annual general meeting

BUSINESS SITUATION, STRATEGY AND PERSPECTIVES

COMMERZBANK

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Commerzbank Annual General Meeting 2004

Klaus-Peter Müller, Chairman of the Board of Managing Directors: Business situation, strategy and perspectives

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klaus-peter müller: business situation, strategy and perspectives

Dear shareholders,
ladies and gentlemen,

"As of today, Commerzbank is a new and better bank". That was my summary at last November's autumn press conference. And today I can confidently repeat the statement: Commerzbank really is a better bank, as it is back on a successful course.

But first of all, I want to extend a cordial welcome to all of you, also on behalf of my colleagues on the Board of Managing Directors. I am pleased that you are taking an interest in Commerzbank and also that you have remained loyal, even during difficult times.

A. Financial statements for 2003

My words last autumn related to the decision which we had recently taken to free the Bank from its unrealized losses by means of a single huge effort.

We have costs well under control; that is why we are now primarily focusing on raising our earnings. Here, we are largely dependent upon external conditions. We need better economic performance and positive stock markets. Then earnings will also flow strongly.

By revaluing our assets, we realized a further way of strengthening Commerzbank's profitability. We removed – in other words: wrote down – the unrealized losses identified per September 30 on our securities and investments.

What advantages did we gain as a result?

- The write-downs have permanently reduced our amortization of goodwill.
- We have cut the funding costs for our participations

  and
- by realistically evaluating our investments portfolio, we have considerably increased the disposability of our shareholdings. Up to now, we have sold our interest in T-Online; in the course of April this year, we concluded the disposal of our 1.9% stake in the Spanish bank Santander Central Hispano (SCH). We will continue to pursue this policy, selling non-strategic investments when the right opportunity arises.
- And last but not least: greater financial flexibility also implies a higher degree of strategic freedom. Commerzbank now presents itself as a focused institution with a realistic chance of achieving profitable growth.
- You, our shareholders, should and indeed will benefit from this in the form of higher share prices and fair dividend payments.

I am sure that you have all followed the reports on our 2003 annual financial statements since mid-February. In addition, as shareholders, you also received our annual report. For that reason, I should just like to sum up the most important points here. In 2003, we achieved an operating profit of €559m. We raised earnings (before other operating result and provisioning) by €250m, lowered provision for possible loan losses by €237m and cut operating expenses by €644m.

After goodwill amortization, the expenses for both the revaluation operation and the restructuring of the Bank, as well as taxes on income and minority interests, a net loss for the year of €2.3bn remained. It was balanced by a withdrawal from the capital reserve. In order to keep the resulting decline in our regulatory capital within reasonable limits, we simultaneously placed a capital increase without subscription rights in November, which provided us with a net €742m of funds. The lively demand for the new shares – the offer was oversubscribed four times over within a few hours – demonstrated that our measures were immediately understood and appreciated by institutional investors. Through the capital increase and the further reduction in risk-weighted assets in the course of 2003, the Bank's core capital ratio at year-end was unchanged at the comfortable level of 7.3%.

As the special write-downs made by the Parent Bank have led to a "zero" result, we are unfortunately not in a position to pay a dividend. The bearers of our profit-sharing certificates will receive a full distribution. This expense has already been taken into account in 2003 net interest income.

B. Business development in 1st quarter 2004

Our revaluation decision was unconventional, widely noted and almost universally praised. That it was the right one to take and an important step is also underlined by the figures for the first quarter of 2004. We published them in advance on April 26, thereby giving a kind of positive profit warning, for the results were well ahead of market expectations. The day before yesterday, the complete interim report appeared, which is available for you today from our information desks.

Let me now make a few brief comments on the individual items of the income statement in the first quarter.

At €718m, net interest income was 1.8% higher than in the same period a year earlier – and that despite the smaller volume of risk-weighted assets. We achieved an increase of 8.3% on the final quarter of 2003.

For provisioning purposes, we have set aside a pro-rata amount of €238m. We have been decidedly cautious here, as the development up to now leads us to expect and hope that we will be able to remain below the €950m budgeted for the year as a whole. Last year, we formed €1,084m of provisions.

Net commission income, benefiting from the more positive development of the markets, produced especially encouraging results. In securities transactions and asset management, we registered solid gains of 25% and 29%, respectively. Overall, net commission income reached €597m in the first quarter, almost 15% more than in the same period a year previously.

In proprietary trading, we achieved a result of €314m, 36% more than a year earlier and generated in almost equal measure by the equities and fixed-income sections.

The net result of €77m on our investments and securities portfolio fell 27% short of its year-ago level. This amount includes no more than roughly €20m in proceeds from disposals of participations, namely from a partial placement of our SCH shareholding.

Our operating expenses show that we continue to have costs under control. At €1,104m, we spent 6.4% less than in the first quarter of 2003. Personnel expenses fell by almost 4%, mainly due to staff reductions. At end-March, we had a workforce of 32,349, a good 3,000 fewer than a year earlier. Other operating expenses were 5% lower.

The balance of operating income and expenses – the operating profit – reached €435m as against €172m in the first quarter of 2003. After goodwill amortization is deducted, which was down by a third, we show a pre-tax profit of €415m, compared with only €38m a year earlier. At that time, namely, we had to set aside €104m of restructuring expenses for the measures adopted under our second cost-cutting offensive. After taxes and minority interests, a consolidated profit of €254m remains, as against €3m a year ago. Earnings per share, therefore, rose to €0.43.

The latest development which I am able to report today is that the positive trend in our business has continued. Our operating profit in April was well on course. In addition, we received roughly €100m from the already-mentioned placement of SCH shares.

We have got off to an acceptable start, therefore. It is still hard to decide whether this encouraging trend of the first four months will be upheld throughout the year as a whole. All in all, though, we have a positive feeling.

All the same, the outlook is for another year that will not be an easy one. As in the past few years, we do not see a clear upward trend for economic performance and the markets. And this would be so important for our business. We probably have to get used to the idea of more lean years.

To conclude my report on the first quarter, I should like to inform you about the successful conclusion of our new internal agreement on the company pension scheme. This topic caused a great stir in the first few weeks of the year. Much was said and written about it. Most recently, I commented upon this issue in the introduction to our annual report. I am pleased that last week, after rapid, fair and constructive negotiations, we found a solution that satisfies all sides and will prove viable in the future.

C. Strategy in core business lines

Occasionally, it is claimed that we lack a clear strategic orientation. For this reason, I should like to stress once again here: our efforts continue to be devoted to achieving a sustained rise in profitability. In order to realize this goal, we have formulated the following strategies in our core business lines:

- We intend to become Germany's best bank with nationwide coverage, both for retail customers and successful *Mittelstand* firms.
- We want to be a preferred relationship partner for European larger corporates and multinational concerns.
- In asset management, we are focusing on the German market and selected European core countries with highly promising growth potential.
- Last but not least, in securities business we intend to concentrate to a greater extent on transactions conducted on behalf of and with our sophisticated corporate and private clients.

The detailed segment reporting in our annual report reveals the extent of our progress in the individual business lines. I now want to describe how our core segments retail banking, asset management, corporate customers and institutions, and securities fared in the first three months of the current year.

In retail banking, we maintained our successful course. While its results benefited in 2003 from the easing of the cost burden, there was now a substantial increase in revenues. These were €63m higher in the first quarter of 2004 than a year previously. But operating expenses also declined further. For that reason, the operating profit soared from €33m in the first quarter of 2003 to €122m in the first three months of this year.

For the year as a whole, we have planned an operating profit that is about 25% higher than in 2003. We primarily intend to realize this improvement through the measures under the "grow-to-win" programme. These consist of a concentration on high-margin business, such as fund and securities products, and on attractive customer groups, such as business customers and the self-employed. At the same time, we are aiming to expand our market share by means of selective external growth.

The first step in this direction was the purchase of the branch business of SchmidtBank in February. After three years of consolidation, this transaction documents the change of trend in favour of expansion. This enables us to gain market shares and to realize earnings and cost synergies. For Commerzbank's retail business, the takeover means roughly 10% more customers and 10% more branch locations.

For weeks, we have been working intensively to incorporate the bank's business operations; from June onwards, the branches of SchmidtBank are to be integrated into Commerzbank. Customers will retain their existing familiar account managers, who will then be able to offer them a considerably improved and extended range of products.

In asset management, the bundling of domestic activities at COMINVEST and the focusing on selected core markets have been completed. The – in some cases – drastic and tough measures are now paying off. Overall, earnings in the first quarter were €27m higher, fuelled by net commission income; operating expenses sank by €10m. The operating profit reached €52m, compared with €15m in the first three months of 2003.

This business line is back on the right course, therefore. For 2004 as a whole, we expect its operating profit to be a good 40% higher. Support in this respect will be forthcoming from third-party sales of ADIG funds, and we want to use further synergies between COMINVEST, the UK subsidiary Jupiter International and the French Caisse Centrale for sales in Germany. In addition, the multi-manager fund specially developed for corporate customers will generate extra revenues. This fund covers all the relevant markets in a balanced manner. For each section, our cooperation partner SEI Investments, one the world's leading providers of such funds, works out the best asset manager. Demand for this product is proving very encouraging; so far this year, sales of the fund have amounted to just over €120m.

In the corporate customers and institutions segment, income before provisioning was €51m lower than a year previously in the first quarter of 2004. Net interest income alone was down by €26m. While our efforts to achieve higher loan margins were successful, the average margin in deposit-taking unfortunately sank to a new record mark. However, as provisioning and operating expenses were down slightly, the operating profit reached €118m, as against €152m in the first quarter of 2003.

Overall, though, we have set ourselves quite ambitious targets in this segment for 2004. This means that we are planning an operating profit of more than €500m, representing a strong year-on-year increase. How do we intend to achieve this? Provisioning should be lowered considerably by portfolio restructuring and the systematic reduction of bulk risks. Earnings should receive a boost, on the one hand, from a further improvement in margins and a more intensive meshing with investment banking. On the other, we will promote corporate banking by differentiating even more clearly between target groups.

Our 20 main branches with 150 sales outlets continue to cover the needs of the *Mittelstand*. In addition, we have set up centres in Hamburg, Düsseldorf, Frankfurt, Stuttgart and Munich for our larger corporate clients. We serve multinational companies from our Frankfurt head office.

Unfortunately, there is no denying that the condition of German business and the decline in credit demand are giving us cause for concern. The disappointing economic performance of the past few years has left its marks. Losses are eroding the already thin equity base of *Mittelstand* firms in particular. Investments are being restricted to what is absolutely necessary and inventories cut to a minimum. We are all aware that complaining gets us nowhere. That is why we are continuing to provide financing for our corporate customers, whom we are also giving clear signals.

With our *Mittelstand* offensive, we want to intensify existing relationships and gain new customers. In spring 2003, we made €3.3bn available for smaller companies. Even now, these funds have not yet been fully used.

For the past few weeks, we have been offering more sophisticated *Mittelstand* clients in particular mezzanine capital in an amount of altogether €300m. The subordinated capital that is provided in the form of a dormant equity holding is especially suitable for those *Mittelstand* companies looking for equity capital but not willing either to weaken their existing equity structure by taking up borrowed funds or to part with rights that grant influence.

Finally, a look at our securities segment. Here, we ended the first quarter with an extremely successful balance. The trading profit was a substantial €80m higher than a year earlier, while expenses were down somewhat. All told, we achieved an operating profit of €120m in this segment, as against €45m in the first quarter of 2003.

Compared with last year, we plan a sizeable increase in revenues for 2004, and not only from trading. For this to happen, though, the mood on the stock exchange has to be positive, making possible a revival in IPO business. We also expect increasing demand for M&A advisory services. These developments should boost net commission income in the securities segment.

All in all, we want to make good progress within the Commerzbank Group towards attaining our earnings targets. We continue to aim for an after-tax return on equity of more than 10% over the medium term, and we intend to come within reach of this target in the current year. Our cost/income ratio should be around 60%.

D. Agenda of present AGM

Let me now make a few brief comments on today's agenda.

To the points which recur every year – presentation of the financial statements, approval of the actions of the Board of Managing Directors and Supervisory Board, and the appointment of the auditors – authorization for the Bank to purchase its own shares has been added in the meantime. Point 5 deals with the possibility of trading in our own shares, while point 6 relates to the purchase or sale of our own shares for other purposes, such as using them as an acquisition currency or in order to issue shares to our staff.

Points 7 to 9 of the agenda are concerned with creating new scope for capital-raising measures. As of April 30, 2004, three authorizations to increase the Bank's share capital expired. All that now remains is scope of just under €24m, which is reserved for issuing shares to employees, however.

In point 7, we request your authorization to increase the Bank's share capital by a maximum amount of €225m. On principle, you – as shareholders – are to be offered subscription rights. These rights may only be excluded on a very limited scale – for fractional amounts, or in favour of the holders of conversion or option rights. This authorized capital will enable us to adjust the Bank's equity position at any time to business and regulatory requirements.

The next two points on the agenda provide us with fresh scope to effect capital-raising measures at very short notice. This would enable us, for instance, to seize acquisition opportunities without delay.

Point 8 relates to the authorization to increase the Bank's share capital by a maximum amount of €225m. Here, we are to be given the possibility of excluding shareholders' subscription rights – for the purposes also envisaged under the authorization proposed in point 7, but also in case we wish to use the new shares in order to acquire a company or a participation.

Point 9 represents the authorization to increase the Bank's share capital by a maximum amount of €150m, with subscription rights excluded. This form of authorized capital offers us the possibility of reacting very quickly to special and attractive stock-exchange situations. We benefited from this in November, for example, when we were able to place our shares at short notice in connection with our revaluation operation. And you, as shareholders, are not placed at a disadvantage by such a measure, as the issue price must be set close to the market price.

These three authorizations give us sufficient scope for shaping our Bank's future. We still have an adequate supply of conditional capital for the issue of convertible profit-sharing certificates or convertible bonds and the authorization does not expire until 2008.

However, I want to stress here that we do not have any plans at the moment to increase the Bank's capital – apart from issuing shares to our staff.

In the tenth and last point of the agenda, we request your approval for three profit-and-loss transfer agreements. In the course of the past two years, we have established intermediary holding companies, where participations of Commerzbank are bundled. These are Commerz Asset Management Holding GmbH, Commerzbank Auslandsbanken Holding AG and Commerzbank Inlandsbanken Holding AG, all with their legal seats in Frankfurt.

The subsidiaries are obliged by the agreement to transfer the profit achieved in a financial year to Commerzbank AG. In return, Commerzbank AG has the obligation to balance any losses for the year at the subsidiary.

Provided that this AGM gives its approval, each of these agreements will become effective retroactively from January 1 of this year and can be regularly terminated on December 31, 2008 at the earliest. As a result, the agreements have the minimum duration of five years that is required for tax purposes. The agreements do not have to be examined by an external expert, as each of the contracting parties is a direct, wholly-owned participation of Commerzbank AG.

The profit-and-loss transfer agreements enable us to achieve an optimal integration of the relevant companies into the Group from the tax standpoint. This would not be possible with any other contractual arrangement.

E. Corporate governance

Mention of the term "corporate governance" is inevitable at an AGM in 2004. In our latest annual report, the Board of Managing Directors and the Supervisory Board present a joint report for the first time on this topic. Commerzbank's corporate governance code follows the recommendations of the Commission almost entirely, only deviating from them in three points. They are explained in our report. We have similarly listed the few deviations from the suggestions of the German Corporate Governance Code.

We also describe the principles of the system of compensation for the Board of Managing Directors and provide some notes on the duties and function of both the Board of Managing Directors and the Supervisory Board. Finally, we present how we communicate with you, our shareholders.

In order to provide you and other interested parties with extensive information about the Bank, we are increasingly using the internet. For reasons of transparency, we have now, for example, published the procedural rules of the Board of Managing Directors and the Supervisory Board. Commerzbank's articles of association have long been available there.

And last but not least, a corporate governance official has now been appointed by the Board of Managing Directors and the Supervisory Board. The great importance which we attach to these issues is underlined by our rating in the evaluation conducted by DVFA, where we already fulfilled all the criteria for good governance.

F. Consolidation of the banking market

By way of conclusion, I want to turn now to a very well-worn topic: consolidation of Germany's banking market.

In this discussion, the focus repeatedly falls on the savings banks. In no way do I wish to dispute the value of these institutions. But it really is high time that privileges are abolished. Thanks to the EU Commission, this will occur, step by step, from 2005 onwards. I am also of the opinion that there is no good reason why practically 50% of the overall German banking market has to remain in the public sector. And for me it is absurd if regional politicians and association officials do not even grant municipal and local parliaments the right to dispose freely of their property. Ossified structures have to be made more flexible again in order to create fair competition at long last in Germany's financial market.

We at Commerzbank have to formulate a strategy which also strengthens us for "going it alone" – in other words, for remaining independent. That is a perspective for shareholders, customers and employees, one for which it is worthwhile to invest effort and commitment. If one day an opportunity arises to expand through acquisitions or to realize our visions through a merger – either within Germany or Europe – we will be open to it and will carefully examine the possibilities.

You can be certain at all times that we will seize the opportunities which the future holds and use them in your interest.

Thank you for your kind attention.

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