Deutsche Bank AG

UBS European Conference

Wednesday, 13 November 2024

Transcript

Speakers:
James von Moltke, Chief Financial Officer
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Mate Nemes: Good morning everyone. My name is Mate Nemes. I'm an equity analyst at UBS. It's my pleasure to welcome James von Moltke, Chief Financial Officer of Deutsche Bank. James, thanks for joining us.

James von Moltke: Mate, thank you for hosting us today.

Mate Nemes: So without further ado, let's dive straight into your financial performance. We are now mid-November, basically halfway through Q4. What can you tell us about the visibility you have on the revenues, specifically going to the € 30 billion mark?

James von Moltke: Thanks for the question and yes we are very encouraged with the momentum we're seeing in the businesses. As you say, we set a goal of € 30 billion for the full year. We were just below € 23 billion in the first nine months, so € 7 billion remaining to be done. And we're feeling very good about the business performance tracking towards those numbers.

Just to give you a bit of detail, the Corporate Bank we think will travel flat in the fourth quarter compared to the third, which is encouraging given the dynamic of the interest rate environment and fee income growth.

The Investment Bank continues to perform quite well across both Fixed Income & Currencies and Origination & Advisory. In Fixed Income & Currencies, we've seen continued momentum that we've had all year. The weeks of October and November have actually been encouraging, so we expect to exceed last year's performance in those businesses and it’s relatively broad based across the FIC product suite. And Origination & Advisory, we think, will also outperform last year considerably given the pipeline that we see for Q4 and then into next year. So all very encouraging there.

In the Private Bank, we expect to be up sequentially driven by interest income. And then in Asset Management, also up both sequentially and year-on-year, given AUM growth that's cumulatively been happening over the year, as well as at least at the moment, an expectation that we'll record some performance fees.

So across the four businesses, encouraging momentum.

Mate Nemes: Excellent. And for this year, I think you clearly guided a flattish performance in terms of NII in the banking book segments.

James von Moltke: Yeah.

Mate Nemes: What can you tell us about the assumptions going into next year on NII and how much you contribute in terms of NII towards that € 2 billion step up in revenues from € 30 billion to € 32 billion? Also, if we can perhaps touch a little bit on interest rate sensitivity, it is a key question in the market. How would your interest rate sensitivity look like, especially in a post- or a sub-2% regime in terms of your rates?

James von Moltke: Sure, thanks for the question. It has been an interesting dynamic through this interest rate cycle based on what banks have been able to do on hedging, as you mentioned, based on what we call the deposit betas, so how much of the interest rate movements are passed on to clients. We, in our disclosure, talk about a net interest income in the banking book to clean up some noise or asymmetry in how IFRS thinks of interest income versus noninterest revenues. But I think it's very helpful for investors to see that banking book performance and we recorded about € 13.1 billion last year in 2023. We actually thought that in 2024, we would be down on that number because of the interest rate changes. And instead our current guidance is that we'll be flat, maybe slightly up on net interest income in the banking book segments this year. So that's really encouraging and it reflects, as I mentioned, the beta performance, which has been consistently stronger than the models had estimated as well as the impact of some of our hedging.

Looking forward to next year, the guidance we've given is that the net impact of deposit margin compression, which will naturally happen in this phase of an interest rate cycle, and the hedges that we've put on, would be a positive in 2025 relative to 2024. Orders of magnitude € 300 to € 400 million based on the curves that are now a little bit out of date, but we don't see much change really driven by the curve movements since the end of September, early October. Then we also expect some growth from the businesses, particularly FIC Financing where we see opportunities to grow the book. So, to answer your question, in terms of the contribution to the € 2 billion of revenue growth that we're looking for in 2025 relative to 2024, so getting to € 32 billion, we think net interest income can contribute in and around € 500 million to that growth. And again, it reflects the hedging that we've done. We gave some disclosure about the interest rate hedges, so here we're hedging the deposit book performance over time, extending the duration of our deposits and in our disclosure we have about € 230 billion of hedges and as those hedges roll over in a higher rate environment, that's supporting the revenues going forward.

Mate Nemes: That makes a lot of sense. So you mentioned the € 500 million contribution to that € 2 billion step up in revenues. I wanted to ask you about the remainder, the other € 1.5 billion in terms of noninterest revenues. Which divisions would you expect this to come from? And to what extent are you looking at market share gains, for example, in the Investment Bank and to what extent are you looking for an expansion in the overall industrial revenue pool?

James von Moltke: So the answer is we were looking for both. And yes, with the € 2 billion that we've been talking about, we've got a lot of work to do on the noninterest income side of the house to generate the € 1.5 billion additional revenues. We actually like the setup that we see now in the marketplace going into 2025.

We think a lot of the drivers in the banking industry of noninterest revenues are encouraging in terms of what the markets are telling us on the forward, on individual investor activity, on corporate activity and obviously AUM in our Private Bank and Asset Management businesses. So we think the setup going into next year is good, and unlike any year in the past several years where either net interest revenues or noninterest revenues have been supportive of revenue growth. Next year, we think both are going in the same direction. So to answer your question, where is the growth coming from?

In order of size if you like, our Origination & Advisory franchise where we've made some considerable investments over the last couple of years. In the banker footprint, our capabilities across industries and also the Numis acquisition, we think that as those investments start to really pay off in terms of revenue performance and market share, we should see some considerable growth as much as € 500 million versus this year's expected performance in O&A. So that's encouraging. That is predicated on both the wallet growing and our market share growing. So there's clearly some execution risk, but as I say, with the very good performance we've seen this year in those businesses and the setup going into next year, we're encouraged that that's primed.

On the assets under management side the same. Private Bank and DWS our Asset Management affiliate, have both seen steady inflows into AUM this year and obviously the cumulative benefit of those inflows starts to flow through into revenues going forward. So we're encouraged on that side.

And we also see investment activity in the Wealth Management. You'll see this in your business as well. The Wealth Management is starting to come back, particularly in some regions that have been out of play for the past couple of years, notably Asia. So we're seeing that development encouraging as well.

In our Corporate Bank, we have lots of different sources of fee income across the businesses, ranging from custody fees, documentary collections, loan inception fees, the payments business is an important part of that, that generate fee and commission income. And if we look at the indicators of activity across those areas as well as the request-for-proposal wins that we've had over the past 18 months, that business is building and we can see that already now on the fee and commission income side. So very encouraging across all of those businesses.

The last piece of the puzzle is our FIC markets business which is performing really well. Over the years Ram Nayak and his team have put in the right people, the right technology, the right risk management, customer connectivity and the rating upgrades have helped. We see ourselves continuing to build market share in that business. In a market that, again, at least as we sit here today, there's no reason to think 2025 would be weaker than 2024, perhaps a little bit stronger.

So really an across-the-board contribution over those four businesses with some degree of market dependence, but actually a good amount of confidence that we're poised to gain some market share.

Mate Nemes: Excellent. So quite broad-based contribution essentially from all divisions. Okay. Shifting gears a little bit, I wanted to talk a little bit about cost as well, especially the fourth quarter. I think in the last Q3 conference call, you spoke about some of the tactical measures you might put in place to influence the cost line in the fourth quarter. Can you give some details on this?

James von Moltke: Sure, happy to. Well, it's early in the quarter to know precise numbers I have to say, and I don't like having to advertise that we might have a messy quarter because we've done it in the past, and so I have some sensitivity around this. But maybe if I start with litigation, as some of you will have seen this year has been an unfortunate year on the litigation side for us. The Postbank takeover litigation matter, which goes all the way back to 2010, produced a very surprising outcome in the courts, initially flagged in April. And that caused us to take a very large provision and then the court back in October at least passed a verdict. Now we get to read the verdict and our goal is obviously to challenge where the court came out because we completely disagree with the legal ruling. That path is uncertain in how long that'll take or how successful we'll be. But I think importantly, by taking 100% of the provision, we've put the full cost behind us so there's only really upside if there's a settlement or some better legal outcome.

What I think that did was cause us to look hard at the rest of our legal profile and work hard this year to put anything more that we can that would be in our power behind us. And so we're continuing to work on that because we don't want to be in the position of throwing surprises at investors anymore the way that this year turned out, again outside of our expectation. So we're working on that, hard to say exactly where those numbers play out, but we're looking at a number of items including an FX mortgage risk that has been ongoing in the industry for some time.

Let me stay with one nonoperating item, restructuring and severance. We guided this year for € 400 million, and to hit the € 400 million, we would have to pay about € 150 million this quarter and given what we're trying to do and setting us up for next year, we might go a little bit beyond that, but we're looking at that line as well.

So then we get to what we call adjusted costs, which is more of an operating measure. And there, Mate, as you know, we've been trying to run the company at about € 5 billion with a declining run rate as the year goes by. That's what we're working on and working hard to deliver into the fourth quarter. What we'd advertise is that there are really two buckets of expenses that we categorize as adjusted costs where we may take additional charges and that those are in real estate and bank levies, oddly enough. Again, too early to quantify, but we've been working over the years to really go after our real estate footprint as I think reflecting the industry and the post-COVID environment. So there's some additional measures that we're working on of that nature.

And then lastly, on the bank levy side, there's some interesting quirks about how the UK bank levy works with the SRF in Europe and we need to finalize our analysis of that.

So those are the items. Hard to quantify any of them precisely at this point, but I do want to just emphasize the focus that we have is on delivering the operating performance on revenues and adjusted costs in Q4 and into 2025 and then cleaning up all the other line items so we deliver finally a clean year in 2025. So hopefully that adds some color for you.

Mate Nemes: Absolutely, and that makes a lot of sense. I think for next year, you have the € 20 billion noninterest expense target, and it sounds like you are employing these tactical measures to get ready, achieving that. Can you talk about your confidence actually hitting that € 20 billion number exactly next year?

James von Moltke: Sure.

Mate Nemes: And how these measures lead to that?

James von Moltke: Look, we've been working on it for some time, so I don't want to create the impression that suddenly you take lots of actions in Q4 of the year before, what we internally sometimes refer to as a measurement year and get to the place that you want to be. We've been investing now for several years in a host of transformation projects that are intended to deliver the outcome that we're looking for on operating expenses next year. And it's really about allowing these investments to deliver run rate cost savings that offset inflation, and offset investments we're making in the business. We think it's very important that we continue to invest in the business, invest in technology, invest in controls, but that we do so keeping costs essentially flat so that we can build the operating margin through revenue growth.

That's a lot of effort, but we've been measuring for investors the net impact or the run rate impact of these initiatives, we call them key deliverables, over time. We've gotten to about € 1.7 billion of that achieved at this point towards a € 2.5 billion target. And so there's still some work to close that gap next year, but that's what gives us the confidence in our ability to manage the run rate. What are those measures? A lot of it's around technology investment and automation. Some of it's around the distribution footprint, particularly in Germany, so branch network reductions. We're looking extremely closely at what I call the front to back processes and data flows in the company. And so all of these are the type of initiatives that are delivering into the run rate over time and we're working hard to deliver for investors, so that hopefully is some color of the things that we have underway.

Mate Nemes: Absolutely, this is helpful. Now moving on to credit loss provisions, just to touch on this briefly, I think with Q3 results, you increased your credit loss provision guidance for this year and that was due to some technical factors partly or largely backward looking. And we've seen some positive side, for example, US CRE provisioning improving in the third quarter. What are you seeing in Q4 so far?

James von Moltke: Consistent with the guidance that we talked about with the Q3 results, and you're right, Mate, this year has thrown us some surprises on the cost of credit.

We now are guiding for about € 1.8 billion full-year CLPs and we're comfortable with that guidance. But that's higher given that it's in the high 30s in terms of basis points of average loans relative to where we started the year thinking it would be somewhere between 25 basis points and 30 basis points. And as you alluded to, the drivers have been three things.

There've been a couple of larger, I guess fallen angels, you'd almost call them. So corporate credits that for us, because of the way we hedge the portfolio, the way we manage those corporate credits is an unusually large cost of credit, about € 225 million in the first nine months. Because we hedge that, actually the shareholders were only exposed to the extent of about 30% of that € 225 million. The rest is a hedge recovery in revenues. So that was one item that pushed up the gross CLPs.

CRE, as you mentioned, has been a feature that takes us above what we'd think is a normalized run rate. So far this year we've had a little over € 400 million of credit loss provisions on Commercial Real Estate. We think that's going to start to ameliorate and we are seeing clear signs. Q3 showed signs of a normalization of Commercial Real Estate including in the US and including US Office. And I think gradually we'd expect that trend to continue and go into 2025 as well.

And then we have something that's very idiosyncratic to DB, which is that the aftermath of the Postbank integration has meant two things, that we've moved to Deutsche Bank models for the Postbank portfolio, that's produced some additional, I'll call it modeled CLPs and then there've been delays in some of the operational processes around collections that has pushed up our credit loss provisions.

And what we've tried to show to investors is that if you peel those three things away, there is a normalized level of credit loss provisions that isn't significantly beyond where we would expect a run rate to be. And I think as we're in this phase of the cycle, we would expect a steady amelioration over the next several years of credit costs.

Mate Nemes: Excellent. And staying still with asset quality, if you don't mind, obviously going into next year, I would love to hear your thoughts about asset quality and I wanted to specifically ask you about Germany. Obviously the German economy is struggling, we have increased political uncertainty as of late, and we've seen some indications of rising defaults. You mentioned some fallen angels, it's just not specific to Deutsche Bank, we've seen it in a number of other banks. What makes you feel comfortable that you can actually maintain a good asset quality also specifically in Germany and get back to a more normalized level of provisioning?

James von Moltke: Look, it's something we're looking at carefully because it's not lost on us at all that the German economy is going through this adjustment right now. Confidence indicators are pretty low. GDP has been hovering around zero, mildly recessionary for the past couple of years.

And so, we're looking very carefully at the credit metrics in our portfolio, particularly focused on the forward-looking metrics, like what is the net ratio of upgrades and downgrades in our internal ratings, days past due in the retail portfolio, number of forbearance and watch list exposures, and those types of things. We have seen a modest uptick in the data in Germany, but it's been modest so far. So not a significant credit cycle that is showing itself yet, whether in the historical numbers, or in the forward-looking indicators, but it's something that we're watching carefully.

And we're also looking now for read across in terms of sectors and areas of weakness. Last couple of years it's been real estate related and from a forward-looking perspective, we're obviously looking at the auto industry and the supply chain for the autos as an area of potential risk. One thing, just to give you a sense of orders of magnitude though, we are much less exposed to the auto industry than you might expect for Deutsche Bank. So funded auto loans today are, in Germany, about 1% of our total loan book, and globally about 1.5%, a little less than 1.5%. And we skew towards the OEMs and the top tier suppliers, not the tail of the supply chain.

So again, we're looking at it carefully, but what we see right now is a degree of stability and, hopefully that'll continue into next year.

Mate Nemes: Excellent. I had one more question for you, and that's obviously on capital return. We have to talk about capital return. With Q3 results, you mentioned you applied for the next buyback. First of all, could you share details of that one? And secondly, you have a goal of an € 8 billion total distribution envelope or € 8 billion plus. When do you plan to achieve this, and how much in terms of additional buybacks can we expect there? Also, if you could help us giving us a sense of what are the key boundary conditions? Is it payout ratios? Are there any regulatory limits, RWA growth? How do you triangulate?

James von Moltke: So Mate, it's actually unusually hard to talk about this in Europe I have to say, because there are lots of moving parts in how we communicate, manage, and also the approval processes. But we've been working to deliver on a trajectory of increased distributions over the past several years, building from the restructuring that we announced back in 2019. And so we provide in the appendix of our investor materials a layout of what that looks like, on the dividend side, working to grow the dividends every year by 50%. So this year was € 45 cents, next year would be € 67.5 cents, and working towards hopefully a dividend of a € 1 per share, payable in 2026. So that's the trajectory on dividends and we've been working to deliver something that mirrors that on the buyback side this year, € 675 million that we completed in July. So that's the goal.

As you say, that adds up to € 8 billion, or actually more than € 8 billion, if we continue on the trajectory over time and we're working to deliver as much of that as we possibly can.

We're encouraged by what we see right now. You will have seen that our CET1 ratio was 13.8% at the end of the third quarter. And we are doing what we set out to do, which is put ourselves in a very strong position from a capital perspective to support next year's repurchases and hopefully on from there. We’ve now applied. We can't say what the number is, but hopefully we'll have more news to share with investors when we get to Q4 earnings.

I will say Mate, there's a lot of moving parts in how capital works and capital planning works. Some of it is managing the business earnings and the demand for capital on our balance sheet. Some of it is also navigating the regulatory environment. And in the regulatory environment we've got a couple of changes coming. CRR 3 is enacted, so that's Basel III, which comes into force in January next year. It has really two phases, operational risk and credit risk, next year in 2025 and at least at the moment, FRTB, so market risk in 2026. Then we've got some other moving parts. There are some countercyclical buffers, there's a mortgage surcharge in Germany, all of which we're hoping will go away as we get through this part of the cycle. So lots of moving parts on the regulatory side that can also guide you as to how much excess capital there is to distribute. And again, certainly management's goal is to continue the distributions, at least deliver on that € 8 billion in the trajectory that we lay out.

The one other moving part for us is SREP. As you know, there's a supervisory review that's an annual process. In that annual process, the regulators, or the ECB in this case, set what's called MDA, so a maximum distributable amount. And our current expectation actually is that the ECB will increase our P2R in that measurement in this year's round, as they recalibrate their SREP. We don't think it's in any way a reassessment of the riskiness of DB, but really a recalibration of their metrics.

We think that'll impact us by about 14 basis points in CET1. We have committed to run the company at least 200 basis points above that MDA level, and so that would imply 13.35%, let's say. So we'd need to run the company in the mid, let's call mid-13s from a ratio perspective as we prepare for that increase in our P2R. Again, I've focused on the 14 basis points, which is the CET1 aspect of that.

Now, just to come back to your question, we have baked that into our capital plans, our approval process. So we're very comfortable that everything that we've just talked about is part of the capital plan, but it gives you perhaps some color on all the moving parts that we work through towards delivery against the objectives we've set.

Mate Nemes: With that, thank you very much for joining us today.

James von Moltke: Mate, thank you very much for having us.

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