

Deutsche Bank 4Q12 reorganisation: old-vs-new CB&S

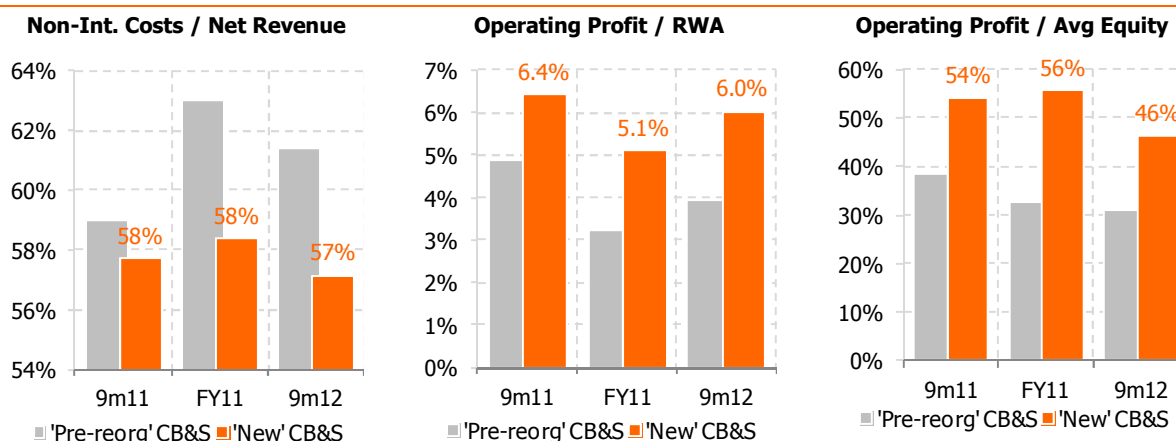
- The 4Q12 reorganisation substantially elevated CB&S reported profitability by shifting a large portion of litigation expenses to NCOU; and ...
- ... moving an ETF business with weak profitability into the newly integrated AWM division.

Deutsche Bank first presented its Groupwide 'Strategy 15+' reorganisation plan in Sept-12, then reported its FY12 results, including 2011-12 periods, in the new format. Combining this with the pre-reorg reporting, but without making adjustments to reported figures, we performed a 'new-vs-old' comparison of Corporate Banking & Securities (CB&S) division, our principal area of interest (Table 2).

The most striking output of this analysis is the substantial improvement in the new CB&S' profitability: the reported FY11 operating margin (here, defined as revenue minus non-interest cost) is \$743m above the pre-reorg level; the comparable 9m12 figure is \$415m. The 'new' FY11 return on RWA and average equity jumped by 59% and 71%, to 5.1% and 56%, respectively (Table 1, below). The two key reasons for this improvement are: the significant transfer of certain costs out of CB&S into the new Non-Core Operations Unit (NCOU); and the wholesale move of the ETF business from CB&S into Asset & Wealth Management (AWM) (Table 3). There was also some cost transfer between CB&S and the Global Transaction Banking (GTB):

- The Non-Core Operations Unit (NCOU), established in Nov-12, has a clearly defined governance structure, financial reporting and relationship with the core divisions. The NCOU's end-2011 pro-forma Basel 2.5 risk-weighted assets (RWA) totalled EUR104bn/\$135bn. Of this total, \$92bn/68% originated from CB&S: trading securitisation portfolio, run-off assets (monoline and legally/regulatory-challenged assets) and IAS-39 reclassified assets. These yielded revenues of only \$74m in FY11 against a sizable \$1.1bn cost. The cost is largely due to litigation settlement and provisions; the bank expects quarterly cost run-rate of c.EUR500m, versus EUR300m for NCOU's predecessor, Corporate Investments. We do not agree with litigation expenses being separated from the mainstream CB&S revenues: while undoubtedly 'irregular', these costs are attributable to specific businesses and, in the current environment, appear to be here to stay.
- To us, the most interesting aspect of the new reporting structure was the reassignment of management responsibilities for CB&S' passive and third-party alternative businesses - chiefly, exchange-traded funds (ETF) - to the newly integrated Asset & Wealth Management (AWM). This business had a FY11 revenue of \$1.1bn and operating margin (here, defined as revenue minus non-interest cost) of \$423m; the equivalent 9m12 figures are \$916m revenue and \$290m operating margin. These numbers imply cost/income ratios of 58% and 68% in FY11 and 9m12, respectively. This strikes us as somewhat high compared to some of the market leaders in the market, which we estimate have run-rate cost/income ratios of well below 50%. It will be interesting to see whether the move to AWM results in improvement in the underlying profitability of this business.
- The refinement of coverage shifted \$115m of FY11 costs (but no revenue) from CB&S to GTB.

Table 1: DBK Corporate Banking & Securities (CB&S): 'New' vs pre-org (US\$m)



Source: Deutsche Bank. Notes: (1) RWA reported on Basel 2 basis until Dec-12, and on Basel 2.5 thereafter; (2) Starting 2012, Deutsche Bank Group derives internal demand for regulatory capital assuming a Core Tier 1 ratio of 9% (previously based on a Tier 1 ratio of 10%). (3) Tricumen made no adjustments to the reported data, other than annualising 9-month figures

Table 2: DBK Corporate Banking & Securities (CB&S): 'New' vs pre-org (US\$)**1.1 CB&S: Prior to 4Q12 re-org (US\$m)**

	9m11	FY11	9m12
Net Revenue	21,239	25,722	20,484
Primary	2,540	3,110	2,335
Secondary	13,245	15,300	12,786
Equity	2,647	3,368	2,452
Trading & NII	1,754	2,210	1,735
Commissions/Fees	893	1,157	717
Fixed Income	10,598	11,932	10,334
Trading & NII	9,025	10,886	9,776
Commissions/Fees	1,572	1,046	559
Other	1,685	2,292	1,596
Loan Products	1,639	2,099	1,211
Other	46	193	386
Global Transaction Banking	3,769	5,020	3,766
Non-Interest Costs	-12,536	-16,204	-12,581
Operating Margin	8,703	9,519	7,903
Additional information			
Headcount (Front Office, FTE)	10,942	10,767	9,864
RWA	238,360	296,488	268,111
Avg Active Equity	30,103	29,107	34,036
Ratios			
Non-Interest Costs / Net Revenue	59%	63%	61%
Non-Interest Costs / Headcount	US\$1.5m	US\$1.5m	US\$1.7m
Operating Margin / RWA	4.9%	3.2%	3.9%
Operating Margin / Avg Active Equity	38.5%	32.7%	31.0%

1.2 CB&S: NEW (US\$m)

	9m11	FY11	9m12
Net Revenue	20,242	24,646	19,413
Primary	2,540	3,110	2,335
Secondary	12,654	14,959	12,234
Equity	2,444	3,109	2,289
Trading & NII	1,650	2,091	1,685
Commissions/Fees	795	1,018	605
Fixed Income	10,210	11,850	9,945
Trading & NII	9,361	11,275	9,002
Commissions/Fees	848	574	943
Other	1,278	1,557	1,077
Loan Products	1,245	1,611	1,081
Other	34	-54	-4
Global Transaction Banking	3,769	5,020	3,766
Non-Interest Costs	-11,681	-14,384	-11,095
Operating Margin	8,561	10,261	8,318
Additional information			
Headcount (Front Office, FTE)	10,662	10,483	9,591
RWA	178,093	200,933	183,876
Avg Active Equity	21,071	18,398	24,022
Ratios			
Non-Interest Costs / Net Revenue	58%	58%	57%
Non-Interest Costs / Headcount	US\$1.5m	US\$1.4m	US\$1.5m
Operating Margin / RWA	6.4%	5.1%	6.0%
Operating Margin / Avg Active Equity	54.2%	55.8%	46.2%

1.3 CB&S: NEW minus Pre-reorg (US\$m)

	9m11	FY11	9m12
Net Revenue	-997	-1,077	-1,071
Primary	0	0	0
Secondary	-591	-341	-552
Equity	-203	-259	-163
Fixed Income	-388	-82	-389
Other	-406	-736	-519
Loan Products	-394	-488	-129
Other	-13	-248	-389
Global Transaction Banking	0	0	0
Non-Interest Costs	855	1,819	1,486
Operating Margin	-142	743	415
Additional information			
Headcount (Front Office, FTE)	-280	-284	-273
RWA	-60,266	-95,555	-84,236
Avg Active Equity	-9,032	-10,709	-10,014

Source: Deutsche Bank. Notes: (1) Operating expenses includes direct comp, severance payments, policyholder benefit & claims and restructuring activities, as reported. FTE = full time equivalent. Pre-org CB&S reports 'FTE'; 'new' CB&S reports Front Office FTE. (2) EUR/US\$ FX rates: used period average for profit & loss items, period-end for risk-weighted assets (RWA) and average equity. (3) RWA reported on Basel 2 basis until Dec-12, and on Basel 2.5 thereafter; (4) Starting 2012, Deutsche Bank Group derives internal demand for regulatory capital assuming a Core Tier 1 ratio of 9% (previously based on a Tier 1 ratio of 10%); (5) Tricumen made no adjustments to the reported data, other than annualising 9 months figures.

Table 3: Re-segmentation effects for CB&S, AWM and NCOU (US\$m)

	FY11					9m12				
	Old	to NCOU	Allocated to AWM	to GTB	New	Old	to NCOU	Allocated to AWM	to GTB	New
1 CB&S (US\$m)										
Net Revenue	20,705	-74	-1,006	0	19,626	16,719	-150	-916	0	15,653
Provision for credit losses	-423	298	0	0	-125	-607	527	0	0	-81
Non-Interest Costs	-16,204	1,120	583	115	-14,386	-12,580	780	626	78	-11,095
Non-controlling interests	-38	7	0	0	-31	-26	5	0	0	-20
Operating Margin	4,041	1,351	-423	115	5,084	3,506	1,162	-290	78	4,457
Additional information										
RWA	296,488	-92,170	-2,982	0	201,337	268,111	-81,522	-2,315	0	184,274
Avg Active Equity	29,107	-10,241	-519	0	18,347	34,036	-9,772	-514	0	23,750
Ratios										
Non-Interest Costs / Net Revenue	78%	1519%	58%	N/A	73%	75%	521%	68%	N/A	71%
Operating Margin / RWA	1.3%	-1.4%	13.2%	N/A	2.4%	1.3%	-1.4%	12.6%	N/A	2.4%
Operating Margin / Avg Active Equi	12.9%	-12.3%	76.0%	N/A	25.8%	10.3%	-11.9%	56.5%	N/A	18.8%
	FY11				New	9m12				
	Old	to NCOU	Allocated from CB&S			Old	to NCOU	Allocated from CB&S		
2 AWM (US\$m)										
Net Revenue	5,233	-289	1,006		5,949	3,517	-122	916		4,311
Provision for credit losses	-77	46	0		-31	-36	17	0		-19
Non-Interest Costs	-4,091	67	-583		-4,607	-3,174	46	-626		-3,755
Non-controlling interests	1	-1	0		0	4	-3	0		1
Operating Margin	1,067	-178	423		1,312	310	-61	290		538
Additional information										
RWA	21,130	-5,185	2,982		18,927	17,873	-4,243	2,315		15,944
Avg Active Equity	7,389	-519	519		7,389	7,458	-386	514		7,586
Ratios										
Non-Interest Costs / Net Revenue	78%	23%	58%		77%	90%	38%	68%		87%
Operating Margin / RWA	4.7%	3.2%	13.2%		6.5%	1.7%	1.5%	12.6%		3.4%
Operating Margin / Avg Active Equi	13.5%	32.0%	76.0%		16.5%	4.2%	16.0%	56.5%		7.1%
	FY11					9m12				
	CI (legacy)	Allocated from CB&S	from AWM	from PBC	NCOU	CI (legacy)	Allocated from CB&S	from AWM	from PBC	NCOU
3 NCOU (US\$m)										
Net Revenue	548	74	289	312	1,223	649	-122	-916	1,747	1,359
Provision for credit losses	-19	-298	-46	-172	-536	-5	17	0	-689	-678
Non-Interest Costs	-2,075	-1,120	-67	-291	-3,553	-1,259	46	626	-1,688	-2,275
Non-controlling interests	3	-7	1	-17	-19	9	-3	0	-35	-28
Operating Margin	-1,544	-1,351	178	-168	-2,885	-606	-61	-290	-665	-1,622
Additional information										
RWA	15,297	92,170	5,185	21,908	134,561	14,401	81,522	4,243	21,088	121,255
Avg Active Equity	1,815	10,241	519	2,204	14,778	1,672	9,772	386	2,057	13,887
Ratios										
Non-Interest Costs / Net Revenue	379%	1519%	23%	93%	291%	194%	38%	68%	97%	167%
Operating Margin / RWA	-9.4%	-1.4%	3.2%	-0.7%	-2.0%	-4.2%	-0.1%	-6.8%	-3.2%	-1.3%
Operating Margin / Avg Active Equi	-79.3%	-12.3%	32.0%	-7.1%	-18.2%	-36.4%	-0.6%	-75.3%	-32.4%	-11.7%

Source: Deutsche Bank. Notes: (1) RWA as reported under Basel 2.5. (2) EUR/US\$ FX rates: used period average for profit & loss items; period-end for risk-weighted assets (RWA) and average equity.

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