Deutsche Bank: some progress but victory not assured

Deutsche Bank CEO Christian Sewing is adamant that the strategy to transform the bank by 2022 is on track, seemingly unfazed by the 14.8% decline in Q3 net revenues, the poor performance of FIC trading, the EUR 832m net loss and the negative 7.3% RoTE.

When Scope cut Deutsche Bank's Issuer Rating from BBB+ to BBB in May, the rating release had noted "the road to successful business-model recalibration and a return to sustainable profitability is still steep and fraught with uncertainties". While there were signs of progress in aspects of Q3 2019 earnings, that comment remains highly relevant.

That said, "the poor market response to the bank's Q3 numbers may have been a knee-jerk over-reaction to numbers that had either been flagged by management or were skewed by costs related to the restructuring that should have been factored into expectations," said Dierk Brandenburg, team leader for financial institutions at Scope Ratings.

When Scope cut DB's Issuer rating, the Stable Outlook anticipated that Deutsche would manage through the period with a minimum level of recurring operating profits as it cuts costs and repositions the balance sheet. The downgrade had been predicated on what Scope saw as continuing steep challenges to the group's multi-year business-model and activity-mix recalibration effort.

"While it's too early to declare victory, particularly amid a challenging set of macro factors – including negative bond yields and interest rates; slow growth and recession in Germany – the depiction by Deutsche Bank's CEO of the bank's status built off a series of positives," said Brandenburg. Trends in the Core Bank, performance of the Capital Release Unit, headcount, costs and capital are all running in line with or better than planned, Sewing said on the Q3 analyst call.

The CET1 ratio (13.4%, including 45bp of Q3 uplift from de-risking) was stable. The CEO listed a number of other positives: adjusted YoY costs lower and in line with plan (9M cost cuts suggesting the group is on track to deliver FY2019 target of EUR 21.5bn). The 15bp YTD loan loss provision is low historically and relative to peers; the 74% loan-to-deposit ratio reflects a strong and stable funding base; the 139% LCR equates to EUR 59bn over required levels. "We are on track to hit our full year 2019 target," Sewing said on the call.

The group is just EUR 4bn short of its 2019 target to cut RWAs in the CRU by EUR 20bn to EUR 52bn; CRU leverage exposure fell EUR 73bn in Q3 (EUR 100bn YTD) and management is confident the full-year target to cut exposure to around EUR 120bn looks achievable (assuming the transfer agreement with BNP Paribas for Prime Finance and Electronic Equities closes in Q4).

The core bank was profitable on a pre-tax basis in Q3. And while revenues fell 3%, reflecting the tough macro factors and impacts from the transformation initiative, adjusted costs fell 5%.

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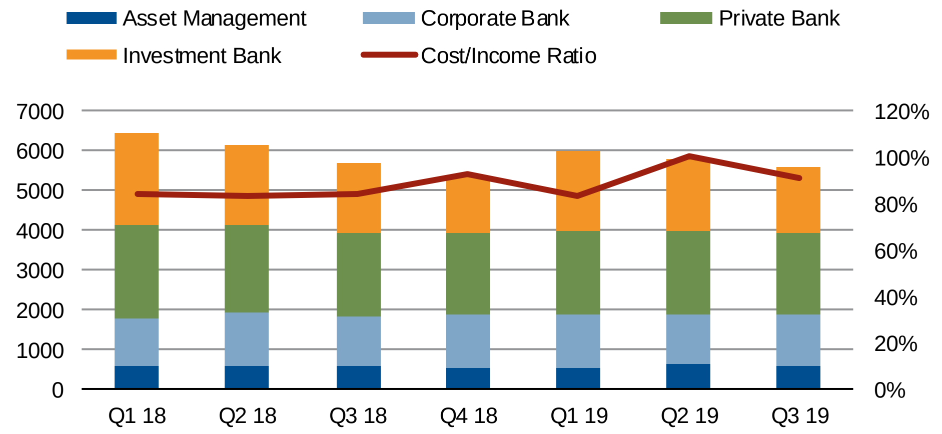
Core Bank revenues and cost-income ratio



Source: Bank numbers

The investment bank, which is doing a lot of the heavy lifting in the restructuring, came under particular scrutiny. Net revenues fell 5.4% but Sewing believes this is satisfactory given the impact of transformation impacts on the division and is in line with internal targets. A bright spot was the 20% growth in Origination & Advisory revenues ((driven by advisory fees) against a reportedly flat industry wallet; FX was “resilient”, although EM rates trading made losses. “One area of concern was FIC sales and trading, where revenues fell 12.7% YoY; a poor showing against DB’s principal US and European peers,” Brandenburg said.

The IB cost-income ratio rose 8.2 percentage points YoY to 94.8% and its post-tax return on average tangible shareholders’ equity was just 0.2%, against a lowly 2.6% in the year-ago quarter. But even in the face of the poor numbers, Sewing found an encouraging underlying trend, pointing to IB revenues mainly being generated from businesses that were either stable or grew in Q3. And only 3% of the 3,000-plus institutional clients with whom the bank did active business in equities reportedly stopped doing business with the bank in products it is keeping.

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