DWS Group GmbH & Co. KGaA

DWS Q1 2019 Investor & Analyst Conference Call

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Transcript

Speakers:

Asoka Wöhrmann

Claire Peel

Oliver Flade

Oliver Flade

Thank you very much, operator, and hello, everybody, from Frankfurt. This is Oliver Flade from investor relations, and I would like to welcome everybody to our first quarter 2019 earnings call. Please be reminded, as always, that the previous Deutsche Bank analyst call outlined the asset management segment results, which have a different parameter basis to the DWS results that we're presenting today.

I'm again joined by Dr Asoka Wöhrmann, our CEO, and Claire Peel, our CFO. And Asoka will start, today, with some opening remarks, and then Claire will take us through the presentation. For the Q&A afterwards, I would ask everybody to limit yourselves to the two most important questions, as always, so that we can give as many people a chance to participate in the Q&A session as possible.

I would also like to remind you that the presentation may contain forward-looking statements which may not develop as we currently expect. I therefore ask you to take note of the declaimer and the precautionary warning at the end of our materials. And now, let me hand over to Asoka.

Asoka Wöhrmann

Thank you, Oliver. Hello, everybody, and welcome. I am very pleased to present the results for the first three months of 2019. It has been a strong quarter for DWS. We saw good flow momentum and recorded return to positive net flows, while our margin proved resilient.

This was based on improved fund performance, especially in flagship funds, and the solutions capabilities we offer to our clients. Both compared to quarter four and quarter one 2018, we saw a huge swing in net new assets, especially in long-term assets which are so relevant to the bottom line.

Managing our cost base and accelerating our cost efficiency measures was, as we had committed, a continued focus in the first quarter, and we were rigorous in executing our cost-saving initiatives, lowering our overall costs by 2% compared to quarter four 2018.

In the context of a dynamic late-cycle market environment, our management team also reviewed the priorities initiatives of DWS to ensure we are flexible in the changing market setting.

This review has resulted, during the first quarter, in, first, simplification and structure changes throughout our organisation, including, in coverage, the CO area and cross-central functions; second, a new segmentation approach within our courage teams which better combines our core investment capabilities with the demand we see from our client base; third, strengthened strategic partnerships which contributed 3 billion euro inflows during the first quarter; and fourth, a refinement of our medium-term targets to reflect changed market conditions. I will go into detail on this point at the end of this presentation.

To summarise, the first quarter 2019 has marked a very successful start to the New Year for DWS. We had a huge swing and return to positive net flows. We continued to execute our accelerated cost efficiency measures, and we are continuing to do our homework reviewing our priorities and initiatives. Let me now hand over to our CFO, Claire Peel, who will run through our financials in more detail. Claire, please?

Claire Peel

Thank you, Asoka, and welcome, everyone. Today, I will present the recent activities and results for the first quarter of 2019, starting with the key financial highlights. Adjusted profit before tax was 153 million in Q1 2019, down 4% quarter on quarter, primarily reflecting slightly lower revenues.

Adjusted cost-income ratio was 71.4%, with quarterly cost reductions offset by lower revenues. Net inflows achieved in Q1 were 2.5 billion, primarily driven by strong performance in targeted growth areas of passive, alternatives and multi-asset. Excluding cash, net inflows were 7.4 billion in the quarter. Fund performance improved, and flagship products supported positive flow momentum in Q1.

Let's move to our financial performance snapshot, starting at the top-left. AUM increased to 704 billion, up 6% quarter on quarter, driven by improved market performance, positive FX movements and net inflows.

Moving to the top-right, revenues of 534 million represent a quarterly decline of 3%, impacted by lower management performance and transactions fees. Management fees recovered faster than anticipated, due to the strong recovery in markets following the sharp Q4 decline, and with a resilient management team margin of 30 basis points.

On the bottom-left, adjusted costs were down 2% quarter on quarter, to 382 million, driven by lower general and administrative expenses. This resulted in a cost-income ratio of 71.4% for Q1. Adjusted profit before tax was 153 million, down quarter on quarter but up year on year, given the continued downward trend in costs.

Let's recap on the market environment in Q1. The first quarter or 2019 has shown signs of recovery following one of the most challenging years for the asset management industry in 2018. All major equity indices have rebounded, with the FSTAX increasing by 14% and the MSCI World Index by 12% since the start of the year.

Although a market rebound has helped, investment sentiment still remains somewhat fragile, particularly in the European retail market. Appreciation of the US dollar also contributed to the higher AUM base this quarter, while lower interest rates negatively impacted fair value of guarantees.

Let's move on to AUM development. Assets under management increased to 704 billion in Q1 2019, driven by favourable market performance, positive FX movements and net new inflows. The stronger equity indices contributed 35 billion of AUM, accounting for the majority of the 42 billion increase at quarter-end, and this was further supported by 6 billion in positive FX movements as well as net inflows, which I will now explain in some more detail.

In Q1, we reported 7.4 billion on net inflows, excluding cash. This reflects improved flows into high-margin active flagships compared to outflows in 2018, and continued demand for our real estate flagship projects. [Unclear 00:08:18] dividend reported strong inflows against a backdrop of XG [? 00:08:22] outflows in the European retail market.

Improved performance at Concept Kaldemorgen resulted in greater inflows, and the DWS Dynamic Opportunities fund exceeded the 1 billion AUM threshold at the beginning of April, flowing inflow in Q1. These were further supported by sustained strong real estate inflows to our 10 billion fund family Grundbesitz, and to our US offering RREEF America II.

Beyond the flagships, we have seen positive trends across most asset classes this quarter, in addition to significant improvements in the Americas region and in our insurance business. Continued momentum in passive contributed 6.2 billion of inflows in Q1, split roughly between new mandate wins, European and US ETP inflows. In particular, our US ETF saw significant progress in the quarter, attracting 1.9 billion of inflows to existing products, as well as to other newer offerings.

Alternative inflows also increased substantially to 2.6 billion in Q1, reflecting strong flagship flows in addition to large US mandate win, and further supported by liquid real assets, which moved into positive territory this quarter.

Looking at active equity, fixed income and SQI, we have seen a much slower rate of redemption in Q1 compared to the previous quarter. In fixed income, we saw improved positive flows in insurance and inflows into our Invest Asian and corporate bond funds.

Altogether, total net inflow, including cash, were 2.5 billion in the quarter. Let's look more closely at the cash trends. We reported 4.9 billion of cash outflows in Q1 '19, with inflows in the first two months including a 1.4 billion mandate win more than offset by outflows relating to European money market reforms and seasonal US cash movements.

Volatility in the cash line is a trend we typically see within the quarters, and due to this inter and intra-quarter volatility in cash flows, we will disclose group flows both including and excluding these cash balances. This has little impact on our P&L, given cash contributes just 1% to 2% of management revenues each quarter.

Moving on to product launches, innovation remains key at DWS, as we aim to develop products to meet client needs in the late-cycle environment, as well as growing demand for ESG offerings. In Q1 '19, we predominantly focused on expanding our ETF offerings, launching four innovative new products spanning schematics and ESG

In the US, we launched the X trackers MSCI USA ESG leaders EFT, with 740 million in seed capital, making it the largest ESG EFT launch in the market. The product was developed in collaboration with the European pension insurance client.

Looking forward to Q2, we have a pipeline of product launches across several asset classes, subject to demand assessments and approvals. ESG remains an important feature to our portfolio, as reflected in almost all of the launches planned for the second quarter, including in the US, where we have partnered with the S&P to launch an ETF that will provide a sustainable alternative to its US equity benchmark, the S&P 500.

Moving on to revenues, adjusted revenues are down 3% this quarter, at 534 million. Management fees and recurring revenues decreased by 12 million, mainly due to a shorter business day quarter.

Given the strong market recovery following the Q4 decline, management fees rebounded quicker than expected, and I will discuss movements in the asset classes shortly.

Performance in transaction fees decrease by 12 million quarter on quarter, due to lower transaction fees in alternatives and reflecting seasonality of higher performance fee recognition in the fourth quarter. Given run rate trends, we anticipate performance and transaction fees to increase in Q2, with a likely contribution from a European infrastructure fund. Other revenues increased by 9 million in Q1, driven by a smaller negative change in the fair value of guarantees, compared to Q4.

Moving to the margin breakdown by asset classes, overall our management fee margin was 30 basis points in Q1, and is expected to remain stable assuming constructive markets. The quarterly decline can be attributed to specific one-off events by quarter, and a smaller market effect than originally anticipated.

Management fees were impacted by fewer business days in the quarter, despite recovering faster than expected from the market turmoil in Q4. SQI management fees and margin were down over the quarter, reflecting net outflows and lower distribution fees in Q4.

For passive, both management fees and margin are up, quarter on quarter, driven by continued net inflows and improved market conditions. In alternatives, margin and fees were both up in Q1, reflecting incremental real estate revenues and the positive effects of liquid real asset inflows.

Moving on to costs, total adjusted costs decreased to 382 million in Q1 2019, down 2% quarter on quarter and down 9% year on year, reflecting our intensified cost-focus and accelerated efficiency initiatives. Total adjusted compensation and benefit costs increased over the quarter, due to normalisation of bonus accruals and seasonal upticks in benefit costs.

However, these increases were more than offset by total adjusted general and admin expenses, which fell by 11% over the quarter. The quarterly decline was driven by a 35 million decrease in non-compensation direct costs, demonstrating tighter cost management through lower third-party transaction fees, as well as lower consulting and legal fees.

Charges for DWS functions in DB entities were 4 million lower compared to Q4, and together these declines more than compensated for the expected higher DB Group service charges, which normalised in Q1 2019.

Let's refresh on the cost glide path. In 2018, we saw costs fall faster than expected, exceeding our guidance and despite continued investment in growth initiatives. In 2019, we have intensified this focus by accelerating efficiency efforts to achieve the full amount of our targeted 150 million of gross cost savings by year-end.

This will be achieved through incremental cost measures such as further integration and simplification of our front-to-back platform, extracting incremental value from consolidation of vendors, and limiting external spend on contractors and professional fees. Additionally, we will calibrate our investment spend to the market environment, given the prospects of continued headwinds in 2019.

Assuming revenues remain flat year on year, we will target a cost-income ratio of approximately 70% by the end of 2019, before achieving our target of below 65% in the medium term.

So to conclude, DWS had a strong start in the first quarter. Intensified efficiency efforts have delivered, putting DWS on track to achieve the top end of its gross cost savings targets by year-end.

Strong flow momentum resulted in 2.5 billion of net inflows and was supported by well-performing flagship funds, and with support from our innovative product launches and strategic partnerships, we anticipate inflows to continue. Thank you, and I will now hand over to Asoka for some closing comments.

Asoka Wöhrmann

Thank you, Claire. Over the past few months, we have successfully made significant progress in making necessary adjustments to DWS, given the continued challenging market environments that we expect. The initial results of our efforts can be seen clearly in our quarter-one financials.

Additionally, we have taken careful consideration and have refined our medium-term targets as part of our management team's review of priorities and initiatives. In this regard, the cost income ratio will become our main priority to ensure maximum shareholder value in the market environment in which we operate.

Assuming revenues remain flat year on year, we will target a full-year cost-income ratio of about 70% by the end of 2019, on our way to achieving our medium-term target of lower than 65%. While we continue to believe net flows are an important key performance indicator for the asset management industry, the volatile market environment might impact annual flows in any given year, which we will now reflect in our targets.

So going forward, we will target 3% to 5% average net flows over the medium term. For 2019, it is our ambition to outperform the asset management industry on net flows, which are currently expected to be around 2% to 3%.

As we do our homework to further improve DWS and to show its full potential and capacity, these are the targets we will focus on, along with our dividend payout ratio to shareholders, which will remain unchanged and untouched. Thank you for your attention. With that, I will now pass to Oliver for the Q&A.

Oliver Flade

Thank you very much, Asoka. And operator, we're ready for Q&A now. And again, if I could remind everybody in the queue to limit themselves to two questions, thank you.

Operator

Ladies and gentlemen, at this time, we will begin the question and answer session. Anyone who wishes to ask a question may press star followed by one on their touchtone telephone. To withdraw your question, you may press star followed by two.

If you are using speaker equipment today, please lift the handset before making your selections. Anyone who has a question may press star followed by one at this time. And one moment for the first question, please. The first question comes from the line of Jacques-Henri Gaulard of Kepler Cheuvreux. Please, go ahead.

Jacques-Henri Gaulard

Yes, good morning, everyone. I have two questions, please. The first one would be on… Claire, you were mentioning the costs and the reduction in Q1 including some non-recurring items which will normalise in the next quarter. If you could actually detail these, that would be really helpful.

The second question, it's a combo on consolidation. The first one would really be on this UBS report in the FT. How come these things actually leak? That's the really main question I have. And the second, that would be a huge, huge undertaking because you would double your size. Considering that you've just been listed, shouldn't your priority be to actually assert the new DWS as it is, rather than launch into something which has quite high execution risks? Thank you very much.

Claire Peel	Good… sorry, it's not good morning. Thank you for the question. I will take the first question on the costs and the one-offs that we've seen in the first quarter that wouldn't repeat. That applies to the compensation costs and also to the G&A. On the compensation costs, we had some seasonality effects, in benefits in particular, pertaining to the bonus period that would not repeat, going forward.
	And on the G&A side, we had some specific external transaction fees that wouldn't repeat, going forward. So the two would effectively offset, to some degree. Going forward, there's always a certain element of small seasonality effects going forward, but not too material.
	I also commented in terms of Q2, on expected contribution from a European infrastructure fund performance fee, bearing in mind that that also comes with a compensation and benefit cost in Q2 as well.
Jacques-Henri Gaulard	Okay, thank you.
Asoka Wöhrmann	Jacques, I think I will take your second question on consolidation apart. Again, first of all, we do not comment on market speculation as a matter of principle. In managing DWS, we have a clear priority on generating organic growth and improving our efficiency.
	And additionally, as we always stated, we want to actively participate in the consolidation of the asset management industry, if it really creates shareholder value and does not interfere with our fiduciary duty of our clients, and if it's going to pay out into our business model. But again, please understand, with regard to recent speculation, we are not really going to comment.
Jacques-Henri Gaulard	Understood, Asoka. Thank you.
Operator	The next question is from the line of Mike Werner of UBS. Please, go ahead.
Mike Werner	Thank you, I've got two questions, one really looking at the fee margin. We saw a fee margin of 30.0, saw strong inflows into alternatives, which is a high-margin product, outflows from cash products, which tend to be low-margin, and yet we saw the margin decline. So I was just wondering, I know there are a lot of drivers to this but how do you explain that decline?

And I didn't see, in the refined targets, any mention about the 30 basis point fee margin. Should we assume that that's no longer a key target of yours in the medium term?

And then, second, we've seen the headcount increase at DWS over the past couple of quarters. Some of this is due to a moving perimeter, but even in Q1 we saw further growth in headcount, and I was just wondering where is this headcount growth being focused on, which areas of the business? And is this something that we can expect as we go through 2019? Thank you.

Claire Peel: Thanks for the questions. I will take your question first, on the fee margin, which was 30.0 basis points in the first quarter, and that compared to 30.3 basis points in the fourth quarter of 2018. We'd originally anticipated a much more significant downward trend from the market downturn we saw in Q4; that was lesser than we had expected and, in fact, what has affected it is more one-off effects that we see between the quarters, which we've pointed to before, where we have various one-off distribution fees or payments that come in and out of quarters and cause some degree of volatility.

What I would rather point to is that the 30 basis points is a reasonably stable expectation that we have, going forward, obviously with a constructive market environment assumption, and the margin of the inflows that we saw in Q1 was greater than the margin of the outflows.

Asoka Wöhrmann: Mike, if I can address your margin question, regarding the target-setting, we want to make very clear we remain committed to delivering a high-margin business, however the average margin – and I mentioned that many times already – it's very much dependant on one non-controllable part from the management, for example equity market movements, like in the fourth quarter.

So therefore, we are directing our business to the high-margin business, and for the future, we are very much, as I said, committed to these high-margin businesses and products, and you can see we are very resilient in the margin, and I do think more than the wider industry. And for us, it's always performance and innovation is a great protection against a fee dilution.

Claire Peel: And I'll just pick up on your question on headcount. I think we had a relatively small increase in headcount in the first quarter, compared to the fourth quarter, the majority of which was related to a final transfer of a branch activity for some coverage staff; 15 staff related to that entity that came in. And otherwise, some

	limited hiring in our alternatives business, to support the fund launches and growth that we have in that area. We would not expect to have substantial headcount growth, going forward.
Mike Werner	Thank you.
Operator	The next question is from the line of Stuart Graham of Autonomous Research. Please, go ahead.
Stuart Graham	Hi, thank you for taking my question. Two questions, please. The first one is, Asoka, you promised us a strategy update; is this it, or is there more to come? Is there an event coming, or what you've said to do is the strategy update? And then, the second question is a number question. You referenced 3 billion of net new money from partners, can you split out where that comes? Is that active equity, is that passive, is that alternatives? Which buckets does that 3 billion come in, please? Thank you.
Asoka Wöhrmann	Again, Stuart, thank you for both questions. And as I said, I know that people are always expecting a big bang in strategy changes. First of all, we had it already, a strategy that has been announced and we talked about to the market during the IPO all the things… you said promised, but I think committed to look to the priorities and projects that are directed to growth, strategically. So that is what I have exactly done, that's what I exactly said. The four items: simplification and structure changes throughout the organisation; second, the new segmentation approach and the coverage area; third, the strength in the strategic partners, your question, I will come in a second to that; and the third [sic] area, the refinement. And I think one of the most asked questions in the last three months, to Claire and to me and to Oliver, is the refinement of our medium-term target and prioritisation of the targets and so on. So therefore, I do think I've felt we've done very substantial refinement actions already in the last six months, and I do think, and I want to say that, also the strategic changes, and that is what I really said and mentioned, we want to do in our own business than what is going on outside our organisation. That means also selected investment in product capabilities, that we've done, and I think Claire has very clearly mentioned the broadening of our ETF product suite, with the new product innovations like ETF, but also I want to bring an additional team, like artificial intelligence, big data, future mobility, this kind of thing. This is very important for us to position us in the industry strategically. We also successfully launched a direct lending

fund that I feel, in the light of low interest rates, will be a great answer for many, many institutional types of clients.

The second area, as I said, distribution capabilities, we really reviewed and aligned our coverage set-ups and, again, mentioned organisational efficiency, a lot of reduction of duplications, we got much leaner; we're on the way to become much leaner, rigorous execution on the cost initiatives, like target operating model refinement, vendor management, and, as I said, the KPIs.

And let me come to the strategic partnerships. Yes, very much the 3 billion is in the flagship areas in Europe, and in Germany, the four products that Claire mentioned, have really received huge inflows from our strategic partners, especially Deutsche Bank, private bank but also in these areas. But I would give this question to Claire, and she can give you all the details.

Stuart Graham — Sure, thank you.

Claire Peel — Just to further address the point on strategic partnerships, which has been absolutely one of the priorities, as Asoka has mentioned, in terms of deepening those relationships, and has resulted in excess of 3 billion of inflows in the first quarter. That's spanning all of our partners.

I recognise you asked for which ones specifically; it was spread across all of those partners all contributing, and also across all asset classes. The largest one that we point to is the Swiss insurer, Zurich, which transferred a large passive investment mandate to DWS. So that was the largest contribution but there is a contribution across all others and all asset classes.

Stuart Graham — Okay, thank you.

Operator — The next question is from the line of Arnaud Giblat of Exane. Please, go ahead

Arnaud Giblat — Hi, good morning. I've got two questions, please. Firstly, on costs, your cost targets for 2019 are very clear, I'm wondering how we should think about any marginal costs on any marginal revenues in excess of 2018 in 2019?

My second question is on M&A. Without looking for any specific commentary on any specific speculation, I'm wondering how you're thinking of M&A as an opportunity to further reduce costs? I'm asking this question especially in light of the significant efforts you're making on cost reduction. Would you think about a large deal as an opportunity to further materially reduce the cost base? Thank you.

Claire Peel

Hi. I'll address your questions on cost. Yes, as you rightly say, we're trying to give very specific guidance for 2019, with an approximately 70% cost-income ratio, and that's assuming broadly flat revenues year on year, which is consistent with the outlook we present and, therefore, indicates a decline in our costs, year on year, after accounting for the 150 million of gross savings that would be captured into that.

I think your question was specifically what are the ups and downs that we would see on either side of that, and we're very much focusing on the 70% cost-income ratio target, we see that as something that we can control in a constructive market environment. It's a profitability driver that's very important for us in terms of managing the business, going forward.

There will always be a certain amount of one-offs that we may see that come and go in the cost base, and that's why we point to the target of 70%, which we can certainly manage within certain degrees of revenue movements.

Asoka Wöhrmann

And I would like to, again, reiterate I can't comment on all the M&A speculation in the market, but I want to say – and I think this question is quite relevant, I do think, for the whole industry – that the industry has to improve, to adopt all the new technology in the industry that is going on. And I do think, for that, we've done already bolt-on investments, for example Skyline an AI shop to introduce more intelligence to our alternative platform.

We have been engaged with Neo [? 00:35:48], a very innovative distribution platform in the Middle East, and we are engaging and we are looking for these kinds of opportunities to modernise and to be a state-of-the-art platform into our asset management platform, in all the asset classes, all the platforms and all the regions. And this is a super-relevant question. I do think this is very much also our strategic thoughts which are going on.

Arnaud Giblat

Okay, thank you.

Operator

The next question is from the line of Anil Sharma of Morgan Stanley. Please, go ahead.

Anil Sharma

Hello, it's Anil from Morgan Stanley. Just one question. The 2% to 3% new money target for 2019. If I look at the consensus, that's just below the bottom end of that range, so I'm curious as to what you think they're missing. I take the point you've got there

	on the slide with the strong pipeline, but could you just give us a bit more colour? Has some of that started to fund, or are there some institutional mandates which you have visibility on that gives confidence that the 2% to 3% range can be hit this year? Thank you.
Asoka Wöhrmann	I do think, Anil, why people are underestimating our potential, what we are seeing ourselves, is always difficult, and as a former investor I would say, yes, it might be the models are underestimating our potential, that is our management work to get that out. I do think, for example, net inflows, there's a huge spread between our aspirations and consensus, how they're guessing and judging and estimating our potential there, but I do think after a very difficult year, 2018, and if you look now, for example, in inflows, the first quarter 2018 compared to first quarter 2019, we had a huge swing of flows of 10 billion; ex-cash much higher, 13.5 billion. I am expecting that this consensus is going to change. That is what I'm expecting, but also, in my opinion, it might be also outlining, in the consensus, difficult market environment, what the industry are expecting. So I think these are two facts that are giving a little bit a spread. But again, we know that we have a very ambitious target and we know that we are expecting… too early to talk about turnarounds after one quarter; we want to continue our momentum, we want to have further inflows especially into our long-term asset base. This is something that we are very much looking at. That is exactly where our profitability is coming from, and, from this standpoint, I do think this… this word is too big to say, conundrum, but that will hopefully more or less converge together in the near future.
Anil Sharma	That's helpful, thank you.
Operator	And there are no further questions at this time. I'll hand back to Oliver for closing comments.
Oliver Flade	Thank you very much, and thank you, everyone, for dialling in today. Obviously, for any follow-up questions, please feel free to contact the IR team, otherwise we wish you good day. Bye-bye.
Asoka Wöhrmann	Thank you.