DEUTSCHE BÖRSE GROUP

Annual report 2018

Excerpt: report on expected developments

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risk-free transfer of commercial bank money, based on blockchain technology. The goal is to enhance efficiency by integrating blockchain technology into the Group's post-trading infrastructure. Through Deutsche Börse Group's central counterparty, it will be possible to reduce the risks involved in the transfer of digital commercial bank money. Moreover, through the interface between Eurex Clearing and Clearstream, the Group's central securities depository, the new concept could also contribute to enhancing the efficiency of post-trading processes such as settlement services or asset servicing.

As at 7 August 2018, Deutsche Börse Group acquired a minority interest in HQLAx S. à r. l. – a fintech company specialising in liquidity and collateral management for institutional clients on the international securities lending and repo markets. The Group is thus strengthening its collaboration with HQLAx, to use innovative technologies to improve efficiency in the fragmented securities lending market. To this end, it announced that it is working with HQLAx on developing a solution for securities lending on the basis of a blockchain platform. The first banks are already in the process of being connected and extensive talks are being held with the relevant supervisory authorities.

Further Group projects are the newly-created Content Lab, working on improving the use of data in providing client services, and the Product Development Lab, which develops micro-services. Beyond this, Deutsche Börse Group is currently examining whether to offer application programming interface (API) connectivity to its systems, in order to facilitate new data and analytical offers to clients using cloud technologies.

Report on expected developments

The report on expected developments describes Deutsche Börse Group's expected performance for the financial year 2019. 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 annual report. In turn, these are subject to known and unknown opportunities, risks and uncertainties. Numerous factors, many of which are outside the company's control, influence the Group's success, its business strategy and its financial results. 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

With global economic growth already slowing during the course of 2018, inflation rising, and monetary policy becoming more restrictive (especially in the US), Deutsche Börse Group expects a further weakening of global growth during the forecast period. The ongoing trade conflict, mainly between China and the US, pressure on emerging markets due to the tighter US interest rate policy, the appreciation of the US dollar, as well as the political situation in Europe, especially with regard to the imminent exit of the United Kingdom from the European Union, are some of the reasons. Against this background, uncertainty should increase among market participants, and market volatility could rise temporarily.
A settlement of the trade dispute, a stabilisation of the political situation in Europe, and a clear direction

in the central banks' monetary policy would have a stabilising effect on markets and a positive impact on economic growth. 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 ECB terminated its bond-buying programme at the end of 2018, the central bank also promised that deposit rates would remain at a level of –0.4 per cent at least until the summer of 2019. The US Fed continued its policy of gradual interest rate hikes in 2018, indicating further increases may be possible in 2019 – provided that the economy (and inflation) accelerate further.

In its economic development forecast published in January 2019, the International Monetary Fund (IMF) predicted economic growth of around 1.6 per cent in the euro area and growth of 1.3 per cent in Germany for the year 2019, i.e. now expecting significantly lower growth than in October 2018. Expectations for the United States are higher than for the euro area: the US economy is forecast to grow by around 2.5 per cent. The highest economic growth by far in 2019 – approximately 6.3 per cent – is anticipated again in Asian countries (especially India and China), due to expected strength in domestic demand. Given the extremely varied estimates for the different economic regions, global economic growth is projected to be around 3.5 per cent in 2019.

Regulatory environment
Governments and central banks have been working to enhance regulation of the financial markets since 2008, so as to stabilise the financial sector and prevent future systemic crises. The initiated measures (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 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.

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 results of operations over the medium and long term. This expectation is based on, among other things, the structural growth opportunities that the company intends to exploit. The Group expects net revenue to increase further in the forecast period. This assumption is essentially based on 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). Moreover, market speculation on future interest rate developments in the US and Europe may boost trading activity in interest rate derivatives at Eurex derivatives exchange in 2019 – while higher or potentially increasing US interest rates could lead to a further increase in net interest income from banking business in the Clearstream (post-trading) segment. Statements on the further development of equity market volatility, which increased significantly in the past financial year, are difficult to make at the beginning of 2019. On the one hand, the company continues to anticipate high uncertainty on the markets, among other things, due to numerous unresolved political issues. On the other hand, past experience has shown that too much uncertainty can also lead to market participants taking a very cautious stance, thus resulting in low trading volumes. The company expects a slightly more reticent market environment in the 2019 financial year compared to 2018, due to the slowdown in global economic growth, increased economic risks, and political uncertainties, especially in Europe.

As in financial year 2018, Deutsche Börse Group expects net revenue growth of at least 5 per cent from structural opportunities. This growth is driven by the Group's investments which follow the objective to transfer market share from OTC to on-exchange trading and clearing and to further expand its positions in existing asset classes by introducing new products and functionalities (for details, see the report on opportunities). In comparison, the development of the business areas depending on cyclical factors largely depends on the degree of speculation regarding future interest rate developments in Europe and on the level of equity market volatility, potentially resulting in further positive or in a negative impact on the Group's net revenue growth. Net revenue growth expected during the forecast period is based on adjusted net revenue of €2,770.4 million achieved in 2018.

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

Within the scope of its growth strategy, Deutsche Börse Group pursues clearly defined 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 exceptional 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 the quality and efficiency of the services offered. At the same time, this results in simplifying Group-internal processes and saving costs. Secondly, the Group resolved a series of structural cost reduction measures in 2018, and has already commenced the implementation of said measures.

As at the publication date of this combined management report, the company expects that operating costs will be affected by exceptional effects of some €100 million during the 2019 financial year. The majority of these effects are attributable to costs incurred for restructuring and efficiency measures, costs incurred in connection with existing criminal proceedings, and to the integration of already acquired companies.

Given the expected increase in net revenue driven by structural factors of at least 5 per cent, and also given the scalability of the Group's business model and its efficient cost management, the Group anticipates a growth rate of approximately 10 per cent for (adjusted) net profit for the period attributable to Deutsche Börse AG shareholders during the forecast period. Provided that stock market volatility does not decline significantly compared with 2018, growth of adjusted net profit for the period could also be somewhat higher. At the same time, growth of adjusted net profit for the period could amount to slightly below 10 per cent in the event of less stock market volatility than in 2018 – despite the possibilities of taking countermeasures with regard to operating costs. This assumption is based on an adjusted figure of €1,002.7 million for 2018. In addition, within the scope of its "Roadmap 2020", the Group confirms its medium-term growth targets of between 10 and 15 per cent on average per year for the adjusted net profit for the period attributable to Deutsche Börse AG shareholders.

Forecast for results of operations 2019

	Based on 2018 €m	Forecast for 2019
Net revenue from structural opportunities (excluding exceptional effects)	2,770.4	+ >5%
Exceptional effects impacting operating costs	244.2	~€100 million
Net profit for the period attributable to Deutsche Börse AG shareholders (excluding exceptional effects)	1,002.7	+ ~10%

Eurex (financial derivatives) segment
Deutsche Börse Group believes that, over the long term, structural growth factors will result in higher trading volumes on the market for financial derivatives in all product segments (see the report on opportunities for further details). In the short term, a further increase in equity market volatility could lead to a more pronounced increase in trading volumes, particularly with regard to equity index derivatives. Speculation regarding money market policy, especially in Europe, could also have a positive impact on interest rate derivatives trading.

Eurex will continue to systematically invest in expanding its product offering throughout 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 neither traded on an exchange nor settled through a clearing house. Regulatory requirements, such as the provision entered into force in 2016 determining that OTC derivative transactions must be settled via central counterparties, can provide significant impetus. The Group plans to further increase net revenue from the OTC derivatives business in 2019. Over the medium to long term, the Group anticipates generating significant revenue with this business – not least due to the extra potential which might arise from uncertainty concerning the outcome of the ongoing Brexit process, and potential changes for the clearing of euro-denominated interest rate swaps which might emanate therefrom.

EEX (commodities) segment
Due to the continuously positive market environment for trading in power and gas products, the Group expects business activity in the commodities sector to continue to exhibit structural growth during the forecast period, e.g. by gaining additional market share at the expense of OTC energy markets and further increasing the share from renewable energy for power generation.

360T (foreign exchange) segment
In foreign-exchange (FX) trading, the Group expects rising demand for multi-bank platforms to further boost trading volumes on the 360T® FX platform in 2019. The platform has gained further attractiveness through the launch of fully electronic FX trading and clearing. During the current financial year, the company expects to increasingly realise the revenue synergies projected in the context of the acquisition of 360T.

Xetra (cash equities) segment
As well as enhancing its cash market offering, the company will continue to closely track changes in the competitive environment in Europe. 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 equities clearing. The stronger competition in the cash market means that further shifts in the market shares of all competitors cannot be ruled out in the next years. Net revenue in the Xetra (cash equities) segment will depend heavily on stock market cyclicality and volatility.

Clearstream (post-trading) segment
In the medium to long term Clearstream expects demand for its TARGET2-Securities (T2S) services to grow, thanks to increasing regulatory requirements and its strong position in the T2S network. Following Clearstream's migration to T2S in 2017, the Group anticipates a moderate contribution from these activities to net revenue, however, not earlier than in the year 2019. This is partly due to the fact that connecting customers is taking slightly longer than originally planned. Another factor to impact Clearstream's business in the forecast period will be central bank monetary policy. Despite the phasing-out of the ECB's programme for purchasing government and corporate bonds last year, the interest rate policy could have a further dampening effect on securities issuance. If, contrary to expectations, monetary policy becomes more restrictive, this would have positive consequences for issuance and for net interest income in the banking business. As a significant portion of customer balances are denominated in US dollars, the ongoing trend of interest rate hikes in the US – initiated at the end of 2016 – will cause a rise in net interest income in 2019, at steady cash balance levels.

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

IFS (investment fund services) segment
The Clearstream subgroup covers all types of funds – from traditional investment funds to exchange-traded funds (ETFs) and hedge funds. Given that supervisory authorities are also calling for more efficient settlement and custody solutions in order to guarantee maximum security for client assets under custody, Deutsche Börse Group expects to acquire additional client portfolios. In line with this expectation, the IFS (investment fund services) segment anticipates continued growth in the forecast period, due to the attractiveness of its fund services.

With regard to its customer structure, the segment expects 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 could lead to a decline in average fees.

GSF (collateral management) segment
Central bank monetary policy will heavily impact collateral management in the forecast period, especially regarding activity in the repo business, but also in securities lending. Despite the phasing-out of the ECB's programme for purchasing government and corporate bonds, the interest rate policy could have a further dampening effect on liquidity management. A positive product mix change could possibly partially compensate for this cyclical development. If, contrary to expectations, monetary policy becomes more restrictive, this would have positive consequences for the use of collateral and liquidity management services.

STOXX (index business) segment

The company anticipates that net revenue in the STOXX 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.

Data segment

This segment aims to accelerate the 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 new growth opportunities in the medium to long term. The segment also envisages additional growth from the Regulatory Reporting Hub, launched in 2018, in the forecast period. Developed in cooperation with the Group's clients, the Hub offers a one-stop shop for solutions, helping clients to fulfil their reporting duties under MiFID II.

Changes in pricing models

Deutsche Börse Group 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 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 derivatives 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.

In accordance with the Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwitschaft und im öffentlichen Dienst (FührposGleichberG, German Act on the Equal Participation of Women and Men in Leadership Positions in the Private and Public Sectors), Deutsche Börse AG's Executive Board has defined target quotas for women on the two management levels beneath the Executive Board pursuant to section 76 (4) of the AktG, in each case referring to Deutsche Börse AG. By 31 December 2021, the proportion of women holding positions in the first and second management levels beneath the Executive Board is planned to reach 15 per cent and 20 per cent, respectively.

Moreover, as early as in 2010, the Executive Board had voluntarily committed to increasing the share of women holding middle and upper management positions to 20 per cent by 2020, and women holding lower management positions to 30 per cent during the same period. The Group maintains this ambition, and has extended the scope of its voluntary commitment, over and above legal requirements. Firstly, the target figures determined in this context relate to Deutsche Börse Group worldwide. Secondly, the definition of management levels/positions was extended to also include heads of teams, for example.

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 future. The Group expects that two significant factors will influence changes in liquidity. Firstly, the company plans to invest some €180 million in intangible assets and property, plant and equipment at Group level. These investments will serve primarily to develop new products and services in the Eurex (financial derivatives) and Clearstream (post-trading) segments, and to enhance existing ones. The total amount essentially 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 €2.70 per share to the Annual General Meeting to be held in May 2019. This would correspond to a cash outflow of about €495 million. Against the background of the growth strategy, the company anticipates that, in future, freely available funds will increasingly also be applied to the Group's complementary external growth options. 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 in the forecast period due to its positive cash flow from operating activities, adequate credit lines (see note 25 to the consolidated financial statements for details), and flexible management and planning systems.

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. Within this range, the Group manages the actual payout ratio mainly relative to the business performance and based on continuity considerations. In addition, the company plans to invest the remaining available funds primarily into organic growth, but also, secondarily, for the Group's complementary external development. Should the Group be unable to invest these funds, additional payouts, particularly share buy-backs, present another opportunity for the use of funds. To maintain its strong credit ratings at Group level, the company aims at a ratio of net debt to EBITDA of no more than 1.75, and a ratio of free funds from operations to net debt of at least 50 per cent.

The parent company, Deutsche Börse AG, plans to invest some €50 to 60 million in intangible assets and property, plant and equipment during the forecast period.

Overall assessment by the Executive Board

The Executive Board of Deutsche Börse AG believes that the company continues to be in a very good position compared with the international competition, thanks to its comprehensive offering along the securities trading value chain and its innovative strength. Against this background, the Executive Board therefore expects to see a positive trend in the company's results of operations over the long term. The purpose of the measures as part of the growth strategy is to further accelerate the Group's growth. In this context, the Group aims to act in a more agile and effective manner, and with increased client focus, to turn Deutsche Börse into the global market infrastructure provider of choice, being top-ranked in all its activities. Looking at the economic and regulatory framework over the forecast period, uncertainty persists concerning capital market participants' behaviour; therefore, it is impossible to come up with a concrete forecast for cyclical growth in net revenues. Nonetheless, Deutsche Börse Group endeavours to further expand its structural growth areas and to further increase their contribution to net revenues by at least 5 per cent. At the same time, the Group plans to safeguard the scalability of its business model throughout the forecast period. To this end, the Executive Board will actively manage operating costs in a way that net profit for the period attributable to Deutsche Börse AG shareholders will grow at a stronger rate than net revenue. Specifically, growth rates of about 10 per cent (excluding exceptional effects) are projected for the forecast period. Overall, the Executive Board assumes on this basis that cash flow from operating activities will be clearly positive and that, as in previous years, the liquidity base will be sound. The overall assessment by the Executive Board is valid as at the publication date for this combined management report.

Deutsche Börse AG (disclosures based on the HGB)

The annual financial statements of Deutsche Börse AG are prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch, HGB) and the supplementary provisions of the German Stock Corporation Act (Aktiengesetz, AktG) and are the underlying basis for the explanations that follow.

Business and operating environment

General position

Deutsche Börse AG is the parent company of Deutsche Börse Group. The parent company's business activities include first and foremost the cash and derivatives markets, which are reflected in the Eurex (financial derivatives) and Xetra (cash equities) segments, as well as the data and index businesses. Deutsche Börse AG also operates essential parts of Deutsche Börse Group's information technology. The development of Deutsche Börse Group's Clearstream (post-trading) segment is reflected in Deutsche Börse AG's business development, primarily due to the profit and loss transfer agreement with Clearstream Holding AG. Deutsche Börse Group's IFS (investment fund services) and GSF (collateral management) segments, in contrast, play a lesser role for Deutsche Börse AG. Nevertheless, the business and framework conditions at Deutsche Börse AG essentially correspond to those of Deutsche Börse Group and are described in the "Macroeconomic and sector-specific environment" section.

Deutsche Börse AG's course of business in the reporting period

Deutsche Börse AG's revenues increased by 3.6 per cent in the 2018 financial year, coming in slightly below the company's expectations. Total costs (staff costs, amortisation of intangible assets and depreciation of property, plant and equipment and other operating expenses) increased by 0.7 per cent. Net profit fell compared to 2017 which, among other things, had been positively impacted by proceeds of €139.5 million from the sale of the stake in Eurex Zürich AG to Eurex Global Derivatives AG. On an adjusted basis – i.e. excluding the aforementioned one-off proceeds included in the previous year – the company's net profit for the 2018 financial year increased by 11.8 per cent and, therefore, exceeded the expectation of an increase of at least 10 per cent. Based on these results, Deutsche Börse AG Executive Board assesses the development in the 2018 financial year as satisfactory.

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