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Commerzbank AG

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## Remarks as prepared for delivery

Ladies and gentlemen,

Welcome to this summer press conference, to present the – in my view: good – half-year figures that we published this morning. As usual, though, I should also like to outline briefly several strategic considerations which are currently occupying us.

The main message for the second quarter is that we have produced another good result, making us confident that we have positioned ourselves properly and that we both can and will play an active role again in shaping the German banking industry. We have achieved an operating profit of Euro403m which is not much lower than in the excellent first quarter and is just over twice as high as in the corresponding quarter of 2003. The after-tax profit of Euro248m from April to June was almost as high as in the January to March period. Even after adjustments, both results are well ahead of our planning and therefore give us cause for pleasure, because they came about under circumstances that continue to be disappointing – weak demand for credit for cyclical reasons and poor stock-market turnover combined with flat share prices.

For the first time, the figures for the branch business of SchmidtBank, which we have taken over, have been included in our balance sheet and income statement. The extra income and expense items largely offset one another. For the year as a whole, too, integration will not have an impact on the income statement. However, we expect this investment to yield a pre-tax return on equity of more than 10% by 2005. At mid-year, SchmidtBank accounted for Euro3.4bn of the Group's balance-sheet total of Euro391.7bn.

What many sceptics feared, therefore – namely that our first-quarter results were merely a seasonal peak, which would rapidly be followed by a hard landing – has failed to materialize. Of course, we are aware that rating agencies, analysts and also institutional investors expect constantly good quarters from us before the reservations or scepticism finally disappear, then making way, I hope, for a fundamentally new assessment of Commerzbank and its share. At all events, I am confident that we will not disappoint the markets in the second half of the year either. However, in view of the considerable volatilities and the continuing lack of momentum in economic performance and the financial markets, I still feel that it is not sensible to simply extrapolate from the present figures, either in one direction or the other.

**Business performance in first half of 2004**

I want to focus on the first half-year in commenting on our interim report. Anyone who is primarily interested in details of the second quarter will find all the figures clearly presented in the report.

To start with the really important message: we are not only benefiting from the cost reductions of the past two years. Rather, we can see a distinct upward trend in our earnings as well. After six months, for example, our overall income was Euro3,070m – a good 14% higher than in the previous year. At the same time, total expenses were down by almost 4%.

Let me give you a few details. Net interest income increased by 5% to Euro1,523m, with the second quarter in particular providing a positive surprise. Despite lower risk-weighted assets, this was produced by the higher interest received in corporate business and also by a decline in the interest paid. Here, last November's revaluation measures are making themselves felt, leading to much lower funding costs for our participations. Unlike in the previous year, we refrained from recognizing under net interest income as of June 30 our share of the profit of Eurohypo, amounting to around Euro50m.

In the course of one year, our average interest margin improved from 2.44% to 2.76%. One of our most important jobs is to make more progress in this area. As we have found out in recent months, our corporate clients are quite prepared to discuss this topic and can appreciate our position.

There is also good news with regard to provisioning. We believe that our long expressed confidence that we will not require the full amount of Euro962m (including SchmidtBank) budgeted for the year as a whole is being confirmed. We now assume, conservatively, that net provisioning for possible loan losses will not exceed Euro880m. For this reason, we made a downward adjustment as of June 30.

After provisioning, net interest income was Euro1,071m – encouragingly, this was a fifth higher than a year earlier.

Commission business continues to perform well. After six months, net commission income reached Euro1,154m, and was thus 11.4% higher. We earned much stronger income on securities transactions and especially on portfolio management. Germany's buoyant export business is also being reflected in rising commission income.

The only earnings item which fell somewhat short of its year-ago level was our trading profit. Group-wide, we earned practically as much in proprietary trading as in the previous year, with earnings higher for equities and lower for fixed-income instruments. However, the net result for financial derivatives, which also forms part of the trading profit, registered a marked decline. All told, we achieved a trading profit of Euro445m. While the first quarter was outstanding and April normal, May was poor, and was followed by a solid June result. As stock-market performance is flat on balance, it is hardly surprising that our trading profit remains highly volatile.

The net result on the investments and securities portfolio expanded from Euro159m last year to Euro258m. This includes the disposal of our interest in the Spanish bank Santander Central Hispano, which generated tax-free income of a good Euro120m for us. As announced, we will continue to dispose of non-strategic participations at prices that are attractive for us.

Our cost management continues to function smoothly. All our expense items remained below budget. In a year-on-year comparison, personnel expenses were down by 2.8%, primarily because we were employing exactly 1,144 fewer people at mid-year than at mid-2003. Without the 580 new colleagues from SchmidtBank included in that total, the reduction in the workforce would have been even more marked.

All in all, we are left with an impressive operating profit of Euro838m after six months, compared with Euro366m in the first half of 2003 and Euro559m in 2003 as a whole. As goodwill amortization sank to only Euro41m thanks to the revaluation measures, we have a pre-tax profit of Euro797m. You can see from these figures that we have refrained from exercising the option of not showing goodwill amortization. In 2004, therefore, we have retained the old, conservative practice, which will no longer be possible after next January. A year ago, we posted a pre-tax profit of only Euro202m – but this was admittedly after restructuring expenses had been deducted.

Given a consolidated profit of Euro502m, this translates into earnings per share of Euro0.85 (previous year: Euro0.14) for the first six months – based on the average number of shares issued.

This progress is naturally reflected in the operative return on equity as well, which – on an annualized basis – reached a pre-tax 16.4%, as against 6.4% last year. After tax, our return on equity was almost 10% and consequently more or less equalled our cost of capital. In our cost/income ratio as well, which was down to 63.4%, we came within reach of our target of 60% after six months.

**Development in core business lines**

The retail banking segment made a major contribution towards our encouraging half-year results. At Euro223m, the operating profit here was almost double its level a year previously. The sharp improvement was due, for one thing, to higher interest and commission income and, for another, to lower costs.

We are therefore well on course to attain our target of a 25% increase in results. The operative return on equity of 25% and a cost/income ratio of 72% underline that we can hold our own against other European banks.

Naturally, this high level of earnings means that it will now become more difficult to realize further improvements. That is why we are checking all possible ways of boosting income while maintaining cost discipline. Having successfully completed the pilot phase at seven selected small branches, we believe that the “branch of the future” conception is an important option here. The experience we have gathered shows that the use of novel self-service machines and the systematic transfer of administrative activities to the back-office area increase the amount of time for selling products and, thanks to the focus on advisory functions, can lead to closer contact with customers. The response in the pilot branches was accordingly positive. This means that the model is not only suitable for branches to be opened in the future but also represents an interesting way of making existing small branches profitable on a sustainable basis rather than having to close them down.

For this reason, we have decided to transform 18 of these small Commerzbank branches before the end of the year. In 2005, we intend to transform a further 80 branches or so and also 17 of those taken over from SchmidtBank. At the same time, we are examining to what extent individual elements of the new branch conception can be realized at larger branch offices as well. This branch strategy is an expression of our ambition to become Germany's best retail bank through operative excellence and a sustained growth strategy. As the present figures demonstrate, this is a realistic goal.

Our asset management activities also developed better than planned across the board. Higher commission income was forthcoming above all from our foreign subsidiaries CCR in Paris and Jupiter in London. The business line's operating profit was a solid Euro92m, as against a mere Euro31m in the first six months of 2003. The strict regional focus and organizational streamlining in Germany are now bearing fruit, as the well above-average operative return on equity of 34% underlines.

The most important project in asset management is a Cominvest umbrella hedge fund to be launched in the next few months. For this purpose, we have agreed to cooperate exclusively with two leading companies. We have Harcourt in Zurich as our adviser, while the technical know-how is being provided by the product platform of the New York PlusFunds Group. It is planned to develop products for both institutional and private investors from a large number of target funds through a single platform. Our declared goal is to position our asset management through these products as a leading provider in Germany's emerging hedge-fund market. Cominvest will benefit here from the years of experience of our Jupiter subsidiary.

Despite the lack of support from economic activity and the resulting persistent weakness in the demand for credit, we see an improvement in earnings performance in the corporate customers and institutions segment. As we were also able to reduce provisioning, the operating profit of Euro283m is a good 8% higher than a year earlier. We have thus taken a large step towards achieving our target of Euro500m. Unless any major and unforeseeable credit risks emerge in the second half of the year, a further reduction in provisioning can be expected, with the related positive impact on corporate business in particular.

The operative return on equity in corporate business improved in the first half of the year to the not quite satisfactory level of 11.8%; the cost/income ratio of less than 50% continues to be acceptable.

We are leaving nothing undone in our attempts to stimulate demand for credit. You will recall our *Mittelstand* offensive with its attractive terms and conditions, which we launched last year. In addition, we are trying to keep the formal hurdles for a loan application as low as possible. That is why we have been offering smaller *Mittelstand* firms since mid-May the opportunity to submit quite uncomplicated applications for amounts of up to Euro250,000 via our companydirect internet portal.

Despite the difficult economic conditions for corporate business, we are adhering to our ambitious target of a 17% pre-tax return on equity for 2006. We intend to achieve it with our strategy programme "Move to the top", the outlines of which I presented to you in February. It is based upon an even more systematic customer-group orientation:

- Our practically 700 larger corporates with annual turnover of more than Euro250m are now looked after in the corporate finance, risk management and foreign business sections at five centres for larger corporates. At the same time, we continue to provide the roughly 100 multinationals with corporate-finance and capital-market products from either our Frankfurt head office or from London.

- For German *Mittelstand* firms, we want to remain the leading nationwide bank and to expand further in this segment – through internal and external expansion. You are familiar with our high target: by end-2006, we intend to have raised the number of *Mittelstand* customers by 9,000 to practically 60,000. The feasibility of this goal is demonstrated by the more than 1,700 new customers gained in the first six months of this year, putting us well ahead of projections.

In an environment characterized by strategically induced restraint on the part of other banks, we see good growth opportunities for our Bank. And in fact our advisers are finding that companies which are not yet customers of ours are very open-minded and are prepared to discuss with us. Here, our nationwide presence with 170 regional branches serving *Mittelstand* customers is an advantage.

Like almost all the other companies in the industry, our securities segment was adversely affected by the worsening market conditions in the second quarter. The development of our trading profit over the past few months was disappointing. The hoped-for earnings from new issues business are still lacking. However, as we have costs well under control in this business line, we achieved an operating profit of Euro73m after six months, which was 18% better than a year earlier. This came about through an excellent first quarter and a minus of Euro47m in the second quarter. All in all, the operative return on equity was 12%. It remains our ambition to show a double-digit figure here for the year as a whole.

We seem to have good chances, therefore, of performing well in all our core activities in 2004, in some cases easily exceeding our own projections. But further improvements cannot simply be decreed; rather, they require support from more positive overall conditions.

**Outlook**

Let us now look a little farther into the future. The most important challenge remains to achieve our earnings target. In the medium term, this is defined as an after-tax return on equity of 10.3%, or 16.5% pre-tax, given a tax ratio of 38%. In our planning, we envisage achieving this goal – and thus earning our cost of capital, including risk premium – by 2006 at the latest. As the figures presented today reveal, the half-year results for 2004 have taken us within reach of these targets.

But positive as the current situation may appear, it is also obvious that the way into Europe’s top group will be a marathon. That is why we are prepared to take the occasional short-cuts by examining possible purchases offering reliable and above-average earnings prospects as well as reasonable financial outlays, preferably for the retail banking area.

Now that the integration of SchmidtBank is running entirely according to plan and will be completed by spring of next year at the latest, we are currently examining the acquisition of ING BHF-Bank. I am sure you will appreciate that, in view of the existing agreements, I cannot make any comments on the ongoing due diligence process.

However, those who argue from the outset that such an acquisition does not make sense fail to grasp what market conditions in Germany are really like. In such a fragmented and divided-up market, only two simple options exist for taking action: stagnate or expand. We have decided in favour of “earnings-oriented expansion”, through which – given suitable target objects – we believe we can achieve our earnings goals more rapidly than through mere passivity.

Let me make a few fundamental remarks. Naturally, we are aware of the media’s need for bold formulations. All the same, we have not ingratiated ourselves and will not do so in the future either. Nor are we out to buy everything that is up for sale, as is occasionally suggested. But we owe it to ourselves and to our shareholders to examine these now rare acquisition opportunities critically and in an open-minded manner. Paradoxically, our critics sometimes claim that smaller acquisitions do not represent the major step towards consolidation in German banking. Actually, no one has ever claimed that they did, nor is that our objective – no more, incidentally, than the occasionally aired view that we are trying to use smaller acquisitions to add to our “weight” in preparation for the “great” national round of consolidation.

A major merger, regardless of the form it took, would not be accepted by the market at the moment, as we know from many talks with analysts, investors and rating agencies. Incidentally, this is an excellent example of how quickly supposedly fixed opinions can be reversed. Only a few months ago, namely, experts were unanimous in recommending to us – or even insisting upon – such a move as the *conditio sine qua non* for successful survival. In an unspectacular yet effective manner, we are now devoting our efforts to achieving under our own steam the profitability target I have mentioned. In terms of organization and strategy, we are well positioned to cope with this task, as seven leading investment banks recently confirmed for us objectively, and independently of one another, at a workshop. Their recommendations to us form a kind of summary of my above remarks:

- Maintenance of sustained cost discipline
- Focus on the successful core segments retail banking and *Mittelstand*
- Regional focus on Germany
- Rapid reduction of participations.

Commerzbank is at present the only nationwide bank in Germany which wants to grow here and can do so. We intend to prove – after two years of restructuring, huge cost reductions and a sharper business focus – that successful banking is possible even under the given market structures. We have laid a solid foundation for this with last year’s revaluation measures and our half-year figures. At all events, Commerzbank's potential for springing positive surprises should not be underestimated.