Time running short for NordLB

NordLB's merger with Helaba or takeover by Commerzbank look to be off the table. The private equity bid is still very much in play but as time starts to run short, an emergency bailout by the savings banks association or a winding-up cannot be ruled out.

The flurry of excitement around a large-scale merger to end NordLB's woes looks to have been premature. Despite genuine interest and strong government support for a merger, neither Helaba nor Commerzbank have submitted bids to date.

Talk in particular of a merger between NordLB and Helaba had caught the imagination last autumn, with conjecture evolving quickly to include waves of later-stage mergers involving DekaBank, LBBW and Berlin Hyp to form a public-sector German banking behemoth. However, Helaba's management pulled out of the deal just before Christmas, not least because time is now too short to complete a transaction that would have involved extensive due diligence on both sides and would have had profound implications for their respective owners.

Nevertheless, a recapitalisation and merger with a stronger Landesbank would have been the most creditor-friendly solution as it would have created the potential to strengthen fundamentals long-term while maintaining the support of the savings banks group.

	NordLB	Helaba
Total Assets	154.8	171.7
Total Loans	93.9	94.4
Loan Deposit Ratio	151%	191%
Net Interest Margin*	0.96%	0.73%
Efficiency Ratio*	56%	70%
Problem Loan Ratio	8.90%	0.70%
Coverage Ratio	40%	62%
CET1 Ratio	11.80%	15.30%

* 3y average SNL, Scope calculations

In a December 3 update, NordLB confirmed it had received four bids from potential private investors. Very little is known about the details of these proposals. A sale of a minority stake is one of the "various far-reaching options" being considered by the state, which is eager to keep control of the bank. Cerberus and Centerbridge are openly discussed as being among the four, which are contemplating writing equity cheques of between EUR 3bn and EUR 4bn for a minority stake. Other interested bidders mentioned in dispatches had been Apollo and Advent.

However, the bank's owners – including the State of Lower Saxony (59.13%) and the regional savings banks associations (35.3%) – say they are "still open to models other than a minority participation by external investors and are continuing discussions with various partners". This could include carve-outs of services offered to discrete customer segments (such as retail and municipalities), or where NordLB acts as central bank. NordLB provides central services to its 66 regional savings banks.

Analyst

Dierk Brandenburg
d.brandenburg@scoperatings.com

Author

Keith Mullin
k.mullin@scopegroup.com

Investor Outreach

Debbie Hartley
d.hartley@scopegroup.com

Media

André Fischer
a.fischer@scopegroup.com

Related Research

More consolidation within German Landesbanken sector both overdue and welcome
31 October 2018

Scope Ratings GmbH

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Continued support

The State of Lower Saxony has signalled that it intends to continue supporting NordLB and has reportedly agreed in principle to recapitalise it by up to EUR 2.5bn. However, EU state-aid rules say this cannot be done without outside investors and a viable business plan to restore profitability. NordLB's other owners have already ruled out any further capital injections.

The scenario looking most likely now is the sale of a 49% stake to private equity investors. "Under this scenario, the State of Lower Saxony would retain 51% and the savings banks would probably try to exit," said Dierk Brandenburg, executive director in the banks team of Scope Ratings, "possibly in exchange for a stake in NordLB's retail subsidiary BLS, which uses the savings bank brand."

While an exit will not in itself immediately discharge the savings banks from their liabilities under NordLB's support scheme, Brandenburg says it nevertheless weakens the link between the savings banks and NordLB going forward.

"A scenario where the state further reduces its stake in coming years can't be ruled out," Brandenburg added. "NordLB will most likely exit the support mechanism after a transition period, like HSH did following its full privatisation in 2018. Thus, going forward, even under a partial privatisation, NordLB's creditors may no longer benefit from the savings banks sector's support mechanisms."

Accepting private investors will be complicated because NordLB is a public sector entity. To save time, NordLB is considering establishing a holding company that would issue mandatory convertible notes to outside investors. While these notes could in theory qualify as CET1, no term sheet is yet available to assess the transaction.

"On the plus side, as well as pushing for a significant revaluation and subsequent sale of the shipping portfolio before injecting any fresh funds into the bank, new investors will demand that management trims the cost base more aggressively," said Brandenburg. Cerberus, for example, is targeting a 40% efficiency ratio at HSH Nordbank compared to the 70% reported by NordLB in 2018.

"Thus, while very painful for existing owners of NordLB's equity and hybrid instruments, a recapitalisation will improve credit fundamentals. This will limit the downside for creditors, though it would take time before any restructuring yields results," Brandenburg said.

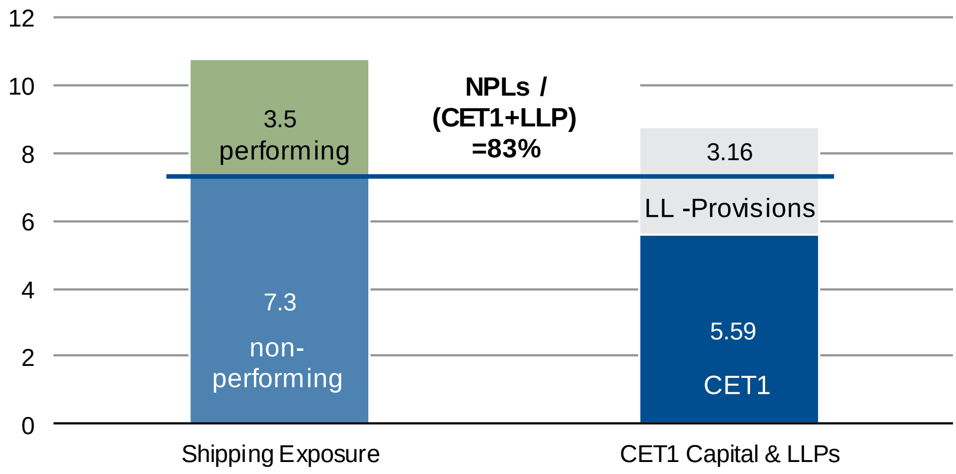
With a merger with Commerzbank or Helaba seemingly off the table, the only other alternative to a minority sale is a winding up of NordLB. As there is very little time left to find an alternative solution, this option remains open, and would push NordLB down the path of WestLB or Hypo Alpe Adria Bank. Under the wind-up scenario, owners risk losing their entire EUR 5.7bn investment in NordLB, and the savings banks' support mechanism would be called upon in case losses exceeded the equity base.

"Like at HSH, the owners are well incentivised to avoid such a scenario as they would lose control of the process while remaining on the hook for any losses," said Brandenburg. "The downside for junior creditors would be considerable," he added.

Shipping portfolio sales

A critical component of any plan for NordLB is dealing with the bank's heavy shipping exposure. Material progress has reportedly been made in recent weeks to offload two large portfolios to Cerberus, split into EUR 3.9bn and EUR 2.5bn blocks. Concluding those sales would take the bank's shipping exposure (EUR 10.8bn as of end-September 2018) below management's target of EUR 5bn by the end of 2019.

Figure 1: NORD/LB Exposure to Shipping Loans



Of the EUR 10.8bn still on the balance sheet at end-September, EUR 7.3bn was non-performing (with 43% coverage, excl. collateral). Shipping NPLs represent 83% of the bank's combined CET1 capital & provisions. The equity injection and sale of the shipping loans are inextricably linked, bearing in mind the hit to NordLB's capital once the bank offloads the heavily-discounted loans.

"The value of the loans in a sale is likely to be significantly below their book value and the expectation is that NordLB would crystallise significant losses upon exit," said Brandenburg.

"For example, if the entire shipping NPLs were to be sold at an average price of 40 cents or less, NordLB would lose well over EUR 1bn. Such losses would have been in excess of pre-provision operating income in 2018 so would have eaten into regulatory capital (partly offset by a reduction in risk-weighted assets)."

Those expenses come on top of already announced restructuring charges. Thus, it is no surprise that regulators are urging the bank to complete its capital raise ahead of its full-year results.

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Paris
1 Cour du Havre
F-75009 Paris

Phone +33 1 82 88 55 57

London
Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid
Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo
Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

Disclaimer