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Transcript

Speakers:
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Mate Nemes: Good morning, everyone. My name is Mate Nemes. I'm a financial analyst at UBS. It is my pleasure to welcome James von Moltke, Chief Financial Officer of Deutsche Bank with us. James, thank you for joining us.

James von Moltke: Mate, thank you for having me this morning. Good morning to you all.

Mate Nemes: So James, it's only fitting, I think, to start perhaps with a quick recap of Q3 results. We're a couple of weeks after the results day. I was wondering if you could walk us through perhaps the key highlights, the positives and also the negatives of your Q3 results. Where are you in the process? And I think you also updated your guidance for the last quarter. If you could just give us a sense, what has changed and what do you expect in the remainder of the year?

James von Moltke: Sure, happy to. So I think if I take a big step back, what we're seeing in 2023 is the value of the work we've done over the past four years to put our four businesses on a sustainable footing and work hard on expenses as well. So you've seen through the first nine months of the year about a 6% top line growth that was pretty consistent with that in the third quarter and expenses growing about 2% if you look at the operating expense base.

So we're pleased with that overall development, and it's across the four businesses, especially driven by growth in the deposit rich businesses of the Private Bank and the Corporate Bank. So they're benefiting obviously from the interest rate environment. We think the other two businesses, the Investment Bank and Asset Management, are actually trading well in what has been a mixed at best financial market environment. And again, you saw that a little bit year-on-year. Those businesses are down, but we think performing well in the market environment.

Credit has remained relatively stable over the course of the year. We're on track to guidance that we'd given the beginning of the year, 25 to 30 basis points of average loans. We think we'll be at the high end, maybe 29, 30 basis points for the full year. And in terms of our outlook, we continue to see it slightly elevated, but steady. On the cost side, we're continuing to work hard to executing our cost plans.

We've announced a total target over the next several years, really through 2025 and perhaps a little bit beyond, of 2.5 billion euros of cost takeout, essentially offsetting investments and also inflation. And we're tracking against that, and so you're seeing that incrementally show up in the cost base and the run rate. That's something that we're working to continue for the balance of the year, essentially driving operating leverage by growing revenues and keeping expenses essentially flat, as flat as possible.

The big highlight from our Q3 results was capital. We've been going through a period of needing to build capital for what we call reg inflation, so changes in models, rules, methodologies that over the last several years has been a significant headwind for us, in addition to some of the restructuring and transformation charges we've been taking over the last few years. And we broke free a little bit from that in the third quarter.

In fairness, if I'm honest, surprising ourselves by some of the model results as we've had a model that was approved or a couple of models approved by the ECB that now puts most of that inflation behind us. But also, how quickly and effectively we've been able to look at some optimization steps inside the complex capital calculation. So at a 13.9% CET1 ratio, Common Equity Tier 1 ratio, we've reached a point where we're not climbing the hill anymore on capital. And it means that our distribution paths are well within reach at this point with the goals that we set for the market.

In fact, as we said, we think we can probably accelerate and expand the distribution path. So overall, I think the shape of Q3 in the first nine months was quite encouraging. As you said, we provided some guidance. We're on track to do about 29 billion euros of revenues this year, which we think is encouraging. We're working, as I say, to keep expenses essentially flat. I mentioned the credit guidance. And the one other thing that we talked about on the third quarter call was some unusual items that are going to come into the fourth quarter for us.

One is an impairment of the goodwill that we take on in the Numis transaction, which is about 250 million euros. Like we had last year, we think we will revalue deferred tax asset attributes up, which we'd estimate at this point is about 500 million euros. We talked about restructuring and severance, and I'll come back to some of the drivers perhaps a little bit later, but that number we now estimate between 300 and 350 million euros, so higher than we guided before.

And then there's still some uncertainty over whether we will be successful in recognizing the restitution of a resolution fund payment that stems from the early part of the last decade and that we've been in discussions to have restored to the banking industry. There's still some uncertainty around that item. So three, four items that will be moving around our fourth quarter results, but we think, depending on how they all fall, net to the positive. So still some work to do in the fourth quarter on those things.

Mate Nemes: I wanted to pick up on one of the topics you mentioned, which is capital. You mentioned this was the biggest positive, and I think you mentioned or you announced that you see another 3 billion euros additional capital relief until 2025. So you have currently an 8 billion euros distribution envelope or distribution target.

And on top of that, you found another 3 billion euros relief. Could you give us some sense how should we think about that 3 billion euros in terms of distributions, allocations, what part of that could be coming back to shareholders on top of the 8 billion euros and what happens with the remainder? Where do you see investment opportunities?

James von Moltke: It's a great question and a real driver at the moment of investors' assessments of banks. Given that as an industry, we've put ourselves in an excess capital position after a lot of hard work building on things like Basel III. So for us, I mentioned the model piece where we're surprised to the upside and some of the work we're doing on optimization.

The third element of what we discovered in the third quarter was that our estimates of the Basel III, the final framework for Basel III, a big portion of which goes live on the 1st of January 2025, at least based on the current legislative discussions, that our estimates have been too conservative. So we'd been estimating between 25 and 30 billion euros of risk weighted assets to come on on that date, and we now think it's closer to 15 billion euros. So the combination of model improvements, optimization and a raised target on optimization.

Earlier we were thinking 15 to 20 billion euros, and you now think it's maybe 10 billion euros higher than that. And the Basel III, as you say, translates into about 3 billion euros of capital, better than we were expecting. So if I take you back to the commitment we've made on distributions, and this is at investor day back in March of last year, we talked about 8 billion euros of capital coming out in respect of the years 2021 to 2025, meaning paid in the years 2022 to 2026. And that that cumulative distribution would be 8 billion euros.

It was based on a very clear ramp on dividends, 50% up a year, which we've now done the second installment of this year at 30 euro cents. We've advertised that next year would be 45 euro cents. And so far our repurchase history, 300 million euros last year, 450 million euros this year, that's been tracking that 50% increase. And if you just do the maths on that, if we continue that for a couple more years, we would at least achieve the 8 billion euros. And then to your question, of the 3 billion euros, how much more would come out in distributions and how much would be reinvested in the business?

Honest truth, it's too early to say because first of all, we're in discussions with the ECB on what our at least initial repurchase next year would be, how we'd size that and get it approved. So we'd intend to announce that with fourth quarter earnings on the 1st of February. And the point is it's against that trajectory that when we talk about accelerate and expand, what we mean is would we do more earlier on this trajectory I just outlined and would we result in something larger than 8 billion euros?

And I think on both of that, we're reasonably confident that we can deliver more than we originally promised while still investing in the businesses. And I know this is a debate we have with investors a lot is the value of distributions today versus investments in the business which we think can drive enhanced distributions and improved returns over time. It's always a balance, and we recognize that at least at the moment, the balance that investors are looking for is more distributions. And so that's certainly informing our thinking.

To your point, we do see investment opportunity. Right now loan growth has been sluggish this past four or five quarters. We think it's going to accelerate going into 2024 and certainly we would want to do that to grow our businesses, support clients. And from time to time, as we saw with the Numis transaction, there are opportunities to acquire. But as I say, there's a balance to be drawn and we've listened to investors' perspectives, so you'd expect a significant amount of the 3 billion euros we found to come out as distributions.

Mate Nemes: That's great. So as you mentioned, I think distributions is clearly one aspect of bank analysts or bank assessment, which is very topical these days. The other one is certainly NII. And so I wanted to discuss that with you. If you could give us a sense of NII and net interest margin development for the group and also perhaps the individual businesses, the Corporate Bank and also the Private Bank, what shall they expect going into next year?

And also if you could perhaps give us a sense how deposit path through rate, the replication portfolio interacts, and then what is the path from here?

James von Moltke: Well, it's a fascinating environment we're in. If you're a lover of interest rate risk models, this has been the most fascinating environment to live through. To give you a sense of the opportunity that presented itself in 2023, we assumed coming into the year that the uplift from interest rates and perhaps some retention of interest rate movements, known as the beta, so the percentage that's passed through to clients, would offer perhaps a billion euros of incremental revenues.

The models said 900 million euros. In the end, it was 2 billion euros. The actual rate path and the pass through outcome versus what the models would've told was worth about a billion euros in revenues, which is... Now, as you know, Mate, you're referring to there's been a pretty spirited discussion between the industry and investors and analysts, how much of that pass through piece will retrace and how big is it and how quickly will it retrace? And to be honest, it's been hard to give concrete answers to that because the reality is the models have just proven wrong so far.

So why would we rely on that going forward? As we're looking at it now, we do see a continued convergence with the models, what we'd expect in terms of pass through. And if that happens, we would be looking at retracing about 500 million euros of the, I'll call it the benefit this year that arose, and maybe a little bit more in Treasury. But in the businesses, 500 million euros. What's going to happen though over the next year or two years as you say is the replicating portfolios. So the longer term hedges of the deposit books will start to assert themselves.

So after a little bit of a dip in 2024, in 2025 and beyond, we would expect to see that value begin to show up, or not expect to see we've now hedged the books in order to produce revenues that would then start to grow again in the interest rate side. I think people have been focused on the dip rather than that the industry's now at a more healthy, sustainable interest rate environment that's supportive of the businesses. That shows up in margin terms.

I think with healthy margins in the Corporate Bank and the Private Bank, they will contract next year and you'll see more of that in the Corporate Bank than Private Bank, but generally in an environment that is much healthier for the businesses and for the value of the deposit books if you like.

Mate Nemes: Makes a lot of sense. Shifting gears a little bit, I think over the last couple of quarters you've been quite excited about non-NII revenues and opportunities for non-NII revenue growth. Could you share some of the details around that? Again, in the Private Bank and in the Corporate Bank. Where is this growth coming from?

And also I think if I just think back to Q2 and Q3 earnings calls, you've been expecting a clear pickup or recovery in O&A revenues. Is that naturalizing? What is the opportunity there? Is that wallet share growth? Is it doing business with a larger client base? How do you think about that?

James von Moltke: Well, Mate, we think we're very well positioned for recovery in non-interest revenue. And so while the focus over the past year, year and a half has been on the interest rate piece of the revenue growth story and a little bit on what we might retrace next year, we think the industry is poised for a resurgence of non-interest revenues. This year has been, relatively speaking, a weak year for non-interest revenues driven by another number of things. There's volumes in the marketplace and the financial market environment that I spoke about earlier. So what do we see taking place next year?

We think we are positioned for revenue growth next year. We started to talk about a ballpark of 30 billion euros next year where non-interest revenues offset the pressure that I described on the interest revenue side. Deutsche Bank, we have a lot of sources of non-interest revenues. If I think about the business, the Corporate Bank has custody business, trust and agency services, fees that are driven by volumes in the payments business and the trade finance business, all of which have been frankly relatively slow this year, but where we see drivers of growth.

By the way, some of which is not market related, but just winning new client contracts and new business. So we feel really good about the prospects there. The Private Bank has non-interest revenue sources, particularly in investment products and the sales of insurance products. We have been generating new assets under management this year, which you don't see in the revenue line because the AUM is down based on markets on a year-on-year comparison. But you'd expect to start to see pickup now if markets are flat to up.

So I think some good momentum underlying there. And actually there was some changes in the conditions, for example, for fee and commission recognition and insurance products that were a dampener this year that will grow over next year. And then to your point, the last piece that's a big generator of... By the way, Asset Management, similar inflows and it's growing over market declines last year and in the third quarter. Then you get to the Investment Bank and there we see real opportunity for growth.

In part because, as you say, the Origination and Advisory business, which for us is the Corporate Finance product suite, that's been going through now seven quarters and counting of a real backup in market activities. We are seeing it begin to come back. So we'd expect, for example, Q4 to be higher than Q3 in revenue terms and we think that that momentum will continue into next year. And of course, now we'll consolidate the Numis revenues as well, giving us a further lift into next year.

So we see significant upside in that area. Now to some degree it'll depend on the wallet recovery. And we also think we've positioned not just with the Numis transaction, but also by hiring bankers in the origination advisory space, we've positioned to pick up some market share which we think of as relatively natural for us given our lending footprint, our client footprint, and where activity is taking place. So just to bring it all together, we look at all those sources of revenues and the market development and feel quite good about the momentum into next year on non-interest revenues.

Mate Nemes: Excellent. It sounds quite broad-based. Another topic that I wanted to discuss with you was related to the Private Bank. There's been quite some media coverage recently related to changes in the Private Bank related to Postbank migration. Could you just give us an update where the service remediation is at, how do you progress with that, and what does that mean to cost or revenues?

James von Moltke: Well, Mate, if I may take one step back quickly, our Private Bank's been through a huge transformation over the past several years. To take one piece of it, by the way, and I'll focus on Germany, but we've been investing in the wealth management business now, pretty consistently, over several years. It's a global platform. It's a great business, and it's set to grow as well as markets recover and client confidence recovers. But the Germany platform is, of course, a huge business for us, and we've been making pretty considerable investments to transform that over the past few years.

In particular, the integration of the Postbank franchise from a legal entity perspective, a business perspective, product perspective, and recently technology perspective. And it's been a gigantic amount of work to do it. You could argue that it's a decade overdue to do it, but we've now tackled it. As you say, as a result of the final phase of the technology integration, we found ourselves with an operational backlog really in July and August that we've been working down since then have actually made a lot of progress now.

As we sit here early November, most of the processes that had fallen out of our service level commitment are back within service level and well over two-thirds of the backlog items are now worked through. And as we said on the third quarter call, we will complete this remediation by the end of the year. It's something we're obviously unhappy took place. I mean, it was obviously an underestimation of the operational issues that were going to arise post that final conversion that we regret and we regret dislocation for clients.

But in the grand scheme of things, the period of time to remediation and where we are now I think has been short and we obviously have to manage to make good, where there’s been customer harm. In terms of financial impact, it was modest in the third quarter on expenses, single digits, maybe more like 30, 35 million euros spent on remediation in the fourth quarter. And there's a temporary credit loss provision piece of this. Just again, as you get a backlog, the collections processes slow down, shouldn't change ultimately the loss profile of the portfolio.

So I expect that to come back and we'll work to close off the tail of the expenses next year. And really I think Claudio De Sanctis' team are focused on pivoting from the negative experience for the past few months for that Postbank client base to a strategy execution for Postbank and the German retail platform, which is driven by great product capabilities, more digitalization of our service offering, positioning both brands in a differentiated way, the Deutsche Bank brand, more aspirational investment product driven, the Postbank brand, everyday banking.

You may have seen that we announced an amendment to our contract with Deutsche Post I think now a couple of weeks ago. Just to give you a moment of background, we provide postal services in the Postbank branch network and that was based on a contractual commitment. Now, with this restructuring of the agreement, we have the ability to reduce our Postbank branch network over the next three years by about 250 branches. That will save us some money and I think help us refocus the franchise.

It is a driver of some of the increased restructuring and severance that we talked about earlier. So 150 million euros of the incremental restructuring severance is related to that item. And another piece of the incremental is just as we talked about in the third quarter call, accelerating a reduction in force into this year that we've been working on for a while, so more severance for that. But overall we think that these efforts with Postbank and generally in the Private Bank are positioning us to really demonstrate to investors a transformed retail platform over the next two or three years.

Mate Nemes: Excellent. Thank you for the update. Just conscious of time, I wanted to give the opportunity also for the audience to perhaps ask any questions. I could go on for a significantly longer time, but if we have any questions in the audience, happy to pass it on. If not, let me ask you perhaps about the Investment Bank.

I can't really let you go without asking you perhaps a quick update on how the revenue environment has evolved quarter to date, what do you see in terms of the trading businesses or capital markets businesses, and also equally, how's the origination advisory pipeline shaping up?

James von Moltke: Yeah, and always a tough question in the fourth quarter because the environment as our clients get ready for year end and the confidence in corporate activity can be mixed. It's always hard to predict. Right now I think we're on track for a pretty good fourth quarter, pretty much in line I think with what the consensus suggests at the moment. But I have to say, the October environment was mixed, in particular what look like a recovery in leveraged capital, debt capital markets and M&A stalled a little bit given the geopolitical uncertainties that were out there.

There's been some volatility in financial markets, but it hasn't been a strong environment, I would say. I'd say it's a mixed, but not a bad environment on the fixed income and currencies side. So for a fourth quarter we're actually reasonably encouraged, but there's still a lot of the quarter left to go.

Mate Nemes: Excellent. Well, on this upbeat note, James, I wanted to thank you for your time.

James von Moltke: Thank you, Mate.

Mate Nemes: And thank you for watching.

James von Moltke: Thank you.