

FIG
 Diversified Financial Services
 Equity – Germany

German small-cap financials

Preview for Q3 results: not so bad, we think

- ▶ **Baader is likely to show improved Q3 results, whereas DAB's results might still be negatively impacted by difficult capital markets and low interest rate environment**
- ▶ **Market sentiment was relatively in line with expectations and we keep our EPS forecasts unchanged**
- ▶ **Maintaining our Overweight (V) rating for Baader Bank with a TP of EUR2.5, we still prefer Baader over DAB bank with a Neutral rating and a TP of EUR3.6**

Baader Bank (BLMG.DE, EUR1.94, Overweight (V), TP EUR2.5) will report its Q3 results on 23 October, and we expect a small profit owing to a strongly improved trading result. The net profit of EUR2.4m should be up q-o-q as well as y-o-y.

DAB bank (DRNG.DE, EUR3.50, Neutral, TP EUR3.6) will also report on 23 October 2012 with an expected Q3 net profit of EUR3.7m being down q-o-q and also y-o-y but our forecasts are still 3% above VARA consensus. We think that DAB should meet its FY2012 guidance and exceed last year's pre-tax profit level of EUR25.7m largely owing to a strong H1 2012. This has also been confirmed by CEO Huber in a recent newspaper interview.

Valuation for Baader Bank: We maintain our target price of EUR2.5, which is based on our 2013 forecasts. As this target price implies a 29% potential return, we reiterate our Overweight (V) rating. The 2011a yield of 1.5% is just a minor add-on, but overall we believe the stock offers a better risk/reward profile.

Valuation for DAB bank: We have a target price of EUR3.6, which is based on our 2013 forecasts. At the time we set our target price, it suggested a potential return which was within the Neutral band and hence we have a Neutral rating. The company is currently trading at 14.7x and 11.9x based on our 2012 and 2013 EPS forecasts, which does not seem cheap to us. However, the high tax-free dividend yield of 6.3% in 2011a is a supporting argument to hold the shares.

Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Catalysts and risks: Any significant change in equity and bond trading volumes always has some effect on the prices of those two stocks. Furthermore, the quarterly results can often surprise as neither stock is followed by many analysts or investors. The main risks are a severe decline in trading activity and an unexpected change in interest rates, which could negatively affect the companies' treasury operations.

22 October 2012

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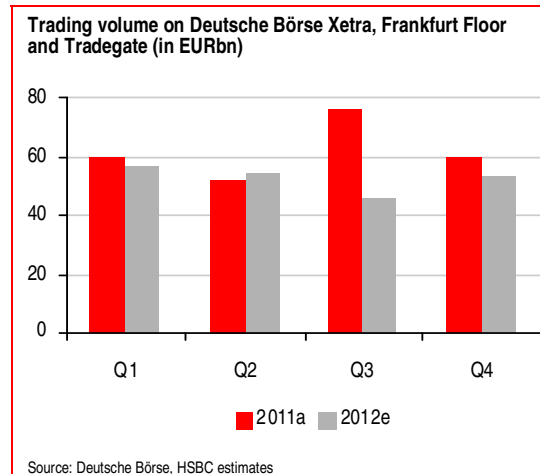
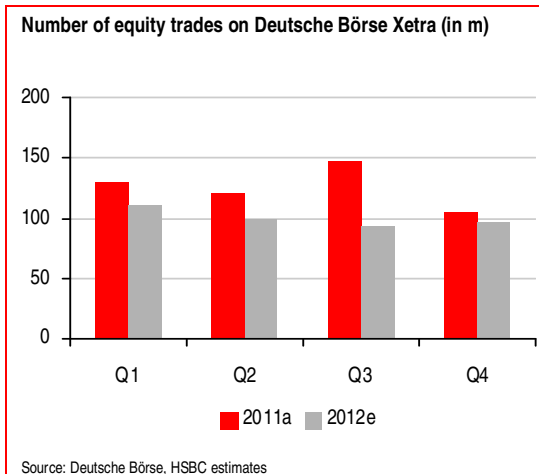
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Activity on German equity markets declines

The business of both companies is heavily dependent on market conditions and market volumes with turnover/trading volume being a better indicator than number of Xetra trades because these are distorted by the high level of high-frequency trading. The retail investor has become more inactive in Q3 2012 due to seasonal effects, which hurts volumes on Frankfurt floor as well as OTC trading. Furthermore, Q3 2011 was driven by massive sell-off.

Baader Bank will show improved Q3 results

Baader Bank will report its Q3 results on 23 October, and we expect a return to profitability after loss in Q2 2012 due to strongly improved trading income which is coming back to more normalised levels. Net interest income after risk provisioning is expected to remain relatively stable despite the effect that the ECB lowered the central rate in July because of a higher deposit base. The operating expenses should slightly increase due to hosting of the Baader Investment Conference and thus reduce the trading result's positive impact on the net result. There is no consensus available for the company.

Preview for quarterly results of Baader Bank

in EURm	Q3 11a	Q2 12a	Q3 12e	QoQ	YoY
Net interest income	2.0	2.3	2.4	3%	19%
Risk provisions	-5.5	1.7	0.5	-71%	109%
Net fees/commissions	7.6	10.3	10.0	-3%	31%
Trading profits	8.2	3.7	12.0	221%	47%
Operating expenses	-21.8	-21.3	-22.1	-3%	-1%
Pre tax result	-9.0	-3.2	2.8	187%	131%
Net result	-9.3	-3.4	2.4	170%	126%

Source: Company data, HSBC estimates

Valuation and risks for Baader Bank

We use an equity value model to compute our target price of EUR2.5, which is based on our 2013 forecasts. We divide our ROE estimate of 10.5% (was 10.8%) by our slightly lower cost of equity (COE) of 11.7% (11.9% before), which is calculated using the CAPM approach, including a risk-free rate of 3.0%, a 6.0% risk premium and a beta of 1.45 (versus 1.49 before) owing to the changing risk profile. We multiply this factor by the estimated book value of EUR2.64 per share and add the 2012e dividend estimate of EUR0.08 to arrive at our rounded target price of EUR2.5.

Baader Bank valuation model

EUR	2012e	2013e	2014e
RoE	10.0%	10.5%	12.7%
CoE	11.7%	11.7%	11.7%
Book multiplier	0.86	0.90	1.09
Book value	2.45	2.64	3.00
Business Value	2.10	2.37	3.25
Dividends	0.08	0.08	0.08
Fair Value	2.2	2.5	3.3
Potential return*	15%	29%	75%
Price/book	0.77	0.72	0.63

*Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated
Source: Company data, HSBC estimates

Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for eurozone stocks of 9.0%. Our 12-month target price of EUR2.5 implies a potential return of 29% which is above the Neutral band; we therefore reiterate our Overweight (V) rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

The main downside risks to our Overweight (V) rating on Baader Bank are: a renewed decline in trading activity, which could harm future revenue development. An unexpected change in interest rates could have a negative impact on the success of the bank's treasury operations. Furthermore, a failure of the bank's IT platform could frustrate clients and damage its business model as this is one of its critical success factors. The low liquidity of Baader Bank's own shares is also a risk. Transparency has reduced with the shift in reporting standard from IFRS to German GAAP (HGB). Last, but not least, the high degree of control by, as well dependence on, CEO Uto Baader remains an investment risk.

DAB's Q3 results should be down again after Q1 and Q2 2012

DAB bank will report its Q3 results on 23 October 2012 with an expected Q3 net profit of EUR3.7m being down q-o-q as well as y-o-y. We are 3% above VARA consensus. Due to a change in the treatment of income from interest rate swaps, the bank will show a shift of income from net interest to net commission income and we adjust our forecasts accordingly.

Changes to our forecasts for DAB bank

in EURm	New 12e	Old 12e	Diff.	New 13e	Old 13e	Diff.	New 14e	Old 14e	Diff.
Net interest income	54.0	56.0	-4%	56.0	60.0	-7%	60.0	64.0	-6%
Net commission income	76.5	75.6	1%	88.2	84.8	4%	98.1	94.3	4%
Results from trading and investments	10.0	8.0	25%	7.0	6.8	4%	5.5	5.5	0%
Operating earnings	140.4	139.5	1%	151.0	151.3	0%	163.2	163.5	0%
Administrative expenses	112.3	111.1	1%	116.4	116.4	0%	121.5	121.5	0%
Pre tax result	28.6	28.9	-1%	35.3	35.6	-1%	42.7	43.0	-1%
Net result	19.7	19.9	-1%	24.4	24.6	-1%	29.4	29.6	-1%
EPS	0.24	0.24	-1%	0.29	0.30	-1%	0.36	0.36	-1%
Transactions (m)	4.50	4.50	0%	4.90	4.90	0%	5.30	5.30	0%

Source: Company data, HSBC estimates

Besides the accounting effect, we expect weaker net interest income as the bank should also see weaker interest margins due the negative impact from declining rates. The net commission income should be stronger owing to higher expected trading activity. The results from trading and investments are expected to decline q-o-q as we expect profits from investment to be on lower level than in the previous quarter. Operating costs should be relatively unchanged except for higher personnel expenses as management board member Markus Gunter left the company at the end of July. DAB CEO Ernst Huber management confirmed their guidance for 2012 results in an interview with Börsen-Zeitung on 16 October 2012. The company still expects to be in line with its 2012 guidance due to better Q4. We expect a 2012 pre tax result of EUR28.6m which is in line with the company's guidance of EUR28.3-29.6m.

DAB bank quarterly results

EUR	Q3 11a	Q2 12e	Q3 12e	QoQ	YoY	VARA	diff
Net interest income	13.6	13.5	12.0	-11%	-12%	12.3	-3%
Net commission income	22.9	16.7	18.8	13%	-18%	17.9	5%
Results from trading and investments	-0.7	4.1	2.5	-38%	-484%	1.4	84%
Operating earnings	35.8	34.5	33.2	-4%	-7%	31.6	5%
Operating costs	29.2	27.1	28.0	3%	-4%	27.4	2%
Pre tax result	6.7	7.5	5.4	-27%	-18%	5.3	2%
Net result	4.3	5.2	3.7	-29%	-13%	3.6	3%
No. of trades (m)	1.47	1.00	1.08	8%	-27%	1.0	9%

Source: Company data, HSBC estimates, VARA consensus

DAB bank's management team will host a conference call the same day at 14:00 CEST. To access the conference, please dial: +49 69 247501895 for Germany, +44 203 3679216 for UK and +1 408 9169838 (US). No PIN is required.

Valuation and risks for DAB bank

We use our equity value model to calculate our unchanged target price of EUR3.6, which is based on our 2013 forecasts. First, we divide our reduced ROE forecast of 11.7% (was 12.0%) by our cost of equity (COE) of 11.2% (was 11.5%), calculated by using the CAPM (capital asset pricing model) approach, which includes a risk-free rate of 3.0%, a 6.0% risk premium and a beta of 1.36 (versus 1.41 previously) due to a change in revenue mix. We multiply this factor by the estimated tangible book value of EUR2.54. Finally, we add the 2012e dividend estimate of EUR0.23 and the estimated add-on value for existing customer relationships to arrive at our rounded target price of EUR3.6.

DAB bank valuation model

	2012e	2013e	2014e
RoE	10.1%	11.7%	13.6%
CoE	11.2%	11.2%	11.2%
Multiplier	0.90	1.05	1.22
Equity capital per share	2.48	2.54	2.67
Business value	2.24	2.67	3.26
Add-On for customers	0.69	0.69	0.69
Dividend 2012e	0.23	0.23	0.23
Fair value per share	3.2	3.6	4.2
Potential return*	-9%	3%	20%

*Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated
Source: Company data, HSBC estimates

Under our research model for stocks without a volatility indicator, the Neutral band is five percentage points above and below the hurdle rate for eurozone stocks of 9.0%. At the time we set our 12-month target price of EUR3.6, it implied a potential return which was within the Neutral band, and as such our rating is Neutral. Potential return equals the percentage difference between the current share price and the target price including the forecast dividend yield when indicated.

Key downside risks to our Neutral stance are: a significant decline in trading activity, which would harm revenue development. A further cut in interest rates could have an additional negative impact on the bank's treasury operations. The treasury operations can also be burdened by further impairments needed for the bank's peripheral sovereign holdings. A failure of the bank's IT platform could undermine client satisfaction and damage its business model. Finally, the low liquidity of DAB bank's own shares remains an investment risk.

Key upside risks include better development in trading activity over the next few months and higher than currently expected interest rates by the European Central Bank, which would boost net interest income.

Financials & valuation: Baader Bank

Overweight (V)

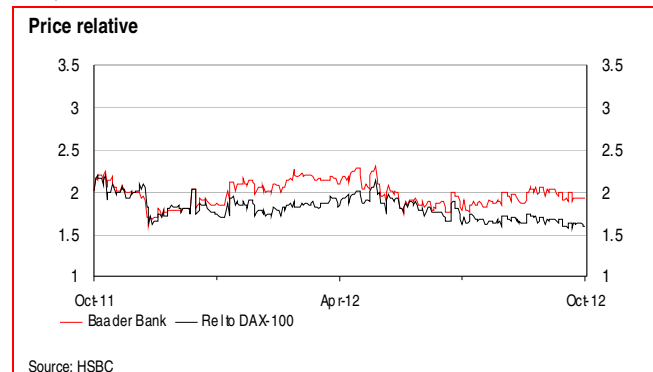
Financial statements				
Year to	12/2011a	12/2012e	12/2013e	12/2014e
P&L summary (EURm)				
Net interest income	6.9	8.8	10.0	11.2
Net fees/commissions	31.2	41.0	50.0	56.0
Trading profits	46.3	43.0	54.0	59.0
Other income	1.5	0.0	0.0	0.0
Total income	85.9	92.8	114.0	126.2
Operating expense	-90.6	-92.2	-98.6	-105.0
Bad debt charge	5.7	12.0	-1.0	-2.0
Other	0.0	0.0	0.0	0.0
HSBC PBT	1.0	12.6	14.4	19.2
Exceptionals	0.0	0.0	0.0	0.0
PBT	1.0	12.6	14.4	19.2
Taxation	-0.1	-1.5	-1.7	-2.3
Minorities + preferences	-0.2	-0.3	-0.4	-0.5
Attributable profit	0.7	10.8	12.3	16.4
HSBC attributable profit	0.7	10.8	12.3	16.4
Balance sheet summary (EURm)				
Ordinary equity	103.2	112.6	121.2	137.6
HSBC ordinary equity	103.2	112.6	121.2	137.6
Customer loans	21.1	21.0	26.0	31.0
Debt securities holdings	213.6	250.0	265.0	280.0
Customer deposits	316.6	320.0	340.0	360.0
Interest earning assets	391.7	320.4	336.0	366.0
Total assets	535.8	525.0	570.0	615.0
Capital (%)				
RWA (EURm)	275.4	302.7	323.9	345.2
Total capital	33.1	34.2	34.6	37.2
Ratio, growth & per share analysis				
Year to	12/2011a	12/2012e	12/2013e	12/2014e
Year-on-year % change				
Total income	-20.2	8.1	22.8	10.7
Operating expense	2.3	1.8	6.9	6.5
Pre-provision profit	-124.9	-112.7	2466.7	37.7
EPS	-95.9	1524.0	13.8	33.6
HSBC EPS	-95.9	1524.0	13.8	33.6
DPS	-74.6	166.7	12.5	33.3
NAV (including goodwill)	-39.9	9.1	7.6	13.5
Ratios (%)				
Cost/income ratio	105.5	99.4	86.5	83.2
Bad debt charge	-20.6	-57.0	4.3	7.0
Customer loans/deposits	6.7	6.6	7.6	8.6
ROE (including goodwill)	0.5	9.8	10.3	12.5
Per share data (EUR)				
EPS reported (fully diluted)	0.01	0.23	0.27	0.36
HSBC EPS (fully diluted)	0.01	0.23	0.27	0.36
DPS	0.03	0.08	0.09	0.12
NAV	1.33	1.60	1.79	2.14
NAV (including goodwill)	2.25	2.45	2.64	3.00

Valuation data				
Year to	12/2011a	12/2012e	12/2013e	12/2014e
PE*	133.4	8.2	7.2	5.4
Pre-provision multiple		147.7	5.8	4.2
P/NAV	1.5	1.2	1.1	0.9
Equity cash flow yield (%)	4.6	10.0	12.2	16.8
Dividend yield (%)	1.6	4.1	4.7	6.2

Note: * = Based on HSBC EPS (fully diluted)

Issuer information			
Share price (EUR)	1.93	Target price (EUR)	2.50
Reuters (Equity)	BLMG.DE	Bloomberg (Equity)	BWB GR
Market cap (USDm)	116.3	Market cap (EURm)	88.6
Free float (%)	33		
Country	Germany	Sector	Diversified Financial Services
Analyst	Johannes Thormann	Contact	+49 211 910 3017

Notes: price at close of 17 Oct 2012



Note: price at close of 17 Oct 2012

Financials & valuation: DAB Bank

Neutral

Financial statements

Year to	12/2011a	12/2012e	12/2013e	12/2014e
P&L summary (EURm)				
Net interest income	53.2	54.0	56.0	60.0
Net fees/commissions	85.6	76.5	88.2	98.0
Trading profits	0.1	10.0	7.0	5.5
Other income	0.7	0.5	0.7	0.9
Total income	139.6	141.0	151.9	164.4
Operating expense	-113.1	-112.3	-116.4	-121.5
Bad debt charge	0.0	-0.1	-0.2	-0.3
Other	0.0	0.0	0.0	0.0
HSBC PBT	26.5	28.6	35.3	42.7
Exceptionals	-0.7	0.0	0.0	0.0
PBT	25.7	28.6	35.3	42.7
Taxation	-8.0	-8.9	-10.9	-13.2
Minorities + preferences	-0.5	0.0	0.0	0.0
Attributable profit	17.3	19.7	24.4	29.4
HSBC attributable profit	18.0	19.7	24.4	29.4

Balance sheet summary (EURm)

Ordinary equity	185.4	204.8	210.4	221.1
HSBC ordinary equity	185.4	204.8	210.4	221.1
Customer loans	267.3	290.0	310.0	330.0
Debt securities holdings	2483.0	2770.0	2980.0	3190.0
Customer deposits	3061.3	3725.0	4100.0	4475.0
Interest earning assets	0.0	0.0	0.0	0.0
Total assets	3406.2	4100.0	4500.0	4900.0

Capital (%)

RWA (EURm)	786.5	989.0	1081.0	1173.0
Core tier 1	15.2	13.8	12.6	11.6
Total tier 1	15.2	13.8	12.6	11.6
Total capital	15.2	13.8	12.6	11.6

Ratio, growth & per share analysis

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Year-on-year % change				
Total income	-7.9	1.0	7.7	8.3
Operating expense	-5.0	-0.7	3.6	4.4
Pre-provision profit	-18.6	8.2	23.8	21.0
EPS	5.0	14.1	23.6	20.9
HSBC EPS	9.5	9.4	23.6	20.9
DPS	10.0	2.9	23.6	20.9
NAV (including goodwill)	10.5	10.4	2.8	5.1
Ratios (%)				
Cost/income ratio	81.0	79.6	76.6	73.9
Bad debt charge	0.0	0.1	0.1	0.1
Customer loans/deposits	8.7	7.8	7.6	7.4
NPL/loan	0.0	0.1	0.1	0.1
ROE (including goodwill)	10.2	10.1	11.7	13.6

Per share data (EUR)

EPS reported (fully diluted)	0.21	0.24	0.29	0.36
HSBC EPS (fully diluted)	0.22	0.24	0.29	0.36
DPS	0.22	0.23	0.28	0.34
NAV	1.93	2.14	2.21	2.33
NAV (including goodwill)	2.24	2.48	2.54	2.67

Core profitability (% RWAs) and leverage

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Net interest income	6.8	6.1	5.4	5.3
Trading profits	0.0	1.1	0.7	0.5
Other income	0.1	0.1	0.1	0.1
Operating expense	-14.5	-12.7	-11.2	-10.8
Pre-provision profit	3.4	3.2	3.4	3.8
Bad debt charge	0.0	0.0	0.0	0.0
HSBC attributable profit	2.3	2.2	2.4	2.6
Leverage (x)	4.4	4.6	5.0	5.2
Return on average tier 1	15.1	14.5	17.9	21.6

Valuation data

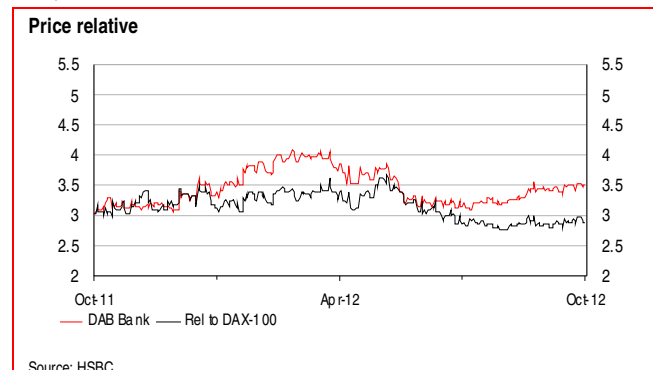
Year to	12/2011a	12/2012e	12/2013e	12/2014e
PE*	16.1	14.7	11.9	9.8
Pre-provision multiple	10.9	10.1	8.1	6.7
P/NAV	1.8	1.6	1.6	1.5
Equity cash flow yield (%)	5.9	1.9	6.2	7.9
Dividend yield (%)	6.3	6.5	8.0	9.7

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (EUR)	3.50	Target price (EUR)	3.60
Reuters (Equity)	DRNG.DE	Bloomberg (Equity)	DRN GR
Market cap (USDm)	379.8	Market cap (EURm)	289.5
Free float (%)	24		
Country	Germany	Sector	COMMERCIAL BANKS
Analyst	Johannes Thormann	Contact	+49 211 910 3017

Notes: price at close of 17 Oct 2012



Note: price at close of 18 Jul 2012

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Johannes Thormann

Important disclosures

Stock ratings and basis for financial analysis

HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

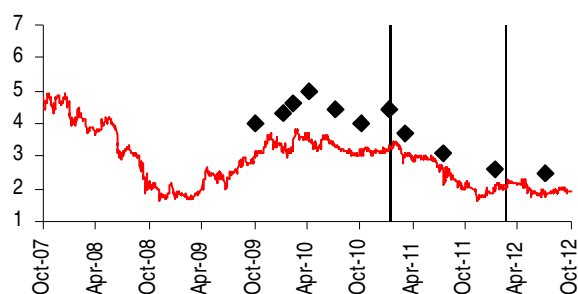
As of 18 October 2012, the distribution of all ratings published is as follows:

Overweight (Buy)	46%	(27% of these provided with Investment Banking Services)
Neutral (Hold)	39%	(26% of these provided with Investment Banking Services)
Underweight (Sell)	15%	(20% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Baader Bank (BLMG.DE) Share Price performance EUR Vs HSBC rating history

history



Source: HSBC

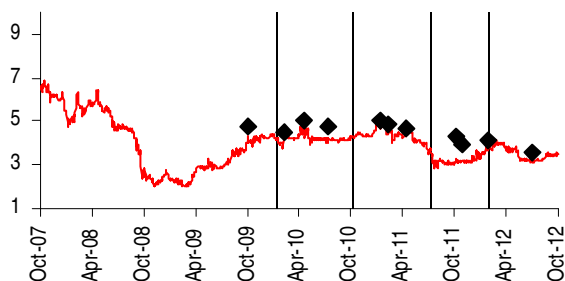
Recommendation & price target history

From	To	Date
Overweight (V)	Overweight	25 January 2011
Overweight	Overweight (V)	02 March 2012
Target Price	Value	Date
Price 1	4.00	23 October 2009
Price 2	4.30	26 January 2010
Price 3	4.60	26 February 2010
Price 4	5.00	28 April 2010
Price 5	4.40	22 July 2010
Price 6	4.00	20 October 2010
Price 7	4.40	25 January 2011
Price 8	3.70	24 March 2011
Price 9	3.10	03 August 2011
Price 10	2.60	31 January 2012
Price 11	2.50	19 July 2012

Source: HSBC

DAB Bank (DRNG.DE) Share Price performance EUR Vs HSBC rating history

history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Neutral (V)	26 January 2010
Neutral (V)	Neutral	26 October 2010
Neutral	Overweight	26 July 2011
Overweight	Neutral	14 February 2012
Target Price	Value	Date
Price 1	4.80	20 October 2009
Price 2	4.50	23 February 2010
Price 3	5.00	05 May 2010
Price 4	4.80	27 July 2010
Price 5	5.00	26 January 2011
Price 6	4.90	02 March 2011
Price 7	4.70	04 May 2011
Price 8	4.30	26 October 2011
Price 9	3.90	18 November 2011
Price 10	4.10	14 February 2012
Price 11	3.60	19 July 2012

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
BAADER BANK	BLMG.DE	1.93	17-Oct-2012	6, 11
DAB BANK	DRNG.DE	3.50	17-Oct-2012	6, 11

Source: HSBC

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