FitchRatings

Fitch Ratings: Deutsche Bank Shows Mixed Progress with Targets and Strategy

Fitch Ratings-Frankfurt/London-29 April 2019: Deutsche Bank's 1Q19 results show mixed progress towards financial targets, Fitch Ratings says. The bank's costs and capital are on track with its prior guidance, but weak revenue generation could make profitability targets harder to reach. Following its decision to abandon a merger with Commerzbank, Deutsche intends to continue its strategic plan, including a 4% return on tangible equity target for 2019 and stricter cost discipline.

Deutsche (BBB+/Negative) did not announce strategic or business changes but said it will continue to assess all options to improve long-term profitability. It said it remains committed to the business model of a global investment bank, with a meaningful presence in the US and Asia. The bank's decision to abandon merger talks with Commerzbank appears consistent with our view that potential synergies were highly uncertain, given the significant execution risks involved.

We believe that Deutsche continues to face wide-ranging challenges in reaching its 2019 targets and proving that its business model can generate adequate and sustainable returns. The bank has yet to show that it can achieve targeted synergies in its retail businesses. These and the asset management operations provide stability but limited earnings. Deutsche's investment bank has yet to show that it can recover lost market share and navigate an uncertain market environment.

Deutsche's 1Q19 results showed cost and capital discipline but weaker revenue generation, reflecting a difficult environment for its markets-driven businesses and the impact of disposals. The annualised post-tax return of 3.6% of tangible common equity, assuming an even accounting of a bank levy fully included in 1Q19, falls short of the targeted 4% for the full year.

Pre-tax profit of EUR341 million, excluding debt valuation adjustments, puts Deutsche at the bottom of European and US peers that have reported so far. Performance was hit by the loss-making Corporate & Investment Bank (CIB) and weak results from the retail, commercial banking and asset management divisions. Revenue decreased more (-9%) than non-interest expenses (-7%) from an already weak performance in 1Q18. The first quarter included a EUR604 million bank levy booked at the start of the year, but no notable conduct costs or other large one-off items.

In CIB, fixed income and currency sales and trading revenues dropped by 19% and equities by 13% yoy, hit by business reductions and the weak trading environment. Origination and advisory fell 5%, driven by lower origination activity, but the bank reported an increased market share, particularly in leveraged finance. Transaction banking revenue increased 6%, benefiting from increased business volumes, particularly in cash management, and from higher US interest rates. The bulk of the bank levy is booked in this division, which contributed to its quarterly loss.

Deutsche's Private &Commercial Bank showed stable underlying revenue as higher lending volumes offset the impact of deposit margin compression, but overall pre-tax profit declined 11% yoy, to a low EUR287 million. The asset management division showed lower revenue due to reduced management fees and net outflows in 2018, but its small pre-tax profit of EUR96 million improved yoy.

Deutsche's capitalisation is a relative rating strength, and its common equity Tier 1 ratio remained above its target of at least 13%, rising to 13.7% despite no profit accretion. The management expects a decline in the ratio following a recent regulatory asset quality review and the ECB's Targeted Review of Internal Models (up to 40bp over the next two quarters). The leverage ratio declined to 3.9% due to higher leverage exposure, driven by client activity in CIB, seasonal effects and regulatory adjustments. The bank targets a 4.5% leverage ratio, which is more in line with peers, but costly to achieve in the short term. The liquidity coverage ratio is well above requirements at 141%, and we expect the bank to continue to manage its liquidity buffer conservatively during its turn-around period.

The Negative Outlook on Deutsche's rating reflects our view of high execution risk in its restructuring. Failure to strengthen performance would put its business model in question, potentially leading to a downgrade.

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