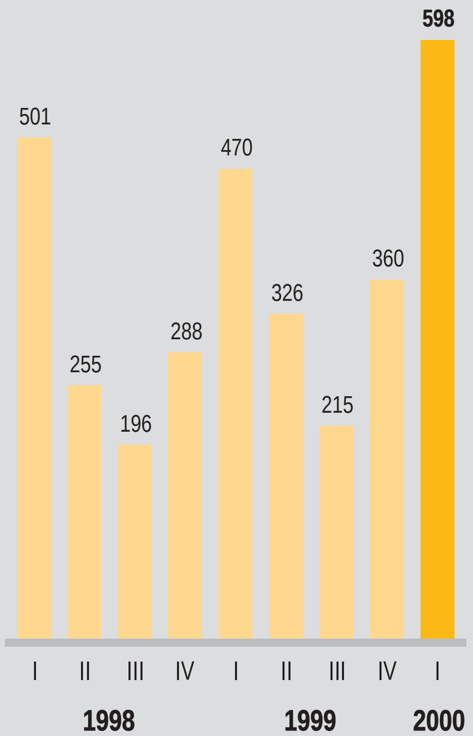
Commerzbank
Annual General Meeting

Business situation, strategy and perspectives

May 26, 2000

Quarterly pre-tax results

Commerzbank Group, in € m



COMMERZBANK

Commerzbank Annual General Meeting 2000

Martin Kohlhaussen:
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Martin Kohlhaussen: Business situation, strategy and perspectives

Dear shareholders,
shareholder representatives,
ladies and gentlemen,

On behalf of the Board of Managing Directors of Commerzbank, I want first of all to cordially welcome you to the Jahrhunderthalle Frankfurt, where we have gathered now for five years in a row for our Annual General Meeting. In addition to my report on the financial statements for 1999 and the development of the Bank in the first quarter of this year, a major part of my remarks will be devoted to the presentation of our strategic objectives.

A. Financial statements for 1999

I want to begin with the presentation of the 1999 financial statements. We have achieved much; the results clearly show that we have embarked upon the right course with our strategy. However, much still remains to be done – and where isn't that the case? – for we have not achieved our targets: a cost/income ratio of 60% and an after-tax return on equity of 15%.

The past year produced an across-the-board increase in our operative earnings of 22%. Together with the once again strong result on financial investments, this enabled us to put an enormous effort into investments for the future. In addition to developing our strategic priorities, we had to make large outlays for regulatory purposes on such projects as the euro, the Year 2000 changeover and the so-called minimum requirements for conducting trading transactions.

Let me take this opportunity to thank all those employees who through their professional and committed work ensured that the turn of the year 1999/2000 was handled without any problems by our Group.

As regards the growth of business volume as well, the Commerzbank Group set a brisk pace again in 1999, expanding its balance-sheet total by 14% to €372bn. Expansion was mainly fuelled by claims on customers, which advanced by 10.5%, assets held for dealing purposes that were 31.6% higher, and financial investments, which we raised by 48.7%.

The item Investments alone expanded by practically €2bn; the principal factors here were our newly acquired stakes in Crédit Lyonnais (€350m) and our Italian partner Banca Intesa (just over €600m), as well as a capital increase at Korea Exchange Bank (€200m). Taken together, these easily represent our largest investments to date in new or existing participations.

On the other hand, we disposed of our interest in DBV-Winterthur Holding as part of the transfer of our bancassurance activities to the Aachener und Münchener Group; the sale of this stake generated net earnings of around €200m. All told, we had at our disposal a result on financial investments of €595m.

In our current business operations, we benefitted strongly from the boom in the international equity markets. The 31% rise in net commission income to €2.2bn was especially remarkable. In syndicated business, we achieved a 90% increase in earnings; this is attributable above all to our successes with IPOs; we were involved in 52 stock-exchange introductions, in eleven cases acting as lead manager.

We managed to achieve a huge increase in securities transactions on behalf of our customers. This is underlined by the fact that more than 40% of our overall commission income derived from this segment.

At €592m, our trading profit was a gratifying 43% higher than a year earlier. Unfortunately, the dynamic trend of the first nine months was not maintained up to year-end. The final quarter was too passive in some areas, as the turn of the year – considered by many as likely to pose serious problems – cast its shadow in advance. Due to the revaluation of certain interest-rate positions, the trading profit of the final three months even slipped slightly into minus figures. The strongest source of earnings in 1999 was equities trading, which at €263m turned in a result almost three times higher than in 1998.

Trading in bonds, notes and interest-rate derivatives produced €250m, twice the amount realized a year previously. The amount contributed by trading in foreign exchange, notes and coin and precious metals, however, was far lower, at €79m. This decline had been expected after the loss of trading opportunities in the former European currencies.

In interest-bearing business, earnings growth was dampened not only by the persistent pressure on margins but also our high level of investment in participations, which in 1999 did not yet produce any income. All the same, net interest income was a good 3% stronger.

The tendency for provision for possible loan losses was decidedly positive; we were able to reduce this item by practically 22% to €689m. The need to make value adjustments was down by 45% in retail banking and by even 77% in our international lending, including country risks.

This positive development reflects not only the economic recovery in the emerging markets but also our clear-cut lending guidelines, our concentration on business involving less risk, and our systematic risk management.

This also became evident in corporate business, where our risk profile continued to improve across the board. However, the Bank had to provide for two unforeseeable large credit exposures, namely Holzmann and FlowTex. After provisioning, net interest and dividend income amounted to €2.5bn, and was therefore up by 13%.

Among operating expenses, other, non-personnel costs climbed sharply. We registered a substantial rise in costs in connection with the implementation of various special projects, especially in information technology. This investment in the future is indispensable in the present environment. We look upon it as a key contribution towards ensuring our technological competitiveness; for this reason, we have consciously made outlays on this scale.

Our rapid and dynamic expansion in recent years has also gone hand in hand with a considerable recruitment of staff. In 1999, our Group workforce again grew by 7% to 34,870. Personnel costs rose by 16.3% to €2.4bn.

With depreciation of office furniture and equipment and also real property included, our operating expenses increased by 23.9% altogether to almost €4.5bn. You can see from this growth rate that we really have made great efforts. However, we realize that the increases cannot continue on this scale.

A minus of €51m appears in our income statement under the item Other operating result. This includes a figure in the double-digit millions which we have set aside as our contribution to the foundation set up by German business and the German government to compensate the victims of forced labour schemes during World War II.

As the balance of all income and expense items, a pre-tax profit of €1.37bn remains – a good 10% more than in 1998. In view of the Bank's improved operative results and lower tax-free income from abroad than a year previously, tax payments surged by a third to €396m. Once the profit attributable to minority interests has been deducted, a consolidated net profit of €911m was achieved, from which we have allocated €500m – virtually the same as last year's record amount – to our retained earnings.

We propose to you, our shareholders, that the remaining distributable profit of €411m be used to make a 4% higher dividend payment of 80 cents. Once this is resolved, those of our shareholders with unlimited tax liability in Germany will receive an additional tax credit of 34 cents per share.
The Bank's equity has risen by altogether 10.7% to €11.14bn, reflecting not only the allocation to reserves and the distributable profit, but also the issue of shares to our staff as well as a capital increase taken over by Mediobanca. The shares from an authorized capital increase acquired by this Italian investment bank augmented our equity by altogether €123m. At the same time, the exercising of option rights generated a further €216m. At year-end, the core capital ratio according to BIS was unchanged at 6.3%; the overall capital ratio had reached 9.7%, compared with 8.7% a year previously.

The scope for capital-raising measures created at last year's AGM is still adequate. For that reason, we merely request authorization for us to acquire our own shares. Point 6 of the agenda relates to the possibility of acquiring a maximum of 5% of the Bank's share capital for the purpose of securities trading. Under point 7, we again request your authorization to repurchase our own shares in a volume of up to 10% of our share capital – either via the stock exchange or by means of a public offer.

We consider this to be an extremely flexible instrument, for we can use the shares repurchased in this way to acquire participations or to sell them again at a later point in time on the stock exchange. But we can also withdraw the shares in order to reduce the number of shares outstanding.

Mr. Frowein has already mentioned point 8 of the agenda, the election of new members to the Supervisory Board. Points 1 to 5 cover the ”fixed” topics, i.e. the presentation of the financial statements, the resolution on the dividend, approval of the actions of the Board of Managing Directors and the Supervisory Board, and also the appointment of the auditors.

B. Business performance in January-March 2000

This year, for the first time, we published a separate interim report – early in May – on the first quarter. In case you have not already picked up the report at your Commerzbank branch or downloaded it from the internet, you can also obtain it here today. It is available from the stands outside. You will notice that we have considerably extended our reporting compared with previous years. Our figures have thus been made even more transparent – an objective which we have been pursuing for several years.

In the first three months of the current year, the Group's balance-sheet total continued its strong expansion; it added 9%, or €33.3bn, to reach €405.4bn. Claims on banks, rising €11.8bn, formed the main contribution to this expansion, but claims on customers also increased by €9.8bn.

We funded growth on the lending side, for one thing, by raising our interbank borrowing by €16.8bn. For another, liabilities to customers went up by a solid €7.6bn as well. The €8.9bn increase in securitized liabilities is above all due to the issue of medium and long-term bonds by our mortgage banks.

For the months from January to March, we achieved net interest income of €757m; this was practically 18% lower than during the same period a year earlier. In addition to the flatter yield curve, this reflects the funding costs for our investments in participations and the absence of the income from the cancellation of interest-rate swaps which we had booked in the first quarter of 1999. Compared with the final three months of last year, though, net interest income was only 0.4% lower.

We put the need for provisioning at €564m for this year as a whole, almost 8% less than we had expected at the same point last year for 1999.

Net commission income continues to achieve encouraging growth rates; it soared by practically 65% to €751m, thus overtaking net interest income after provisioning for the first time. Given lively stock-exchange activity and numerous new issues, our securities transactions on behalf of our customers continued to be very brisk. As a result, commissions in this area went up from €220m a year earlier to €420m.

In asset management as well, we achieved a strong increase in commission income; the first-time inclusion of ADIG and ADIG-Investment Luxemburg S.A. made a major contribution here. But the Jupiter International Group also doubled its result.

Our stronger trading activities were primarily reflected in the equities area; all told, we achieved €360m, 91.5% more than in the first quarter of 1999. Our result on financial investments was €67m, as against €46m a year previously.

In a comparison of the first quarter of this year with the identical period of 1999, our operating expenses still show a sharp climb of 21.4% to €1.2bn. Comparison with the previous quarter, though, reveals a different picture: expenses were 6.8% lower than in the October to December period of 1999 – a clear sign of our many various measures to contain costs.

Compared with the first quarter of 1999, personnel costs were a good 19% higher at €664m, while we had to spend 1.2% less than in the previous quarter. Our workforce expanded to 35,325, 6.4% more than at end-March 1999. However, this increase also includes the just over 400 employees of ADIG and ALSA.

As the balance of all income and expense items, a pre-tax profit of €598m remains, which is 27.2% higher than that for the same period last year. This means that we have achieved the best quarterly result in our Bank's history. With a tax ratio of 36%, the after-tax profit amounted to €381m, almost 7% more than a year ago. €17m of the result is attributable to minority interests, enabling us to post a 7% higher profit of €364m. This translates into 71 cents per share, as against 69 cents a year previously.

As we achieved an after-tax return on equity of 9.3% in 1999 and a cost/income ratio of 68.5%, these key ratios are now showing distinct signs of improvement. The after-tax return on equity reached 13.6%, while the cost/income ratio declined to 61.8%.

The results for 1999 and the first quarter of 2000 underline the fact that we are able to tackle the challenges of the financial markets successfully; we can grow with them; and we can make use of business opportunities which generate earnings for us. But the figures also show that the trust which you place in our Bank is justified and that the Commerzbank share remains a rewarding investment.

In view of the encouraging development of operative business in the first quarter, we are also optimistic with regard to the rest of the year. We expect a further boost for earnings from the stock-exchange introduction of comdirect, which will receive a listing in the Neuer Markt on June 5. At the moment, a capital increase involving 20.5 million shares can be subscribed to by private and institutional investors.

If we assume a price of €31, comdirect and, by extension, the Commerzbank Group will receive new core capital of €635.5m. At the same time, we are offering 7.6 million existing shares in the market; this will generate income for us of a maximum amount of €235.6m. A few weeks ago, we announced that we are selling a 25% stake in comdirect – prior to the capital increase – to T-Online. In return, we will receive a shareholding worth the same amount (=2.1%) in what is Germany's largest internet provider.

After the IPO, Commerzbank will hold 58.65% of comdirect, and T-Online 21.35%. The free float of comdirect's shares will amount to 20%.

C. Macroeconomic perspectives

Before I present our strategic goals, I want to outline for you the economic setting in which we operate and which we have to take into consideration in our business policy.

The economic situation in Germany and the euro-zone has improved considerably in the past twelve months; all the same, the nervousness and uncertainty in the financial markets are greater than they were a year ago. For one thing, this is because the central banks of the industrial countries – with the exception of Japan – are tightening the monetary reins again and it is not clear today how far they will go. For another, the uncertainty in the countries participating in European monetary union stems from the euro's sharp decline in the foreign-exchange markets.

In fact, the phase of sluggish economic activity in Germany and the euro-zone had already been overcome by mid-1999. This was thanks above all to the improved outlook for exports and the stimuli provided by monetary policy. Since then, the economies of both Germany and its partners in the euro-zone have been growing at an annual rate of 3-3½%. I expect that this quite satisfactory tempo can be upheld this year and in 2001 at least. At the same time, the price climb remains weak. The inflation rate will average about 2% this year, and considerably less in Germany.

Since last November, the European Central Bank has raised interest rates several times. After the cyclical turning-point had been reached last year, there was no longer any justification for very low money-market rates. However, a restrictive monetary policy with much higher interest rates than today's is neither needed nor likely. This also represents an important difference between conditions here and in the United States, which is frequently overlooked in the financial markets. Since the mid-nineties, growth in the US has exceeded all the forecasts. The related expectations are very high and, in my opinion, ultimately cannot be met. My impression is that we are not far away from the point at which the financial markets will focus more on the imbalances in the American economy and the New Economy will lose its shine.

The financial markets seem not only to have anticipated the positive trends in the form of a protracted stock-exchange boom but also to have exaggerated them. A correction here would entail considerable risks for us in Western Europe as well.

The still unbroken strength of the US economy is the main reason for the weakness of the euro in the foreign-exchange markets. In these circumstances, the D-mark would also have buckled. Nevertheless, not every effort has been made in the euro-zone to counteract the depreciation of the currency, which is having – on balance – negative consequences. The deepening of the European Union in the direction of a political union is marking time, and on the whole the frequently called-for structural reforms to make the economy more flexible are not making sufficient progress.

Most recently, the inclusion of Greece at the start of next year and above all the prospect of monetary union being enlarged eastwards have had an adverse impact. I think this is an exaggerated reaction and premature in terms of the timetable. Rather, I believe that the euro has considerable upward potential, which will probably only be realized, though, when the economic prospects on either side of the Atlantic are viewed more realistically.

I am confident as regards the financial markets in the euro area. At 5½%, long-term interest rates have reached a level which is in line with macroeconomic conditions. Even if the European Central Bank were to raise interest rates further, this would have little effect on the long end of the market. It is more important that no upward pressure to raise interest rates is forthcoming from the United States. This danger will increase as economic growth there loses momentum.

The euro equities market has already decoupled itself from developments in the United States. This reflects the more favourable perspectives for the medium term in the euro-zone. A change of trend for the euro would further enhance the attractiveness of Europe's financial markets.

D. Strategic goals

I now turn to the last major section of my remarks, our strategic goals. The planned merger between our two closest rivals, which was announced in February but later collapsed, prompted us to examine our own strategy. We have found that a radically new approach is not needed, for we appear to be on the right path. This is underlined not only by the figures that I have presented but also by our success in gaining market share, in the growth of our customer base and – last but not least – by our early and successful internet orientation.

For years, our focus has been on branch business in particular, which is claimed on all sides to be unprofitable for the major banks. At Commerzbank, things are different.

- A decade ago, we introduced the tripartite structure of our branch network in order to operate more efficiently and economically and so that we could concentrate more on providing advice.
- Several years ago, we removed back-office settlement from the branches and concentrated it at six centres.
- With our Commerzbank Shops in supermarkets, we embarked upon a successful new course, gaining more than 45,000 new customers.
- With our P2000 scheme, we were the first and, even now, still the only bank to have already implemented a data warehouse conception for retail banking.

The success we have scored is revealed by the figures. In our segment reporting, which you can find on pages 80-82 of our Annual Report, we show that in both retail and corporate business, Commerzbank is earning money. We see no reason, therefore, to reduce our nationwide coverage.

Both within the national and international framework, we will continue to examine the possibilities for cooperation in the various areas of business – especially investment banking – in production, and in settlement. In this way, namely, we can increase our product and cost efficiency and strengthen our selling power.

When recognizable opportunities arise, we will examine actively and in an open-minded manner, as we have up to now, whether and in what form cooperation with others is sensible. However, these have to be opportunities which point to advantages for Commerzbank and its shareholders. To this extent, I should not only draw attention to our acquisitions in Poland (BRE Bank), Korea (Korea Exchange Bank), USA (Martingale and Montgomery Asset Management), the United Kingdom (Jupiter International Group) and France (Caisse Centrale de Réescompte) and to the acquisition of a majority shareholding in ADIG, but also to the network formed with our European partners. Frequently, we hear the criticism that so far this net-work has not led to more than a – very lively – European platform.

But is it really better to do nothing at all if a major achievement is not yet possible? It is an established fact that Commerzbank is the only German bank to have set up a network of bilateral bank relationships in the core European countries. In many instances, criticism of our partial success betrays both envy and imperial arrogance, as if other European countries represent less developed banking markets that are merely waiting for the blessings from Germany to arrive.

I believe that the vision of a cross-border European bank remains a sensible one and is worth pursuing. Yet the basis for this vision must be a Commerzbank that is developing strongly within its own home market. In this respect, we are making good progress. Interested readers will find this presented in a readily intelligible form in the Annual Report. Over the past few years, we have achieved strong and dynamic expansion, not least through takeovers and cooperation agreements. We will continue to do so. But our corporate identity will retain its great importance for us.

All in all, our strategy can be described as follows.

First, we continue to adhere to a policy of growth. We intend to systematically use the opportunities for growth that arise in times of major changes in order to expand our customer base in both the retail and the corporate segments. We will continue to focus especially intensively on small and medium-sized enterprises (SMEs), which not only form the backbone of the German economy but have also been our Bank's main target group among corporate clients for years. I see a realistic chance for Commerzbank to secure its position as one of the leading banks for SMEs.

I am also saying this for the benefit of the many politicians, who are apparently all too willing to believe the legends disseminated by our public-sector competitors.

Second, we will step up our efforts to create a technology network, enabling us both to cut our production costs and to enlarge our settlement capacity. Here we are not only negotiating with prospective partners in Germany but also on a cross-border basis in Europe.

Third, we intend to become the leading internet bank. We will vigorously develop these activities in order to further secure our position in this dramatically expanding market. For this purpose, we are making available the necessary funds on a large scale.

We have bundled together all our internet activities in Commerz NetBusiness AG, which was formed a few months ago.

More than 300,000 of Commerzbank's retail customers are already familiar with the advantages of conducting their banking transactions electronically via internet by means of the online banking web introduced at end-1997, or using special homebanking applications. At the start of May, we launched our personal service and finance portal, called ComPort. Thanks to this product, Commerzbank has become the first German bank to enter this market and is at least a click ahead of its rivals. Here internet users are offered not simply banking services, but also a variety of information from areas of general interest and different opportunities for taking up contact.

The portal will be developed further into a virtual branch, a fully-fledged online distribution channel for the Bank's branches. It is quite possible, therefore, that our distribution channels in Germany will be shifted to some extent from the branches to the internet bank. At least, we will be a multichannel bank. And in the final analysis, it is up to customers to decide which distribution channels they prefer.

At all events, we consider it an important competitive advantage that our customers have the opportunity both to go to their branch and to avail themselves of our banking services via internet, telephone, direct selling or field agents. The local branch will increasingly concentrate on products requiring intensive counselling.

In our internet strategy, comdirect bank – Germany's number 1 direct broker – is of great significance. It is growing at a breakneck pace and already has roughly 520,000 customers, compared with 277,000 at end-1999; moreover, it is on the way to offering its services in other European countries. If its customer base continues to expand at this speed, it might have a million clients by year-end.

Rheinhyp is providing another component of our internet activities. In its subsidiary baufinanz directservice, it has an independent internet broker for building finance. In the form of "eXtrahyp.de", a joint venture with the leading UK online provider of financial services, it will now be in an even better position to seize the great opportunities in the electronic market for building finance.

Commerz NetBusiness AG will devise internet products for our corporate clients with the support of competent partners.

I want to round off the description of our strategy with a fourth point. What we have achieved in the various segments of investment banking is substantial. The figures confirm our success; the sceptics are being proved wrong. However, we have not yet reached the end of the road. We need stronger market penetration in Europe, and especially in Germany.

We have broadened our base as regards products for private customers and SMEs and also in M&A business, and we have gained a leading position in the area of stock-exchange introductions. As a customer-oriented, European investment bank, we need to play these trump cards even more than we have.

Our goals also include investigating both peripheral product lines and our presence in Germany and elsewhere. Wherever sustained profitability does not seem achievable, we will draw the relevant consequences.

The successful implementation of our programme will

- secure for us larger shares of the SME market,
- bring about a technology network with a high level of productivity,
- make us the market leader in the internet world, and cause Commerzbank to become an
- integrated, customer-oriented European investment bank.

By way of conclusion, I should like to make a statement about Commerzbank's circle of shareholders.

On April 19, we were informed that Rebon B.V., Amsterdam, holds 9.9% of the voting rights of our Bank via a German subsidiary. Last week, we learned that this shareholding had been increased to 17%.

To our knowledge, just under 20% of Commerzbank's shares had previously been held as permanent investments. The rest are widely dispersed, in the portfolios of institutional investors in Germany and abroad with whom we are well acquainted and also private investors.

Discussions with representatives of the Rebon investors' group have revealed that they regard their stake as a financial investment, are fully in agreement with our existing successful business policy, and are prepared, if necessary, to help us find a strategic partner. Contrary to the many rumours, none of those involved want to have a seat on our Supervisory Board. All this was confirmed in the press releases put out by the shareholder group on April 19 and May 16.

For years, the Commerzbank share has been one of the twelve most strongly traded DAX equities – without any notable major shareholdings. For this reason, it was always a possibility that a block or parcel of shares might be built up over a longer period. However, the rumours which have arisen on several occasions were never confirmed by the regular surveys of our shareholder structure which we conducted. From the intensive contacts which I have with my European and American colleagues, I know that they are not assembling any blocks of Commerzbank shares.

The group of investors who now hold the voting rights of a sizeable number of domestic and foreign investors have the same interest as any other shareholder, namely to see their invested capital increase in value. There is no conflict at all here with the policy that we have formulated and pursued, which is committed to increasing the value of the Commerzbank Group. However, as I have said in the past, we as a provider of services have to see shareholder value as a triad made up of the interests of shareholders, customers and employees.

In this connection, I call upon the media, as they compete with one another, to be objective, diligent and responsible in dealing with the facts. The flights of fantasy which we have been experiencing since mid-April are likely to harm Commerzbank. They are causing unrest and uncertainty among staff, customers and shareholders. And they make it more difficult for us to recruit new, well-qualified employees.

I am certain that this appeal, based on the common interests of shareholders, customers and employees, will find the full support of all the shareholders gathered here today.

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