COMMERZBANK

Capital Markets Day
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Bettina Orlopp
CFO

The bank at your side

Transcript

Bettina Orlopp, Chief Financial Officer

Good afternoon to all of you.
Let me now provide you with the update of the financial framework of our strategy. The update is based on our annual planning process. In it, we have reviewed our strategy and have confirmed the key elements and our direction of travel.

Compared to last year, our planning has started from a significantly improved basis thanks to our achievements in 2021. Our revenues are 300 million higher; our underlying cost base is 200 million lower; our capital ratio improved by 40 basis points.

While starting from this improved base, our updated targets for 2024 are still based on very prudent assumptions. We have planned with Euro interest rates from end of Q3 last year and assumed that they will be unchanged until the end of 2024. Any potential upside from higher rates – as currently expected by the market – would come on top.

For Poland we had originally assumed interest rate increases to around 80 basis points by 2024. However, there have subsequently been rate hikes in Poland, significantly beyond our original expectations. The increases until Feb. 4th are now included in the plan. They lead to additional revenues of 200 million Euros, starting already in 2022.
I will cover the upside potential from rates in more detail later on.

As on the revenue side, our plan includes additional costs from higher inflation in Poland. This is the reason for the increase of our cost target to 5.4 billion.

Concerning the general economic outlook, we have assumed a normalisation of the regulatory environment and an ongoing economic recovery. Our economists currently expect German GDP to grow by 3% in 2022. This obviously doesn't include any potential impact from the current Ukraine crisis. We clearly expect the accelerated adoption of digital banking due to the pandemic to continue. And we do not assume any competitive easing in the German banking market.

All in all, I firmly believe our improved target of more than 7% Return on Tangible Equity is realistic and achievable.

The RoTE target has not factored in any potential benefits from higher Euro interest rates.
Improved profitability will also further increase our CET1 ratio, raising our potential to return capital to shareholders.

Let's move to the next slide and the **revenue** outlook.
In our original plan we had expected revenues to be slightly lower or flat in 2021 compared to 2020. In fact, we managed to increase revenues by 300 million last year. This elevates the starting point of our revenue bridge to 2024.
As detailed by Thomas and Michael, we plan for around 100 million extra revenues from PSBC Germany and around 100 million lower revenues from Corporate Clients.

The negative effects of expected churn and focusing of the business model are balanced by business growth with target clients and profitable products.

mBank is expected to deliver 600 million revenue growth. This includes the 200 million benefit from higher rates and is in line with mBank's growth track record. The line items reflect the expected development. Most of the increase is in NII, driven by mBank.

For PSBC Germany we continue to plan with a drag from the still existing negative rates environment that is offset by growth and pricing.

For Corporate Clients we expect lower revenues from our closure of foreign locations and offboarding of non-core, low RWA efficient clients, not fully offset by growth.

Expected churn in PSBC is the biggest potential drag on NCI. I'm convinced that we can overcompensate the impact with our respective measures – especially in the securities brokerage business of PSBC but also cross-sell in Corporate Clients.
With these initiatives we expect NCI to increase by nearly 200 million.

As we have planned prudently, we do see upside potential to our plan. Churn could be lower than anticipated. But as Thomas said: we believe it is too early to revise our planning.

We have also seen better growth than expected in 2021. We will be looking for additional opportunities beyond our plan. But we will always stick to the rule that profitability trumps growth.

In 2021 we benefitted from our investments in CommerzVentures, contributing 216 million Euros to revenues. However, the timing of gains cannot be reliably predicted. We therefore have not assumed any gains in 2024.
And, above all, we would significantly benefit from Euro rates increases.

Let's look at the **rates potential** on the next slide.
You will probably all know our interest rate sensitivity from our Q4 disclosure. We had planned with continued low rates which would lead to a reduction in NII by around 300 million by 2024.

When assuming that the forward curve from early February will materialise, NII from deposits at PSBC and Corporate Clients could be 850 million higher than plan.

However, we want to see real action by the ECB before including any of this upside in our plans.
Having said this, we are already benefitting from the higher 10-year rates. We can currently reinvest modelled deposits at the higher, current market rate. Every month with higher rates gives an incremental benefit to NII that will accumulate over time.

Let's now look at **CommerzVentures**.
We are very happy with the investments made so far. They have contributed more than 500 million revenues over the last years. By their nature, returns from venture investments cannot be planned with certainty. They usually take several years to mature before reaching their potential.

Our first fund has delivered the gains we have seen so far. The second fund is reaching the end of its investment phase and is developing well. We expect gains in due course. But it will take more time to reach its full potential.
Building on our positive experience and with the established management team of CommerzVentures, we are currently launching a third fund. It has an investable volume of 300 million and should add to revenues over time.

As with the first funds, we stick to investments in finance related start-ups. Having started with fintechs in the first fund, we have extended our investment scope to insurtech, climateFintech, DeFi and other finance related business models with the second fund.

With the third fund we have committed to a bigger size. This allows us to participate in larger funding rounds, when we see value.

Let's move to **costs** on the next slide.
My colleagues have already touched on the cost savings in their segments. Please note, that the savings from head office and operations are allocated to the segments and are reflected in their numbers. Both segments plan to deliver around 600 million in savings each.

The staff costs are chiefly lowered by headcount reductions, mainly in Germany but also by moving work to cheaper locations.

Admin expenses are lowered by three main drivers.

- First, the optimisation of our IT platforms and the reduction of external IT staff.
- Second, the reduction of occupancy costs due to branch closures and streamlining of international locations.
- Third, increased efficiency in Head Office and operations.

On top of these, we expect a lower European Bank Levy in 2024. However, it remains to be seen what effect might result from the current consultation initiated by the SRB.

As mBank pursues its successful growth path, and as we have seen the clear effects of inflation in Poland, we have increased costs by 100 million Euro compared to the original strategy. This is more than compensated by the higher revenues included in the plan. mBank will continue to manage the business on a cost-income-ratio of 40 to 50%.

More than 6,000 **FTEs** have already left the bank in 2021 or have signed individual contracts to leave. This is ahead of our original plan.

With signing and communication of the Partial Settlements of Interests – including all details regarding Strategy 2024 in November 2021 – the full range of instruments from the Social Plan is now available.
With this milestone achieved, we will further increase the number of contracted leavers and proceed to our gross reduction target of 10.000 FTEs. The aim is to reach agreements by 2023 so that they become effective for 2024. This is to ensure the full cost saving effect for 2024.

As Manfred already stated, the net reduction has been revised to 7,100 FTEs for the Group. There are three key drivers for this adjustment.

- First: The decision to keep the securities settlement business in house. The savings from not paying an external provider cover the costs of the additional staff.
- Second: The decision to allocate additional tasks to nearshore and offshore locations. This is linked to compensating reductions of vendor costs.
- And third: Further growth at mBank that leads to increased headcount demand and contributes to the planned cost increase at mBank.

With these adjustments we can maintain our cost savings plans while continuing to ensure the high stability of systems and processes – and enabling the growth at mBank.

This leads to the overall cost path on the next slide.
Our cost reduction path until 2024 is characterized by lower costs every year. We are firmly sticking to our reduction plan and are fully focussed on implementing our cost measures. By the end of this year, one third of the savings – excluding mBank – will be realized.

All the cost figures in the plan already include the necessary IT investments of 1.7 billion.
This 1.7 billion reflects our change-the-bank projects until 2024. As this is a cash spend number, not all of it directly shows up in P&L. Our average capitalization ratio stands at roughly 50%. We have moved some of the cash spend but have not changed the overall investment budget.

The cost target has increased by 100 million due to growth at mBank and higher inflation in Poland. For 2022 we stick to our cost reduction target in Germany.

All savings are net of our assumed average cost inflation of around 1.7%. Current general inflation in Germany is significantly above this level. We will closely monitor if this will become persistent and how this will affect our cost base.

The biggest potential driver is the ongoing wage negotiation for the German banking sector. The negotiations are currently stalled. We hope to get more clarity in due course.

To be perfectly clear: with our Strategy 2024 we aim for a competitive cost-income-ratio. For me this is a CIR of 60% as targeted for 2024. If inflation turns out higher than planned, we will look at further measures to compensate the inflationary effects and reach the 60% target.

We would have more flexibility if revenues are higher than planned due to interest rate increases, as expected by the market. This would give us potential headroom on the cost side. But we want to see clear evidence of higher rates first.

Now let's look very briefly at the **restructuring charges** and the risk result.
We have nearly completely booked the 2 billion charges. Only around 70 million are still outstanding. The remaining charges relate mainly to real estate. We can only book these charges when the formal requirements for location closures are met.

From the risk result we do not predict an unusual burden. We plan with a normalised **risk result** of around 25 basis points for the planning horizon. This is the level we had pre-pandemic.
Manfred has already given you an overview of our Russia related exposures. There are surely some financial burdens resulting from the crisis. But it is too early to quantify them given the uncertainty how it will evolve.
We have kept the Top Level Adjustment of around 500 million available to cover potentially remaining pandemic related effects. It could also help to cover effects of the Russian crisis. This gives us some comfort that we can reach our targets.

Let's now look at our updated bridge to the **operating result** and our targets.
The improved revenues lead to an operating result that is 300 million higher than our original target.
The Cost-Income-Ratio will improve to 60%.
And our RoTE will be at 7.3% when paying a dividend with a 30% pay-out ratio.
I want to stress again that any upside from higher rates would come on top of our targets.
Reaching the RoTE target depends not only on the improved operating result but also on RWA and capital management.

On the next slide I will therefore go through our **RWA** planning.
We work with RWAs that are on the level of the original plan but with a different allocation.
FRTB has been postponed to 2025 and therefore we expect lower market risk RWAs in 2024.
At the same time, we expect higher credit risk RWAs. The main drivers are model changes and delayed improvement in ratings in Corporate Clients. These will add 7 billion RWAs.
They will be largely offset by RWA management of 5bn. Net, credit RWAs of CC will be around 2 billion higher.
In 2025 we expect to see the delayed improvements in ratings, compensating the delayed effect of higher RWA from FRTB.

In PSBC we assume lower RWAs than originally planned, as we expect less growth in consumer loans. Instead, revenue growth will come from products that generate fewer RWAs. These are wealth management and investment products, mortgages, and loans to small business customers.

RWAs in Others and Consolidation will be reduced by 6 billion. To remind you, around half of the current 33 billion credit RWAs result from long-term legacy positions. The remainder is mainly due to the liquidity portfolio and RWAs for DTA.
Overall, we expect Risk Weighted Assets of 182 billion by 2024.

We start with a **CET1** ratio of 13.6%, well above the 13.2% we had in 2020. Our MDA is currently at 9.4%. It's predicted to increase to 10.2% from countercyclical and sector specific buffers.

With currently more than 400 basis points above the MDA we feel also well positioned for any potential impacts from Russia. With our Strategy 2024 and retained earnings we will build further CET1. Our CET1 ratio should increase to 14.8% on a pro-forma basis, assuming an annual dividend pay-out ratio of 30%.

This clearly results in excess capital on top of our 200 to 250 basis point buffer above MDA.
We are convinced that these 200 to 250 basis points are the right buffer for our business model.

So, let me close with our thoughts on **capital distribution**.
Manfred has already presented our dividend and capital return policy with the Q4 results.
After distributing dividends with a 30% pay-out ratio, our strategy delivers a return of 7.3% at a CET1 ratio of 14.8%.
This is a clear improvement on our original plan. Our CET1 ratio will be around 100 basis points higher at the same capital distribution level.

Thanks to the strong capital creation and given our target buffer above the MDA, we have the potential to not only pay a dividend. In total we can distribute 3 to 5 billion to shareholders – a significant improvement.
The instruments can be higher dividends or share buy backs, which are subject to receiving the prior permission of the ECB.

We know that the latter is an attractive instrument given the valuation of our shares. However, we need to have a second year of improved returns as proof point for the success of our strategy before considering buy backs.
On the slide we have run the maths to provide you with a sense of the capital that could be eligible for distribution if our plan works out.

A capital return of 3 billion Euros would translate into a CET1 ratio of 13.9% and a return on tangible equity of 7.6%.
The distribution of 5 billion Euros lifts the return to 8.1% and still reflects a CET1 ratio of 12 .8%, which represents a 250 basis points buffer to our expected 2024 MDA.
The potential for higher dividends or buy-backs will become fully visible in 2023.
Any return, obviously, depends on many future factors and requires concrete resolutions of the rel evant bodies.

Our aim is clear:

We want to provide attractive returns for our shareholders, and this includes the distribution of capital! And I am absolutely convinced we can achieve this.

Thank you very much for your attention!

Disclaimer

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Commerzbank AG
Head Office
Kaiserplatz
Frankfurt am Main
www.commerzbank.de

Postal address
60261 Frankfurt am Main
Tel. +49 69 136-20
info@commerzbank.com

Group Investor Relations
www.commerzbank.com/ir-contact
ir@commerzbank.com

COMMERZBANK