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Deutsche Bank's Q3 Earnings Highlight Risk Of Further Near-Term Earnings Volatility

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FRANKFURT (Standard & Poor's) Oct. 30, 2008--Standard & Poor's Ratings Services today commented on the third-quarter earnings release of Deutsche Bank AG (AA-/Negative/A-1+).

The group's pretax income was €93 million in a challenging quarter. However, pretax income would have been about €1 billion lower, excluding the reclassification of certain trading assets and those available for sale into the loans and receivables category--under International Accounting Standard No. 39 and International Financial Reporting Standard No. 7--and excluding fair-value gains on own debt.

The bank has announced that its corporate banking and securities division posted a pretax loss of €789 million, including the benefit from asset reclassification of €820 million. This loss stemmed mainly from higher-than-expected losses from proprietary trading of €1.3 billion and further markdowns of €1.2 billion on still sizable holdings of leveraged finance loans, loan commitments, and other credit market exposures, which highlight the risk of further near-term earnings volatility. The previously mentioned asset reclassification, which includes €8 billion of leveraged loans, does not solve the bank's problem of holding a large and undiversified portfolio of non-investment-grade loans through an economic downturn. On the positive side, the division demonstrated relatively strong underlying revenues for the quarter, adjusted for major markdowns and proprietary trading losses.

There was some earnings erosion in Deutsche Bank's other business lines,

mainly in asset management and private clients. This reflects the impact of market conditions on asset-based fees, performance fees, and brokerage commissions, as well as increased impairments and nonrecurring charges. Earnings from global transaction banking remained solid.

"In the near term, aggregate earnings from these 'stable' business lines should be lower than those of previous quarters, especially in asset management," said Standard & Poor's credit analyst Bernd Ackermann.

The group's regulatory Tier 1 capital ratio improved to 10.3% from 9.3% as of June 30, 2008, in line with its revised target of 10%. However, the Sept. 30, 2008, ratio includes a €2.2 billion capital increase in anticipation of the acquisition of a 29.75% stake in Deutsche Postbank AG (A-/Positive/A-2), which is expected to close in the first quarter of 2009. Ignoring this effect, the group's capitalization rose about 30 basis points from June 30, 2008. However, its capital ratios include a €1.1 billion deduction for accrued dividends, which might provide some flexibility for Deutsche Bank in managing these ratios in the fourth quarter of 2008.

"The outlook on Deutsche Bank is negative because the investment banking industry is still under heavy pressure and, indeed, markets further deteriorated in October," said Mr. Ackermann.

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