on lending business and the appreciation of the US dollar, standing at EUR 1,956 million as of 30 June.

Capital ratios under strain - funding targets achieved

Despite ongoing deleveraging, HSH Nordbank's total assets rose slightly to EUR 138.1 billion (31.12.2011: EUR 135.9 billion) in the first half of 2012 due, among other things, to the sharp appreciation of the US dollar against the euro during this period.

As of the end of June, the Tier 1 capital ratio excluding hybrid instruments stood at 10.0 percent (31.12.2011: 10.3 percent) and thus remained higher than the regulatory minimum and the ratio of at least 9 percent prescribed by the European Banking Authority. The Tier 1 capital ratio including market risk positions came to 12.7 percent (31.12.2011: 13.8 percent). The decline in the equity ratios compared with the end of 2011 is due to the substantial increase in risk-weighted assets, which was only partially offset by measures to reinforce capital, the ongoing deleveraging of non-strategic portfolios and the second-loss guarantee. The main reason for the rise in risk-weighted assets was the renewed appreciation of the US dollar in the last few months and the crisis in the shipping industry, which has caused risk parameters to deteriorate significantly.

In the period from January to June 2012, HSH Nordbank was able to further reinforce its solid funding base. One key focus of issuing activity continued to involve the placement of unsecured bonds within the German savings banking system and with institutional investors. The sale of covered bonds was successful. The Bank's main issues included two benchmark mortgage-backed covered bonds, which were issued in March and May each with a volume of EUR 500 million for a term of five and four years, respectively. The issues met with a very broad demand on the part of national and international institutional investors. All told, the Bank's issuing activities for 2012 were above schedule as of the middle of the year.

Outlook

HSH Nordbank expects the underlying conditions for its business to remain challenging throughout the rest of 2012. Global economic growth is likely to continue losing momentum, while there is no swift solution in sight for the euro debt crisis, something which could cause the dollar to continue appreciating. In the wake of these unfavourable trends, uncertainty in the shipping industry has also strengthened. Accordingly, HSH Nordbank does not anticipate any rapid improvement in the situation and does not expect the industry cycle to bottom out for another twelve to 18 months. Currently, it does not see the emergence of any gradual recovery in freight rates, time charter rates and ship prices before the end of 2013.

Consequently, it projects a further increase in loan-loss provisioning. In the current environment, it is therefore likely to become more challenging for HSH Nordbank to fully achieve its financial targets despite the progress which it is making in implementing its strategy program. When it announced the figures for the first quarter of the year in May, the Management Board had already stated that the forecast for full-year net income was contingent upon the absence of any further escalation – like it has now happened - of the situation in international shipping.

In addition to resolutely continuing realignment, which was commenced in the previous year, the Bank is therefore now examining additional measures for lowering the increased risk potential and for achieving acceptable capital ratios on a sustained basis. The results of this examination are expected to be available in the course of the year. "We already have a number of possibilities for making adjustments and will be doing everything we can to cope with the additional challenges which lie ahead of us," Lerbinger insisted.

Despite this, the Bank expects to achieve additional progress in client business in the course of the year. "We are not allowing the recent obstacles to discourage us and will be remaining on our course undeterred," Lerbinger says. "The gradual implementation of the new business model is increasingly unleashing the desired effects even in the current very difficult market conditions and, looking forward, we will continue to systematically make use of the potential arising from the realignment of HSH Nordbank while strictly observing the EU stipulations."

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Income Statement (€m)	January to June 2012	Following Adjustment January to June 2011	Change in in %
Interest income	5.021	6.034	-17
Interest expenses	-4.486	-5.320	-16
Net income from hybrid financial instruments	-82	-79	-4
Net interest income	**453**	**635**	**-29**
Net commission income	44	61	-28
Result from hedging	9	-10	>100
Net trading income	-210	1	>-100
Net income from financial investments	152	118	29
Net income from financial investments accounted for under the equity method	-6	-56	89
Total income	**442**	**749**	**-41**
Loan loss provisions	-111	317	>100
Administrative expenses	-385	-382	1
Other operating income	265	13	> 100
Net income before restructuring	**211**	**697**	**-70**
Result from restructuring	-19	2	>-100
Expenses for government guarantees	-157	-211	-26
Net income before taxes	**35**	**488**	**-93**
Income tax expenses (-)/income (+)	35	-150	>-100
Group net income	**70**	**338**	**-79**
Group net income attributable to non-controlling interests	9	1	> 100
Group net income attributable to HSH Nordbank shareholders	61	337	-82

Other HSH Nordbank Group key figures	**30 June 2012**	**31 December 2011**
Total assets(€ bn)	138	136
Tier 1 capital ratio* (%)	12,7	13,8
Tier 1 capital ratio excl. hybrid financial instruments* (%)	10,0	10,3
Equity capital ratio* (%)	19,4	21,3
Employees**	3.436	3.684

* including the market risk positions; after adoption of interim results

** Full-time employees (FTEs)