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Bulletin:

As Commerzbank And Deutsche Bank Talks End, What Now For The Two Banks?

April 26, 2019

PRIMARY CREDIT ANALYSTS

Harm Semder
Frankfurt
(49) 69-33-999-158
harm.semder
@spglobal.com

Giles Edwards
London
(44) 20-7176-7014
giles.edwards
@spglobal.com

SECONDARY CONTACTS

Felix Winnekens
Frankfurt
(49) 69-33-999-245
felix.winnekens
@spglobal.com

Bernd Ackermann
Frankfurt
(49) 69-33-999-153
bernd.ackermann
@spglobal.com

FRANKFURT (S&P Global Ratings) April 26, 2019--Yesterday's announcement from Germany's Commerzbank AG (A-/Negative/A-2) and Deutsche Bank AG (BBB+/Stable/A-2) that they have ended their early stage merger discussions shifts investor attention back to their original stand-alone strategies, which carry their own risks.

As we discussed in "Commerzbank And Deutsche Bank Potential Merger Holds Promise Of Increased Efficiencies But Also Risks," published on March 18, 2019, domestic consolidation offered Commerzbank and Deutsche Bank some potential synergies. The two management teams have concluded that the overall business case was insufficiently strong. Although shareholders may be relieved that they have avoided the capital call that would likely have come with a deal, they have no immediate reasons for optimism, in our view.

Both banks are now focused on their original stand-alone strategies, which form the base cases underlying our ratings. However, these have their own challenges, not least because the slowdown in the domestic and European economies has been bigger than expected, equity and capital markets have been lackluster, and the ultra-low interest rates and stiff competition have persisted. Accordingly, we consider both management teams remain under pressure to build investor confidence in their stand-alone business models' ability to combat their key weaknesses. These include subpar profitability, which is partly driven by high cost structures.

In this respect, we think Commerzbank is somewhat less challenged than Deutsche Bank, although our negative outlook on Commerzbank continues to reflect downside risks. Commerzbank's management reiterated its belief that its "CBK 4.0" strategy is the right one, though this strategy could evolve as part of the bank's regular annual strategic review that ends later in 2019. In our view, the bank's strong franchise in the small and midsize enterprises segment and its stable and granular deposit base, combined with a weak equity valuation and the relatively steady state of its operations, still make it potentially attractive as a merger target. Some European banking groups have already expressed their tentative interest in a combination, according to media reports.

Deutsche Bank, which we rate below Commerzbank, reported its first-quarter results today. Weak market activity undermined revenue at its investment bank, in line with its peers. Nevertheless, the bank has made some progress in increasing its revenue and demonstrated further cost control. As such, management felt able to restate its target of a 4% return on tangible equity for the 2019 financial year. Consensus estimates suggest that the market considers 4% to be unlikely, however.

In stating that it continues to review all alternatives to improve long-term profitability, we consider that Deutsche Bank has acknowledged that it may need to take further strategic actions to achieve its longer-term objective of adequately covering its cost of capital. In our view, the bank will remain under strain until it starts to close in on this objective.

This report does not constitute a rating action.