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Q3 2024 Earnings Call

23rd October, 2024 | 10:00 CEST

Transcript

Speakers:

Oliver Flade

Stefan Hoops

Markus Kobler

Oliver Flade

Good morning to everybody, from Frankfurt. This is Oliver from Investor Relations, and I would like to welcome everybody to our earnings call for the third quarter of 2024. Before we start, I would like to remind you that the upcoming Deutsche Bank analyst call will outline the Asset Management segments results, which have a different parameter basis to the DWS results that we are presenting now.

I'm joined, as always, by Stefan Hoops, our CEO, and Markus Kobler, our CFO. Stefan will start with some opening remarks, and Markus will take you through the main presentation. For the Q&A afterwards, please, could you limit yourself to the two most important questions, so that we can give as many people a chance to participate as possible.

And 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 disclaimer and the precautionary warning on the forward-looking statements at the end of our materials. with that, I now pass on to Stefan.

Stefan Hoops

Thank you, Oliver. Good morning, Ladies and Gentlemen, and welcome to our Q3 2024 earnings call. During our last quarterly call, we outlined our belief that DWS's transformation journey has been completed, and we've become a predictable company with an exciting investment case based on disciplined cost management and focused investments into promising areas of growth.

One part of predictability is stability in management. And as it is indeed my 10th quarterly earnings call, let us celebrate this anniversary by letting Markus do most of the talking, as he will guide us through today's deep dive. Like last time, the aim of the deep dive is to give you more transparency on one key lever on our path to deliver our ambitious 2025 financial targets.

As you may remember, we used the Q2 call to describe, in detail, our client franchise, which trends we see and how we address them. This time, Markus will explain how we categorise our cost base and address the different cost items. And most importantly, he will shed some light on why we are confident in our ability to deliver our 2025 promise of an adjusted cost/income ratio of below 59% and an earnings per share of €4.50.

But before we get there, let me briefly summarise Q3, a quarter of true client focus, hard work, and decisive implementation of our plans. We are steady as we go. Overall, we are positive about today's numbers, as they show good financial results and also the resilience of our business. In a quarter that provided some market challenges for the asset management industry, we delivered strong net inflows.

Long-term net flows were at a record high for a quarter, mainly driven by the highest quarterly net flows into our passive and Xtrackers businesses and a strong contribution from active fixed income. And despite the fact that we saw outflows in alternatives in Q3, we still expect to return to overall net inflows in this asset class for the second half of the year, mainly driven by expected inflows into infrastructure investments in Q4.

Assets under management are at a record level, given the strong inflows in market appreciation. Speaking of markets, we are particularly pleased with how our teams navigated this spike in market volatility in August. As an example, the event had no negative impact on the performance of our flagship multi-asset fund, Concept Kaldemorgan, for which our expectation of a significant performance feed to be booked in the current quarter has not changed.

With increased revenues of 1% and reduced costs of 1%, we delivered an adjusted cost/income ratio for the quarter that is below our guidance for all of 2024. For the full year, we expect the adjusted cost/income ratio to land at the lower end of our guidance for 2024. When we look at the composition of our revenues, we are pleased to see a further increase in management fees.

And lastly, profit before tax and net income also increased, benefiting from continued operating leverage. All in all, we are quite happy with these results and are convinced that 2024 will be a significant step forward towards reaching our 2025 targets. More on that later, but for now, let me hand over to my great partner, Markus, to explain our Q3 results.

Markus Kobler

Thank you, Stefan. And also, from my side, a heartfelt Grüezie from sunny Frankfurt. In the third quarter of 2024, we reported record levels for assets under management, long-term flows, and for inflows from passive, including Xtrackers. These results, strengthened our momentum towards meeting our 2025 strategic targets with management fees of €626 million, showing a strong development despite ongoing margin pressure.

Supported by ongoing positive operating leverage, we delivered an adjusted profit before tax of €262 million. The adjusted cost/income ratio further improved to 61.7%, being below guidance, for the full year 2024, of 62 to 64%.

Moving on to the financial performance snapshot in the third quarter. Starting at the top left, total assets under management increased by 3%, quarter on quarter, to €963 billion, benefiting from markets and flows. On the top right, adjusted revenues totalled €685 million, which is a 1% increase, quarter on quarter. On the bottom left, adjusted costs decreased by 1%, quarter on quarter, and totalled €423 million, resulting in an improved adjusted cost/income ratio of 61.7%.

The adjusted profit before tax continued to benefit from a positive operating leverage and further enhanced to €262 million, which is a 5% increase, quarter on quarter.

Let's recap on the market environment. In the third quarter, mixed growth and inflation expectations, combined with hopes for a swift response from central banks, remained a dominant theme, affecting both government bond yields and equity markets. However, despite pronounced volatility, which spiked sharply during the summer months, global equity markets showed resilience, benefiting from the initiation of rate cuts.

Most indices, especially in Europe, were trending upward as we approached the end of the quarter. The government bond market was characterised by falling yields for most of the third quarter. In the US and the eurozone, we have finally left behind the inversion of the curve in the two- to ten-year range. Overall, the market environment remained notably favourable for our AUM development, despite the negative impact of the Euro/US dollar movement, which I will now outline.

We reported €963 billion of total assets under management at the end of the third quarter, marking a record high level. Our assets under management were supported by a positive impact from markets and total net flows, amounting €45 billion. This impact was partly offset by negative exchange rate movements of €14 billion.

The passive business, including Xtrackers, continued to thrive and stood at €307 billion, accelerating 6%, quarter on quarter, which marks a growth level of above our 12% CAGR strategic growth target. Our active asset classes benefited from the continued market tailwinds and net inflows, which led to assets under management of €447 billion. Assets under management for alternatives remained flat at €106 billion.

Moving now to our flow development. In the third quarter, we reported total net flows of €18.3 billion, including long-term net flows of €16.7 billion. Our active business was overall positive. A key contributor was active fixed income, which generated €10.3 billion of inflows, including one large insurance mandate. Despite the continued risk aversion in active equity, we see positive examples where we generated inflows, thanks to our innovation and distribution alpha, such as our DWS ESG Akkumula, or our DWS US growth.

Our passive franchise, including Xtrackers, continued to see strong momentum in the third quarter, with €9.5 billion of inflows, primarily driven by UCITS ETFs, predominantly in

EMEA retail. Our ETF market share further increased from 10.5% to 10.7%. Our top-four bestselling Xtrackers alone generated €6.4 billion of net inflows in the third quarter, whereas our systematic solutions, SQI, was flat in the third quarter.

It keeps capturing the upward-trending, positive market environment, reporting €1.9 billion of inflows, year to date, with double DWS funds invest Zukunftsstrategie, being the key contributor. This is a remarkable turnaround, compared to year to date, Q3 2023. Alternatives had €0.5 billion of net outflows in the third quarter, mainly driven by outflows in LRA and real estate.

However, this was partly offset by net inflows in our infrastructure products, including our infrastructure debt opportunities, as well as our pan-European infrastructure funds. Despite the fact that we saw outflows in alternatives in Q3, we still expect to return to overall net inflows in this asset class for the second half of the year, supported by inflows into infrastructure products in Q4.

A more detailed picture on our AUM and flow development can also be found on slide 16 in the Results presentation.

Let us turn to our product launches. Our commitment to product innovation within the organisation remains high. Since our Capital Markets Day, the number of our above-1 billion funds grew by over 20%, already exceeding our ambition to increase the share of active funds of above-€1 billion in AUM by 20% between our Capital Markets Day in 2022 and 2025.

We further recorded inflows of over €10 billion, mainly driven by inflows from our above-1 billion funds in Xtrackers. We continued to grow our inflows through new funds since the IPO to €67.8 billion, with ESG products accounting for 41% of the fund launches. In Q3 2024, we attracted around €3.1 billion ESG net inflows, which were mainly driven by the EMEA region, where the ESG demand remains strong, especially from retail clients.

Article 8 and 9 products reported inflows of €2.3 billion. Regarding our product launches, there are two highlights. In passive, thematics remain a pivotal focus of our product strategy approach. We have successfully launched our Artificial Intelligence and Big Data ETF, and we successfully closed our third tranche for our private European infrastructure equity Strategy. We further have a strong fund pipeline across our major asset classes for the fourth quarter, 2024.

Moving on to revenues. Total adjusted revenues amounted to €685 million in Q3, a 1% increase, quarter on quarter, driven by higher management fees. Our management fees stood at €626 million, up 2%, quarter on quarter, benefiting from a continued increase in our average total assets under management, which amounted to €950 billion. This quarter, we had a slightly negative impact of 0.2 basis points on our management fee margin, which stood at 26.2 basis points.

This is mainly attributable to technical effects. Performance and transaction fees stood at €12 million and remained at a low level. In this context, I would like to re-emphasise that we remain confident to reach our guided level for performance fees of 3 to 6% of adjusted revenues. As already outlined, we are booking our performance fees when they are realised on the recognition date and not on a pro rata basis.

Performance fees for our flagship product concept, Kaldemorgan, are usually booked in the fourth quarter. Assuming stable performance, we would expect a sizeable contribution from Concept Kaldemorgan in 2024. Other revenues decreased, quarter on quarter, and stood at €46 million, which is partly attributable to our lower net interest income contribution, resulting from the dividend payment in June. A 15 million contribution from our Chinese investment harvest is included in other revenues.

Moving to costs. Total adjusted costs stood at €423 million, being 1% down, quarter on quarter. On a reported base, cost stood at €440 million, being 4% down, quarter on quarter. Looking at our cost components, we reported adjusted compensation and benefit expenses of €211 million, being down 2%, quarter on quarter, thanks to lower compensation costs, which benefited from our internalisation and location strategy.

Adjusted general and administrative expenses were broadly stable and amounted to €212 million, despite further investments into growth projects. Hence, our adjusted cost/income ratio decreased by 1.5 percentage points, compared to the previous quarter, to 61.7%. As a result of this continued progress, we feel comfortable to specify our adjusted cost/income ratio outlook for 2024 to be at the lower end of the range, which we guided for the full year, namely 62 to 64%.

And now, moving to our deep dive on costs. Costs are my favourite topic, and I'm really passionate to talk about it. Within this deep dive, I would like to take you through our cost management approach, the toolkit, which we use to manage costs effectively, while facing cost challenges. And, most importantly, our strategic approach to workforce management.

Our cost management is structured around three different categories, each with a distinct nature and impact on our business, as well as with a different share of our overall cost base. Starting with externally driven costs or industry costs, which represent the smallest share in our cost base, even though they are external in nature, there are still ways we can control them, to some extent.

By optimising our value chain and renegotiating contracts, we are able to directly address these external costs. Our goal is to keep them as low as possible and reasonable.

The second largest category includes volume-based costs, which we call good costs, and which represent approximately 20% of our cost base. These expenses are closely linked to our AUM growth, or to some of the variable compensation components, which are dependent on business success. Examples would be asset servicing costs, index provider costs, custody fees, as well as carry costs that are part of performance fees.

Clearly, we are also not relaxed about these costs and address them constantly. But generally speaking, we see them as good costs, as any growth here refers to growth of our business. As you can see, the vast majority of our costs are discipline-based costs, which means they are within our control and allow us to proactively manage them by using detailed reporting and the relevant tools.

They account for approximately 75% of our cost base and include workforce-related costs, costs for external vendors, and other non-compensation costs, such as marketing and business travel expenses. Managing these different cost types is essential to maintain both operational excellence and financial discipline.

We define those addressable costs wider than other players. To give you just one example, some people might say, building lease costs are beyond control, but we consider them within our control, by way of the right location strategy, which I will further elaborate on the next slide.

Our cost management approach is not purely about cost containment and reduction, but about leveraging people and capabilities as a strategic, appreciating asset. Thereby, a pivotal aspect is how DWS strategically manages its workforce, which I will dive into more on the next slide.

Let us take a closer look at our discipline-based costs and elaborate on how DWS effectively manages its largest cost driver. Our approach to workforce management is not just about reducing headcount or saving costs. We see it as managing our human capital because we value our people as appreciating assets. Unlike machines, which depreciate over time, we view our employees as appreciating in value.

Through investment in learning, networking and career development, our people become more valuable to the company. That is why we prefer to call this category, human capital management, which is a crucial part of our discipline-based costs.

Allow me to elaborate briefly on what steered our thinking. We've made three key observations that drive and incentify the strategy. Firstly, we compare spends for severance and for training, we spotted that we spent 20 times more on people leaving than on people staying. This showed the opportunity we have to shift toward preventive measures, investing more in our people, in our appreciating assets, helping employees to grow within the company.

Secondly, attrition leads to fixed remuneration being wasted. On the one hand, for employee salaries during their notice period, if we allow them to leave earlier, and on the other hand, for new joiners who require some time and on-the-job training to reach a similar level of productivity. Applying industry-wide attrition rates, this amounts to between 5 and 10% of fixed pay not being used productively.

And lastly, the cost of external hiring. Hiring externally often comes at a premium, due to higher compensation and recruitment fees. Given current employment markets, we are talking about a mark-up of 20 to 25%. This reinforces our strategy of growing internal talent and reducing reliance on external hires.

Addressing these observations brought us to our strategic human capital approach. This mindset positions us, not only as an attractive employer, but also reduces costs while improving operational efficiency through a constantly learning organisation. Rather than simply cutting costs by reducing hire numbers, we limit recruitment in hubs, focusing instead on internal mobility, while upskilling through training.

Additionally, we have implemented a juniorisation programme, where we invest in training young talent. The programme enables us to develop talent internally, and at the same time, we save on market premium costs associated with external hires, such as recruitment fees and elevated compensation packages. In this context, to ensure a healthy pipeline of young talents in 2024, the number of our graduates more than doubled, compared to 2023.

Lastly, this year, we made a major move to replace external contractors with hiring in India and the Philippines, which offer a broad pool of attractive talents for DWS, and which, again, helps us to appreciate our human capital by building up internal knowhow and skills.

Talking about non-compensation items, I would like to give you some further context. At DWS, procurement is part of finance, which provides another effective tool for cost management. Moreover, in the course of the last 12 months, we have centralised the spend for legal fees under the remit of our CIO, Karen Kuder, so we have clear accountability for the interaction with external law firms.

and they decide whether we can do the work internally more efficiently. We further reduce external vendor costs via internalisation, a direct consequence of our human capital management. And lastly, we continuously review and optimise our office footprint to ensure sustainable cost control.

In addition to non-compensation items, we also focus on change and growth projects. Managing projects has been part of my professional life since I started working in our industry. It is a well-known fact that 90% of large projects fail. They usually do not deliver the initial planned scope and exceed both their original timelines and budgets. I would even say, they often take twice as long and cost at least twice as much to what the original budget was.

That is why we put special emphasis, increased focus, on our project portfolio. To give you an example of how we run change, growth and regulatory projects, we regularly review our strategy, where one of our board members takes on the role, as a critical and constructive challenger. We then prioritise the project portfolio to speed up the strategic focus topics on success-based funding and active reallocation of resources.

Tight monitoring is in place. Budgets are released only after specific milestones are achieved. This disciplined approach ensures that we stay focused on delivering projects within scope, on time, and within a given budget.

And now, moving to the next and last cost slide. Let me translate our cost management measures into the common cost P&L components, highlighting the key dynamics. We aim to focus on driving internal value through efficient cost management in all key cost buckets, compensation and benefit costs, general administrative costs and cost adjustments.

The key cost steering measures we are focusing on include regional footprint changes, internalisation and juniorisation, as well as investment into transformation and growth. Starting with our compensation and benefit costs, we have already taken crucial steps to optimise our organisational structure. As part of our ongoing reallocation of workforce, cost has decreased by limited hires in hubs, as well as our juniorisation approach.

Moving to the second bucket, general and administrative costs, our strict cost discipline in controllable areas, such as external vendor costs, which can be reduced, is partly offset by volume-based or goods costs.

Looking at our cost adjustments, in terms of cost adjustments, we have achieved a significant reduction in transformation costs, as our journey is now largely complete. Another significant achievement is the settlement of ESG allegations with the SEC, with one investigation still outstanding, where we have built adequate provisions. Going forward, we aim to significantly reduce cost adjustments.

Overall, our efforts to streamline costs and create value through efficient cost management with a focus on human capital management, are showing positive results. We have successfully achieved several key milestones, while continuing to address ongoing cost opportunities, as well as challenges in each cost bucket. As we look ahead, our disciplined approach will continue to drive cost reductions in areas, which we can actively manage and control.

We will continue to balance cost discipline with smart investments into our people, our appreciating assets and focused investments into growth. Let me hand over to Stefan.

Stefan Hoops

Thank you, Markus. Before we open up for Q&A, let me briefly recap on what we just presented. In Q3, we recorded strong net inflows and are confident to continue this momentum in the fourth quarter and reach our financial goals for this year. When it comes to our 2025 targets, we continue to move forward on the path, as laid out in our bridge to 2025.

You recall that we needed to increase our profit before tax by roughly €450 to 500 million, compared to our 2023 results, to deliver our earnings per share target of €4.5 in 2025. On our costs, Markus just elaborated on our approach, and especially our passion, for managing human capital.

While a presentation by a CFO on costs will inevitably sound technical, hopefully, you are taking away that we do not just appreciate our people, but in fact, view them as assets that appreciate and value, which our clients and shareholders will benefit from.

He explained that we already completed a variety of measures to address compensation benefits, general and administrative costs and cost adjustments. And he also described that we have a number of ongoing initiatives to further manage these categories, which we execute with a sense of urgency. And given that our transformation journey is complete, we substantially reduce transformation costs.

We are, therefore, confident to reach our 2025 target of an adjusted cost/income ratio of below 59% and hope that the walkthrough provided you with the same level of confidence. On performance and transaction fees, we can confirm that the progress on asset sales and the realisation of performance fees from PFEIF is ongoing and in line with our expectations.

And on management fees, we feel that, with €626 million in Q3 and further-increasing average AUM, we are on a solid trajectory to reach the run rate that we need for 2025. While we are pleased with the quarter, and generally speaking, with where we stand on our journey, you will not see us letting our guard down or starting to become complacent. We will continue to deliver on our strategy with a sense of urgency. Thank you, and over to Oliver for Q&A.

Oliver Flade

Yes, thank you very much, Stefan, and Operator, we are ready for Q&A now. And if I may just remind everybody to limit yourselves to the two most important questions. That would be very kind. Thank you very much.

Operator

We will now begin the question-and-answer session. Anyone who wishes to ask a question may press star and one on their touchtone telephone. You will hear a tone to confirm that you have entered the queue. If you wish to remove yourself from the question queue, you may press star and two. Questioners on the phone are requested to use the handsets when asking a question.

Anyone who has a question may press star and one at this time. Our first question comes from Michael Werner from UBS. Please, go ahead.

Michael Werner

Thank you very much for the presentation, and congrats on the results. Two questions from me, please. We did see a bit of an uptick in the employees, I think, about 3%, quarter on quarter, in Q3. I was just wondering if there was any one-offs here? Was there any bringing in external consultants? And ultimately, could this have an impact on cost growth in the coming quarters, especially in light of, Markus, what you just described, in terms of your costs focus?

And then, second, we did see quite a sharp decline in the fund performance within your equity asset class, especially in retail. I know you guys have done a really good job of turning around the fixed income performance in recent years. I was just wondering what changes or what type of focus you're putting on this and how you plan to turn this around? Thank you.

Markus Kobler

Thank you, Mike, and I'd like to take the first question, with regard to FD, and that is linked to the cost management approach I explained before, namely, the location strategy and juniorisation. The increase in Q3 is mainly driven by hires in offshore locations, India and the Philippines, and the graduate intake, which we had in September. And they had no material impact on our compensation and benefit costs.

Stefan Hoops

And Mike, on the second question, which is not great, meaning the equity performance, specifically in Q3, I personally spent quite a bit of time with that PM, who is one of our best and brightest, Andre Koettner, who co-runs Equity. And given that the performance is volume-weighted, in that case, it was really two very large funds that performed very well.

So, it's two funds that are always between 4 and 5 stars in Morningstar, who didn't do great in Q3. That case, without going into too much detail, but it was for four reasons. One, when China did very well in the last week of Q3 and so, therefore, you may see the same thing in Q4, the source of cash were some of the likes of Samsung, TSMC and so on, that we had quite a bit in that fund. Secondly, we have two stocks in Europe that we liked quite a bit that didn't do well in Q3.

We were underweight Tesla and Nvidia, which was not great in Q3, because both stocks did very well. And we are underweight real estate and utilities in those two funds. And given the slight change in rates expectations in Q3, those were sectors that did very well, and we were underweight. So, I'm not trying to belittle it. It is an issue, and as we typically see, performance is a very good indicator for forward flows, so therefore, we're definitely on the case.

But in that case, it was really two large funds that have done very well so far, also in relative terms. And we feel that we have full confidence in the ability of our fund managers to turn it around.

Michael Werner | Thank you.

Operator | The next question comes from Jaques-Henri Gaulard from Kepler Cheuvreux. Please, go ahead.

Jaques-Henri Gaulard | Yes, good morning, everyone. Obviously, when I hear about juniorisation, being 56 years of age, I feel a bit scared, but anyway, well done. Two questions. On the cost base, you've maintained a remarkable, it has to be said, stability since the beginning of your tenure, Gentlemen, so very well done. And you did that in a context where you had inflation being quite strong. Is there any opportunity to even lower that number, in absolute terms, now that we're back into, what seems to be, good old European deflation? That's the first question.

And the second, you're now getting very close to the 1 trillion threshold, in terms of AUM. Obviously, the point of acquisitions come back, because you have the feeling that you're never able to really quite get to a situation where you could get a really good fit. Is it a matter of your perception, of lack of critical mass from people you're talking to, or is it a price problem? Thank you very much.

Markus Kobler | Thank you, Jacques-Henri. Let me take your first question, and, Stefan, you may take the second one on AUM. With regard to your question, are we aiming to reduce our cost even further, when you talk about the way we look at it, we're saying, us, it is not about cutting costs or reducing costs, but it's a strategic approach, also to reinvest into people and into growth.

The point is just about keeping the overall amount under control, and then you have the operating leverage that increases that or improves the cost/income ratio. I'll give you one example. You asked that question about the inflation costs. We don't just take inflation for granted and say, oh, well, that's inflation, we have to take it on. But we ask the people in charge to manage that proactively, constantly seeking for ways to improve.

And that gives you, afterwards, also the flexibility, in order to fund the investments, which we plan to do. Because that that is important. That's the core of our business. We invest.

Stefan Hoops

And, Jacque-Henri, on your second question, you're right, we are getting close to the €1 trillion. It's not that we look at it every day, but all of you are better in maths than I am, so you know that 1% equity is roughly 3.8 billion of AUM. And in a one cent-stronger dollar, it's, kind of, the same, so just under 4 billion. So, both have held in October. And as you would imagine, with China doing very well, the last week of Q3 and the first couple of weeks of Q4, that has greatly helped our US ETFs that are specifically focused on Asia. So, we're getting closer, not quite there yet.

But then your question was really on M&A, where I think our message hasn't changed. So, hopefully, people will have seen that us saying that, in the West, we really are betting on our ability to organically grow AUM, that seems to have worked fairly well. And we feel, we'll do even better going forward with alternatives kicking in much more. But we continue to look for opportunities outside of the West.

So, again, M&A should be done, not talked about. But I don't think that we need it, in order to create scale in the West. But always looking to broaden our scope outside of the West.

Jaques-Henri Gaulard

Thank you.

Operator

The next question comes from Hubert Lam from Bank of America. Please, go ahead.

Hubert Lam

Hi, Good morning. Thanks for taking my questions, and again, thank you for the discussion on the costs. I thought it was very informative. So, firstly, the question on costs. So, how flexible is the cost base if there is a market downturn? I know the volume-based costs should be flexible, but how about the rest? And tied to that, what cost/income ratio do you think you can manage to in a weak year for markets? That's the first question.

The second question is on alternatives. So, it's good to hear that momentum is improving into Q4. And so, just a question is, what is the outlook for the alternatives into 2025? So, what are the new launches you're having into next year? And also, what is the redemption pipeline for the real estate funds? So, just to see what the outlook is into next year, and hopefully it's positive. Thanks.

Markus Kobler

Let me take the first question, Hubert, and then Stefan may take on the other one. We don't look at costs, as I explained, as fixed costs and variable costs. We look at them in the three categories. In the long run, all costs are variable, and the variability is then, again, depending on the timing. You can take immediate measures, for instance, to reduce business travel or stop spending on marketing. Building and leases takes more time to stop or reduce them.

But again, lead with a discipline-based approach. I often believe, when you look at it from a fixed-base point of view, then you just say, I'm in fixed-base. We can't do anything. Let's focus on what's variable. And then you end up with a very small proportion. But in our case, when we say, we can manage the discipline-based costs, which are 75%, then you don't take no for an answer.

You address all these cost items. But again, there is a timing effect, how fast you can execute on these cost items.

Stefan Hoops

Hubert, just to quickly add to the point that Markus just made, and then I will answer your question on alternatives. So, the part of the cost base, which clearly goes up and down with markets, is the part, which is volume-based, which, by the way, would be bad. So, if markets go down, yes, those costs would go down, but so would revenue. So, therefore, that wouldn't be a good thing.

But hopefully, what you've seen is, and I'm just reiterating what Markus said, that 75% of the cost base is discipline-based in good or in bad times, and we will be disciplined in good times. I don't know if, at some point, Markus should put together a compendium of the hundred ways of cutting costs, even in good times. But what you would see is that we've done many, many, many super-simple things, which are just not easy to actually do on a day-to-day basis.

All of us work for large institutions, so all of you, when you hire people, will have different categories of hires. And one category is typically replacement hire. So, there's almost like the automatic approval of anyone who's a replacement, which we just stopped. So, we said, every hire needs to be checked, compared, ideally coming from internally, to the point Markus made. And it just completely changed momentum in the way we look at hires.

We could continue. The point he made about all legal fees being centralised took us a few months of simply assessing the misalignment of incentives, where our Legal team had an FTE target. So, there was a certain number of internal lawyers they allowed to have, but then everyone else had external legal spends. So, we simply said, well, if we simply centralise everything in Legal, and they can choose whether they add internal lawyers or spend on external advice, that would lead to very different incentives and very different decisions than, if what we collectively spend across Legal is spread across the firm.

And again, that was a way for us to reduce costs without… I trust my internal lawyers more than external advice because the internal lawyers would sit there tomorrow and would feel bad if they gave poor advice. So, therefore, I feel that our level of productivity has gone up, and costs have gone down. So, you will see us be disciplined, and you will see costs continue to be well-managed.

Now, for alternatives, I think we're probably going to provide a deep dive on alternatives next time. So, I'm looking at Oliver. We haven't decided that yet, but I have now put it out there, so you can, maybe, vote, as our client base. We could either do alternatives or maybe digital capabilities. But I think, on alternatives, we have a pretty packed agenda for 25. I think, what has worked well in Q3 and will work well in Q4, is specifically infrastructure.

So, last time, I was not allowed to actually mention some of the funds and active fundraising, and now I am allowed to mention that, for PEIF 4, we had the first close. We expect more coming in Q4. So, there, we continue to target €4, 4.5, 5 billion, which will be very helpful for fees. We've done quite well in infrastructure and our debt opportunities in the US, so that helped in Q3.

We've now opened the warehouse for our first CLO, and are looking at the first investment. So, that's in private credit, nice progress. I think, in Q4, you will see us close a couple of interesting transactions in the solution space and private credit. In real estate debt, we've now hired the team that we've been speaking about. So, they joined us in August/September, focused on real estate debt. That's, that's happening.

So, hopefully you've seen that, while Xtrackers has a very short horizon payback, so, you make investments, and reasonably quickly, you see the payback, hopefully, you give us some benefit of doubt that the longer-term investments we've made in alternatives will also pay back and pay out as much as the Xtrackers. And that's something, which you will see in 25. And, subject to Oliver permitting it, we'll provide much more context on the alternatives growth path in the next quarterly deep dive.

Hubert Lam: Can you also talk about the redemption pipeline, as well, give us some visibility there?

Stefan Hoops: Redemption in alternatives?

Hubert Lam: Yes.

Stefan Hoops: So, and I know you know this, for the European retail, we have very good visibility, to the point you just made, because there's a 12-month notice period. We will still have redemptions because we see them in the queue, but the cancellations have dropped considerably. So, we'll benefit from that being less and less. And at the same time, we had a couple of nice wins in European real estate. So, we won a 1 billion mandate from institutional investors, and from one investor from pretty attractive fees.

So, I think that European real estate will also start to not be a drag on the overall AUM. We still have a little bit of redemption queues in the US, but that has also come down quite a bit. And with the ten-year going down, last couple of days have been less helpful. But with that being closer to four than to four and a half, we've seen interest in US real estate. So, therefore, there, we also feel that going forward, inflows will probably make up, or surpass, the outflows.

In LRA, that's something that you wouldn't really have a queue. There, people would just take money out and that we've seen slow. And we have plenty of RFPs that we're competing for. So, that's why, when doing my prepared remarks, I mentioned that, for the second half, in total, we expect positive inflows. I guess, it implies that, for Q4, we must expect at least half a billion of inflows, in order to be net positive for the half-year.

So, I think that's also an indication for redemptions slowing down and being surpassed by net new inflows.

Hubert Lam — Great, thank you.

Stefan Hoops — Thanks, Hubert.

Operator — The next question comes from Angeliki Bairaktari from J.P. Morgan. Please, go ahead.

Angeliki Bairaktari — Good morning and thank you for taking my questions. With regards to the multi-asset funds, which continue to see outflows, and outflows have actually widened, Q on Q, what is the outlook there for 2025? And have you seen German retail investors go into deposits or other safer products in the past two years? And if that's the case, is there scope for that to reverse, as rates decline in Europe, to the benefit of higher-margin products, such as the multi-asset funds that you sell?

And second question, with regards to the passive flows of €27 billion, year to date, which is really a remarkable number, how much of that is coming from institutional clients, and how much is coming from retail? And can you give us some colour, with regard to the retail sales of ETFs? In which geography and in which channels do you see those gaining the most traction? Thank you.

Stefan Hoops — Thanks, Angeliki. Let me start, while we're trying to pull out a part of the second answer. So, I will try to win some time for the team to dig it out, because you asked one thing that we actually don't know, off the top of our head. So, in multi-asset, so we have many funds, Concept Kaldemorgan has done fine from a flow perspective, but we have a variety of other multi-asset funds.

Some of them are pension-related, so essentially, institutional clients, at much lower margin. So, the average fee you see is a blend with much higher fees in retail and much lower fees in institutional. I think your question on, have we seen people go into deposits, that has not really been the case. What we have seen is that private banks like to sell discretionary portfolio management.

So, they go to retail clients, saying, well, instead of you buying a bunch of funds, how about you allow us to be your DPM manager, and then we select Xtrackers or other ETFs or whatever underlying. So, therefore some of the flows were actually not into deposits, but into DPM. So, that is something that, maybe, we will then see in our Xtrackers' inflows, but not necessarily a move into deposits.

I'm not sure whether that's going to change, going forward. We combine multi-asset and what we call the SQI, so Systematic and Quantitative Investments, because they target a similar client base. I think, overall, that combined category, which is a bit over 120 billion for us, will go up as you have pension reform in Germany and other things that that asset class, or it's not a real asset class, but that solution space, would benefit from.

But you're right, the 1 billion outflows and SQI being flattish for the quarter is not great. But I would imagine the future to look a bit brighter for that.

Now, on your second question, it has been quite strong. I actually don't know the exact split between retail and institutional, but Markus looks at me knowingly.

Markus Kobler

Yes, I can step in here. Thank you, Stefan. Angeliki, as you mentioned, year to date, 17 billion on the passive side. And that breaks down into the major contributor, UCITS ETF and ETCs, of 21.8 billion. Then the 1940 Act of around 700 million and the mandates of 4.9 billion.

Stefan Hoops

And so, now that I have the numbers, I can give a bit more context. So, the last category, obviously, was institutional. That's super-low margin. I think we continue to win mandates. We won a very large one, which will come in, in Q4, but all of that is similar to fixed income, very low margin. I think the US number is a bit misleadingly low. What we've seen was outflows from institutional investors in our US ETF business and then inflows from local retail.

So, I think that, underlying, it looks flattish, but I think the composition is much better. And we would expect larger net inflows, going forward, from the US business. I think Q4 will be strong. As you know, we are focusing on thematic ETFs, and one big theme was Chinese A shares. So, I guess you would expect that to have done well in Q4.

And yes, I think the UCITS, that's mostly retail. You asked about the channels. One very important channel remains digital distribution partners. So, roughly one third of that 21 billion of UCITS is distributed through digital partners. In many cases, that's savings plans, so it's very easy to anticipate what will come in every quarter. So, we think that this is reasonably sticky.

Angeliki Bairaktari

Thank you.

Operator

The next question comes from Bruce Hamilton from Morgan Stanley. Please, go ahead.

Bruce Hamilton	Hi. Morning, guys, and thanks very much for all the colour. One question on product innovation and one on this post-retirement space. So, in terms of the product innovation alpha you talk about, clearly, you're having good success with ETFs. Can you give us the names of the four products, I think you said, were selling very well? And then, in terms of active ETFs, obviously, a lot of innovation going on at an industry level, so how are you thinking about the active ETF opportunity, both for the US and for Europe? Obviously, US, you get a tax benefit, Europe less so. And then the second question, which I think touches on the solutions point you made previously, but asset managers are generally focused on the accumulation phase, but increasingly, the post-retirement opportunity, given ageing, is significant and, in our view, underserved. So, how are you thinking about tackling that part of the market? What sort of products look best placed?
Stefan Hoops	Hey, Bruce. I'm very happy to start. So, the four bestselling ETFs in Q4 were our overnight offering. So, not really new innovation, but that has done very well. Our equal-weight S&P, and we have two versions, one ESG and a normal one, and a physical gold ETC. So, those were the four bestselling. One of the things that we like, the inflows. They were at a slightly lower margin, so about 12 basis points on average. Given that the overnight is at 10, equal weight is at 20, gold at 11, therefore, it was slightly below our 16 basis point that we typically have, on average. But still, very good quarter for our ETF business. Now, on active ETF, that is something where I honestly feel we could have done better in the past. So, it's a trend that will just become more relevant. I think the past, we described it as, essentially, more packaging, as opposed to a true innovation. I don't think that you can take an average fund, just wrap it into an active ETF, and it becomes awesome. I think you need to have good strategies. And then it's, basically, a different, let's call it, dissemination method, where you would then be able to target digital distribution platforms for others that simply wouldn't buy mutual funds, but would buy ETF. And then you're able to access that channel. So, I think it would simply broaden your universe of possible buyers for certain strategies. So, it's something that we are actively, sounds silly to actively work on active ETFs, but we are, in a very focused manner, working on that. And I think you will see more from us. We already had decent success with our Natural Resources active ETF in the US. Your second question on solutions, that is something that I believe, especially for Germany, will be a very interesting

opportunity, probably starting in 25, but then really 26, 27 and beyond. I think, when you look at the three pillars of, specifically Germany, but then I think you can broaden that to other countries, the first pillar is always interesting, but that's more like covering a sovereign wealth fund.

I think the second pillar is one we would have tremendous upside as DWS, because accessing corporates, mid-cap corporates, that in Germany, typically have a pay-as-you-go pension system, so they're not funded. So, even the DAX, very few companies are fully funded.

So, once companies go to actually funded pension plans, that will offer tremendous opportunities for us, A, because we understand the product. It's like institutional savings plans. But we will also have access to those clients through collaboration with Deutsche Bank's Corporate Bank.

And then, thirdly, when it comes to private post-retirement, I think we've done very well in the past with ours, like ICPPI products, the Riester Rente, and are actively working on new product innovation, in which case, we would typically do it through distribution partners, where we also have access to the right distribution partners.

So, I think, typically, when you look at the products, it is, as you know, reasonably basic products then compiled, combined in a solution manner. And I think DWS has a very good track record in being able to deliver that to the market.

Bruce Hamilton — Great. Thank you.

Markus Kobler — Thanks, Bruce.

Operator — The next question comes from Arnaud Giblat from BNP Paribas. Please, go ahead.

Arnaud Giblat — Yes, good morning. I've got two questions, please. Just if I could follow up on the M&A question, as you said, and it's been also in the press, you're focusing more on distribution, on the international, perhaps more on Asia. I'm just wondering if you could help us square this up with valuation, so that we're seeing it in listed Asian asset managers, clearly, trading at double/triple the valuations, versus European managers. Could you explain to us how you think about a return on invested capital framework, if engaging in M&A?

And my second question is on private debt. Thanks for the update on the pipeline that you mentioned. I'm just wondering, given your presence in the US and the fact that you've got quite a bit of insurance clients, would you consider asset-backed financing as a capability to expand? That's been having quite some success there. I'm just wondering if that's something you're thinking about. Thank you.

Stefan Hoops — Thank you, Arnaud. So, I think Markus feels that I've been riding shotgun enough during today's call and should do some of the work. He's looking at me So, let me take both questions. So, on M&A, I think you're very, very smart in how you ask the question. Unfortunately, you will not get an answer out of us because, again, I think M&A should be done and not talked about.

They're clearly countries that trade at a gigantic multiple of where we trade. India, for example. So, I think it's probably unlikely that we would make a significant acquisition in India at the current point in time. When you look at India and you look at India being mostly mutual fund, mostly equities, fixed income, very little private assets, very little infrastructure, very little real estate, I think you could see a scenario, in which we would team up with someone in India to then deliver our knowledge of alternatives and combine it with somebody locally.

So, again, if you look at India, great country. What the country needs is a lot more investments in logistics, so infrastructure. And that is something, which we've been doing for decades. So, I think India probably wouldn't be an acquisition, for the reasons you point out, but more teaming up with someone.

But then, there are other countries. China, we like. Markus was in China last week. I will be in China twice before the end of the year. And that is a sector, which is currently trading cheaper to European asset managers. So, I think Asia is an incredibly large and interesting continent, and we would need to be smart in how we approach the respective markets.

Now, when it comes to private debt, specifically the US, to some extent, real estate debt is asset-backed. When you look at more esoteric forms of asset-backed, we would need to have differentiated origination channels. I think, just honestly speaking, if we wanted to compete on US soil with some of the Apollos, Blackstones and so on and so forth, we would need to explain, even to our lawyer client base in the insurance space, that we have better access to risk than those competitors. That's a sophisticated client base.

Quite honestly, I think, for us, independently, as DWS, that would not be easy to pull off in the US. So, we feel that, in Europe, we have differentiated access to risk. In the US, that's not really the case, unless we properly team up with Deutsche Bank. And then, one of the things that we spoke about at our Capital Markets Day two years ago is that there's tremendous upside in teaming up with, I would say, the vast origination channels of DB's Corporate Bank, Investment Bank and so on.

And if we actually pulled off properly teaming up with them, then I think we could also consider asset-backed financing in the United States.

Arnaud Giblat	Thank you.
Operator	The next question comes from Nicholas Herman from Citi. Please, go ahead.
Nicholas Herman	Yes, good morning. Thanks very much for the presentation. Two from me, please. On alternatives, I guess, it looks like there has been a pretty negative FX impact on alternatives. And if I exclude that, it looks like the performance may have been up in the quarter. Can I just ask, what drove that? Was it all LRA, or have you seen any benefit from lower rates on some of your private assets? I guess, how are you thinking about the performance of alternatives going forward, please? And then, secondly, on costs, I'd be interested to find out, understand, learn a bit more about what proportion of your discipline costs do changing growth projects comprise? And similarly, where do you expect that to level out over time, as you finalise your transformation? And I guess, what do you see, industry average? How would that compare, then, to the industry averages across large asset managers like yourself? Thank you.
Stefan Hoops	Nicholas, let me take the first question and then hand back to Markus for the second one. So, I think, when you look at the AUM and you take outflows and simply look at the impact from our performance, so did the funds do good or bad, market, so the beta, and then FX, we show in euro, but many of the assets are in dollars. But I think, if I try to break it down for LRA and real estate equity, then real estate equity did not have a good beta. I think the markdowns slowed in Q3, but it's not that we actually had markets doing better. I think our performance, so idiosyncratically, the alpha we create has been quite strong in real estate equity, but typically hasn't really had a massive effect over the last couple of years as the beta was so negative. I think FX should have been reasonably flat in Q3. LRA, the underlying businesses, so essentially, the beta, if you want, was positive in Q3. So, with the change in rates outlook, as you would have expected, real estate benefit, that I made the comment earlier when your colleague asked the question about some of our global equity funds not doing well, I said that they are underweight real estate and utilities. Obviously, LRA is like the opposite. They invest in that. So, they have done quite well, performance-wise, from a beta perspective in Q3. And when you look at the performance of the alpha that we create, those are also really good performing strategies. So, therefore, that was positive, from an AUM perspective, even though flows still haven't fully recovered. And then the FX comment is the same as in US real estate equity. And before I hand over on cost to Markus, I think, when it

comes to investments, I would differentiate between transformation and, let's say, the non-revenue-generating transformation. So, moving apps into the cloud, building a ledger and things like that, there we'll continue to be super-disciplined. Those costs would be materially lower than in the past, but you will always have some maintenance you have to do.

And we're just very disciplined, which I would differentiate from growth, meaning investments in new humans, tech investments and digital channels and so on. And there, I think the way that Markus described how he is running the success-based capex applies to both types. But I would imagine that the transformation, so what you try to do as little as possible, that will materially go down. We will always do substantial growth investments because we want to be able to grow and grow revenues.

Markus Kobler

And happy to take on your other question, Nicholas, on the growth projects or investments, as you call it. And it is referring back to the three buckets or levers of the discipline-based costs, which is our human capital management, the non-comm items and the growth investments. And they're not messy. So, we don't have an allowance for investments, because that, again, probably would be detrimental to the discipline.

Because the way we look at it is that we look at the strategic opportunities first, then we prioritise and only focus on a few items, on a few projects, which then bring us forward. And then on a success-based approach that people have proven in the past that they can deliver, they get the budget allocated only after they have started spending it, so to continue that discipline.

And so, we don't measure, let's say, we just take up a number here, that we have, whatever, 15% of our cost base in investments or into growth and regulatory. That, again, has a mindset afterwards, saying, oh, it's almost like an entitlement. That is like something we want to spend. What I can assure you is that we have enough means to invest into growth areas successfully.

Nicholas Herman

That's helpful. Thank you very much, and I look forward to the future deep dives on alternatives and digital capabilities. Thank you.

Operator

The last question for today's call comes from Pierre Chédeville from CIC. Please, go ahead.

Pierre Chédeville

Yes, good morning. I have two questions left, I would say. First is about internalisation, because I was a little bit curious about what could be internalised, in order to have better cost, because generally speaking, when you externalise, it's because you think that you may have economies of cost, thanks to mutualisation, for instance, or a non-recurring task to be done externally while internalising them. So, I would be curious to see what you mean by that.

And regarding M&A, of course, it's normal that you don't want to comment, and we all have seen that the main difference between you and your predecessor is the fact that you do not put the focus on external growth. But I was curious to see, how do you react to the merger between BNP and AXA IM? And if, according to you, it is changing something in the competitive landscape? Thank you very much.

Markus Kobler

And thank you, Pierre. Let me take, or answer, the first question, and Stefan, you may add afterwards. internalisation. Mike asked about the FTE increase in the second or the third quarter, and the answer there was, it was internalisation. What do we mean by that? We have addressed the topic of having an external workforce. They're very important. They contribute to projects where we don't have the expertise.

However, we have made an effort over the last 12 months, and in particular, in 2024, to look at them and then to decide, what do we need, in terms of human capital internally? What is crucial to deliver our strategy? And as a consequence, when you do that, you have, afterwards, also cost savings because you save more than what you spend on compensation and benefits.

Why that, again? Because a lot of these colleagues have been hired in our locations in Mumbai, Pune, Bangalore, and Manilla. And you no longer have an external workforce where you spend the cost of that person. On top of it, you have a profit mark-up, and on top of that, you have VAT. So, it's beneficial on multiple fronts. It saves cost, but it also increases the value of the human capital of the DWS employees.

Stefan Hoops

And Pierre, just to add to that, and then you will also see how that influences the thinking on M&A. So, I really enjoy working with Markus, and we are both bonding over many things, even though we come from different angles. So, Markus is incredibly detailed in everything he does. Well, I try to be slightly more big picture, but I look at incentives. So, I've spent a lot of time, academically, on incentives. I feel the world can easily be explained by incentive setting.

So, therefore, when it comes to cost, we really bond on, for every single cost item, he has all of the details, and then we always think about, how do we set the right incentives for people to do the right thing? And that's fun. That also applies to how we think and talk about M&A. So, think about me running around, constantly talking about externally driven M&A. This is how we grow as a company.

What's the incentive for our people, internally, to run as hard as they can? So, the reason why we always say, in the West, we are really well set up, and we want to see tremendous organic growth is because M&A is a little bit like taking steroids. You just have to go to the gym and work hard, and then you can organically grow.

And if you just take a shortcut by constantly talking about M&A or taking steroids, that feels good for the moment, but doesn't really drive underlying strength. So, therefore, the reason why we don't talk about it is because we want to hold everyone at DWS accountable for tremendous growth. What we do, day to day, without talking about it, you may see one day, but you wouldn't necessarily get regular updates on.

Now, M&A inorganic growth is important. Obviously, we're following the market. I think what happened in France is interesting. You actually have an insurance company that, in that case, was willing to give up control, which doesn't apply to all insurance companies. I think that case, obviously, they move from life to P&C, probably care slightly less about asset management. So, it was a good opportunity for them to part ways and for BNP to grow.

They are great partner, formidable competitor in some areas, but also great partner in many other areas. I think that that makes sense for BNP. I think it's a good move for AXA. It will create a strong competitor, stronger than before, across retail and institutional. So, that's clearly something, which we are following. I think would probably be slightly more problematic for our large French competitor than for us, but obviously something we are following.

But again, we really want to have the underlying growth from organically growing. But maybe the last thought, the one thing that Markus and I can always agree on is the discipline. We're saying it over and over, and it may sound like a broken record. I know that all of you are much more focused on the numbers, but then again, you need to read between the lines.

And Markus and I are both convinced that extraordinary things are done by ordinary people with uncommon discipline and many things, which are very simple and not easy to actually do every single day. And we feel that we are both, average talented, but above-average disciplined. And I think that's something that you will see in the future at DWS.

So, I guess, handing back to Oliver, it seems that people are interested in knowing more about alternatives. But, again, Oliver will decide what we spend the next deep dive on. But I think, from Markus and I, thank you very much for today's call.

Pierre Chédeville: Thank you.

Oliver Flade: Thank you very much, everybody, for listening in and the good questions. And please reach out to the IR team, in case there are any open questions left. Otherwise, we wish you a fantastic day. Thank you very much, and bye-bye.