DEUTSCHE BÖRSE
GROUP

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Financial report 2017

Excerpt: report on expected developments

External growth opportunities

In addition, the company regularly explores external growth opportunities, which are subject to the same kind of stringent analysis as its organic growth initiatives. For this reason, only a small number of the opportunities analysed are ultimately realised. Examples of external growth in the past few years include the takeover of Citco's hedge fund custody business, the majority interests in EEX, the full acquisition of Powernext and the joint ventures STOXX including Indexium, as well as the full acquisition of 360T.

Report on expected developments

The report on expected developments describes Deutsche Börse Group's expected performance in financial year 2018. It contains statements and information on events in the future and is based on the company's expectations and assumptions at the time of publication of this corporate report. In turn, these are subject to known and unknown opportunities, risks and uncertainties. Numerous factors influence the Group's success, its business strategy and its financial results, many of them outside the company's control. Should opportunities, risks or uncertainties materialise or should one of the assumptions made turn out to be incorrect, the Group's actual performance could deviate either positively or negatively from the expectations and assumptions contained in the forward-looking statements and information contained in this report on expected developments.

Developments in the operating environment

Macroeconomic environment
Deutsche Börse Group anticipates that the global economy will further grow moderately during the forecast period. In the case of the emerging markets, the Group expects that countries with a current account surplus will expand at an above-average rate. Due to cyclical as well as structural factors, these countries will no longer be able to achieve the high growth rates seen in the past. Moreover, the Group expects a continued recovery of developed economies, with growth rates set to rise compared to previous years. Looking at Europe, the Group expects further improvement of the economic situation, driven by developments in Germany and France, the two largest economies. Against this generally positive background, the Group assumes that market participants will have more confidence in the capital markets compared to the previous year, which was marked events such as the French presidential elections, the very slow progress in negotiations concerning the terms for the UK's impending exit from the EU, or disillusionment in the US following the November 2016 elections. However, current uncertainties could once again upset the markets. These include geopolitical crises, the development of commodity prices, monetary policy moves by the Federal Reserve (Fed) in the US and the European Central Bank (ECB) in Europe, or a crisis of confidence in the growth of certain emerging market countries, especially in Asia. It remains unclear as to how the UK's exit from the EU will work out, and what the impact on markets will be. Regarding interest rate trends, the Group does not expect to see any fundamental departure from the current low interest rate policy in Europe. While the monthly volumes of the ECB's bond-buying programme will be further reduced and the programme is set to expire in September 2018, the deposit rate is expected to remain at –0.4 per cent. In the absence of any material impact of this monetary policy on cash and derivatives markets trading volumes during 2017, the Group does not expect any such stimulus for 2018 either. The turnaround in US interest rates continued in 2017, and we expect further hikes in 2018 – provided that the economy (and inflation) accelerate further.

In its economic development forecast published in January 2018, the International Monetary Fund (IMF) predicted economic growth of around 2.2 per cent in the eurozone and growth of around 2.3 per cent in Germany for the year 2018. Expectations for the United States are slightly higher than for the eurozone: the US economy is forecast to grow by around 2.7 per cent. The highest growth by far in 2018 – approximately 6.5 per cent – is again expected in Asian countries (especially India and China), due to expected high domestic demand. Given the extremely varied estimates for the different economic regions, global economic growth is projected to be around 3.9 per cent in 2018.

Regulatory environment
Governments and central banks are currently working to enhance regulation of the financial markets so as to stabilise the financial sector and prevent future crises of the magnitude already experienced. The initiated measures, and in some cases already implemented, range from revising the legal framework for banking business and capital adequacy requirements through rules for clearing over-the-counter (OTC) derivatives transactions down to improving financial market supervision (for more information, please see the "Regulatory environment" section of the report on economic position). For Deutsche Börse Group's customers, the ultimate impact of these far-reaching regulatory reform projects on market structures and business models is difficult to gauge accurately at present. Deutsche Börse anticipates that this uncertainty will continue to weigh on market participants' business activities during the forecast period. For the Group itself, the various regulatory projects will have both positive and negative consequences. Overall, however, the Group sees the changing regulatory environment as an opportunity to expand its business further; see the report on opportunities for further details.

In addition to the structural opportunities arising from regulation, the Group expects to see further debate in the forecast period on the potential introduction of a financial transaction tax. The introduction of a financial transaction tax will continue to be pursued in 2018 by a number of EU Member States, which have formed an alliance to achieve greater cooperation. The introduction of such a tax would negatively impact Deutsche Börse Group's business performance. Since the ten Member States concerned have been unable to date to reach agreement on the tax base, tax rates and technical collection and remittance methods, it is not possible to gauge the concrete impact on the Group's business.

Future development of results of operations

Given its diversified business model and multiple sources of revenue, Deutsche Börse Group continues to consider itself very well positioned and expects to see a positive trend in its results of operations over the medium and long term. This expectation is based on, among other things, the growth opportunities that the company intends to exploit over these periods. The Group expects net revenue to increase further in the forecast period. This assumption is based on two main factors. Firstly, a further slight increase in economic growth could improve investor confidence, and motivate US investors to continue to return to European markets. Moreover, market speculation on interest rate developments in the US and Europe may boost trading activity in interest rate derivatives at Eurex derivatives exchange – whilst higher or increasing US interest rates could lead to a further increase in net interest income from the banking business in 2018. Secondly, the Group expects a further increase of the contribution from its structural growth initiatives as well as from new growth opportunities (for details, please refer to the report on opportunities).

In financial year 2018, Deutsche Börse Group expects net revenue growth of at least 5 per cent from structural opportunities as well as from the success of new products and functionalities. At the same time, the Group expects the cyclical economic environment to develop in such a way that net revenue will not decrease, at least, in those business areas that depend on cyclical factors. Net revenue growth expected during the forecast period is based on net revenue of around €2,462.3 million achieved in 2017.

Even if, contrary to expectations, the operating environment turns out to be worse than described above, and clients were to scale back their business activities, particularly in the Group's business divisions which depend upon trading, Deutsche Börse Group believes it is in a position to continue to do business profitably thanks to its successful business model and its cost discipline.

Within the scope of its growth strategy, Deutsche Börse Group pursues specific principles for managing operating costs. The core element of these principles is to ensure the scalability of the Group's business model. To this end, the Group continuously manages operating costs adjusted for non-recurring effects relative to the development of net revenue. Essentially, the Group achieves the necessary flexibility in managing operating costs through two different initiatives designed to enhance operating efficiency. Firstly, the Group has implemented a continuous process to improve operating efficiency by focusing even more on client needs in order to further enhance quality and efficiency of the services offered. At the same time, Group-internal processes are simplified, generating costs savings. Secondly, the Group resolved a series of structural cost reduction measures during the reporting period, and has already commenced implementation. For instance, we reduced the number of external service providers. This included the shift of tasks from external to internal staff, or the hiring of external service providers as internal staff. In the year 2018 and beyond, the company's focus will include continuously increasing efficiency through digitalisation, automation, and the use of cloud-based infrastructure. As at the publication date of this combined management report, the company expects that operating costs will be affected by non-recurring effects of some €80 million. The majority of these effects is attributable to the integration of acquired companies, but also due to efficiency measures, restructuring and costs incurred in connection with criminal proceedings against Clearstream Banking S.A. in the US.

Given the expected increase in net revenue driven by structural factors of at least 5 per cent, and further given the scalability of the Group's business model and its efficient cost management, the Group anticipates a growth rate of at least 10 per cent (excluding non-recurring effects) for net profit for the period attributable to Deutsche Börse AG shareholders during the forecast period. This assumption is based on an adjusted figure of €857.1 million for 2017.

With regard to the cyclical environment and structural growth initiatives, Deutsche Börse AG's expected business development is based on the same factors that influence the expected business development of Deutsche Börse Group as a whole. For 2018, the company expects sales revenue to be above the level of the previous year by at least 5 per cent (2017: €1,348.0 million).

Given the expected increase in Deutsche Börse AG's sales revenue of at least 5 per cent and its efficient cost management, the Group anticipates a growth rate of at least 10 per cent (excluding non-recurring effects) for adjusted net profit for the period for the forecast period (2017: €618.1 million).

Eurex segment

In the past year, cyclical factors (see the "Future development of results of operations" section for details) led to an overall decline in derivatives trading volumes. Traded equity index derivatives volumes declined significantly due to a marked reduction in equity market volatility, especially during the second half of 2017. Conversely, trading activity in interest rate derivatives benefited from the improved interest rate environment in the US. These contracts posted significant increases in volumes, which however, were not sufficient to compensate for declines in the other product groups. Deutsche Börse Group believes that structural growth factors will remain the dominant feature over the long term, and that they will positively influence trading volumes in all product segments (see the report on opportunities for further details). In the short term, a positive economic environment as well as a rise of stock market volatility would result in increasing trading volumes, in particular for equity index derivatives – whilst the present direction of monetary policy, especially in the US, would have positive effects on interest rate derivatives trading.

Eurex will continue to invest systematically in expanding its product offering in the forecast period in order to take advantage of structural factors, such as regulation or changing customer needs. The focus of our efforts will be on the acquisition of new business, which is currently not settled through an exchange or clearing house. We are expecting positive developments along these lines due to regulatory requirements determining that OTC derivative transactions must be settled via central counterparties. This requirement entered into force in 2016. Having already generated additional net revenue from these investments (made in the previous financial year) in 2017, the Group plans to further increase revenue in 2018. Over the medium to long term, the Group anticipates generating significant additional net revenue from this initiative – not least due to extra potential which might arise from uncertainty concerning the outcome of the ongoing Brexit negotiations, and potential changes for the clearing of euro-denominated interest rate swaps which might emanate therefrom. European Energy Exchange AG (EEX) trading volumes in commodities declined in 2017, largely due to lower volumes on the German power market – which in turn was predominantly attributable to significant market uncertainty caused by the announcement of a split of the German/Austrian price zone at the beginning of 2017. Against this background, EEX launched separate electricity futures for Germany and Austria in April 2017, and traded volumes in these products have risen consistently ever since. The new products established themselves as the new benchmarks for European power by the end of 2017. Due to the positive market environment for trading in power and gas products, the Group expects the business activity in the commodities sector to exhibit structural growth again during the forecast period, e.g. by gaining additional market share at the expense of OTC energy markets, but also through cyclical growth, assuming the market environment for power products in Germany and Austria continues to stabilise. In foreign-exchange (FX) trading, the Group expects rising demand for multi-bank platforms to further boost business activity at the FX platform 360T®. This has gained further attractiveness through the launch of an electronic trading platform. The company plans to include clearing services in the value chain of fully electronic FX trading during the 2018 financial year, in order to realise the revenue synergies projected in the context of the acquisition of 360T.

Xetra segment
As in the past, net revenue in the Xetra cash market segment will continue to depend heavily on stock market cyclicality and volatility. Trading volumes could rise during the forecast period, driven by a gradual improvement in economic growth as well as a rise in investor confidence. Furthermore, the company expects stock market volatility to increase, at least temporarily, making further positive contribution to business development.

As well as enhancing its cash market offering, the company will continue to closely track changes in the competitive environment for the European cash markets. As in the past, it considers itself well positioned to retain its status as the market leader for trading German blue chips and to offer its customers across the globe an attractive range of products and services for cash trading in German and European equities, and for equities clearing. However, the stronger competition in the cash market means that further shifts in the market shares of all competitors cannot be ruled out.

Clearstream segment
The Clearstream segment's main net revenue driver is the settlement and custody of international bonds – a business that is much more stable and less sensitive to capital market fluctuations than the trading business. The Group anticipates a structurally driven increase in demand for collateral and liquidity management services due to regulatory requirements. In the medium to long term, Clearstream expects its attractive collateral and liquidity management and its strong position in the TARGET2-Securitites (T2S) network to result in increased business activity and hence in significant additional net revenue. As Clearstream migrated to T2S in February 2017, the Group anticipates only a moderate contribution to net revenue for 2018. Another factor to impact Clearstream's business in the forecast period will be central bank monetary policy, as it has been in the past. Transaction activity is expected to increase in the medium term, as a result of the ECB's ongoing commitment (at least until September 2018) to the programme for purchasing government and corporate bonds. At the same time, however, the continuation of the programme could have a dampening effect on securities issuance and liquidity management. If, contrary to expectations, monetary policy becomes more restrictive, this would have positive consequences for securities issuance, the use of collateral and liquidity management services, as well as for net interest income in the banking business. As a significant portion of customer balances are denominated in US dollars, the turnaround in US interest rate policy – initiated in December of 2016 and continued in 2017 – will cause a rise in net interest income in 2018, at steady cash balance levels. Moreover, thanks to its attractive funds services, Clearstream anticipates growth in this area to continue. Clearstream covers all types of funds – from traditional investment funds to exchange-traded funds (ETFs) and hedge funds. Given that regulators are also calling for more efficient settlement and custody solutions in order to guarantee maximum security for client assets under custody, the Group expects to acquire additional client portfolios.

With regard to its customer structure, the company continues to expect that consolidation in the financial sector will persist and that customers in Clearstream's domestic and international business will merge. These larger customers would benefit from greater discounts, which would lead to a decline in average fees.

Although Deutsche Börse faces especially intense competition in the settlement and custody of international bonds, the company does not expect this to have a major impact on its net revenue or to result in a loss of market share during the forecast period.

Market Data + Services segment

This segment aims to accelerate expansion of Deutsche Börse's technology leadership and expertise in the area of market data by pooling all relevant resources within the company in a dedicated, market-driven business unit. The goal is to open up untapped growth opportunities in the medium to long term.

The company anticipates that net revenue in the Market Data + Services segment will further increase during the forecast period. This expectation is based on the continuous expansion of the product range in all areas and greater marketing of these products in growth regions. The Group's index business is set to benefit from this development in particular. Moreover, the Group considers the significant structural growth in the market for passively managed assets as an additional growth driver that is expected to further strengthen demand for index licences for ETFs. In addition to distributing index licences, the Group also benefits from the growing investment volumes in these products. In this light, the Group believes it is well placed to increasingly extend the positioning of its globally focused range of indices to the Asian market as well.

The company also envisages additional growth from the Regulatory Reporting Hub, launched in January 2018. Developed in cooperation with the Group's clients, the Hub offers a one-stop solution, helping clients to fulfil their reporting duties under MiFID II.

Changes in pricing models

Deutsche Börse anticipates sustained price pressure in some of its business areas during the forecast period. The company's objective is to cushion this price pressure by continually improving its products and services and by offering selective incentives for price-elastic business.

Over the long term, the average net revenue per unit (e.g. trading or clearing fees per transaction, or fees for custody services) is expected to decline slightly in all areas of the Group. This is a result of laddered pricing models that lead to a decline in income per unit as customers' business activities increase.

Trends in non-financial performance indicators

Initiatives to promote the transparency and security of the markets will continue to be a key focus during the forecast period, ensuring that Deutsche Börse Group adds value to society. Against this backdrop, the company expects to maintain the availability of the different trading systems for the cash and derivative market at the very high level seen in previous years throughout the forecast period.

Responsible management that focuses on long-term value creation is of considerable importance for Deutsche Börse Group as a service company. Given demographic change and the resulting shortage of specialist staff, the company aims to continue to position itself adequately and among other things to increase the number of women in management positions. The Executive Board already set a voluntary target in 2010 for Deutsche Börse Group to increase the proportion of women in middle and senior management to 20 per cent and in junior management to 30 per cent by 2020. These targets remain in place. They relate to Deutsche Börse Group worldwide, including subsidiaries.

In accordance with the Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst (FührposGleichberG, German Act on the Equal Participation of Women and Men in Leadership Positions in the Private and Public Sectors), the Supervisory and Executive Boards of Deutsche Börse AG additionally resolved in September 2015 to maintain the existing quotas of women on the two management levels below the Executive Board, i.e. 6 per cent on the first and 10 per cent on the second management level, at least until 30 June 2017. Deutsche Börse AG achieved these targets with a quota of 11 per cent on the first and 15 per cent on the second management level. Hence, the Executive Board of Deutsche Börse AG determined new targets, and now endeavours to achieve a female quota of 15 per cent on the first management level and of 20 per cent on the second management level by 31 December 2021.

Future development of the Group's financial position

The company expects operating cash flow, which is Deutsche Börse Group's primary funding instrument, to remain clearly positive in the forecast period. The Group expects that two significant factors will influence changes in liquidity. Firstly, the company plans to invest some €180 million per year in intangible assets and property, plant and equipment at Group level during the forecast period. These investments will be included in cash flows from investing activities, and will serve primarily to develop new products and services in the Eurex and Clearstream segments and to enhance existing ones. The total amount mainly comprises investments in trading infrastructure and in risk management functionalities. Secondly, the Executive Board and Supervisory Board of Deutsche Börse AG will propose a dividend of €2.45 per share to the Annual General Meeting to be held in May 2018. This would correspond to a liquidity outflow of about €450 million. In addition, the Group announced that it would implement two share repurchase programmes of €200 million each. The first programme was launched at the end of November 2017, and is scheduled for completion by the end of June 2018. The second programme will be completed by the end of 2018 at the latest. Apart from the above, no other material factors were expected to impact the Group's liquidity at the time the combined management report was prepared. As in previous years, the Group assumes that it will have a sound liquidity base due to its positive cash flow, adequate credit lines (see note 36 to the consolidated financial statements for details), and flexible management and planning systems.

Within the framework of a programme to optimise its capital structure, Deutsche Börse Group generally aims to distribute dividends equivalent to between 40 and 60 per cent of adjusted net profit for the period attributable to Deutsche Börse AG shareholders. In recent years (where the Group's net profit for the period attributable to Deutsche Börse AG shareholders was lower), the dividend payout ratio was kept at the upper end of this range, in order to distribute stable dividends to shareholders. In connection with the expected earnings growth, the company is targeting a dividend payout ratio approximately at the centre of a range between 40 per cent and 60 per cent.

Against the background of the growth strategy, the company anticipates that in future, freely available funds will increasingly be applied not only to support the Group's organic growth, but also to complementary external growth options. The company wants shareholders to continue participating in the company's success in a well-balanced manner; the two share repurchase programmes of €200 million each serve this purpose, amongst other factors.

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