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Contacts

Olivier Panis +33.1.5330.5987
Senior Vice President
olivier.panis@moodys.com

Andrea Pasceri +33.1.5330.1021
Ratings Associate
andrea.pasceri@moodys.com

Laurie Mayers +44.20.7772.5582
Associate Managing Director
laurie.mayers@moodys.com

Ana Arsov +1.212.553.3763
MD-Financial Institutions
ana.arsov@moodys.com

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Deutsche Bank AG

Profit drops despite continued revenue growth, driven by large exceptional charges and rise in cost of risk

All comparisons in this report are made versus Q4 2022 unless otherwise indicated.

On 1 February, Deutsche Bank AG (DB, A1/A1 stable, baa2[1]) reported profit before tax of €0.7 billion in Q4 2023, 10% weaker than the prior year, primarily because of higher risk charges and exceptional operating expenses. Adjusted revenue[2] increased 10%, benefitting from solid business growth in corporate banking (CB), private banking (PB) and investment banking (IB). Growth in adjusted operating expenses surged by 9%, weakened by material exceptional items.[3] Cost of risk in the quarter increased significantly by 39%, primarily driven by model overlays, contrasting with positive model changes impacts in the previous quarter, and rising commercial real estate risks. Excluding those effects, we expect the bank's cost of risk would have been broadly in line with the previous quarter, albeit confirming the full-year trend showing rising Stage 3 provisions, only partly offset by lower forward-looking provisions on performing loans. Lower quarterly earnings were more than offset by deductions for dividends, share buybacks and regulatory deferred tax resulting in a 13.7% Common Equity Tier 1 (CET1) ratio, down 20 basis points from the previous quarter.

Adjusted revenue increased 10%[4] to €6.7 billion and benefitted from rising rates, primarily in CB (revenue up 9%) and PB (adjusted revenue up 9%). The performance in CB and PB was achieved despite loan volumes being 4% and 1% lower, respectively, year-over-year. However, loan volumes stabilised from the previous quarter. This performance more than offset the continued normalisation of IB, whose adjusted revenue was up 8% from a relatively weak performance in Q4 2022, but down 18% from the previous quarter. Asset Management revenues continued to lag the year-earlier performance, 5% lower than in Q4 2022, affected by lower management fees from alternative products and higher funding costs. While the net interest margin continued to rise in Q4 2023 for CB, PB and IB, the bank projects a slight decline in net interest income in 2024, reflecting a normalisation of deposit costs, only partly offset by the benefit from the rollover of deposit and equity hedge portfolios and the expectation of rising volumes. However, the bank projects net interest income in 2024 that remains 15% higher than in 2022 and 40% above 2021. The bank also expects a rise in fees that will support a new annual revenue growth target of 5.5% to 6.5% in 2024-25, in line with the growth delivered in 2022 and 2023, and above the initial target for the 2021-25 medium-term plan of 3.5% to 4.5% annual growth.

Group adjusted[5] operating costs were up 9% and sequentially up 7%. However, excluding a number of non-recurring exceptional charges, including those related to Postbank remediation or the FDIC special assessment applied against uninsured deposits in the US[6], the recurring operating cost level is broadly in line with the previous quarter and around €5 billion. The bank expects exceptional items to reduce in Q1 2024 and to return to a €5 billion quarterly run rate, as it benefits from incremental savings from ongoing efficiency plans. The achievement of a cost to income ratio of less than 62.5% by 2025 remains an ambitious target from the 75.1% ratio reported in 2023. The bank plans to progress on its €2.5 billion operational efficiency programme, of which measures representing €0.9 billion of savings were already completed at the end of 2023.

Credit impairment charges increased to around €488 million, up from €351 million in the previous year and €245 million in the previous quarter (Exhibit 1), representing 41 basis points (bps) of gross loans (31 bps for the full year 2023 and 25 bps in 2022). The sequential increase reflects non-recurring model-driven provision releases that did not repeat in Q4, but also an increase in Stage 3 provisions, confirming the gradual increase in impairments reflective of subdued global economic conditions. Stage 3 provisions of €457 million increased both in PB and CB, only partially offset by a provision reduction in IB. DB's cost of risk for the full year 2023 ended up slightly above its guidance of a 25-30 bps loan loss rate.

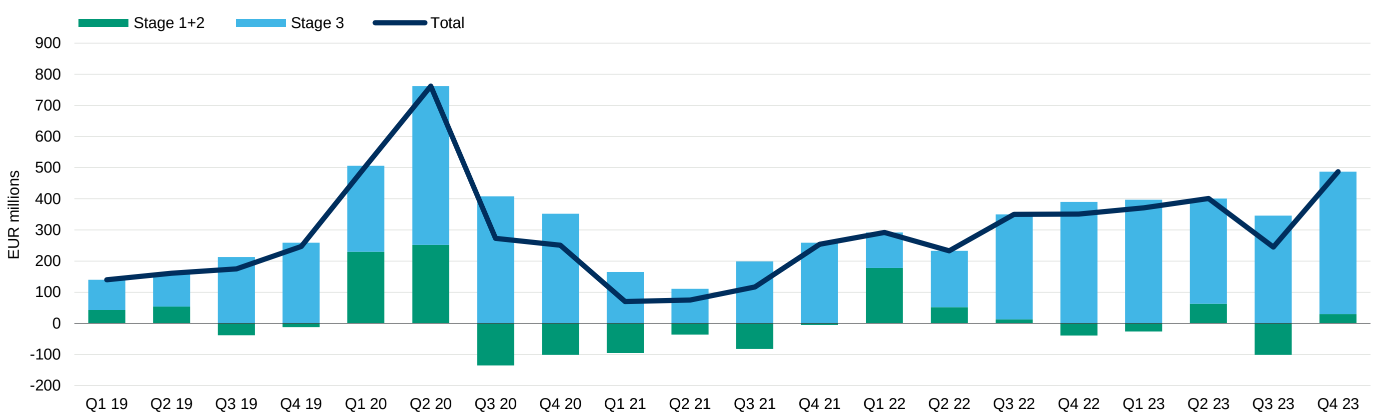
Pretax income was down 10% in the quarter and post-tax profit declined 28% to €1.4 billion, largely reflecting some non-recurring and non-operating items such as the goodwill impairment for the acquisition of Numis, lower DTA valuation adjustments year-on-year, and some non-recurring disposal gains recorded in 2022. DB reported a net return on tangible equity (ROTE) in the quarter of 8.8%, lower than 13.1% achieved the prior year and the 10% target set for 2025. ROTE reported for the full year 2023 was 7.4%, lower than 9.4% in 2022. At the group level, DB reported for Q4 an adjusted net return[7] on shareholders' equity of 4% (stable from Q4 2022), a net return on total assets of 0.18% and a net return on risk-weighted assets (RWA) of 0.66%.

DB's earnings in the quarter were more than offset by capital distribution and regulatory deductions, leading to a decrease in its capital ratios. DB's CET1 capital ratio ended the quarter at 13.7%, down 20 bps sequentially but up 40 bps from year-end 2022, and around 260 bps above its minimum regulatory requirement in 2024 of around 11.2%. Considering the bank already achieved at year-end 2023 around €13 billion of its €25 billion-€30 billion RWA reduction target by 2025, it now has higher capacity to grow business and distribute capital than anticipated at the beginning of the 2022-25 strategic plan. As a result, DB announced a capital distribution of around €1.6 billion in the first half of the year, including €675 million share buybacks (up from €450 million in 2023), while aiming to maintain a CET1 ratio of 13.5% at year-end 2025. The leverage ratio was 4.5%, down 13 bps sequentially, one of the lowest among peers (Exhibit 2).

The bank's strong, high-quality liquid assets of €219 billion at year-end 2023 increased by €9 billion sequentially, and were stable from year-end 2022. The liquidity coverage ratio (LCR) increased materially to 140% from 132% in the previous quarter, representing an excess of €62 billion above the minimum, and its Net Stable Funding Ratio remained broadly stable at 121%, at the top end of the bank's managed target of 115-120%. Average deposit volumes increased 1% in the quarter and back to the year-end 2022 level, while average loans were broadly flat sequentially and down 4% over the full year.

Exhibit 1

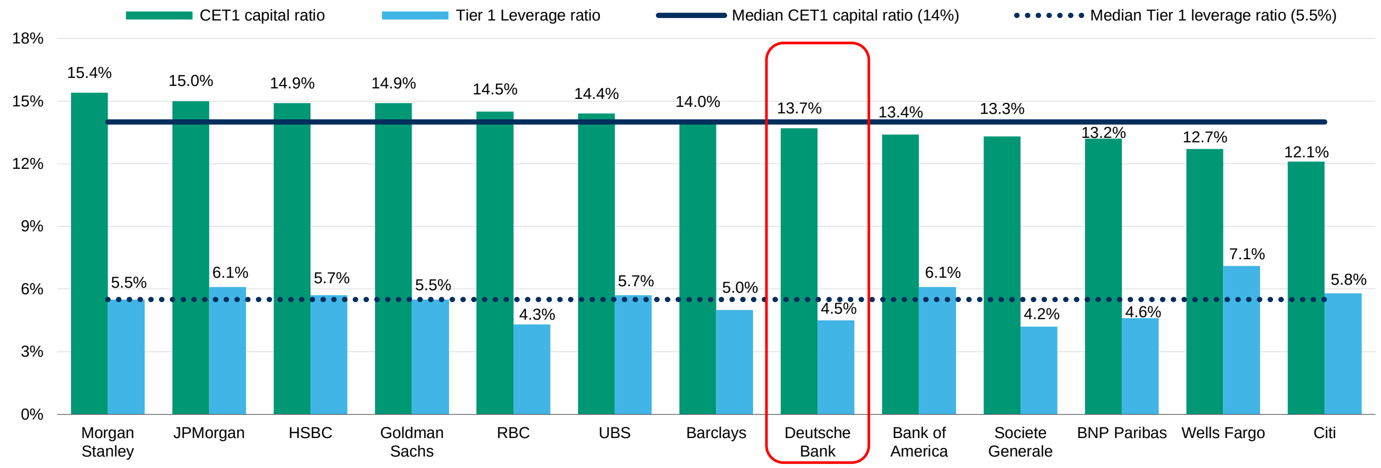
Loan loss charges (LLC) remain low but provisions for nonperforming loans are gradually increasing (€ millions)



Sources: Company reports and Moody's Investors Service

Exhibit 2

Common Equity Tier 1 (CET1) ratio and Tier 1 Leverage Ratio for global investment banks, as of end-December 2023



Notes: 1) Q4 2023 for Deutsche Bank, BNP Paribas, Morgan Stanley, JPMorgan, Goldman Sachs, RBC, Bank of America, Wells Fargo and Citi; Q3 2023 for all others. 2) The Tier 1 leverage ratios of UK and European banks are calculated per the Capital Requirement Regulations, and they exclude certain central bank balances as temporarily allowed; for US banks we show the supplemental leverage ratio (SLR). 3) The CET1 ratio for US banks is calculated under the advanced approach.
Sources: Company reports and Moody's Investors Service

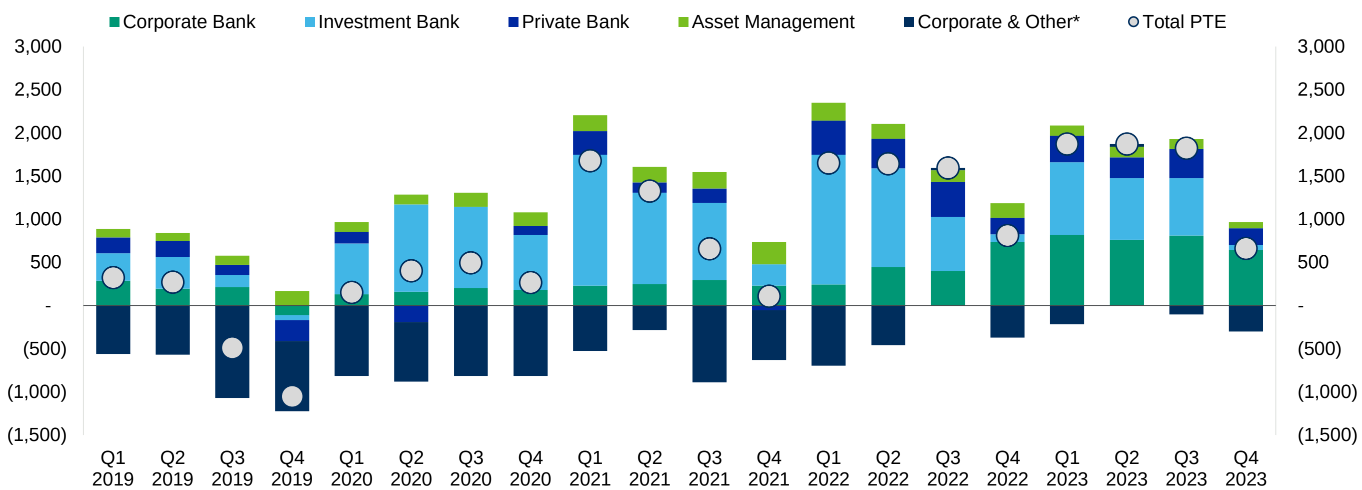
Segmental results commentary

Unless indicated otherwise, figures displayed below are on a DB reported basis and comparisons are made versus Q4 2022.

Exhibit 3

DB's profitability benefits from solid revenue performance in PB and CB, despite a slowdown in IB primary revenue and weak asset management performance fees

Adjusted quarterly pretax profit by business line (excluding litigation, impairments, DVA and one-offs), € millions



* Capital Release Unit (CRU) discontinued from 2023 and restated in 2022 (moved to C&O). Quarterly 2019-2021 figure for C&O reflects combined CRU and C&O.
Sources: Company reports and Moody's Investors Service

The **Investment Bank** reported a pretax loss of €258 million, compared with a loss of €22 million in the same quarter the prior year. Adjusted revenue increased by 8% to €1.9 billion, driven by a recovery in Origination and Advisory (O&A) services' performance, whose revenue was 56% higher than a year earlier. Given a stable performance in Fixed Income and Currencies (FIC), O&A's contribution to IB revenue increased to around 17% from 12% in the same quarter of the prior year. DB outperformed its US peers in both FIC and O&A. O&A revenue increased 65% in dollar terms for DB compared with an aggregate US peers' performance increase of 4%, mainly because of the comparison with the low O&A revenue reported the previous year, in which inflows from debt origination were constrained by the mark to market losses posted in leverage debt capital markets. DB's performance in FIC also compares positively with its US peers (up 7% in dollar terms versus US peers' aggregate of down 8%). Adjusted costs increased 4% from the prior year, and 6% sequentially. Provisions for credit losses more than doubled year-over-year to €186 million, mainly because of higher provisions on the performing portfolio due to model changes and new provisions on deteriorated exposures, mainly in commercial real estate.

The **Corporate Bank** reported a pretax income of €685 million, down 6% year-over-year, driven by an 18% rise in adjusted costs, which were not fully offset by the 9% increase in revenue. The better performance across all business lines is mainly attributable to higher interest rates, with net interest income up 11% in the quarter compared with the prior year and 4% sequentially, albeit loan volumes were stable quarter-over-quarter. Revenue in Corporate Treasury Services increased by 2% year-over-year, Institutional Client Services revenue rose 12% and Business Banking revenue was up 25%. The increase in costs was driven by both personnel and administrative expenses, which increased by 19% and 16%, respectively, from the previous year (9% and 7% sequentially). Loan loss provisions in the segment increased by 33% to €74 million year-over-year, mainly related to a higher provisions booked on the nonperforming portfolio.

The **Private Bank** reported a pretax profit of €215 million, down 58% compared with the previous year, and down 36% sequentially. Adjusted revenue was up 9%, supported by growth in Private Bank Germany (up 10%), and International Private Bank (up 8%). Private Bank Germany's revenue benefitted from higher net interest income, only partially offset by lower fee income. Assets under management increased by €12 billion during the quarter, driven mainly by €7 billion of net inflows and positive exchange rate movements. Adjusted costs were up 3% year-over-year, mainly because of higher investment in control functions, Postbank service remediation and inflationary pressures, which more than offset the benefits generated from the cost efficiency measures. Provisions for credit losses decreased by 13% from the previous year, resulting in a 4 bps decrease in cost of risk, but increased 12% sequentially (3 bps increase in cost of risk sequentially).

Asset Management reported a pretax profit of €70 million, down 21% year-over-year. Revenue decreased by 5% to €580 million (down 2% quarter-over-quarter), reflecting a 3% decline in management fees, which are the main source of revenue in the segment. Assets under management increased 9% year-over-year to €896 billion, and increased by around €36.5 billion sequentially, driven by €11 billion of net inflows and positive market impact. Adjusted costs were up 17% year-over-year, mainly because of a change in accounting variable compensation in 2022. Sequentially, adjusted costs increased by 5%, driven by a double-digit increase in general and administrative expenses, which more than offset the moderate decrease in personnel costs.

Rating Considerations

Deutsche Bank has a BCA of baa2 and is rated A1 for deposits, A1 for senior unsecured debt, Baa1 for junior senior unsecured debt and is assigned a Counterparty Risk Assessment of A1(cr)/P-1(cr) and Counterparty Risk Ratings of A1/P-1. The long-term senior debt and deposit ratings carry a stable outlook.

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» Deutsche Bank AG: Strides in profitability show bank's credit positive restructuring is solidly on track, August 2021

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Rating Methodology

» Banks Methodology, July 2021

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Endnotes

1 The ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment).

2 Adjusted for specific items that mostly included non-recurring revenue from the workout of Sal. Oppenheim and the gain on sale of Financial Advisors business Italy in Q4 2022, as well as the impact of debit valuation adjustments (DVA) in Q4 2022 and Q4 2023.

3 Including, among other one-off items, €42 million costs for real estate charges related to the Deutsche Post agreement, €35 million Postbank operational backlog remediation, and €51 million FDIC special assessment applied against uninsured deposits.

4 Stated revenue increased 5%, but was up 10% when adjusted for specific items as disclosed by DB.

5 In Q4, adjustments reflect some material items, including a €233 million impairment of goodwill related to the acquisition of Numis, some €189 million of restructuring and severance costs, partly related to Postbank, partly offset by a release of litigation charges for €255 million.

6 This special assessment implemented by the FDIC in 2023 follows the closure of Silicon Valley Bank and Signature Bank, and associated cost of approximately $16.3 billion attributable to the protection of uninsured depositors.

7 We assume an average tax rate net of deferred tax asset effects of 35%.

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