Deutsche Bank AG

Deutsche Bank Q1 2024 Fixed Income Conference Call

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Transcript

Speakers:
James von Moltke, Chief Financial Officer
Richard Stewart, Group Treasurer
Philip Teuchner, Investor Relations

RICHARD STEWART

Slide 1 – Delivering against key objectives

- Thank you, Philip, and welcome from me
- In February, we laid out a clear path to our 2025 objectives for financial performance and capital distributions and we have delivered in line with our objectives and targets
- Let me unpack some of the drivers of our first quarter results on slide 1
- Pre-provision profit was up 11% year on year to 2.5 billion euros, and more than 20% higher since we launched our *Global Hausbank* strategy
- This reflected continued progress on driving operating leverage, which is a core element of our strategy execution
- We increased revenues in our operating divisions by 3% year on year, while Group revenues were up 1% on a reported basis
- Group revenues include Corporate & Other, which tends to add some level of volatility into our revenue line
- As committed, we delivered growth in noninterest revenues, and saw an increase of 11% year on year in commissions and fee income, mainly in divisions where we made investments last year
- Net interest income remained stable in our banking books, but declined on a reported basis as expected
- We reduced adjusted costs by 6% year on year and 5% sequentially to around five billion euros, in line with our guidance
- Now let me turn to the progress across our strategic dimensions on slide 2

Slide 2 – Strong foundation for strategic execution

- Starting with revenues, we have delivered a compound annual growth rate of 6% since 2021, in line with our raised target range of 5.5 to 6.5% from 2021 to 2025
- As promised, we grew mainly in capital-light businesses with strong growth in Origination & Advisory, as well as in the Private Bank and in Asset Management, supported by high inflows of assets under management, underlying our franchise momentum

- We aim to build on these developments as our franchise expands following our investments in growth initiatives across all business segments
- With net interest income resilient at the start of the year, and growth in noninterest revenues, we feel we are well on our way to our 2025 revenue ambitions
- We continue to deliver on our 2.5-billion-euro Operational Efficiency program; we have completed measures with delivered or expected savings of 1.4 billion euros, nearly 60% of our target, with around 1 billion euros in savings already realized
- The incremental efficiencies this quarter were driven by optimization of our business in Germany and the reshaping of our workforce in non-client facing roles
- We have further incremental measures already underway, including re-engineering of our operating model via additional front-to-back improvements of product processes, and harmonization of infrastructure capabilities
- This gives us full confidence that we will deliver on our commitment of a quarterly run rate of adjusted costs of around 5 billion euros in 2024 and total costs of around 20 billion euros in 2025
- Finally, on capital efficiency, we achieved a further 2-billion-euro reduction in RWAs in the first quarter, bringing aggregate reductions to 15 billion euros, already more than half our target range of 25 to 30 billion euros
- We continue to progress the capital efficiency measures with further reductions coming from data and process improvements, as well as further securitizations

Slide 3 – Provision for credit losses

- Let us now take a look at provision for credit losses on slide 3
- Provision for credit losses in the first quarter was 439 million euros, equivalent to 37 basis points of average loans
- The decline compared to the previous quarter was driven by moderate stage 1 and 2 releases of 32 million euros due to improved macroeconomic forecasts and model recalibration effects which occurred in the prior quarter

- Stage 3 provisions at 471 million euros remained elevated at a similar level compared to the previous quarter. This included continued weakness in the commercial real estate sector, mainly impacting the Investment Bank, and the continued impact of the operational backlog in the Private Bank
- Our full year guidance for provisions is unchanged at the higher end of the range of 25 to 30 basis points of average loans
- This reflects our expectations that provisions will remain elevated in the first half of the year and should gradually reduce in the second half of the year
- The decline is expected to be driven by an improvement in the CRE sector and the partial reversal of backlog-related provisions in the Private Bank
- Overall, the underlying quality of our loan portfolio remains solid

Slide 4 – Deposit growth path intact

- Moving now to the development in our loan and deposit books over the quarter on slide 4
- All figures in the commentary are adjusted for FX effects
- Overall, loans have remained essentially flat during the first quarter
- Across segments, client demand has remained muted while we have seen encouraging momentum in O&A within the Investment Bank and the Private Bank
- Looking ahead, despite a challenging macro environment for lending businesses, we continue to expect growth in strategic areas by gaining market share
- Our deposit book grew by 9 billion euros compared to last quarter
- This growth has been most pronounced in the Corporate Bank with 8 billion euros of inflows, while growth in other segments was essentially flat
- We remain very pleased with the quality of our deposit portfolio as we benefit from a strong footprint in our German home market and from high diversification across client segments and products with little reliance on institutional wholesale funding
- For the remainder of the year, we expect a moderation of our deposit growth compared to prior quarters

- In the appendix we provide further granularity around the quality of our loan and deposit portfolio

Slide 5 – Net interest income in-line with guidance

- Let us now have a look at our net interest income on slide 5
- Net interest income for the Group at 3.1 billion euros decreased by approximately 100 million euros compared to the previous quarter, with the reduction being driven by accounting effects
- As a reminder, these effects are revenue neutral on a Group level as the decrease in NII is offset by an increase in noninterest revenues
- Excluding these accounting effects, banking book NII was essentially flat as a decline in the Private Bank was offset by an increase in the Corporate Bank and lower funding costs in the Investment Bank and Corporate & Other
- The reduction in the Private Bank NII was largely driven by the non-recurrence of favorable one-off's as well as the ongoing impact of beta normalization
- On an absolute basis, NII in the Private Bank is in line with last quarter's guidance
- The increase in Corporate Bank NII was due to a positive one-off impact from a CLO recovery which was accounted as NII, with deposit betas showing a steady increase in line with our assumptions
- We expect to see Corporate Bank NII decline in the coming quarters as betas continue to normalize
- NII in FIC Financing was essentially flat quarter on quarter
- We are starting to see margin expansion on the asset side which, if it continues, will help offset margin compression from beta normalization
- In summary, the development in the first quarter reinforces our expectation that we will meet or improve on our prior guidance of a 600-million-euro reduction in banking book NII for 2024 relative to the prior year

Slide 6 – Limited net interest income sensitivity in 2024

- On slide 6 we provide details on the sensitivity of our net interest income to interest rates
- Our rate sensitivity is slightly lower compared to the prior quarter due to effects of beta normalization as well as the impact of increased hedging as we look to position the balance sheet for the current interest rate environment
- Our sensitivity increases over time as a greater share of our portfolio comes due for renewal with the majority of our sensitivity in the later years coming from our Euro books
- Given that our hedge portfolio has an average duration of between 4 and 5 years, more than 90% of our hedge income for 2024 is already locked in
- As we discussed last quarter, our strategy is to stabilize NII, reduce sensitivity to unexpected market moves and at current rates we would expect to see a long-term tailwind from the rollover of our hedge books at current long term rates

Slide 7 – Sound liquidity and funding base

- Moving to slide 7, highlighting the development of our key liquidity metrics
- With a daily average liquidity coverage ratio of 136% we continued to operate with a robust liquidity position throughout the first quarter
- The stock of 222 billion euros of HQLA, of which about 95% are held in cash and Level 1 securities, was essentially flat compared to last quarter
- Deposit growth in the Corporate Bank facilitated the full repayment of our remaining 15 billion euros of TLTRO
- This included voluntary prepayments of 12 billion euros, well ahead of scheduled maturity
- The surplus above the regulatory minimum slightly decreased by about 4 billion euros to 58 billion euros as a result of higher net cash outflows, mainly on the back of continued deposit growth
- The net stable funding ratio at 123% reflects the stability of our balance sheet despite the early repayments of TLTRO in the quarter
- This corresponds to a surplus of 112 billion euros above the regulatory requirement

- The available longer-term stable funding sources for the bank remain well diversified and are mainly supported by a robust deposit franchise, which continues contributing about two thirds to the Group's stable funding base
- We aim to maintain this funding mix going forward

Slide 8 – Strong CET 1 ratio

- Turning to capital on slide 8
- Our first quarter Common Equity Tier 1 ratio came in at 13.4%, compared to 13.7% at year-end 2023
- We had a strong capital supply this quarter and the sequential decline was driven by our distribution actions and plans, together with business growth
- 19 basis points of the decrease reflects the ECB approval for our 675-million-euro share buy-back which we commenced in March
- Half of first quarter net income was deducted for future capital distributions, in line with our 50% payout ratio guidance, with the remainder supporting other deductions
- 12 basis points of the decrease came from RWA growth
- The increase in RWA is net of reduction due to RWA optimization achieved during the quarter

Slide 9 – Capital ratios well above regulatory requirements

- Our capital ratios, whilst reduced quarter-on-quarter, remain well above regulatory requirements as shown on slide 9
- On the first of January this year, our Pillar 2 requirement has reduced following last year's SREP process
- This has lowered our MDA level by 3 basis points for the CET1 ratio and by 5 basis points for the Total Capital ratio
- Our CET 1 MDA buffer now stands at 229 basis points or 8 billion euros of CET1 capital

Slide 10 – Leverage ratio stable

- Moving to slide 10
- At the end of the first quarter our leverage ratio was 4.5%, 8 basis points lower compared to the previous quarter
- The decline was primarily driven by lower Tier 1 capital, in line with the movement in CET1 capital
- Leverage exposure was materially unchanged with lower cash balances offset by higher trading related exposure

Slide 11 – Significant buffer over MREL/TLAC requirements

- We continue to operate with a significant loss-absorbing capacity, well above all our requirements, as shown on slide 11
- The MREL surplus, our most binding constraint, stood at 16 billion euros at the end of the quarter, a comfortable level continuing to provide us with the flexibility to pause issuing new Eligible Liabilities instruments for approximately one year
- Looking ahead, we expect a slightly higher binding MREL requirement from the SRB in the second quarter of 2024 which will only marginally reduce the existing headroom

Slide 12 – Issuance plan in line with previous guidance

- Moving now to our issuance plan on slide 12
- We took advantage of the favourable market conditions in the first quarter to make further progress on completing our issuance plan
- As of now, we have issued 7 billion euros, which is close to 50% of the midpoint of our 2024 plan
- Highlights included senior non-preferred issuances in US-Dollar, Euro and Sing-Dollar, together with a 3 billion Renminbi senior preferred transaction, our third and largest Panda bond to date
- We reaffirm the guidance of 13-18 billion euros for the full year 2024 issuance plan and expect to be active across the capital stack for the remainder of the year
- Some of you have asked us about our approach when evaluating call decisions, particularly those coming up in 2025 for our AT1 securities

- I can reiterate our previous guidance that we always assess the economics of any call decision, for example, the refinancing or replacement costs versus the coupon reset
- There may also be instances where there are additional impacts such as the FX revaluation impact for AT1 securities accounted for as equity which we also consider

Slide 13 – Summary & outlook

- Before going to your questions, let me conclude with a summary on slide 13
- The first quarter showed that the expected benefits from our investments are materializing and will help to drive growth in noninterest revenues, while we have limited the downside on our interest income through our interest rate hedging activity
- This demonstrates that our businesses are positioned for further growth, contributing to delivery of our revenue target of around 30 billion euros in 2024
- We affirm our target to maintain our quarterly run-rate of around 5 billion euros of adjusted costs this year and around 20 billion euros for the full year
- We expect provisions for the year to come at the higher end of our guidance range of 25 to 30 basis points of average loans
- We are well positioned with our CET1 ratio of 13.4 % and we maintain a comfortable liquidity position above our targets
- Overall, our full focus remains on our progress, through the execution of our strategy and delivering on our 2025 targets
- With that, let us turn to your questions

Questions and Answers

Daniel David (Autonomous)	Hi, all. I have a couple of questions. You've kind of referred to it partially with your remarks at the end of that, but with the capital instrument issuance of 1 to 2 billion in the plan this year, can you give us any steer what’s informing that decision here? Noting there isn't any causal maturities this year, but clearly there is next year.

And then separately, maybe related, how do you think from today's perspective regarding the calls of the three AT1's that are up for call next year? Assuming that the economics can vary deal-by-deal, would you make different decisions based on those numbers on how you see it? Any information would be great.

And then secondly, in the earnings call yesterday you were quite bullish on outperforming the prior guidance on NII. Can you remind us just the divisional trends you're seeing and how this may play out in 2025? Thanks.

Richard Stewart

Thanks Daniel and happy Friday and thanks for joining. I think the first question on the AT1s, you're right, I did allude to it in my remarks, but just for clarification. We stick with our guidance, as you say, for capital instruments of around 1 to 2 billion in AT1's or Tier 2's in 2024. And we will update you in due course when we reach a decision around which instrument and the timing of that.

In terms of calls, DB will continue to make decisions regarding the exercise of an issuer call closer to the exercise date, balancing the interests of all of our stakeholders. Our approach is based on economic factors, including the usefulness of the instrument for capital funding and rating agency metrics, as well as the cost of the instrument versus other alternatives. I would note that the non-euro AT1 instruments, the historic FX balances also can play a role and can change that call decision, even if that call is beneficial from a credit perspective. We would note that despite the improvement of AT1 spreads we've seen this year, the recent spreads on most instruments are still below current market new issue levels, which is reflected in some of those instruments trading below par. Obviously we'll continue to monitor this as we progress through 2024.

In terms of the NII question, I think bullish is a pretty fair characterisation. We touched on this in a few different answers to question yesterday, so let me try and bring the overall picture together. In terms of magnitude, I think our CFO said yesterday that comfortable in a triple-digit millions for 2024 would be a reasonable assumption, and I would reiterate that, but as you know, it's not our practice to be more specific at this stage. We see that benefit persisting into 2025 and beyond, in fact. You can think of that as a parallel shift up versus the prior guidance.

In terms of drivers of that improvement, there are a few different elements. One is on the deposit side, where we have been seeing some higher volumes, as well as betas increasing, but still up following our initial model assumptions. Our loans, like other banks who've also reported, we are beginning to see some margin expansion as our forward funding rates are coming down and client rates remains stable. Then our funding costs are benefiting now, we're seeing that in the marketplace as our new issuance spreads continue to tighten, relative to our peers and less of an outlier. Obviously we're pleased by that, reflecting the rating upgrades that we've seen over the last year or so, in part because of the continued delivery on our strategy.

And across the portfolio, really the only area where we are not seeing a tailwind is in the loan volumes. Again, as with other banks, we've seen less client demand at this point in the cycle. When I think about the divisional picture, I'll say this is largely unchanged from our prior guidance. In our prepared remarks that James and Christian went through yesterday, we talked to the fact that for this quarter the trends are a little bit impacted by one-offs, which is a sequential negative for the Private Bank and a positive one for the Corporate Bank.

When we look through that, the underlying development to the business is very much consistent with our previous messaging. We expect a larger decline in the Corporate Bank than in the private bank over the full year. But, as I said, the overall outlook is looking more positive than we guided at the start of the year. Hopefully that answers your questions, Daniel.

Daniel David	Thanks. If I could just push you maybe on the AT1. You've got a couple of calls on the same date in 2025 with slightly different reset spreads. Is it right to assume that you'll address them differently, depending on the way that the economics play out, i.e. you could call one and extend another?
Richard Stewart	It's an interesting theoretical question. We'll look at that when we get closer to the time. The initial assessment will be done on an issue-by-issue basis.
Daniel David	Thanks a lot.
Lee Street (Citigroup)	Good afternoon. Well done on the results and thanks for taking my questions. Two from me, please. Firstly, quite high level, but as you sit there today you're taking all factors, be it operational, market, regulatory, economic, what do you think is the greatest risk to Deutsche Bank not hitting its 2024 and 25 financial objectives? Secondly, looking the balance sheet from a Treasurer’s perspective, what do you see is the least efficient part of the liability side of the Deutsche Bank balance sheet and what might you look to do about it? That would be my two questions. Thank you.
James von Moltke	It's James. Maybe I'll take the first. We have to execute, so we've laid out a plan. I think we’re executing, as we've just demonstrated in the first quarter, well on that plan, but of course that needs to continue. Second, obviously market developments. Whether it's financial markets, the state of the economy, interest rates and all that will of course play a role. There's lots of things in our control, there are of course some things that aren’t in our control. We look at some of the non-financial risks carefully, and that includes litigation risk and other things like cyber, but there again we do everything we can to manage to the best outcomes possible in the environment that we’re faced with.
Richard Stewart	Maybe I'll take up the balance sheet question. Big picture, I think we’ve done a lot of good work over a number of years now to get the balance sheet that we

like, given our business strategy and business mix and clients. In that sense, I think we're in pretty good shape. I think the issuance stack is as optimised as we can be, given the constraints that we need to solve for. I think there's always a question around can we be more efficient at that segment of our portfolio. But overall, I'm pretty happy with the quality of our funding mix.

Lee Street	All right, fair enough. Thank you both.
Robert Smalley (UBS)	Hi, thanks for taking my question and doing the call. A couple of questions on loan loss provision and then one on capital. With respect to the loan loss provision coming down in the second quarter and you make provisions for real estate, could you give us a little bit of colour on some of the renegotiations around real estate? And real estate by nature being very lumpy, is most of this done in the first half of the year or is it spread out through the year and that might be some of the reason why the provision is going down? Secondly, on the provision, how much of that is predicated, if anything at all, on ECB cuts and refinancing there and a little relief for corporate clients? We are seeing, certainly domestically, the IFO index up three months in a row, German PMIs up. How much of that also plays into that too? And then on capital, just in general, you mentioned that 229 basis points MDA headroom and you like to keep that buffer around 200. Could you just give us a little sense of how you came up with the 200 number and is that subject to change at any time? Thank you.
James von Moltke	Thanks, Robert, it's James. I'll start on both and Richard may want to add. First of all, there's no specific cadence to the renegotiations or the extension events or refinancing events in the CRE portfolio. They just come as they do, approach their maturities. We enter into negotiations with the sponsors as we approach those maturity or extension dates. In certain instances their restructuring is needed, support, commitment on both the part of lenders and sponsors. And it's in those events, whatever the outcome of those events is, may

affect our provisioning decisions. They're lumpy in the sense that they're big exposures. Remember, the provisioning really will reflect what we believe the recovery is in each individual instance. So, each event doesn't necessarily have to be a major CLP event in its own.

As you said, we do see it on a gradual improving trajectory for a number of reasons, including better stability in terms of pricing recently. As we've talked about pretty consistently, I'll call it good behaviour or good partnership between sponsors and lenders that is persisting.

Lastly, your question was how much are we relying for the CLPs generally on stronger economic environment. Actually, the recent German data has improved beyond what we thought and were aware of at March 31st. So, we're really commenting without the benefit of more recent, more favourable data coming in.

And them quickly on the distance to MDA. There came a time when that appeared to be where the market was doing. We had input from yourselves as credit investors and analysts from the rating agencies, and so we took it to be a good buffer to set. But as you've probably heard me say in the past, that the interesting thing that is I would argue creditor friendly, is lots of things are taking place in the calculation, making that calculation and, consequently the buffer, more and more conservative over time. And that's either the measurement of RWA as models change, some of the rules and methodologies that are changing. You're aware that we have a countercyclical buffer, plus for mortgage it's a sectoral buffer. And lastly, on a relative basis, a high G-SIB surcharge that applies domestically much higher than our international.

So, lots of things we think support that buffer as appropriate. There's no consideration at the moment to moving that, but I wouldn't view it as it's forever in place. If there's changes around us, including in things like P2R or some of the MDA drivers, we might reevaluate, but for now we’re comfortable where we sit.

Robert Smalley: Makes a lot of sense. Thanks for your detailed answers and for doing the call.

James von Moltke: Thanks, Robert, as ever.

Alexei Lougovtsov (Bank of America): Good afternoon. Thank you very much for taking my question. My question is also about loan loss provision. You discussed your US exposure on slide 22. There you have 10 billion of modified, restructured or defaulted loans. Is it possible to get some breakdown about modified restructured and defaulted?

Also, you have 4.8% coverage with CLP, so how do you expect this number will evolve? Would it be sufficient to have a 4.8% coverage for this portfolio? Also, when discussing slide 3 provisions, you mentioned that provisions should improve in H2 and you specifically mentioned that real estate should improve. You just discussed that your expectations are based partially on better economy in Germany, but specifically to real estate, what indications do you see that the situation can get better? Thank you.

James von Moltke: We don't break out the defaulted, necessarily. But in fairness, the Stage 3 component of the total portfolio is I think a good indication. But I do want to just say that, just to clarify, the 4.8% represents the credit loss provisions that we've taken cumulatively against that 10 billion of loan modifications that is also a cumulative number. We’re trying to help people understand what the amount of credit loss provision is that’s being produced by modifications over time. Reflecting, as I answered earlier, the difference at each event, the book value and what we estimate to be the realisable value.

As I said yesterday on the equity call, that modification will continue to rise, as more loans get to maturity or extension dates. But based on our overall perspective that we’re in an improving trend, then I would expect that the percentage of new CLPs to the new balances that are modified will start to improve. That’s the main driver.

What is causing us to give you this kind of perspective of confidence that we're on an improving trend, it's mostly the valuations in the marketplace that we're seeing. Whether that's on externally available information like indices that are public or what's going on in our own portfolio, as we get updated valuations, they've tended to firm and in some cases actually improve. That's what we're seeing, but it is, of course, path dependent from here. Hope that helps.

Alexei Lougovtsov

It helps a lot. As a follow-up, difference between modifications and the restructuring, which cases you require sponsors to go to more equity? Any colour on this would be helpful.

James von Moltke

In the worst case, when the sponsor doesn't believe there's value to the project, they will hand the property back to the lenders and then the lenders need to work out as real estate owned, that project. Typically, what happens in most of the cases, I might say 90% of the cases, there would be concessions made on the lender's part, extensions, modifications, sometimes rate concessions. But typically, in return for equity injection on the part of the sponsors, meaning a paydown of a portion of the loan. And so, that's the behaviour that we've been seeing.

We've had pretty significant paydowns over the last six, nine months. And that reflects, if you like, that sponsors see value in the projects and, therefore, lenders and sponsors work together to get those projects through this current cycle.

Alexei Lougovtsov

Thank you very much.

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