Deutsche Bank AG

Deutsche Bank Q2 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

Slide 1 – Robust underlying profit driven by disciplined delivery

- Thank you, Philip, and welcome from me
- After another quarter where we made progress across the businesses on our strategic initiatives, we are clearly on track to hit our financial targets
- Our progress continued to be recognized by rating agencies this quarter – either through rating affirmations or by Morningstar DBRS changing our rating outlook to positive in June
- Let me discuss some of the drivers of our first half results on slide 1
- Pre-provision profit was up 17% year on year to 4.7 billion euros, excluding the impact of the Postbank takeover litigation provision
- We also demonstrated positive operating leverage, a core element of our strategy execution
- We grew revenues in our core businesses by 3% year on year, while Group revenues were up 2% on a reported basis
- We saw strong growth in commissions and fee income of 12%, which demonstrates clearly that our strategy to grow our capital-light businesses is working
- And we continue to deliver better-than-expected NII performance in our banking books, which provides additional comfort to our revenue path for 2024 and in the years thereafter
- We reduced our adjusted costs by 2% to 10.1 billion euros year on year, and we continue to deliver savings through our Operational Efficiency program
- Now let's look at the franchise achievements across our businesses, on slide 2

Slide 2 – Strengthening franchise underpins revenue momentum

- In the first half year, the Corporate Bank delivered a 16% increase in incremental deals won with multinational clients compared to the prior year period
- Our successes with our clients were also rewarded with a series of high-profile awards
- The Investment Bank made significant advances across the franchise

- Origination and Advisory increased its global market share to 2.6% in the first half year, a gain of more than 70 basis points over the full year 2023
- Fixed Income and Currencies revenues were up 3% year on year, supported by a 7% increase in Financing revenues, even compared to a strong prior year period
- The Private Bank also continued to build momentum with 19 billion euros of net inflows in the first six months, supporting growth in assets under management of 34 billion euros
- And in Asset Management we grew AuMs by 37 billion euros, to 933 billion euros, in the first half year
- Now let me turn to our strategic objectives on slide 3

Slide 3 – Continued execution across strategic pillars

- We continued to make progress across all three pillars of our *Global Hausbank* strategy
- Starting with revenue growth, we have delivered a compound annual growth rate of 5.7% since 2021
- This underscores the benefit of a well-diversified and complementary business mix
- Stable NII in our banking book segments was supported by strong noninterest revenues following investments in our growth initiatives
- Looking at the drivers behind commissions and fee income strength in the first six months, we saw growth mainly in our capital-light businesses
- We will continue to build on these developments and with business volumes growing, we are confident that our revenue trajectory will remain strong in the second half of the year
- While the impact from the expected NII normalization will be lower than initially anticipated, we expect full year NII in our banking book segments to be broadly stable to the prior year level
- We will see continued commissions and fee income growth, mainly in Origination and Advisory, Corporate Bank and Asset Management
- This puts revenues of 30 billion euros clearly in sight

- We continue to deliver on our 2.5-billion-euro Operational Efficiency program, having completed measures with delivered or expected gross savings of 1.5 billion euros, 60% of our target, with around 1.2 billion euros in savings already realized
- This gives us firm confidence that we are on track to deliver on our commitment of a quarterly run rate of adjusted costs of around 5 billion euros in 2024, and that we will further reduce this run rate to closer to 4.9 billion euros by the end of the year to meet our noninterest expense objective of around 20 billion euros for 2025
- On capital efficiency, we achieved a benefit equal to a 4-billion-euro RWA reduction in the second quarter, through data and process improvements. As a result, cumulative RWA reductions from capital efficiency measures have already reached 19 billion euros
- Let's now turn to provision for credit losses on slide 4

<u>Slide 4 – Provision for credit losses</u>

- Provision for credit losses in the second quarter was 476 million euros, equivalent to 40 basis points of average loans
- The sequential increase in stage 1 and 2 provisions to 35 million euros was mainly driven by the net effect of overlays and model enhancements, which were partly mitigated by quarter-on-quarter portfolio movements
- Stage 3 provisions remained at an elevated level but reduced slightly to 441 million euros. The decrease was mainly driven by the Private Bank, while provisions in the Investment Bank remained stable and were largely related to Commercial Real Estate exposures. Provisions in the Corporate Bank increased which was driven by two larger impairment events
- Looking ahead to the second half of the year, we are now seeing some stabilization in the broader US CRE sector, though US Office remains broadly unchanged. Overall, this should lead to lower provisions compared to the first half, but our US Office CRE portfolios will continue to be impacted
- We also continue to conservatively manage our loan book with lower growth rates, including active management of single-name concentration risks through well-established comprehensive hedging programs

- Reflecting on these items, and considering developments in the first half of the year, we revise our full-year guidance for provision for credit losses to be slightly above 30 basis points of average loans

Slide 5 – Steady deposit growth over last four quarters

- Moving now to the development in our loan and deposit books over the quarter on slide 5
- All figures in the commentary are adjusted for FX effects
- Overall, loans have remained stable during the second quarter
- Within that, we have seen encouraging momentum in key strategic growth areas such as FIC Financing and Wealth Management, but also a net reduction in mortgage products in line with the strategy
- For the remainder of the year, we expect these broader trends in our loan book to continue
- Our high-quality deposit book increased by 5 billion euros compared to the last quarter
- Balances in the Private Bank grew by 3 billion euros mainly driven by growth in fixed-term deposits in our Private Banking and Wealth Management segment
- Corporate Bank deposits increased by 2 billion euros in the quarter, or 10 billion euros year-to-date, which was materially supported by growth from certain client accommodation activities that are temporary and expected to normalize in the fourth quarter
- In the appendix we provide further granularity around the quality of our loan and deposit portfolio

Slide 6 – Net interest income expected to outperform prior guidance

- Let us now have a look at our net interest income on slide 6
- NII was essentially flat across all of our key banking book segments at 3.4 billion euros, slightly above prior expectations
- Corporate Bank NII is stable sequentially, with higher deposit volumes and loan margin expansion offsetting the expected beta convergence

- As in the prior quarter the Private Bank continues to benefit from a slow pace of beta convergence and ongoing hedge rollover, while our FIC Financing business continues to deliver stable results
- Our base case is that our quarterly NII run rate will remain broadly stable and we reiterate that we expect to improve on our earlier guidance for the full year banking book NII
- The Group number, reflecting accounting effects, decreased by approximately 100 million euros compared to the previous quarter to 3 billion euros. This effect is offset by an increase in noninterest revenues and has no overall revenue impact to the Group

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 131% during the quarter we operated with a sound liquidity position at our targeted level
- The quarter-end stock of 221 billion euros of HQLA, of which about 95% are held in cash and Level 1 securities, was essentially flat compared to last quarter
- Quarter-over-quarter our spot Liquidity Coverage Ratio was also unchanged at 136% representing a surplus above the regulatory minimum of 58 billion euros
- The net stable funding ratio at 122% reflects the stability of our funding base and corresponds to a surplus of 110 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 strong deposit franchise, which continues contributing more than two thirds to the Group’s stable funding sources
- We aim to maintain this funding mix going forward

Slide 8 – CET 1 ratio remains stable

- Turning to capital on slide 8
- With 13.5% our second quarter Common Equity Tier 1 ratio was up slightly compared to the previous quarter

- CET 1 capital improved slightly, reflecting lower regulatory capital deduction items and strong net income for the quarter, largely offset by the Postbank takeover litigation provision
- Risk-weighted assets increased from businesses growth, together with higher operational risk RWA, including the impact of the Postbank takeover litigation provision, mostly offset by reductions from strong delivery of capital efficiency measures

Slide 9 – Capital ratios well above regulatory requirements

- Our capital ratios remain well above regulatory requirements as shown on slide 9
- The CET 1 MDA buffer now stands at 231 basis points or 8 billion euros of CET1 capital
- This is broadly unchanged to the prior quarter as the impact from the higher CET1 capital ratio was largely offset by higher countercyclical capital buffer settings, notably in the Netherlands, Ireland and Belgium
- The buffer to the total capital requirement increased by 38 basis points, driven primarily by our AT1 issuance, and now stands at 279 basis points

Slide 10 – Leverage ratio increase led by AT1 issuance

- Moving to slide 10
- At the end of the second quarter our leverage ratio was 4.6%, 13 basis points higher compared to the previous quarter
- 12 basis points of the increase were driven by higher Tier 1 capital, due to the Additional Tier 1 capital issuance in June

Slide 11 – Significant buffer over MREL/TLAC requirements

- We continue to operate with a significant loss-absorbing capacity, well above all requirements, as shown on slide 11
- The MREL surplus, our most binding constraint, increased by 1 billion euros and now stands at 17 billion euros at the end of the quarter
- We had to absorb a slightly higher binding MREL requirement from the SRB in the second quarter

- Higher RWA and higher countercyclical capital buffer requirements added to higher MREL demand
- This was more than offset by higher MREL supply from the issuance of AT1 and other eligible liability instruments
- Our surplus thus remains at a comfortable level which continues to provide us with the flexibility to pause issuing new Eligible Liabilities instruments for approximately one year

Slide 12 – Issuance plan well advanced

- Moving now to our issuance plan on slide 12
- We stick to the guidance to issue 13 to 18 billion euros to meet our 2024 funding requirements
- Year to date, we have issued 13 billion euros, equal to the lower end of our 2024 plan
- After a very constructive first quarter we continued to take advantage of the favourable market conditions and issued more than 5 billion euros in the second quarter
- We issued a 1.5 billion euros AT1 note in June, which improved the leverage ratio by 12 basis points, as already mentioned
- Further highlights included our inaugural 500 million euros social bond in senior non-preferred format, our third and fourth panda bonds comprising 6 billion Renminbi in total as well as a multi-tranche Japanese Yen transaction
- The social bond refinanced assets in the areas of affordable housing and access to essential services and further expands our ESG funding footprint
- The residual funding activity for the year remains focused on senior non-preferred and senior preferred notes, both in benchmark format as well as private placements and retail-targeted issuance
- Many of you have asked for our intentions regarding potential calls of AT1 instruments in 2025, so let me outline how we think about this
- We look at the costs of refinancing versus extending the instrument and here the refinancing spread vs the reset spread is a key input, as well as any additional carry costs we would incur

- Furthermore, we think about any other financial impact from a call, such as the FX revaluation impact when calling at an FX rate which differs from that at the issue date
- As always, we will take all relevant aspects into consideration
- To be clear, we have not yet made a decision and as you know, calls of capital instruments require regulatory approval
- Therefore, you can expect us to take a decision closer to the call date

Slide 13 – Summary & outlook

- Before going to your questions, let me conclude with a summary on slide 13
- The performance in the second quarter and first half of the year demonstrate the successful execution of our strategy and we remain confident that our businesses have strong momentum and are positioned for further growth
- And so, our full year 2024 guidance for revenues and adjusted costs has not changed, respectively at 30 billion euros and around 20 billion euros
- Provision for credit losses for the year are now expected to come in slightly above 30 basis points of average loans
- Regarding issuance activities for the year we are well advanced which provides flexibility regarding timing of new issues
- Overall, our full focus remains on the execution of our strategy and the progress made in 2024 positions us well to achieve our 2025 targets
- With that, let us turn to your questions

Questions and Answers

Lee Street (Citibank)	Good afternoon and thank you for taking my questions. I have three, please. Firstly, you mentioned a FX revaluation impact, when calling AT1 securities not issued in euros. Aside from not calling, is there anything you can do to actually mitigate or avoid that impact? Secondly, on the slightly increased loan loss guidance for the year to just above 30 basis points. Is there any broader read across? I know there were a couple of specific loans in the quarter, but is there any broader

read across to the book at large? That's my second question.

And then finally, I remember a few years ago, the comment was made about being an industrial logic to banking consolidation in Europe.

Now, obviously, with your restructuring successfully completed, and lots of excess capital forecasted to be made, would you consider using your excess capital for M&A, as opposed to shareholder return? And if yes, under what conditions? Those are my three questions. Thank you.

Richard Stewart

Thank you, Lee, and thank you for joining. Maybe I'll take the AT1 question, and maybe I'll let James take the CLP and the M&A question. So, AT1 and FX revaluation impact, and what we can do about it. So, our AT1 securities, which have a temporary write down feature, are accounted as equity under IFRS, meaning the AT1 FX rate is frozen at the time of issuance, and any FX impact is realised, upon termination, for example, a call, a buyback, or at maturity.

Under the current structure, there is no natural instrument to hedge that economic risk, as well as the accounting risk, which means we have a choice to make between quarterly P&L volatility and RWA impact, or we mitigate that, but at the cost of FX revaluation upon termination.

I will just note that any impact is taken through capital, rather than through the P&L line. And we've made the decision, when we issued these, to avoid that P&L volatility intra quarter for the life, but that just comes with that economic risk that we talked about, in terms of the revaluation impact.

We recognise that different AT1 structures, for example, with an equity conversion, rather than the write down, are an interesting alternative, and allow for debt accounting under IFRS. This would avoid this issue, as the security would be accounted for as, if you like, a normal bond. But I would note that that requires a few changes, in particular, shareholder approval.

A switch, if we were to pursue that further, would have a certain lead time. And then, I guess, in terms of the rationale behind the AT1 issuance we did in euros in early June. So, one is the market was pretty conducive for euro AT1s across the street, but also, for our own spreads in the first half of the year. So, there was an element of opportunism, given the demand we were seeing, and the depth of the market.

But the primary reason was just to manage our leverage ratio, given what we're seeing, in terms of internal demand. And you should see it in that vein, rather than any intention to de-risk the calls we have coming during 2025. So, hopefully, that answers your question, and maybe I'll pass on to James for the CLP response.

James von Moltke

Thank you, and, Lee, thanks for the question. Look, no read across, really. Our guidance was initially 25 to 30 basis points. Incidentally, there is a bit of a denominator effect, as well. We had assumed more loan growth in our original guidance than we've seen, so we thought we'd be closer to 500 billion, on average, than 480.

But leave that aside, there has been a handful of events in the first half of the year that have taken us above what we think is a pretty stable run rate of credit loss provisioning in the portfolio. So, above a run rate in the businesses of around 250 per quarter, we've been running at a little bit above now, 100 million or so, on commercial real estate.

And then in the first half, we had a couple of larger corporate credits that defaulted, as well as the overlay action that we also disclosed in the second quarter. And so, when we strip those things away, the last two, the first half was relatively in line with our expected 350 million run rate. Now, our expectation is that the second half will revert to that type of level, which is why, at this point, we've moved the guidance up a bit.

But really, our expectations for the second half are, more or less, unchanged. And what's driven us up in the first half are either, as I say, corporate positions that are hedged in CLOs, so our net exposure has been much smaller than the gross amount that's reflected in the CLPs, and the overlay that I described. So, the read across is stuff happens, and that's mostly in the rear-view mirror.

Obviously, we're watching credit carefully in the German books, in commercial real estate, but by and large, our outlook remains that the second half should see improvement on the first. And then on consolidation in Europe. It's been on the come for a very long time, and I think, from our perspective, remains that way.

On your last question, there has been a series of barriers, but for us, we've mostly focussed on the need to put DB into a much stronger position, in terms of our internal controls, our technology, our capabilities, before we would consider that. So, there's more homework, as we've referred to it, to do.

And the barriers to consolidation, such as they are, but you can think about the fair value gap, for example, that are on the balance sheets today in Europe, remain in place. So, the short answer is, we remain focussed on delivering against the objectives that we've laid out, the commitments we've made to shareholders, and we'll see how the world evolves much further down the road.

Lee Street	All right. Thank you very much for those very full answers. Thank you.
Daniel David (Autonomous)	Good afternoon, all. Congratulations, and thanks for taking my questions. I have three. The first one is just on AT1 and just goes over some of the points that you made to Lee, just a second ago. So, should we think about the AT1 you've printed as refinancing the 7.5%? I note that's got a higher reset, and also, got a lower FX impact on the call date.

So, I guess that leaves the 4.789, and I guess my question would be, would you consider any more AT1 this year, if the market was willing and open? And would you consider an LME alongside, which is something we've seen some of your peers conduct? The second one is just on leveraged finance, and clearly, we've seen the headlines.

I'm just interested in any update you've got on leveraged finance, but also, the interaction with the Pillar 2R add-on. So, what I'm thinking is, could we see, potentially, more provisioning, but being offset by a change in your capital requirements, as a result of Pillar 2R add-on dropping away? Anything you could say there, would be great.

And then finally, just on MREL. There has been a bit of talk with regard to subordinated MREL requirements linked to the CMDI package. I note that you've always maintained quite a high subordination percentage in your MREL, so you fill your MREL with fully subordinated debt.

Irrespective of what the regulators decide to do, is there ever a scenario where you would lower the amount of subordinated MREL you target, or are you filling your MREL requirement with more senior preferred? I'm just interested to hear your views on that. Thanks.

Richard Stewart

Thank you, Daniel. So, again, maybe I'll take the AT1 question and the MREL question, and then I'll pass on to James, to give a bit more colour on leveraged lending. So, around how to think about the issuance, I would delink the call strategy for next year, and the issuance, is my first statement.

So, as I said in my earlier remarks, the AT1 we did in June is really to solve for ensuring we can meet the incremental demand that we need, and the capacity we need, to take advantage of the opportunities we see in our business. And so, it shouldn't be seen as linked to any future derisk in the calls we have in 2025.

So, that would be the first point. I think, when it comes to calls for next year, we haven't made any decision on that at all, and we will be waiting until closer to the call date. As ever, we are very mindful of how the market views these products, where we feel makes rational and economic sense for us to take action.

But we're also very mindful of our overall stakeholders, and make sure we act in the interest of all of them. And then, I think, in terms of liability management, we have always seen that as a useful tool. It's something we've used in times gone by. But, as you know, for me to announce what I might be doing in liability management, it defeats the point of liability management. So, we find it a useful tool, and where we think it makes sense, of course, we'll take a look at it.

I think when it comes to MREL, you're right, the CMDI negotiations or conversations continue. The trialogue is later on this year. We don't really see much movement in what this means, from a formal perspective, for another couple of years.

But we're comfortable with our MREL levels, and the mix that we have. And so, we don't have any intention to restructure the stack, at this stage. James, do you want to pick up the leveraged lending piece?

James von Moltke

Thanks, Richard. The leveraged lending, it's very hard to judge, at this point, any actions that may come from the industry review that's been underway, and we await to hear the feedback. As I said yesterday, we've been engaged, over many years, in a dialogue with the ECB about leveraged lending, the practices, the ways that we can improve definitions, methodology, and we look forward to continuing that engagement, which has been very constructive.

It's hard to say what the interactions are between P2R and any other actions or tools. As you may recall, we, along with a couple of other banks, did receive a P2R add in two years ago of 20 basis points, which was reduced to 15 basis points last year, which we viewed as good progress, and constructive. Just to give you a sense of the nature of this business for us.

What I'd call the funded loan book, the whole book, as we've disclosed before, is about 1% of Group loans, and 4%, or so, of loans in the IB. So, to give an order of magnitude of the whole book there. And then the commitment book, it goes up and down, based on volumes in the market, but can run anywhere up to around 20% of the total funded loans on the IB balance sheet.

So, those are orders of magnitude, again, depending on the market environment. Now, one thing to bear in mind is that the risk management practices we have around that book, it starts with it's an originate to distribute model, and so, our focus is, of course, on a strong origination, first of all, underwriting, and then distribution capability. In addition, we hedge portions of the portfolio.

And then on the funded book, there can be loan loss provisions. Some of it's also held in the fair value book, so you see market valuation adjustments go through revenues. So, it's an interesting book, in terms of how it performs, and how it's also risk managed, and how the risks associated with it flow through the income statement, but I thought giving you a little bit of colour on how we think about it, and manage it, and its relative size in the Group, might be helpful.

Daniel David	Thank you. Could I just ask one follow-up? Is the 15 basis points RWA Pillar 2R add-on linked, in any way, to the ten basis points on leverage?
James von Moltke	No. They are completely separate considerations that have gone into that, as far as we're aware. But obviously, we think their origins are completely different.
Daniel David	Thanks.
Louise Miles (Morgan Stanley)	Hi. Thanks for taking my questions. It's Louise here. Just two from me. On slide 12, you talk about the issuance plan. It looks like the biggest so far, relative to your year-to-date issuance on senior non-preferred. Can you give us a bit of a feel for what currencies maybe you'd prefer to issue in for the senior non-

preferred, if possible?

And then just a quick question on the fundamentals. Can you give us a little bit of colour as to how you're seeing the performance of German commercial real estate development loans, or just European development loans, more generally? I know you spoke about US commercial real estate a fair amount in the presentation earlier in the week, but it would be good to hear about developments, as well.

Richard Stewart

Thank you for the questions, Louise. Maybe I'll take the issuance question. The remaining plan is going in the senior preferred, and the senior non-preferred space, just to close things out. Like, we say, we've already done 13 billion or so, year-to-date, so we feel in pretty good shape. So, I think it's about one to three billion to go, and we'll likely issue in the cheapest currency.

So, as you've seen, we've tapped a number of different markets this year across dollars, euros, and renminbi and yen. And so, where we see the most demand, and the what makes economic sense for us, is where we'll issue. But it will be in the main currencies, is our current thinking.

James von Moltke

And Louise, very briefly, on development loans in Germany. Our German commercial real estate exposure is relatively small, and within that, the exposure to developers, even smaller, and we don't see concerns in that portfolio at all. We tend to gravitate to the highest quality of that spectrum, and hence, it's not been a noticeable point for us.

Louise Miles

Great. Thanks.

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