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Transcript

Speakers:
James von Moltke, Chief Financial Officer
Chris Hallam, Goldman Sachs

Chris Hallam: Good morning, everybody. And it's my pleasure once again to welcome James von Moltke, President and Chief Financial Officer of Deutsche Bank to our conference. Thank you, James, for joining.

James von Moltke: Chris, it's a pleasure to be here.

Chris Hallam: Let's start with revenues. Thinking about revenue diversification, in Q1, we saw stronger than expected performance in the Corporate Bank and the Private Bank. Could you elaborate on the process regarding building out that more predictable recurring stream of revenues within the business mix, and how durable we should expect those revenues to be heading into 2024, 2025? Is it too early to call peak NII in those businesses?

James von Moltke: Chris, it's a good place to start, lots to talk about there. I'll try to be as brief as I can. So, first of all, I think the first quarter performance, and we see that same development in the second quarter, as we talked about it back in January, February, it's evidence of how far we've come through the transformation.

As we talked about the transformation since 2019, a lot of it was about building the resilience, the sustainable profitability of the company, the business mix shifting towards what we've thought of as stable or more stable businesses, and somewhat away from the Investment Bank. And you've certainly seen that in the performance. The share of revenues of pre-tax profit now that are comprised or contributed by the Private Bank, the Corporate Bank, and Asset Management are quite a lot higher. I think that was one of the things that investors were looking for. In fact, in Q1, the Investment Bank was around a third of the total. So that progress is there.

Chris, as you say, part of it is driven by the change in the interest rate environment. Of course, the last 12 months have been dramatic in terms of that change. And naturally, that's benefited our Corporate Bank and Private Bank businesses. And in a sense, the Investment Bank has gone from what I'd call over-earning in the environment that we had seen in 2020 through 2022 to a normalized and I think still quite good and strong performance. So that has helped the mix shift in the businesses.

We do think we're making the investments to continue that progress over time. And so, seeing investments that we're making actually across the businesses, but perhaps less visible because it gets less attention in the press, but investments in our Corporate Bank business, investments in our Private Bank business, a strategy we're pursuing and investments in DWS, our Asset Management business. And so we're quite comfortable and confident about the future revenue trajectory that we're building across those businesses.

To your point about peak interest rates, we do believe that we passed a peak in Q1, and I want to be very clear here, we think there will remain a tailwind for the industry as we've gone from a negative and very adverse interest rate environment to a much more supportive, and over time I think, normalized interest rate environment. And so that's a good thing. But the peak is defined by what we call Beta, so the amount of retention, if you like, of the incremental interest rate increases that the banks have kept versus passing on to clients. And as you've heard about from us and our competitors, that's been much more favorable over the past several quarters, three or four quarters, than our models would've suggested.

We do expect that this dynamic will shift over time, and we've consistently expected that to happen. It continues to be slower than we'd anticipated. So this, while I think there is competition for liquidity, competition for liabilities, the progress, if you like, of convergence towards what the models would tell us that we need to pass on, remains slower. So that peak, while there is a downdraft in the next several quarters that we'd expect, it's actually coming in milder than we would've expected to this point.

In short, you're seeing, I think, continued progress in terms of this underlying development for us around steady revenue growth, I think more constructive tailwinds in the environment, and a mixed shift towards the more stable businesses that we've been working on now for several years.

Chris Hallam

And you mentioned in the answer to that answer, the 30% or so revenues in the Investment Bank, what is your current outlook for, and you've already seen a degree of normalization there, for the revenue trajectory within the IB?

How much further normalization could there be to come, and what is your latest expectations, whether it's already in Q2 or through the subsequent quarters, on the shape and the timing of the recovery and advisory?

James von Moltke

Also, a really fascinating question. Well, let me start Chris a little. I'm sure others have talked about their sense of what the environment looks like. To me, the banking environment today is actually mixed. I think on the negative side of the equation, you have slow economic growth, probably a recession coming. There'll be some impact of course on credit costs that comes with that. How severe that'll be, we don't know, both the economic environment and interest rates, so refinancing costs that'll take place. And you see in the Investment Banking business, particularly, you see a trailing off of volatility that has helped the macro businesses at the current moment. So, a couple of items that are a drag on the sector.

On the positive side, and this has surprised us this year to the upside, you have the continued benefit from interest rates, and as I just said, Beta coming still slower than we anticipated. You have actually asset markets that have maintained relatively strong levels, and that benefits fits us in a couple of our businesses, including Asset Management. And you have, I think, an overall environment that is where you haven't seen as dramatic an impact, for example, of the very rapid increase of rates. Now, we could say LDI and the turbulence in March are a sign that there's been an impact in terms of market confidence from the interest rate environment. But, I would still be on the side of the equation that says that that's been more moderate or modest in terms of impact than you might have expected for a move that is as big as we've seen the past year. So that's how I'd characterize the environment. Incidentally, by the way, in the stable business, asset growth is also in influenced by the general environment and for loans, essentially.

Now, the Investment Bank, we came into the year expecting at some point there'd be a trailing off of the very strong macro product environment that we had, especially last year. It was just a record year for the industry in macro products and we expected that to trail off. And the question was how quickly would the micro, so things like, well, credit in particular, but also financing transactions leveraged at capital market transactions, M&A equity, begin to come back. And is there a bit of a trough in between those two things?

We are seeing the trail off in the macro, but actually still quite encouraging activity, despite all the things we've been through, debt ceiling and what have you. But compared to this outstanding, especially Q1, Q2 for us last year, we're naturally going to have a step back, and I'd estimate that to be in a range between say down 15 to 20% in our FIC product area.

For what we call Origination and Advisory, so corporate finance advice and underwriting businesses, we think we're starting to find the floor, which is encouraging. So you've started to see at least Q4 to Q1 a sequential stabilization. And as I think some of our peers have talked about, beginning to see more activity. April, by the way, was extremely quiet, so I think it was carryover from the turbulence in March. But we've seen it starting to pick up, and so I certainly believe that we'll start to see potential increases in the pool, in the wallet and activity generally. How quickly that comes back, how robust that environment is will depend, but we certainly see that as encouraging.

So if I pull that all together for the quarter, starting with O&A, we think is probably flat to up this year relative to Q2 last year, in part, by the way, because of the non-repetition of leverage of capital market positions that started in the second quarter of last year. And that produces, I think for the Investment Bank generally as a down 15, maybe a little worse than that, quarter for us, but with some dynamics that continue to support, I think, a reasonably favorable outlook for us. Just a shift in the business mix in the Investment Bank.

Chris Hallam

And among costs, the progress in Q1 on costs was clearly quite encouraging, obviously helped by lower SRF, but in one way or another essentially the exact opposite of what we saw in Q1 2022. How do you see the rest of the year developing, in terms of trying to meet that flat cost target versus 2022 while also encompassing the new restructuring charge and all structuring charges that you announced in Q1? How would those feed into accelerating the strategy ambitions that you have? And maybe a bit more color on just specifically what this restructuring relates to.

James von Moltke

Sure, lots of moving parts on it. Well, look, let me start with just the overall statement that our focus on costs remains very intense. It's something that we know we need to deliver on and we're continually working to find new measures, execute on those measures, and maintain the discipline while of course preserving this balance that we've talked about for the last couple of years around the needed investments and controls, technology and what have you. So that's the balance we're trying to strike. As you say, our guidance has been, and we'll reaffirm that, that we're working to keep our expenses essentially flat at the top level in 2023 relative to 2022. In that there are a number of moving parts. I think most importantly what I'll call our operating expenses.

So take SRF out for a second, what we've called adjusted costs, we've been talking about a range of monthly expense of € 1.6 to € 1.65 billion, and that produces € 4.9 billion a quarter, essentially flat to the fourth quarter. And as you say, that's something that we achieved in Q1, we're working to achieve in Q2, we think we're in line with that. Even though FX, by the way, relative to Q1 has pushed us up a little bit in the range, just weakening Euro again. So lots of moving parts, but working to keep that as flat as possible.

On the rest, what I'll call non-operating expenses, as you say, Q1 SRF assessment was a bit better than we'd assumed and better than last year. That's helpful towards our overall full year guidance. What is a feature now and we'll be reporting in Q2 is higher non-operating expenses than we might have anticipated when we started the year. As you say, that's partly with restructuring severance that has been a deliberate decision. I'll come to what we're trying to do with that higher restructuring and severance, but in this quarter, I would expect total non-operating expenses to be in a range around € 600 to € 700 million, of which the restructuring and severance would be somewhere around € 250 to € 300 million.

The balance reflects a litigation quarter that has been unusually adverse, and you've seen some of the reports and the announcements. So we've had some adverse surprises. I don't think it's representative of a normal quarter and we can go into it a little bit, but that that's driving non-operating expenses higher in Q2, not something we'd expect to see repeating in the balance of the year. There are, though, some offsets that have helped us towards the full year guidance. You mentioned SRF is one, and there are others that are on our radar screen that we think will help continue the path towards the guidance for the full year, excluding, by the way, Numis, which we'll talk about a little bit in July, but should close in the fourth quarter.

Chris Hallam

That's a very helpful overview on cost for this year. But if we think about the medium term, frankly, consensus has a tough time believing the 62.5% cost income ratio. It's there on the revenue figures I think, but not there on cost. I think, what do you think is missing, I guess, in that consensus build? Or what can you give us in terms of color that would put a bit more confidence into that view that you can get down to a 62.5% efficiency target?

James von Moltke

Yeah, look, the basic model that we laid out in March of last year and we're continuing, I think, to show evidence of, is creating operating leverage by growing our top line and keeping the expenses essentially stable over time. What changed since March of 2022? Interestingly, the revenue environment is considerably better than we thought at that time, and that of course is partly driven by the interest rate environment. As we've talked, it's given us increasing tailwinds on the NII side, and that will carry through to 2025 and of course is quite visible and estimable for us. But we're also obviously working on is building the non-interest revenue base in the businesses in the ways that I described. So if we thought about a compound annual growth rate at the time between 3.5% and 4.5%, we are running to date quite a lot higher than that. It's been 7%, 6%, 5% depending on the quarterly comparison, and a lot of those kind of drivers and tailwinds are very much in place.

Now, expenses, we had a step-up last year because we made some decisions about, as I mentioned, technology controls relative to what we were looking at initially. But we think that's been more than compensated for by the increased revenue view. So it means we need to be laser-focused on expenses over the next several years, execute on the things that we've been working on. You mentioned the restructuring and severance. So as I say, we upped our guidance for the full year to about € 500 million, recognizing that in essence we needed to do more to offset the impact of inflation, some of the investments we wanted to make, and the environment, but overall preserve this model of generating operating leverage.

And so we've taken a number of actions. We're restructuring our mortgage platform, especially in Germany. We did a reduction in workforce. We've completed now the exit from our Russia tech center and working on a variety of other steps here in order to execute on a gross cost saving over that four-year period now of € 2.5 billion rather than the € 2 billion that we talked about in March of 2022. So that's the work we've been doing, and my colleague Rebecca Short now has even more oversight and control of our cost base based on some management changes we made in April, and I'm thrilled to have her ever stronger as a partner in this expense journey. That should give you some sense of what we're trying to do and how it helps to deliver that overall model of operating leverage.

Chris Hallam

Very clear. If we try and wrap the revenue and cost comments you've made together into a profitability topic, one of the numbers I thought was most remarkable in the first quarter was, ex the SRF costs, you delivered 10% return on tangible equity. It's tempting to ask, why didn't you upgrade the targets with Q1 results? But maybe the other side of the question is, could you speak a little bit about the things we should be watching to explain some of that quarter to quarter volatility that we're inevitably to be going to see through the year and through a new year.

James von Moltke

Let me start with saying hopefully less volatility over time in the businesses. So when we talked about this mix shift, and actually it was in 2021 I think at this conference and I started talking about us seeing a range of revenue performance on a monthly basis in the Investment Bank that was becoming more consistent over time. And the range that I gave at the time was € 2 to € 2.5 billion per quarter of revenues in the Investment Bank. Obviously, there's some seasonality and there can be outliers in either direction, but that was basically the core of what we were seeing in the Investment Bank and that's something that we're continuing to see and deliver on. But unlike the past, you have the other businesses really performing and so you have the Private Bank at something approaching that same level, well over € 2 billion. You have the Corporate Bank performing around a € 1.9 billion level of revenue. So that gives us, I think, more and more confidence in terms of what we're doing. Sorry, there was another element of what you asked for.

Chris Hallam

No, it's really just you did so well in the first quarter, there's always these volatile points quarter to quarter trying to stay on top of what those moving parts are. I mean, we've already talked a little bit about what to look through through the rest of the year but I get the sense from you-

James von Moltke

Oh yeah, why not upgrade the target. It was a nice way to put the question. Well, look, we were obviously encouraged by what we saw in Q1. The SRF assessment is an irritant because the accounting says you've got to take it all in the first quarter and we've struggled to estimate what it would be. But leave it aside. You can either spread it over the four quarters or you can take it out entirely, but what you saw in terms of underlying performance for the company, ex SRF, was better than a 10% ROTE and well below a 70% cost/income ratio. And essentially for us, that was demonstrating that all the work we'd done over those four years was delivering against the goal that we'd set for ourselves.

As you say, we need to continue that. Why not up the targets? I guess two things. One is we still need to go through a period of time now working out some of the uncertainties in the environment, so rates recession in those things and we still have work to do on completing transformation steps that we've been working on, whether that's technology or controls and other things. So still some work to do. But good underlying momentum and that's something that you're going to continue to see we think in the quarters ahead given the way the mix has shifted.

I think the second thing is it's a little early to start going after that. What you did see from us in Q1 was some statements and some indications of work we're doing to try to accelerate our path towards the goals we've set for 2025. Hopefully exceed those goals but also build on that momentum for beyond 2025. And so we've been hard at work with initiative steps, actions on the expense side, on the capital side and on the business growth side to try to continue building that engine of earnings growth and business performance. So we're feeling really good about it but it's probably a little bit early to talk more about what to see. And we need to work through the remainder of this year and into 2024, some of the things, we're chopping wood still.

Chris Hallam

So my final question before I turn to the audience, going down is around capital distribution. One of the questions I received a lot in the immediate aftermath of the Numis announcement was why didn't Deutsche Bank just do a bigger buyback? And I'm sure you had the same question, so maybe if you could help us understand how you think about the prioritization of capital use in terms of organic, inorganic distribution. And then we've also seen the specific dividend targets you gave previously. Since then, earnings expectations for yourselves and for many European banks have gone up a lot and other banks or some of your peers have taken up their distribution targets or their distribution ambitions. So maybe just a comment on how you think about distribution on a go forward.

James von Moltke

Well, look Chris, we're obviously very aware that investors want to be rewarded, especially having been through a journey with us. So it's, believe me, not far from our mind that this is an important piece of what we're doing. I guess the first part of the answer is, the core work we're doing is increasing the sustainable profitability of the company, the ROTE generation, the capital generation, which over time will support I think much larger distributions. While we're doing that, we've been focused on executing on a distribution path that we'd laid out I think reasonably clearly last March. And that, again, is front and center for us. If you ask about the order of operations then I think it's generating the capital. First, regrettably remains a capital build to support, I'll call it regulatory inflation. So whether it's model adjustments or preparing for Basel III, at the end of the day, that has to be the first, the priority in terms of how we think about capital planning. After that, absolutely delivering for investors on the promises that we've made around distribution.

As you've seen with the efforts around share repurchases is also something that we take very seriously and want to work on and deliver. And then we also need to balance all of that with business growth and investing in the future. And hence Numis, by the way, hence organic business growth, an important part of how we think of capital planning. But also in these instances where opportunities present themselves that we think are going to drive real value for our business franchise for our shareholders, we are open to inorganic steps. You can always ask whether that capital could have come out in a distribution. As you've heard me say, I don't think of them as entirely fungible, this idea of capital applied to an inorganic move versus distributions. But either way, we think we've struck a good balance in terms of investing in the future. And we think the Numis acquisition will really support then the earnings and capital generation over time, creating an attractive profile for investors.

Chris Hallam	Very clear. Okay, I think this is the point at which we wanted to come to the audience and see if there are any questions.
Question 1	Probably it's not very significant but have you benefited from the Credit Suisse, in terms of hiring and creating new positions and less competition?
James von Moltke	I'd say we have. It's always hard to measure these things but we've been focused on client acquisition, on hiring some bankers. As you've seen, there's been some press on it in a targeted way. And so we think there are benefits for us, we're a natural home for clients seeking to diversify their relationships, especially in Wealth Management. Obviously, investment banking, but within investment banking, again, corporate finance, origination & advisory for us. And then thirdly, also in corporate bank is, you shouldn't disregard that Credit Suisse was a major service provider in the DACH region and Switzerland. So we see benefits to measure and it'll take some time but benefits for us.
Question 2	Going back to Credit Suisse, you found yourself among the banks that were particularly targeted, especially in the debt markets. I guess maybe there's some false perceptions, but how do you intend to address that issue that whenever there's market upheaval, the securities from Deutsche Bank found themselves under pressure?
James von Moltke	I think just continued delivery. I mean, it is our goal, believe me, going through an environment like March, to be in a place where it just never comes into consideration that you might be vulnerable. So very present for us. Frankly, what's gratifying is after the market took a look, quite quickly, and by the way, without us necessarily having to speak for ourselves, the market saw that we didn't have the

vulnerabilities that the market was concerned about, whether it was interest rate risk or stability deposits and on and on. These were all things the market was looking at. I think the executing

on our strategy, building sustainable profitability, but then also risk management is key. First of all, we would like to think we've built a good track record on risk management and that track record is visible to all of you and hence investors take that into account in their thinking.

What I think March showed, and in a way the other events over the last several years, I mean we've been through COVID, we've through the Russia war, we've been through Archegos, we've been now through this and each of those crises tested a different vector, if you like, of risk or dimension of risk that banks have and banks need to manage. And it means that you need to run a bank at all times prudently or you need to manage those risks both, by the way, non-financial and financial risks really carefully because you never know which is going to be tested in any given sort of market environment.

Again, I think we showed that not just in March by the way, but over the years. And so again, after going through that experience, what was gratifying for us is the market took a look and based on knowledge that investors have and the disclosures we have out there, people concluded, yeah, Deutsche Bank should be okay. First prize is never taking a look.

Question 3

I was just wondering with the economic backdrop, if you've seen anything change on the consumer side of things, either from a function of higher rates or how they're thinking about their savings?

James von Moltke

We have. So well, actually, let me start on one thing which is going back to March a little bit, stability of the deposit base. So one of the things that I think investors looked at was how stable is the deposit base, in our case about € 600 billion. I think a very good split between retail and corporate deposits, very stable, insurance, all those good things that lead to a stable funding base anchored by the deposits.

German retail is obviously an important part for us. We have seen in the segment sort of really two dynamics. One is in the sort of lower income household segments, this run out, this inflation impact on household savings, the runoff of sort of excess savings coming out of COVID, that's present and has continued. And then you are also seeing more competition for deposits on pricing in the German market.

As I said earlier, I don't think that competition for deposits on pricing is outside of the norm at this point and arguably a little bit inside of the norm of what our models would tell us, but there's a competitive marketplace now and so investor depositors are getting new money offerings that naturally will shift a little bit between the providers and the market back. So those two dynamics are present. We're doing okay by the way. So we've had some deposit campaigns protecting our deposit base, but it's a little bit today sort of running to stand still in that environment and that's not unexpected for us.

Chris Hallam

Maybe just on the regulatory side, with all the turbulence we've seen in the US and here with Credit Suisse, have you had any conversations with the supervisors or with the regulators as to any adjustments you might need to see on liquidity or funding metrics or anything at all really?

James von Moltke

Yeah, going back to the times in March, any crisis environment like the one we live through is one where you're very intensively involved with your supervisors and I think in a positive way. They have very clear understanding of what each bank is going through. They can see how well you're faring, not just in terms of the balances and liquidity, but also are you in control of your shop, do you have the data, do you understand where things are? So in a sense it's sort of a bonding experience that when you go through these together with them. But they're also through all of that, they're getting some good insight into what's working in terms of the models, the liquidity drivers, how different customer segments behave and what have you. So it's a good real world test.

To start with, what we do internally, every time we go through one of these experiences, we step back and look at that data set that's provided and challenge our internal liquidity stress test models. Are they accurate? Are they conservative enough? What do we do? So we're going through that process naturally and it tells us something about the various sources of liquidity that are out there and client behavior. When you then switch to the regulatory metrics, I don't have the sense that there's a need for, or that at least speaking for the European regulators, there's a concern that they somehow failed. I just don't think that's the case. I don't think there's evidence to support that they did. So I don't see the need. They're not thinking too hard about that. But you never know. You never know what happens.

As I've said in some calls and what have you, one problem I think we have as an industry, and Credit Suisse unfortunately started to undermine confidence in the things that we talk about, which are CET1 ratios principally as the measure of solvency and LCR principally as the measure of liquidity resilience.

And what the world doesn't really see is just how conservative those measures are today and therefore how well capitalized how liquid the banks are and resilient in their ability to deal with stress. So my own view is these are good tools, they're well functioning, they're appropriately conservative and as we test them we always learn.

Just not to go on for too long. But if I go back to COVID, what was really fascinating is there was one liquidity driver that went close, I won't say to its max, but started to go towards its max and that was draws on unfunded liquidity facilities because that was the behavior that was happening at the time. Every corporate was drawing on their funding to make sure that they were okay. So there was a test of that liquidity driver, but we never kind of went through the peak of it. But we also saw that pretty much everything else was pretty stable. So you saw an overall LCR that was tested but only in respect of one of the drivers, meaning all the other buffers for every other form of liquidity outflow or stress was essentially unused. And that's kind of interesting and we saw something similar now in March that was only a handful of the liquidity risk drivers that were really showing any kind of indications of stress. And so the overall edifice is pretty solid.

Chris Hallam

So the clock's telling us, we're basically at time. But just one quick fire question to finish with. Looking ahead, what gives you cause to be optimistic? What gives you cause for concern? How do you strike the balance between the two in the end?

James von Moltke	You have to be on the concern side as I mentioned about the risk management. We just have to make sure that there are no vectors that are that. So that asset quality is one. We've talked about commercial real estate where we've gone through another effort to stress test our portfolio and do all of that work. So mission one is make sure we are well protected on those risk factors. Incidentally, completing this work on regular remediation, very high and control improvements very high on our agenda, so still work to do there. But then also building for the future and this making sure that our businesses are performing in a way that has real momentum value for our clients, gaining market share in some areas where we think we can. And so building that franchise for the future, while it's secondary to the risk management, is front and center for us and undergirds some of the optimism that we have in answer to your earlier questions.
Chris Hallam	Perfect. James, once again, thank you so much for joining us and sharing that, that was very helpful.
James von Moltke	Thank you for your questions.