Daiwa Capital Markets

Deutsche Bank AG

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	Senior Preferred	Senior Non-Preferred	Outlook
Moody's	A3	Baa3	Stable
S&P	BBB+	BBB-	Negative
Fitch	BBB+	BBB-	Negative

Source: Moody's, S&P and Fitch

Background and ownership

Deutsche Bank AG (DB) is a universal bank active in wholesale banking and trading, transaction services, consumer finance, retail banking and wealth management. 87,000 employees serve clients across 70 countries. Its franchise is strong in international corporate banking and securities businesses, particularly with large German corporates. Total assets of €1.38tr and AUM of €1.23bn at 3Q20 make DB one of the largest investment banks in the world.

DB has a broad shareholder base, its shares are listed on stock exchanges in Germany and the US, with the majority of its shares owned directly or indirectly by institutional investors (72% of total). Shareholders with holdings ≥3% are BlackRock Inc (4.98%), Capital Group (3.74%), Hudson Executive Capital (3.18%), Paramount Services Holding (3.05%), Supreme Universal holding (3.05%) and Cerberus (3.0%).

Deutsche Bank – Key Data	3Q20
Total Assets (€bn)	1,387
Loan Book (€bn)	432.6
Loans to Deposits (%)	75.3
Cost to Income (%)	87.3
Net Profit (€m)	309
LCR (%)	151
FL CET1 (%)	13.3
Leverage Ratio (%)	4.4
Market Cap* (€bn)	19.9
P/B*	0.37

*Source: Bank statements, Bloomberg. *As of 08/01/2021*

Main activities

After several restructurings, the bank now operates across four main business divisions: **(1) Corporate Bank** (CB, 20% of revenues in 9M20) which aggregates global transaction banking, corporate finance and capital markets products; **(2) Investment Bank** (IB, 39% of revenues) focusing on trading and hedging of financial products, origination & advisory and FICC; **(3) Private Bank** (PB, 32% of revenues) offering retail banking and wealth management services in Germany and abroad; and **(4) Asset Management** (AM, 9% of revenues) operating under the DWS brand offering broad range of investment fund products and services to both retail and institutional clients. As part of its most recent restructuring efforts, DB created the **Capital Release Unit (CRU)** to accelerate the wind-down of non-core business units. The CRU houses leveraged exposures of €90bn (8% of total) and RWAs of €39bn (12% of total). These were greatly reduced over the past year (-49% yoy and -30% yoy respectively). However, the anticipated residual leverage exposures of the CRU in 2022 were meaningfully upsized against initial targets which we believe will continue to drag on DB's revenue performance.

Restructuring progress visible

Deutsche Bank appears to be on course to meet the main 2022 targets of its strategic overhaul launched in July 2019. This included the disposal of less profitable capital market activities considered 'non-core' such as the global equity sales and trading division, the prime finance business and the downsizing of its rates business. DB has also made considerable progress in reducing adjusted costs as it already achieved 51% of the targeted €6bn amount, in part through headcount reductions. Moreover, DB has already booked 85% of the €8bn transformation-related charges at end-2020, which should put the bank in a better position to tackle the adverse economic effects of the pandemic and help achieve its 2022 RoTE target of 8%.

Key Targets	9M20	2022 Targets
RoTE	5.6%	8.0%
Core Revenues	€24.2bn*	€24.4bn
Adjusted Costs	€18.3bn*	€16.7bn
Cost to Income Ratio	87.3%	70%
CET1 Ratio	13.3%	min. 12.5%
Leverage Ratio	4.4%	~4.5%

*Source: Bank statements; *Last twelve months (LTM) core-bank only*

The resulting simplified business model aims to make the group more Germany- and Europe-focused with the 2022 strategic endpoints placing the bank on a stronger foundation. Despite the progress to date, there remains a degree of execution risk as the bank's digital transformation is ongoing with the effectiveness of sizeable investments in controls and technology yet to be seen. The bank also made minor downward adjustments to some of its 2022 targets due to pandemic-related challenges and resulting lowered regulatory requirements for the leverage ratio. So far, cost reductions have supported DB in reaching its interim revenue goals, but as stated by DB management it will be challenging to sustain the revenue base of its fixed income business while growing its corporate and private banking franchises under the existing, highly uncertain macroeconomic conditions. Therefore, DB's profitability target of 8% RoTE appears ambitious in our view, backed by a rather low consensus analyst forecast of just 3.3% to be achieved by 2022. Capital levels have benefitted from the significant deleveraging to date, strengthening the bank's loss absorbing capacity and liquidity levels.

Financial strength indicators

Asset quality – DB's balance sheet stood at €1.38tr (-7.5% yoy) comprised of loans to customers (31%), trading and related assets (18%) and cash and central bank balances (13%). Geographically, over half of the bank's loan book is geared towards a strong, granular customer base in Germany (51%), followed by other European countries (22%), N. America (17%) and APAC (8%). The largest portion of loans relates to German mortgages, which accounted for 35% of the total. During the first nine months of 2020 DB booked loan loss provisions of some €1.5bn (9M19: €474m) which saw the bank's annualised cost of risk rise to 47bps vs 15bps in 2019 resulting in a slight deterioration in the bank's asset-quality metrics. NPLs rose to 2.9% from 2.3% one year prior and the coverage ratio fell to 33% from 41%, which may indicate some under-provisioning as most of the impaired loans are stage 3 under IFRS9. NPL and coverage ratios are slightly below European banking sector averages of 2.9% and 45.3% respectively, as reported by the EBA. Government guarantee and loan deferral schemes offered during the pandemic have helped support the strong asset quality ratios. We deem the bank's balance sheet to be in a better position to absorb further potential loan loss charges due to its lower cost base, improved revenue performance and the reduced exposure to higher risk and volatile business streams following the restructure.

Profitability – Over the last five years, Deutsche reported cumulative losses of €5.1bn due to a wide range of factors, including tax adjustments, restructuring charges, litigation, goodwill impairments, weak capital market activities, the low interest rate environment and overcapacity in the German banking sector. There were signs of improvements during the first nine months of 2020 as profits amounted to €436m helped by the strong performance of its investment-banking arm, which saw top line revenue performance rise 35% yoy. DB's revenue forecast of €24.4bn by 2022 (LTM: €23.8bn) appears credible as it plans to achieve it with continued cost discipline, backed by a track record of 11 consecutive quarters of falling expenses. As more revenue is coming from its investment bank, growth is expected to rise to 3% for the period 2018 through 2022, up from previous expectations of 2%. Nevertheless, performance still lags DB's global investment banking peers, especially those in the US that have enjoyed growth rates about twice as high in their fixed income, currencies and commodities (FICC) business segments.

Deutsche Bank - Additional Data

Key Ratios (%)	9M20	FY19	FY18
FL CET1	13.3	13.6	13.6
Total Capital	17.6	17.4	17.5
Leverage Ratio	4.4	4.2	4.1
LCR	151	141	140
Cost to Income	87.3	108.3	92.7
RWA TLAC	32.5	34.6	33.71
€bn			
Total assets	1,388	1,298	1,348
Loans	432	434	405
Senior Pref. Debt	4	3	1
Senior Non-Pref Debt	48	56	55
AT1 / Tier 2	14	12	14
CET1	43	44	47
Total MREL	109	115	118
Liquidity Buffer	253	222	259
Total AuM	1,236	1,255	1,203
€m			
Revenues	24,263*	23,165	25,316
o/w Origination & Advisory	-	*1,606*	*1,784*
o/w FICC	-	*5,534*	*5,646*
o/w Equities	-	-	*1,957*
Expenses	18,367*	25,076	23,461
Loan loss impairments	1,787*	723	525
Net Profit	435	-5,718	-52

*Source: Deutsche Bank earnings reports, as stated, *LTM core bank*

Divisional performance in 3Q20 was overall positive leaning predominantly on the IB (40% of total revenues) while Asset Management (9.5% of total) provided another bright spot with revenues up 4% yoy to €563m on the back of strong asset net inflows of €11bn, positive fair value changes of guarantees and lower funding allocations. ESG-dedicated funds now account for a third of all net inflows during 2020 highlighting the growing importance of this sub-segment. In the IB, FICC as the main income driver grew 47% yoy due to higher client retention and activity, improved rates performance and growing credit trading. Origination & Advisory also improved after some lacklustre quarters in recent years. Revenues were up 15% driven by both equity and debt origination income growth that was based on market share gains. Income from the Private Bank (34% of total), which includes the German retail-banking arm, remained flat against last year as business volume growth was offset by continued deposit margin compression. To improve revenue performance in the division, DB will need to increase synergies from its Postbank integration, transforming sizeable deposit volumes into fee-yielding investment products. Lastly, revenues in the Corporate Bank (21% of total) were down 5% yoy as interest rate headwinds and lower client activity hurt cash management income and outweighed positive effects from deposit repricing and ECB tiering.

Capitalisation – The group's capital position is robust with CET1 at 13.3% as at 3Q20, which is comfortably above its SREP requirement of 10.4%. As a result of the restructure, regulators recognised Deutsche's reduced organisational complexity leading to a Pillar 2 requirement reduction of 25bps while the FSB moved the bank from bucket 2 to bucket 3 on the G-SIB list. Regulatory capital relief measures in response to the pandemic further lowered DB's capital requirements over the course of the year, resulting in sizeable buffers over SREP and MDA of some €9.4bn (+285bps) and €8.4bn (+259bps) respectively. DB expects to maintain a CET1 level of at least 12.5% over the next two years, which we deem feasible.

DB's fully-loaded leverage ratio was up slightly to 4.4% vs 4.2% at the beginning of 2020, benefitting 36bps from the ECB 'quick fix' which allows for the temporary exclusion of certain central bank balances from leverage exposures. Without the exclusion, the ratio would have been 4.1%, still well above the 3% required amount applicable from June 2021 (3.75% from 2023).

Subordinated TLAC/MREL amounted to €105bn at 9M20 vs a subordination requirement of €66bn. Total TLAC/MREL (including vanilla senior preferred debt) amounted to €109bn against a €92bn requirement. The stated figures already exclude €4bn in bonds issued under UK law that are de-recognised as of January 2021. As per above, outstanding MREL is well in excess of requirements, yet the bank aims to maintain this surplus in expectation of higher MREL subordination and requirements during 2021. Deutsche is also considering replacing some of its outstanding SNP with cheaper SP paper however, this could lead to a lower LCR ratio, restricting its operational flexibility.

Funding & Liquidity – As at 3Q20 Deutsche Bank's funding base consists primarily of €575bn customer deposits of which 52% were granular retail deposits. Customer deposits thus accounted for 58% of the bank's net balance sheet highlighting DB's strong retail base, especially in Germany. Reflective of the ongoing deleveraging, trading and related assets have fallen to €158bn (-5% yoy) accounting for 16% of the net balance sheet while capital market funding reliance is considered low, totalling just €162bn (16% of total). In 9M20, DB issued debt of €14bn, including €7bn Senior Non Preferred (SNP) and €3bn Senior Preferred (SP). This largely completes the bank's revised funding plan for 2020, which stood at €10-15bn. However, DB announced that it would prefund some of its 2021 requirements if market conditions would allow for it, which it promptly did in November issuing three SNP for a combined amount equating to €4.6bn.

Deutsche also participated in the ECB's T-LTRO III programme for a total of €34bn, taking advantage of recalibrated and favourable funding conditions that have been offered since June and that were improved further in December 2020. Liquidity reserves of €253bn are sizeable and split by cash balances (66%) and highly quality liquid assets (34%), amounting to 25% of the bank's net balance sheet. They have grown by €31bn since the beginning of 2020 which was mostly due to participation in the ECB's funding programme. However, we expect a gradual reduction of liquidity reserves to €200bn in line with DB's communicated target, supporting expected balance sheet expansion and reducing the negative carry associated with central bank cash balances. Liquidity indicators LCR and NSFR remained adequate and above minimum requirements at 151% and >100% respectively.

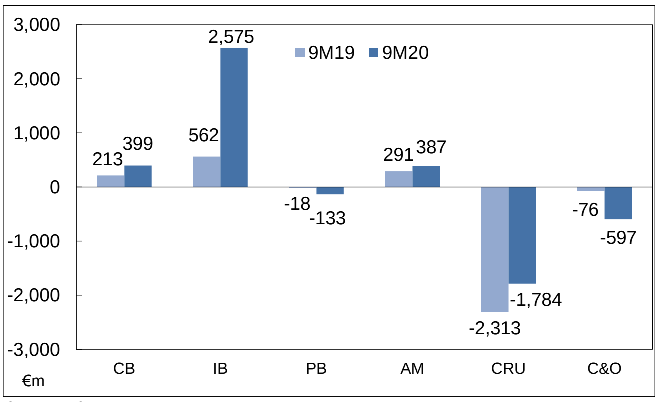
Rating agencies' views

Moody's affirmed Deutsche's deposit and senior unsecured debt and issuer rating at A3 stable and changed the outlook to stable from negative. The affirmation and change in outlook reflect progress in executing its new, more radical shift in strategy, which has put the bank in a better position to absorb the effects of the coronavirus-driven macroeconomic shock, supporting its standalone credit strength. But Moody's acknowledged that execution remains key to improving DB's credit profile and ratings.

S&P affirmed its ratings for the SP (BBB+) and SNP (BBB-) while noting that the cyclical downturn arising from the COVID-19 pandemic has led to a weakened economic and operating environment for Deutsche Bank. The agency expects the bank's earnings, asset quality, and capitalization to be weaker than previously envisaged through end-2020 and into 2021. The management's restructuring plan is still considered fundamentally on track. And S&P's judges that the management will likely deliver a significantly improved business and operating model, bringing the bank close to covering its cost of capital by 2022. However, the negative outlook acknowledges substantial downside risks.

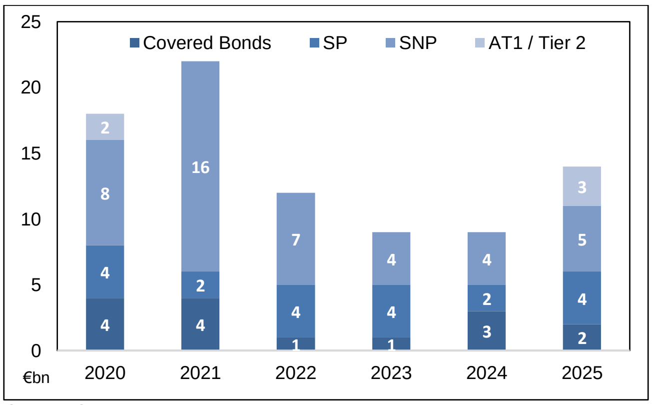
Fitch: Deutsche Bank's IDRs and SNP debt ratings (BBB) are equalised with the VR while the SP rating (BBB+) is sensitive to a downgrade in the respective IDR. The latter reflects progress but also continued challenges associated with the bank's ambitious multi-year restructuring. Fitch judges that the restructuring should result in a more focused and profitable business model, but will weigh on the bank's financials in the near term, at a time when the external environment has also come under shock due to the coronavirus pandemic and related lockdowns. Continued medium-term risks to Deutsche Bank's strategy and financial profile in view of the weak economic outlook are reflected in the negative outlook.

9M pre-tax profit by business segment



Source: Company reports

Debt Maturity Profile as at 9M20



Source: Company reports

Recent Transactions

Issue Date	Security	Maturity	Currency	Size (m)	Type	Coupon	Yield	Final Spread (bps)
17/11/2020	Senior Non-Preferred	6NC5	USD	2,000	Fixed	2.129%	2.129%	T + 175
09/11/2020	Senior Non-Preferred	10NC9	EUR	1,500	Fixed	1.750%	1.792%	MS + 205
09/11/2020	Senior Non-Preferred	5NC4	EUR	1,500	Fixed	1.000%	1.119%	MS + 160
10/09/2020	Senior Non-Preferred	11NC10	USD	1,500	Fixed	3.547%	3.547%	T + 287
10/09/2020	Senior Non-Preferred	4NC3	USD	1,750	Fixed	2.222%	2.222%	T + 207
28/08/2020	Senior Non-Preferred	6NC5	EUR	750	Fixed	1.375%	1.461%	MS + 185

Source: Deutsche Bank, BondRadar

This is an issuer profile and contains factual statements only. All statements are sourced from Deutsche Bank financial reports, which can be found at https://www.db.com/ir/index_en.htm

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Additional notes for Japanese-based investors

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