

European Banks

When the leverage is low,
the jewels stand out



Sector rating: Neutral

May 2011

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Due to his previous position with BNP Paribas, Cyril Meilland is currently not authorised to issue an investment recommendation on the BNP Paribas share



■ Profits are normalising...

- Loan loss ratio
- Cyclical upturn vs. structural problems, core vs. periphery
- Interest rate sensitivity and funding costs

■ ... But profitability will not return to its pre-crisis levels

- Regulation will further dampen ROTE
- CIB: a game of chicken
- Banks vs. Utilities: banks' margins cannot be regulated
- THE question mark: what is to happen to margins? The best players will benefit

■ Appendices

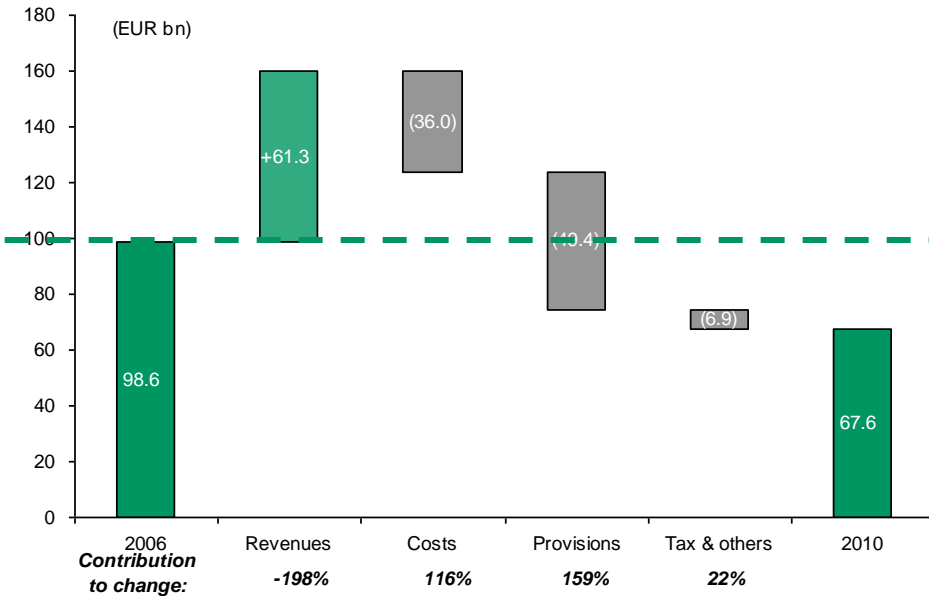
- Valuation
- PIGS exposure

Profits are normalising...



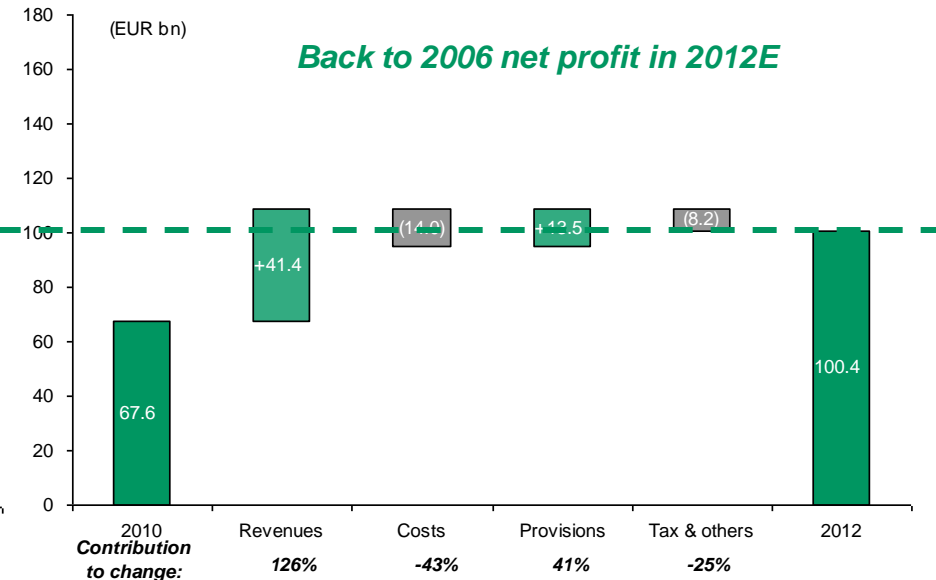
European banks (Cheuvreux coverage): combined net profit

2006-2010:



Source: Cheuvreux

2010-2012E:

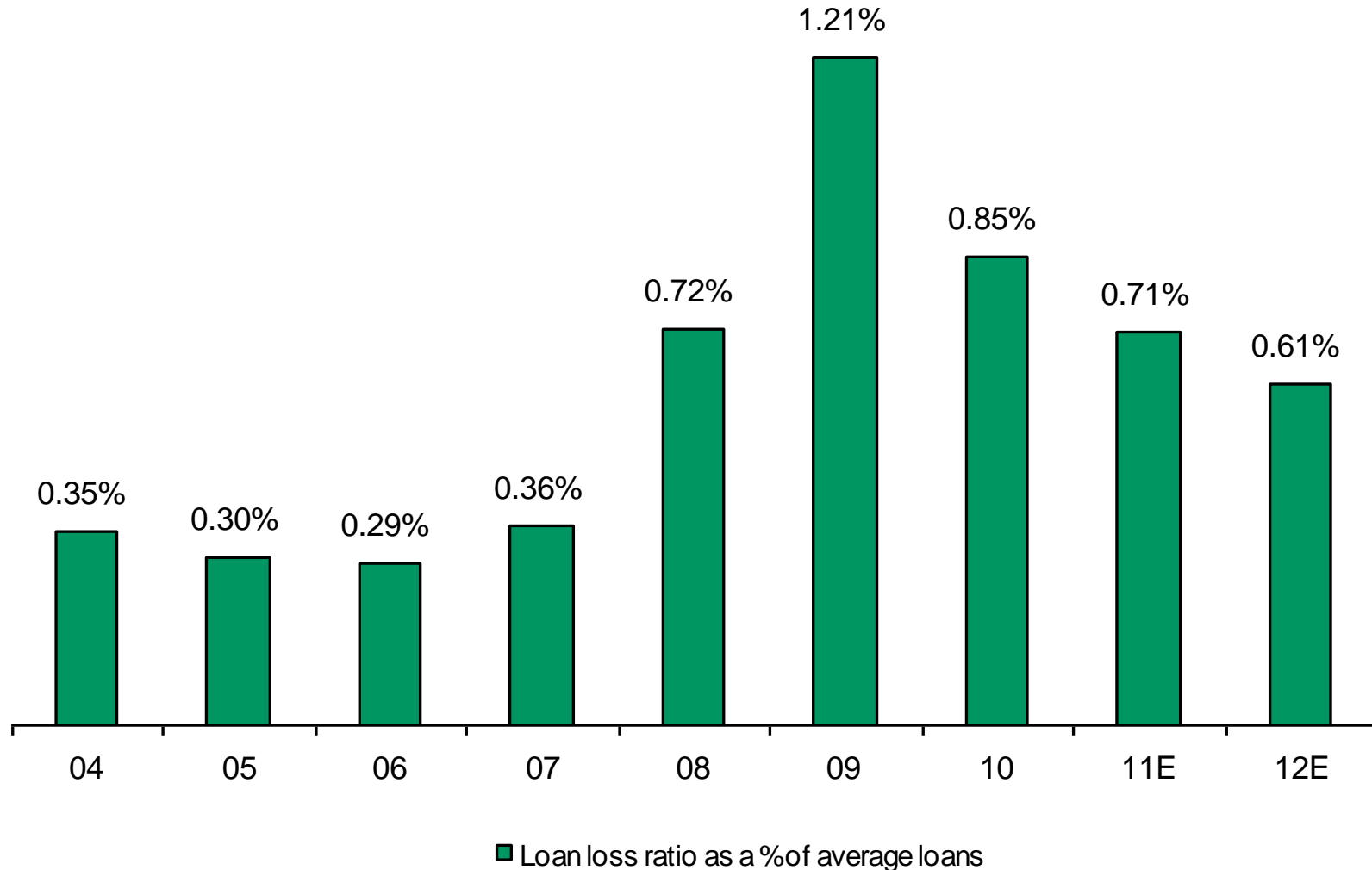


Source: Cheuvreux

Loan loss ratio is gradually normalising



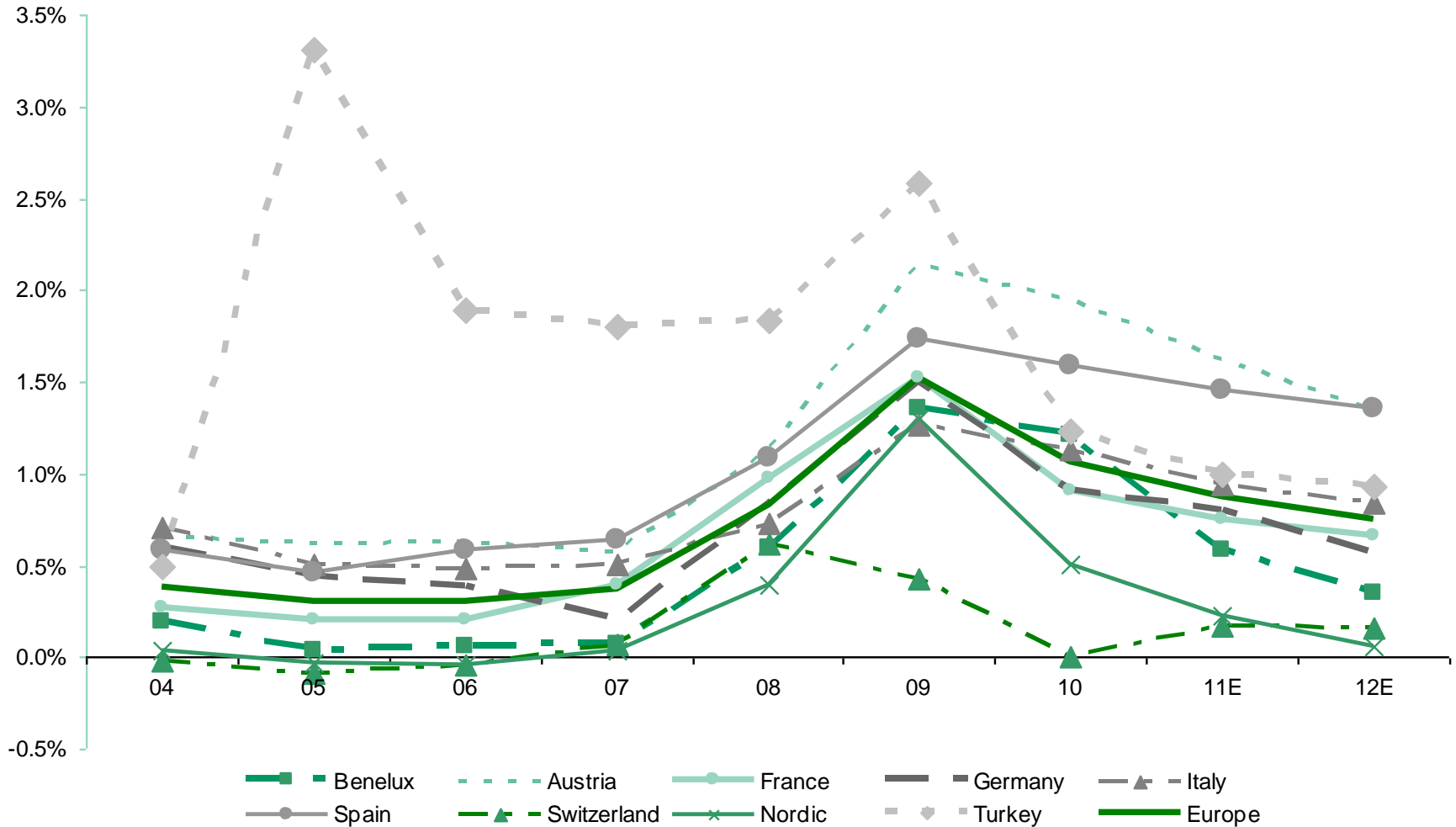
European banks (Cheuvreux coverage): loan loss ratio as a % of customer loans, 2004-2012E



Source: Cheuvreux

Loan loss ratio by country

European banks (Cheuvreux coverage): loan loss ratio as a % of customer loans, 2004-2012E, by country

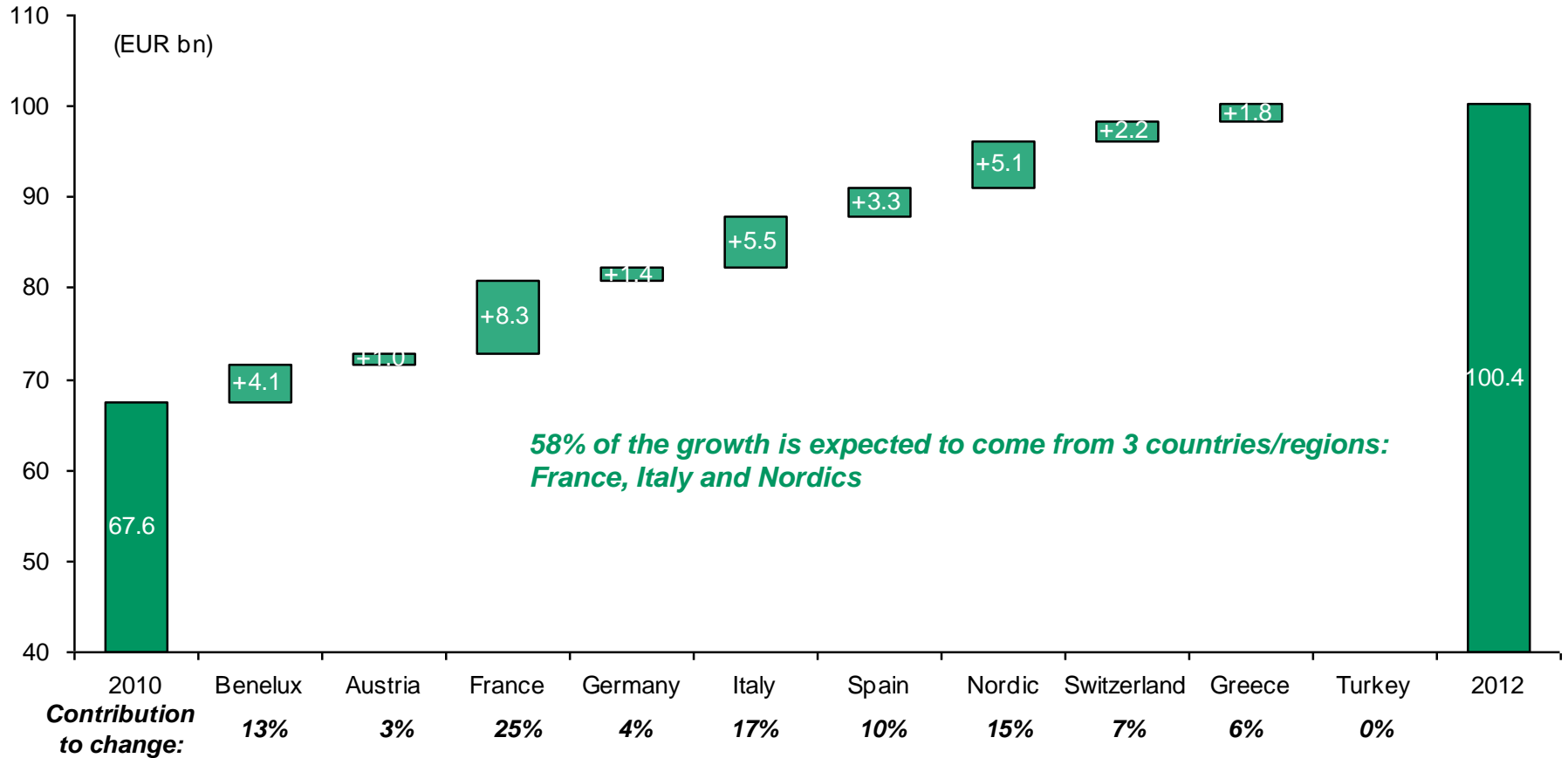


Source: Cheuvreux

Contribution to growth



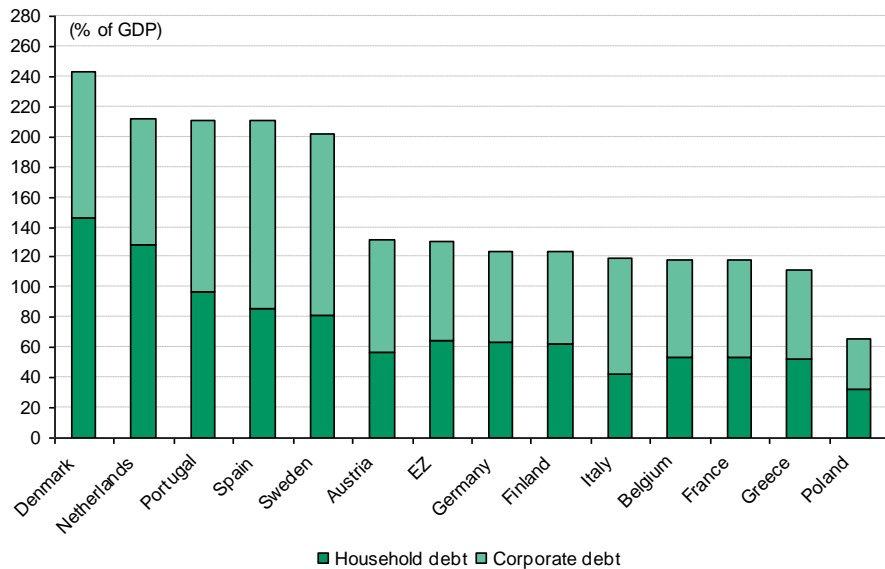
European banks (Cheuvreux coverage): contribution to net profit growth, 2010-2012E, by country



Source: Cheuvreux

Cyclical upturn vs. structural problems

Europe: private indebtedness as a % of GDP

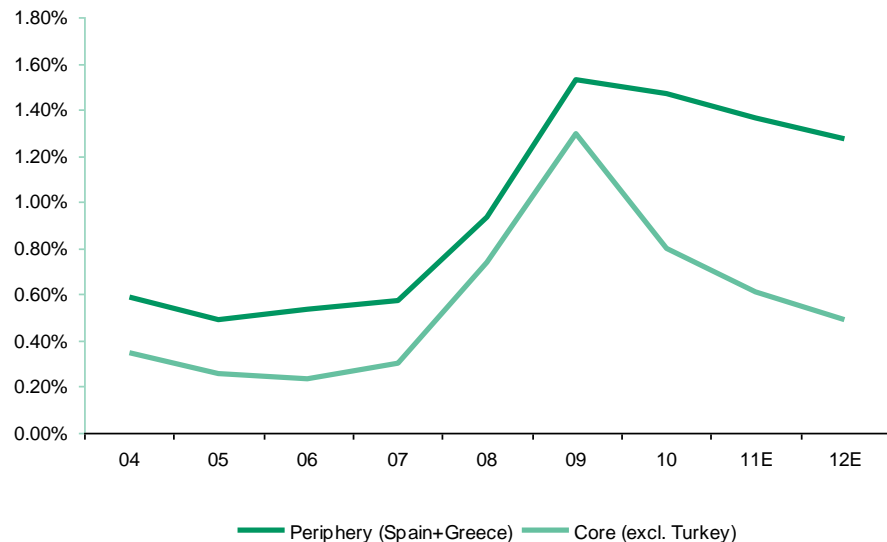


Source: Eurostat

Loan loss ratio, core vs. periphery

De-leveraging: core vs. periphery

European banks (Cheuvreux coverage): loan loss ratio 2004-2012E, Core vs. periphery

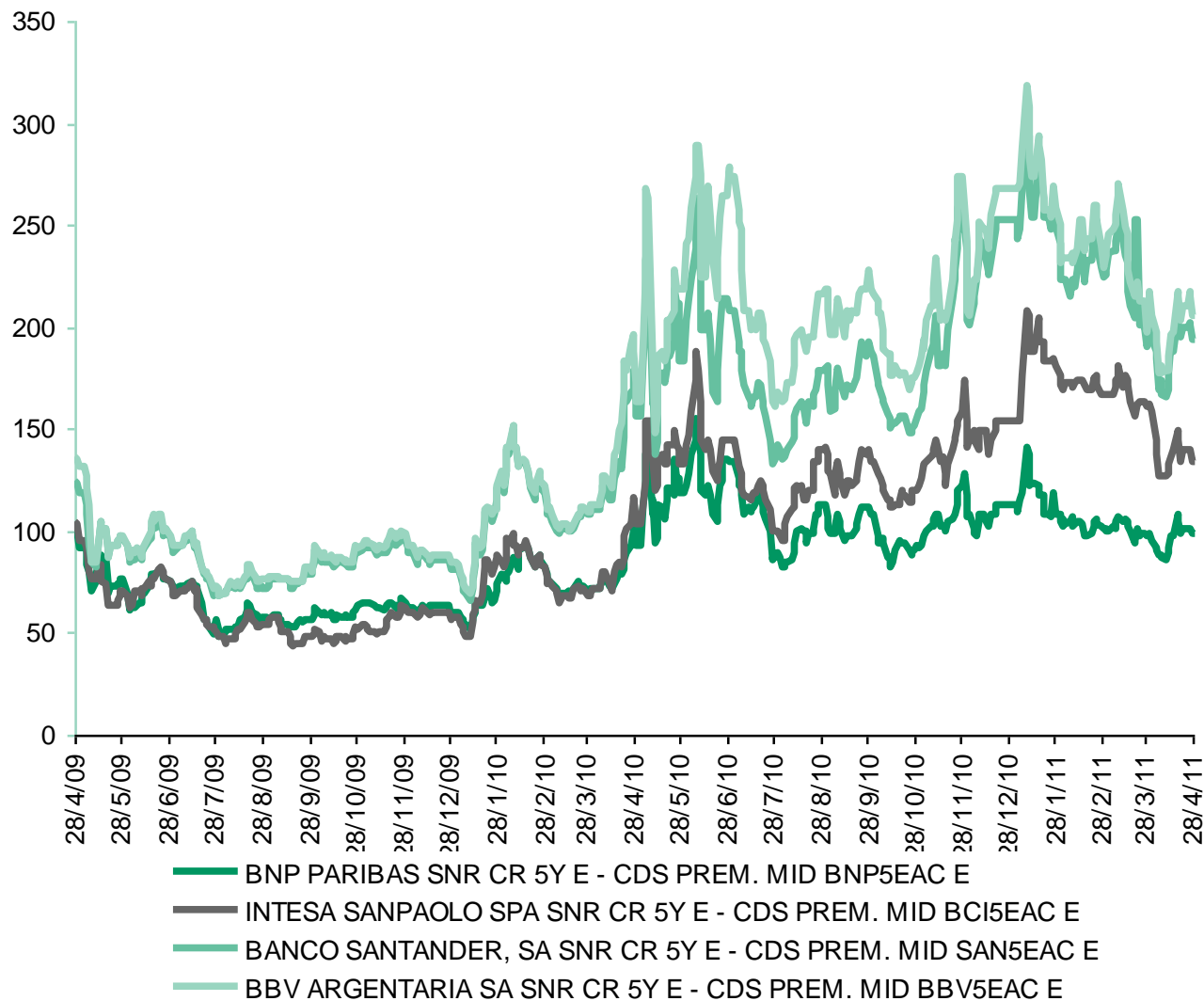


Source: Cheuvreux

Massive advantage for banks in core countries



Selected European banks: 5-year senior CDS spreads, 2009-today

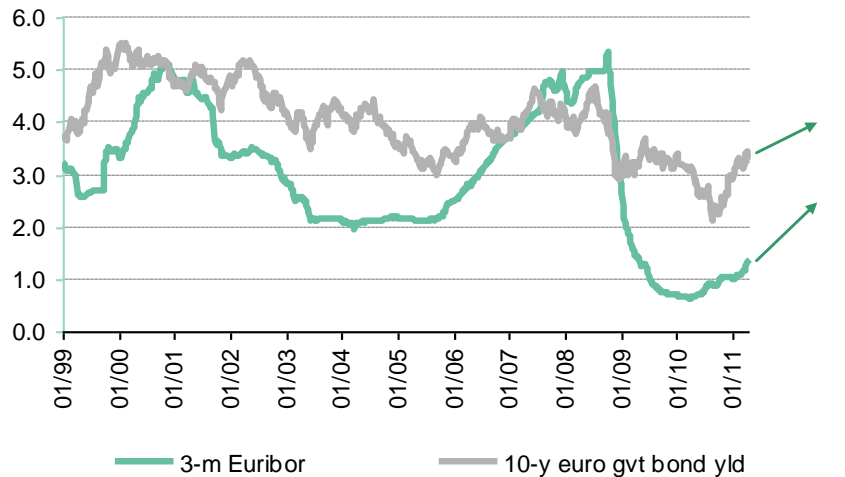


Source: Datastream

Sensitivity to interest rates: only Italian banks

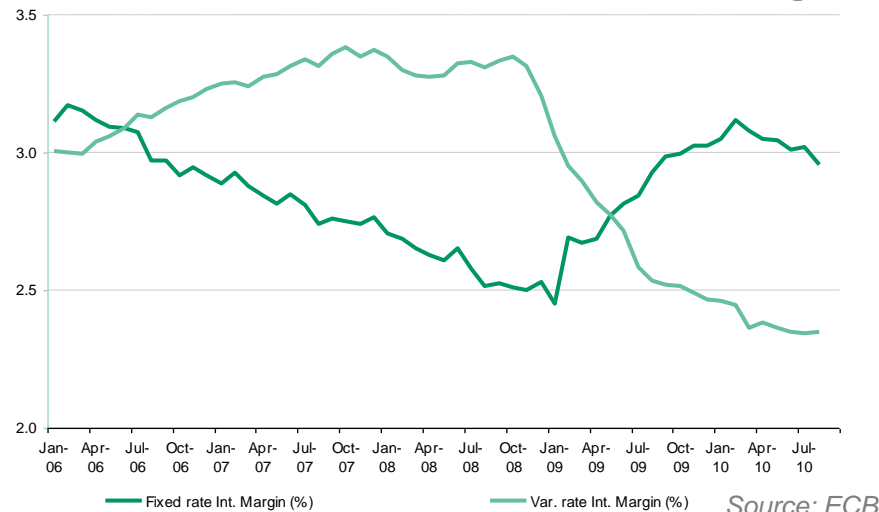


3-m Euribor vs. 10-year gvt bond yield (Bund)



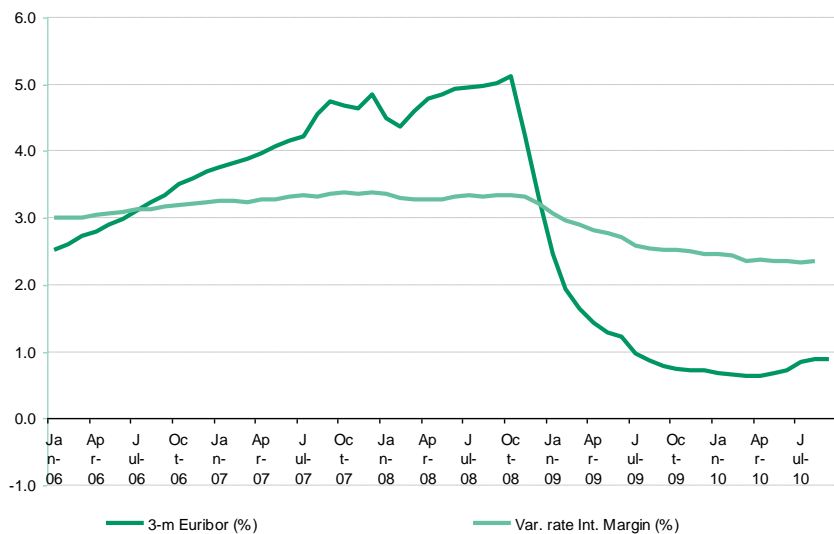
Source: Datastream

Fixed rate countries vs. variable rate countries margins



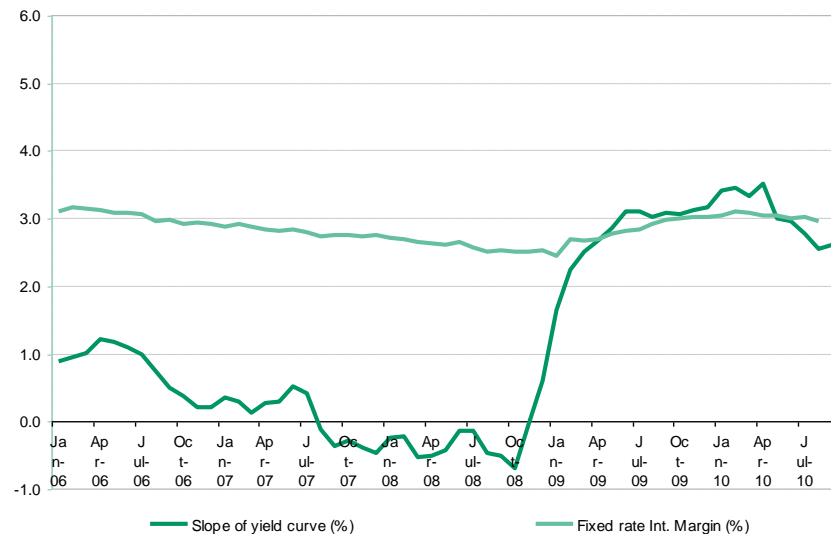
Source: ECB

Variable rate countries vs. 3-m Euribor



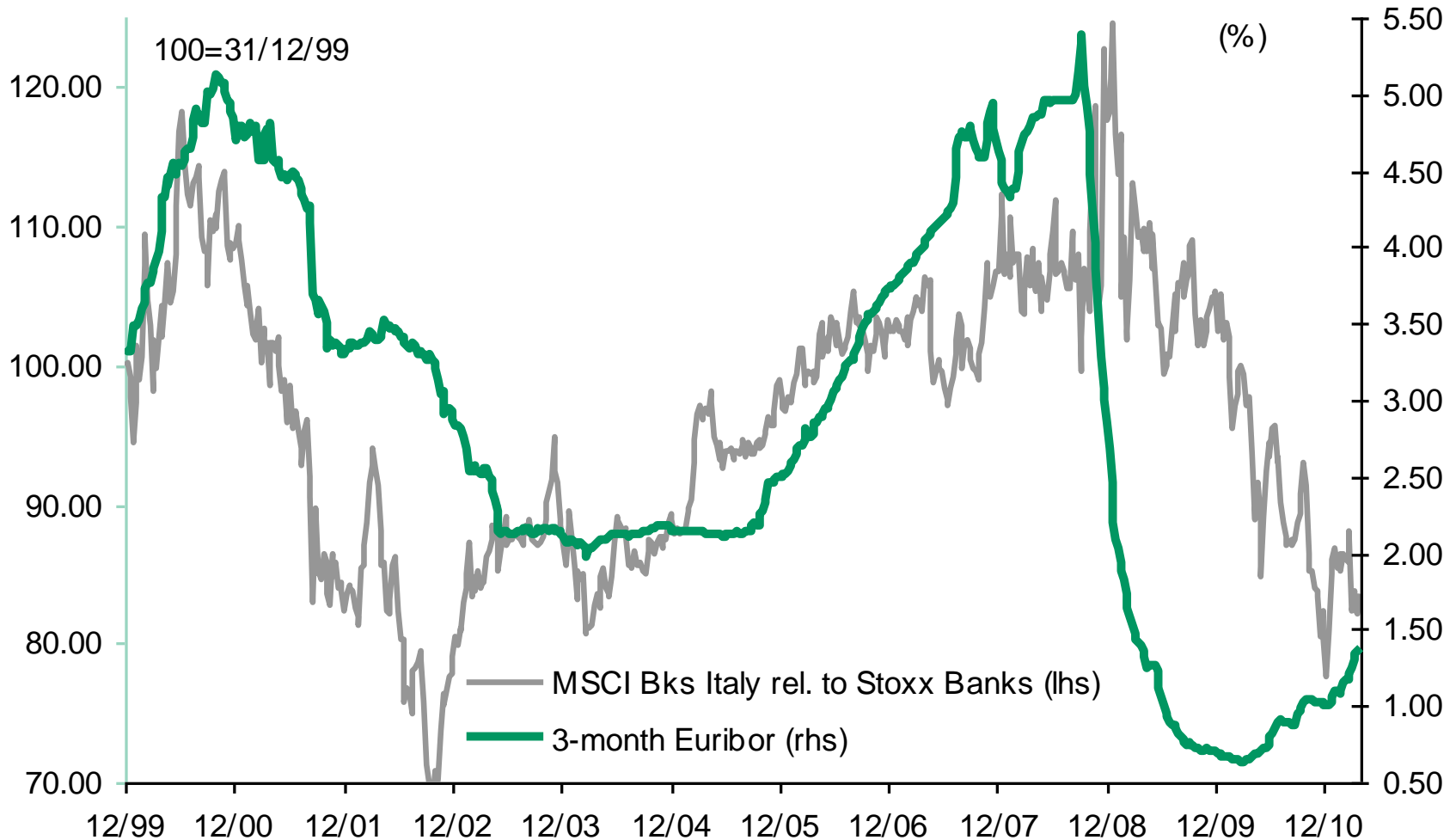
Source: ECB

Fixed rate countries vs. yield curve slope



Source: ECB

Cyclical upturn: Italian banks vs. 3-m Euribor

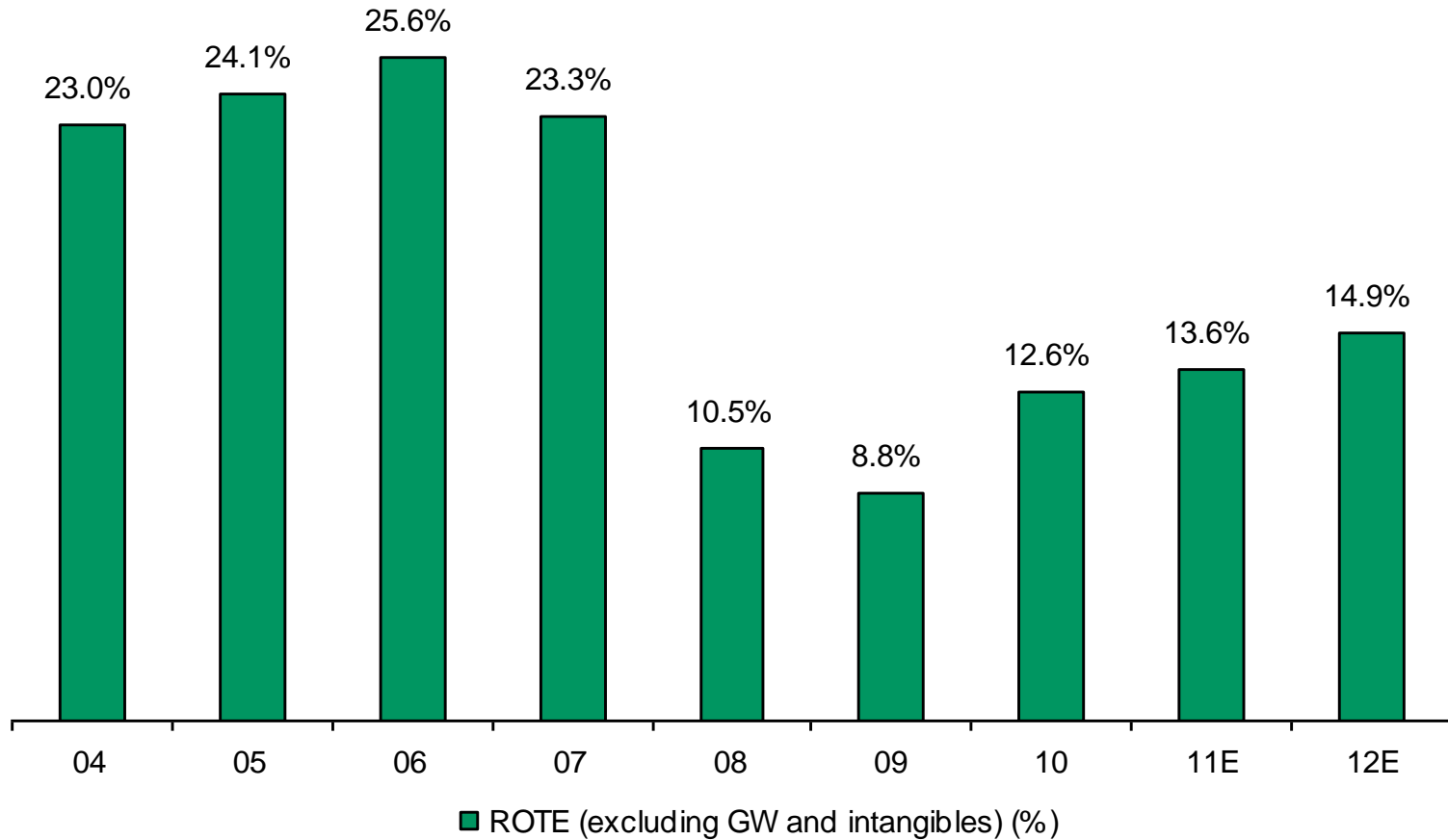


Source: Datastream

... but ROTEs are far from their pre-crisis peak

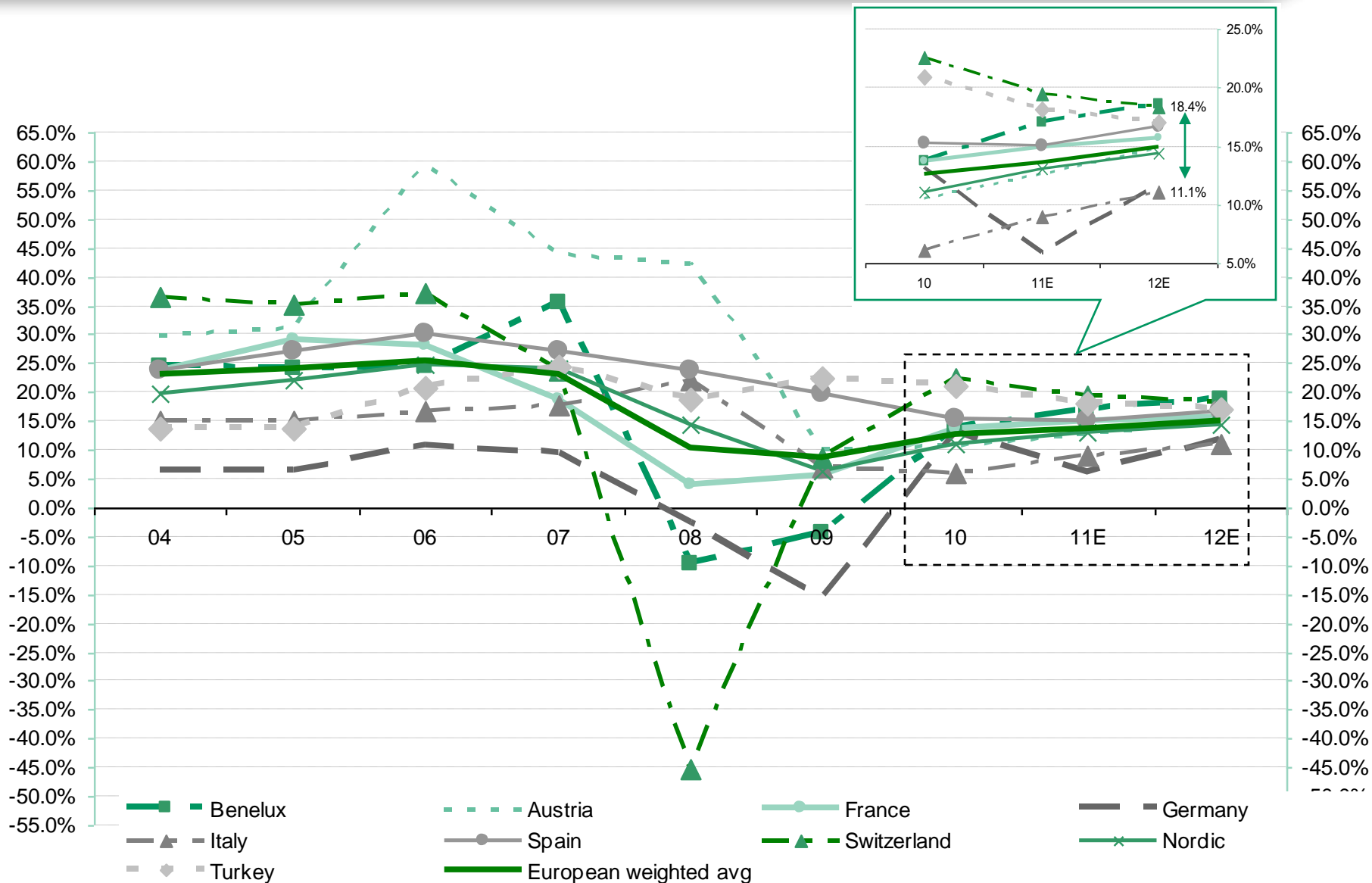


European banks (Cheuvreux coverage): weighted average ROTE 2004-2012E



Source: Cheuvreux

ROTE evolution by country



And this will get worse under Basel 3



Basel 2, as a % of RWA			
Net profit 2012E	1.39%	1.39%	
Normalisation of LLR	0.18%	0.18%	From 0.76% to 0.58%
After tax	0.13%	0.13%	
Normalised net profit	1.51%	1.51%	
Normalised Core Tier 1	10%	9%	Assuming core Tier 1 = tangible net equity
ROTE normalised	15.1%	16.8%	
Basel 3, as a % of RWA			
Adjustment of RWA	15%	15%	more RWA under Basel 3 / Basel 2
New normalised net profit	1.32%	1.32%	as a % of B3 RWA
CET1 / Core Tier 1	-10%		
Normalised CE Tier 1	10%	9%	Assuming CE Tier 1 = tangible net equity -10%
New normalised ROTE	10.3%	12.7%	Assuming that banks adjust to 10% CET1 (ie increase their CET1 to compensate increase in RWA and additional deductions)
To return to 15%:	1%	0%	additional RoRWA (on Basel 2 RWA)
Before tax	1%	0%	
% change / estimates 2012E	15%	6%	

Source: Cheuvreux

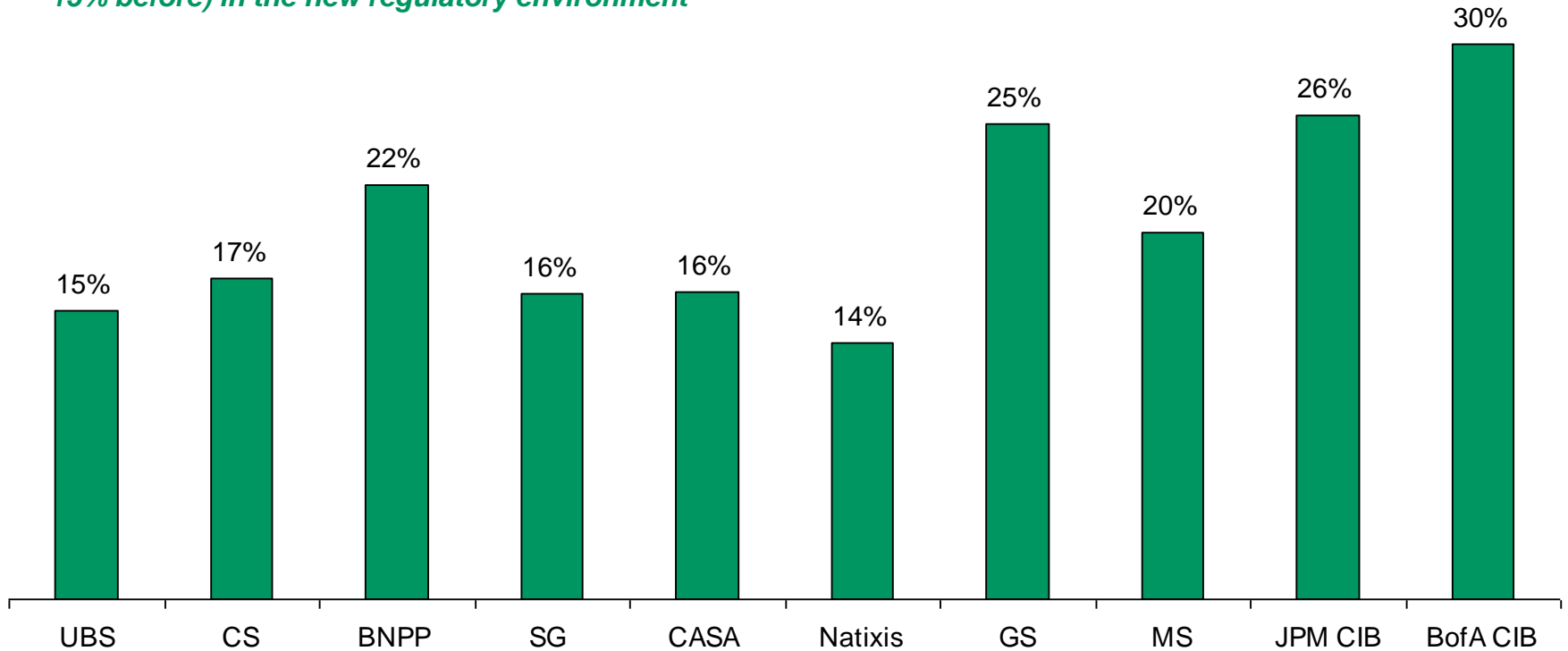
- Basel 3 will have a significant impact on the capital ratios
 - Sector RWA will increase by ca. 15-20%
 - Basel 3 CET1 capital will be ca 10% lower than Basel 2 Core Tier 1 capital
- At 10% CET1 ratio, the sector's ROTE would decline to 10%
 - It would take a 15% increase in the revenues for the ROTE to return to 15%
 - At 9% CET1, the necessary increase in revenues would still have to be 10%
- Regulators are likely to become softer from now on
 - Eg. Switzerland's FINMA, Bank of Spain
- However only the best banks are likely to return back to 15%
 - Eg BNP Paribas, CS
 - Julius Baer: no major capital constraint

CIB: a case of chicken



European & US CIB divisions: Pre tax ROE 2013E of the CIB business, 10% equity allocation

Not many banks will comfortably exceed their cost of equity (10% after tax, ie ca 15% before) in the new regulatory environment

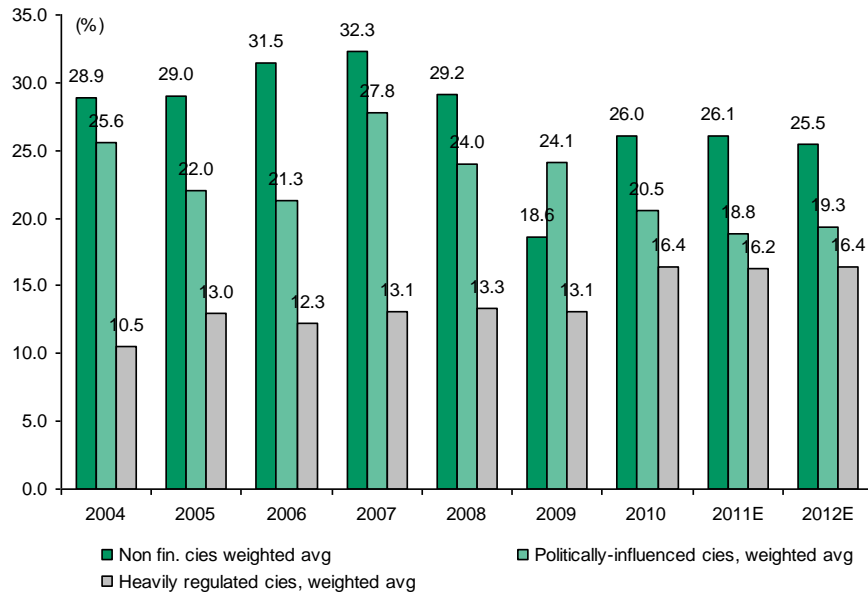


Source: Cheuvreux

Banks vs. Utilities

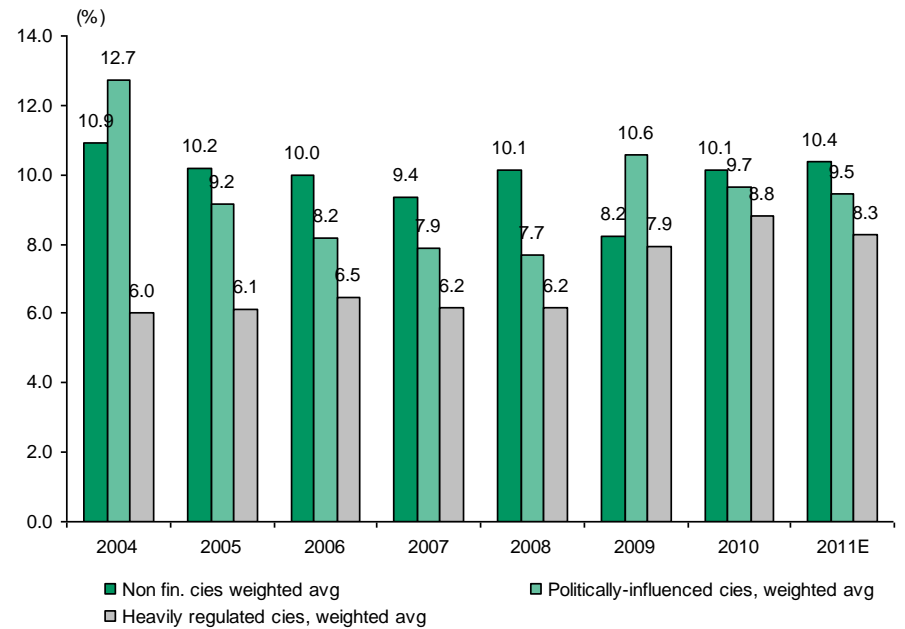


ROTE (%)



Source: Cheuvreux

COE (%)

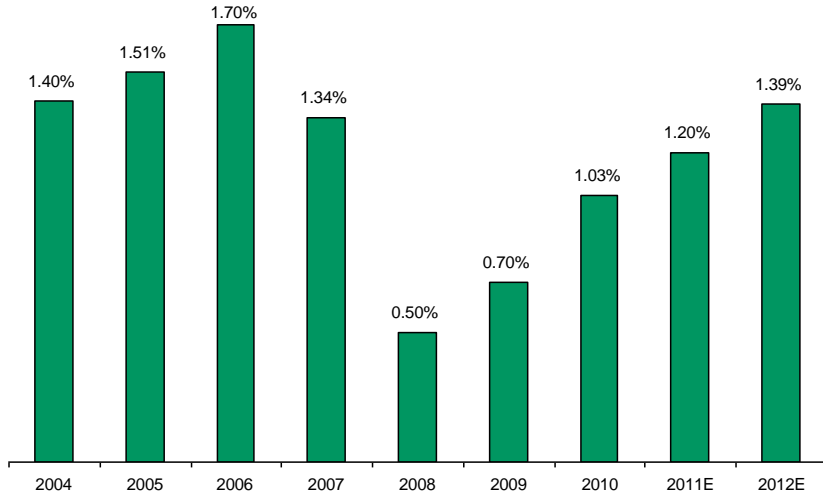


Source: Cheuvreux

Margins will have to rise (% of RWA)

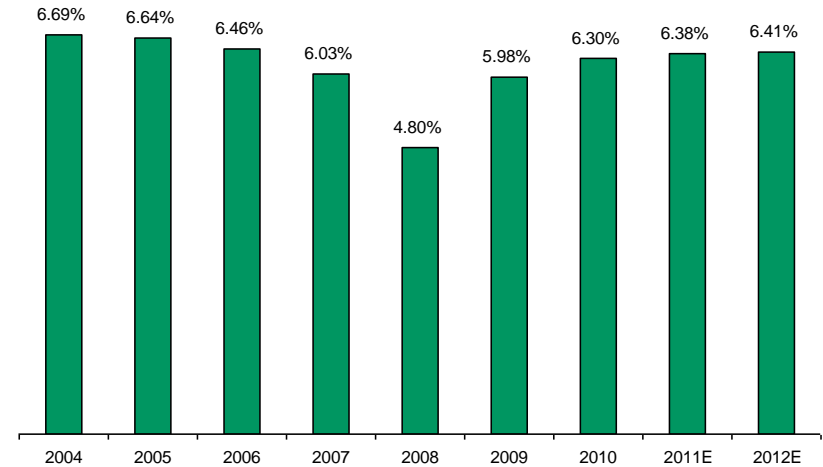


European banks (Cheuvreux coverage): P&L items as a % of RWA



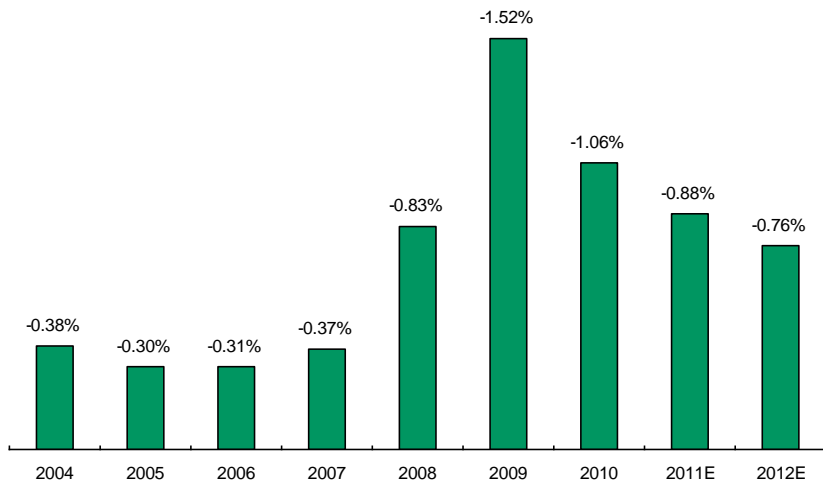
■ Net attributable profit

Source: Cheuvreux



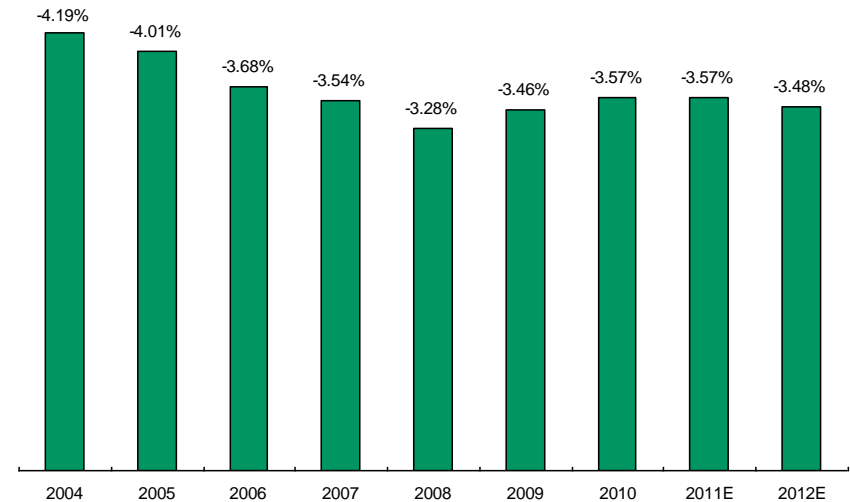
■ Revenues

Source: Cheuvreux



■ Loan loss provisions

Source: Cheuvreux



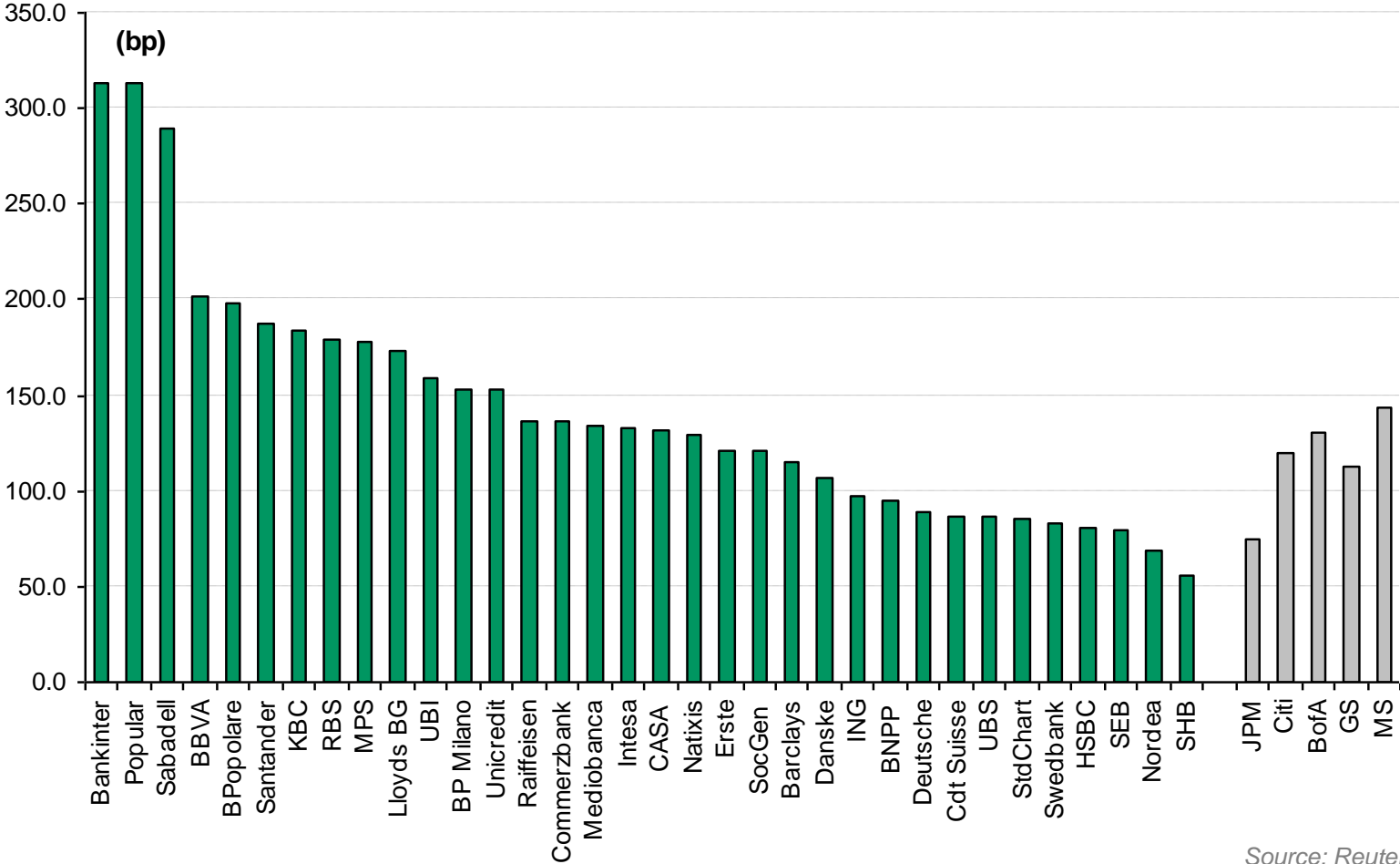
■ Op. costs

Source: Cheuvreux

More differentiation from funding costs



European banks: 5-year senior CDS spreads



Source: Reuters

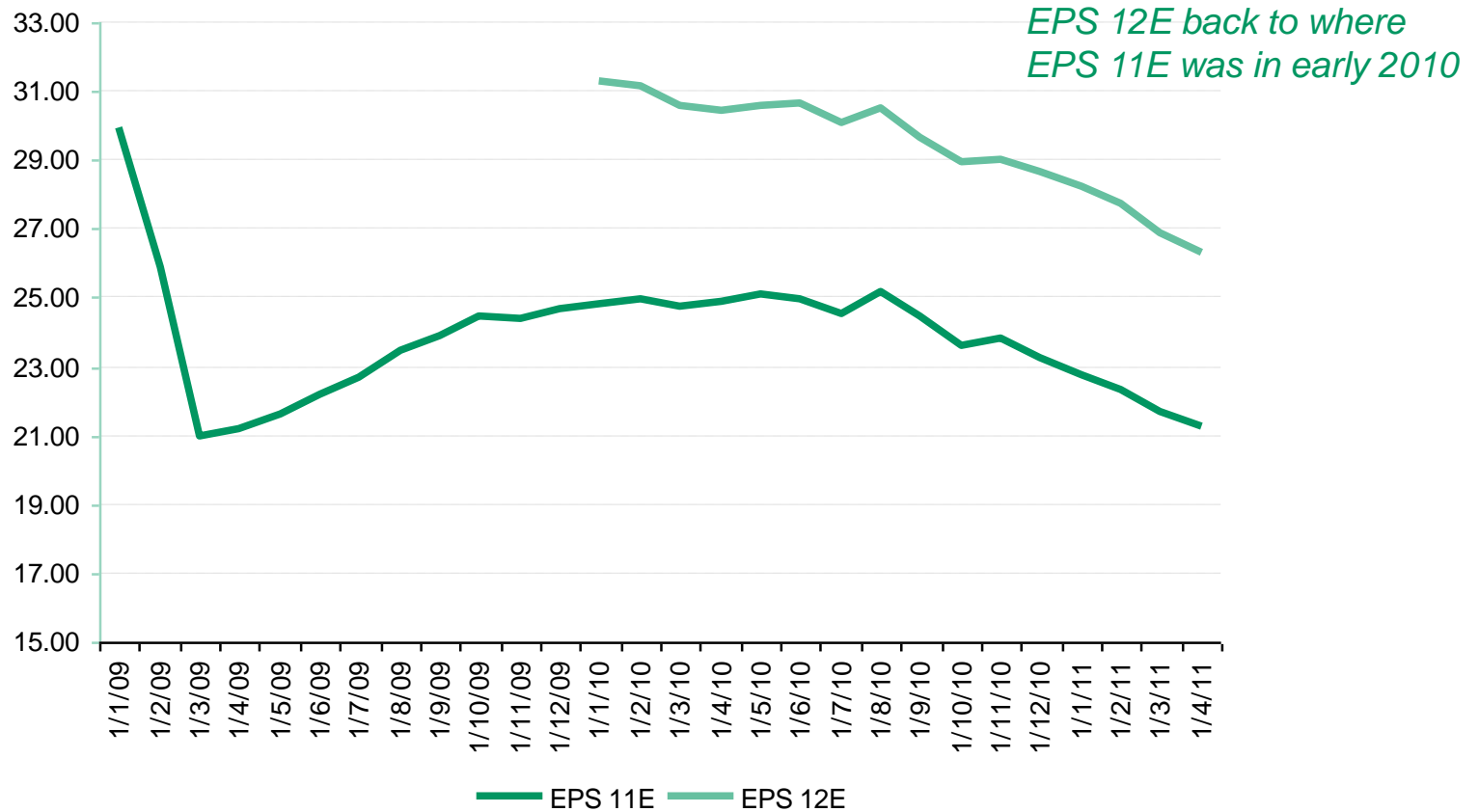
Appendices



2010 was a lost year



Consensus estimates for Stoxx Banks, EPS 11E and EPS 12E

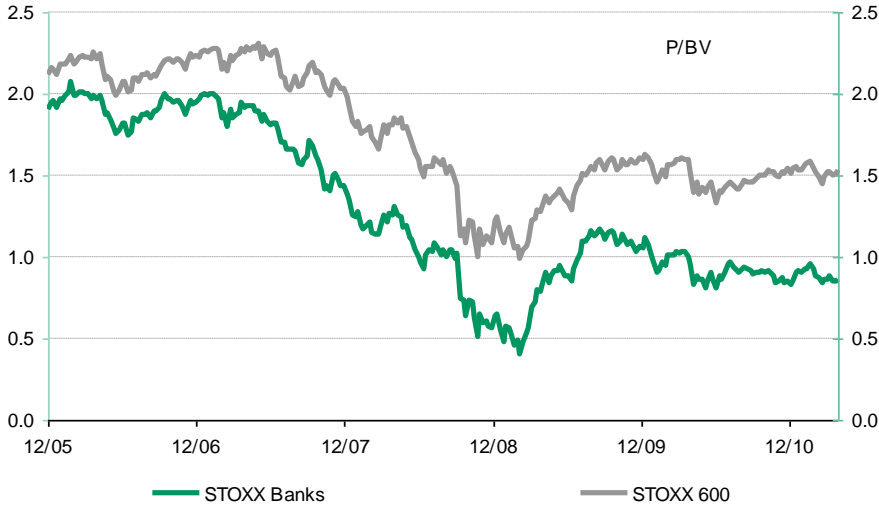


Source: Factset

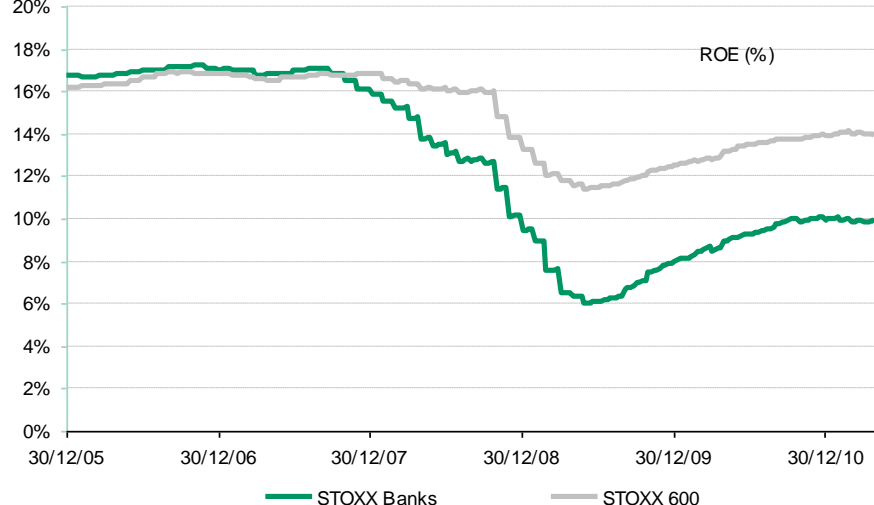
Lost market leadership



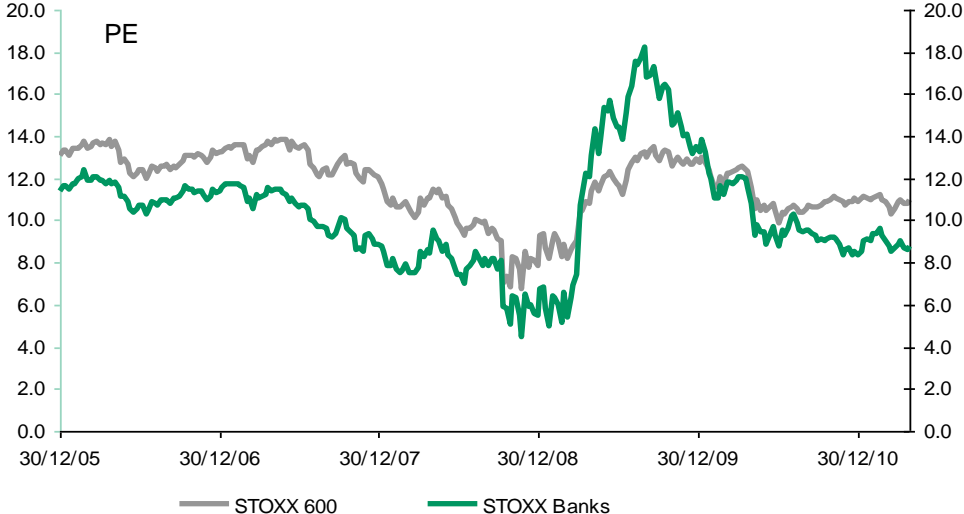
European banks vs. market: forward P/BV 2005-2010



European banks vs. market: forward ROE 2005-2010



European banks vs. market: forward PE 2005-2010

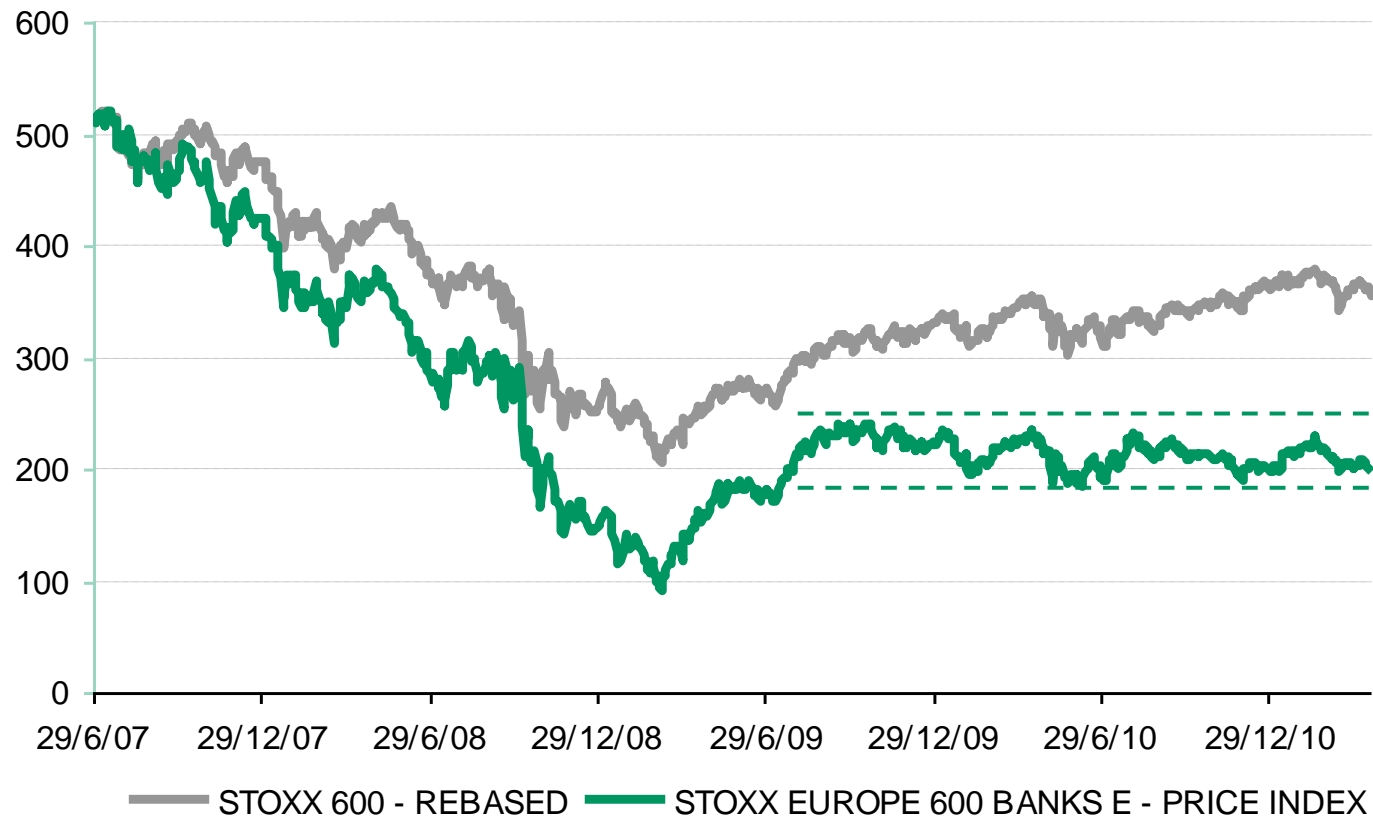


Source: Factset

Sector to remain volatile and range-bound



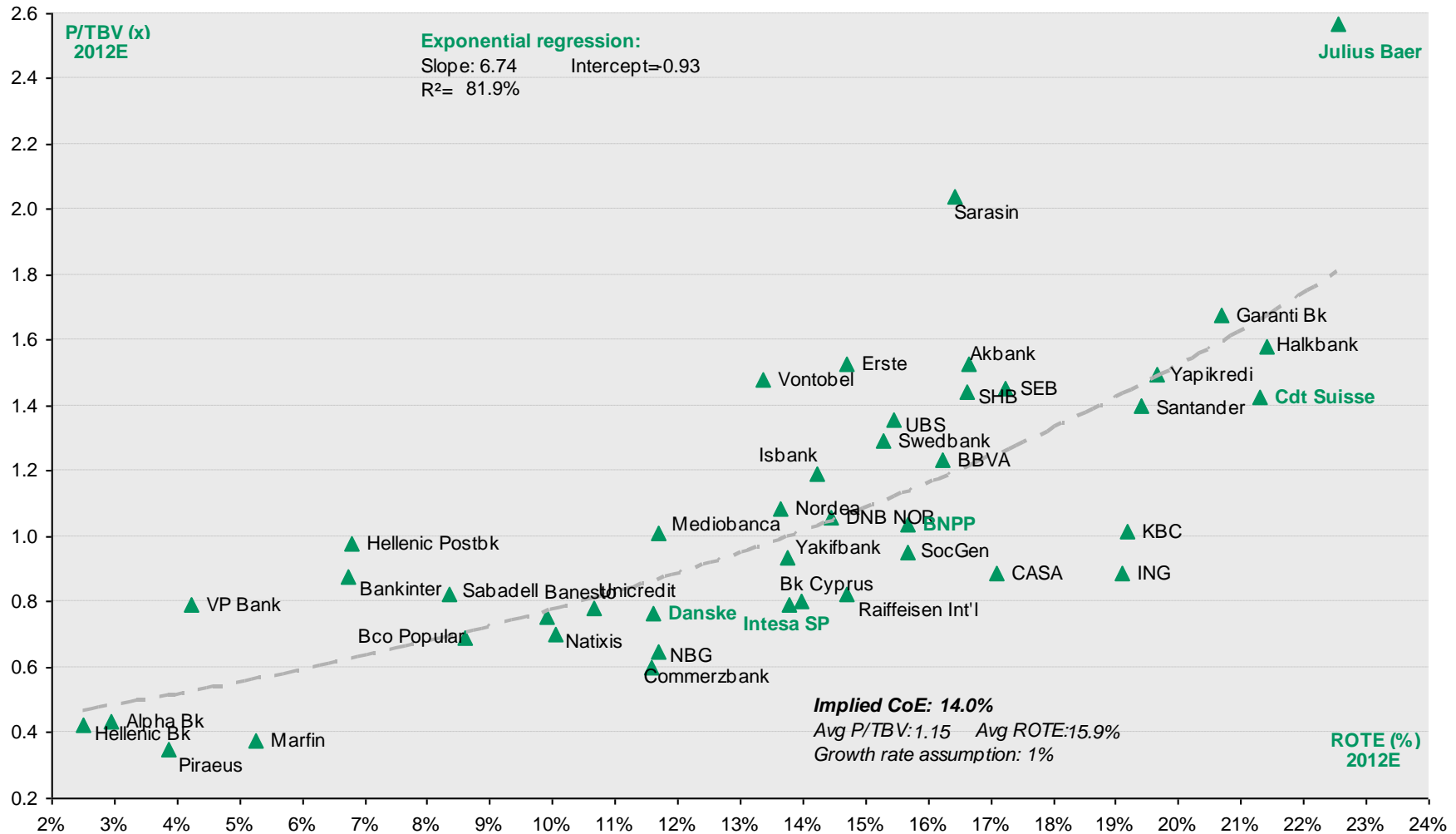
European banks vs. Stoxx 600: relative performance crisis to date



European Banks: Valuation



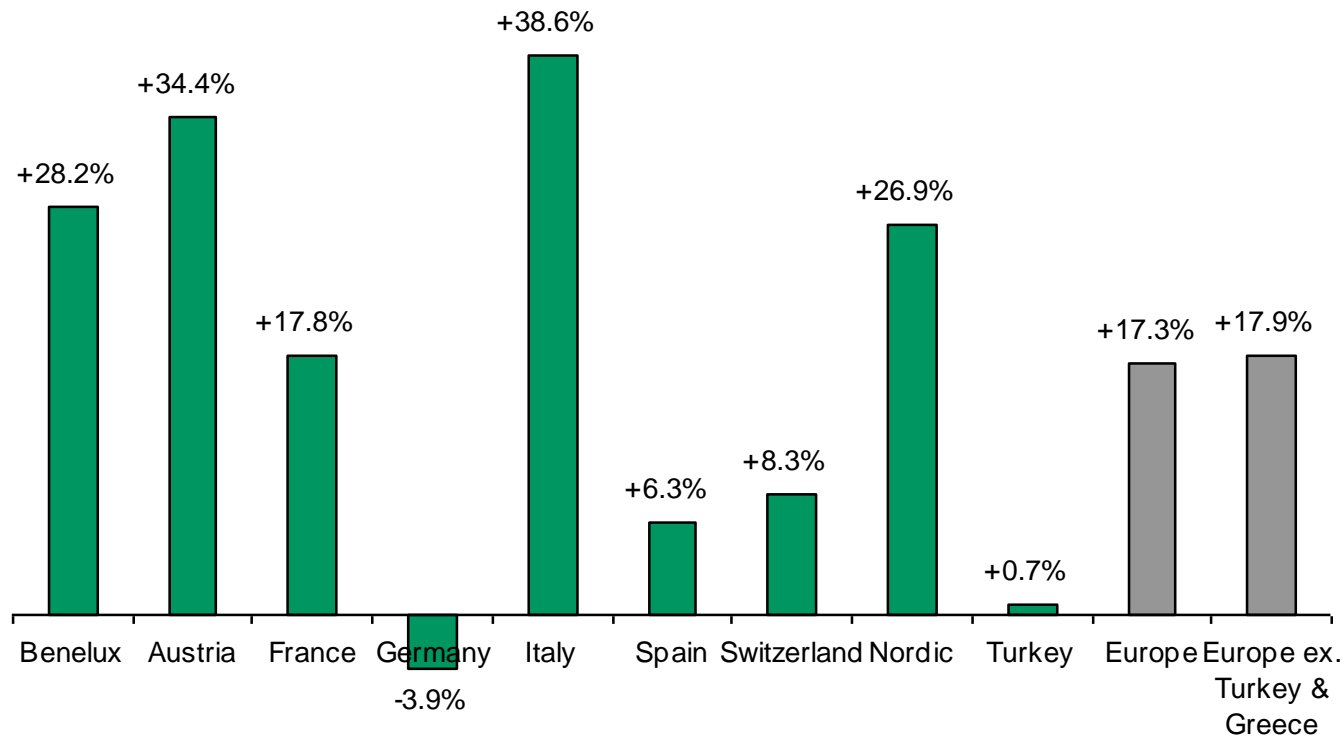
European banks (Cheuvreux coverage): P/TBV 2012E vs Return on Tangible Equity 2012E



Source: Cheuvreux



European banks (Cheuvreux coverage): EPS CAGR 2010-12E

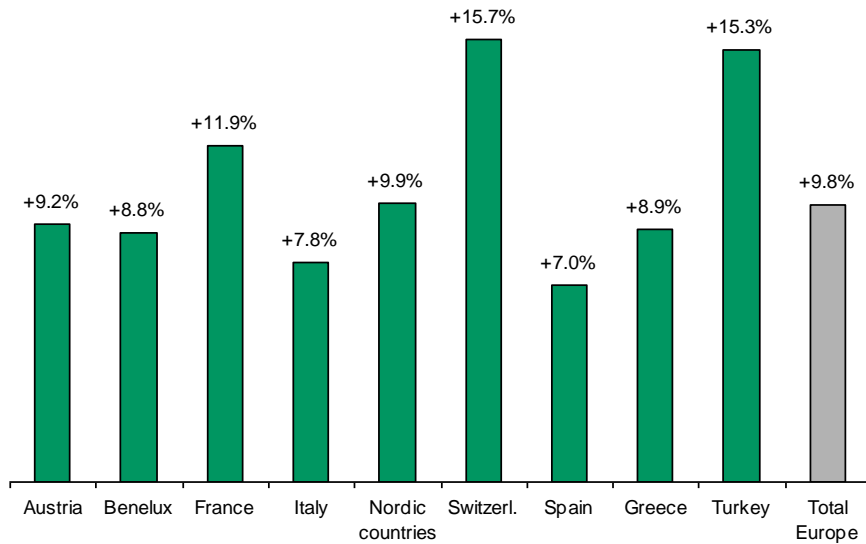


Source: Cheuvreux

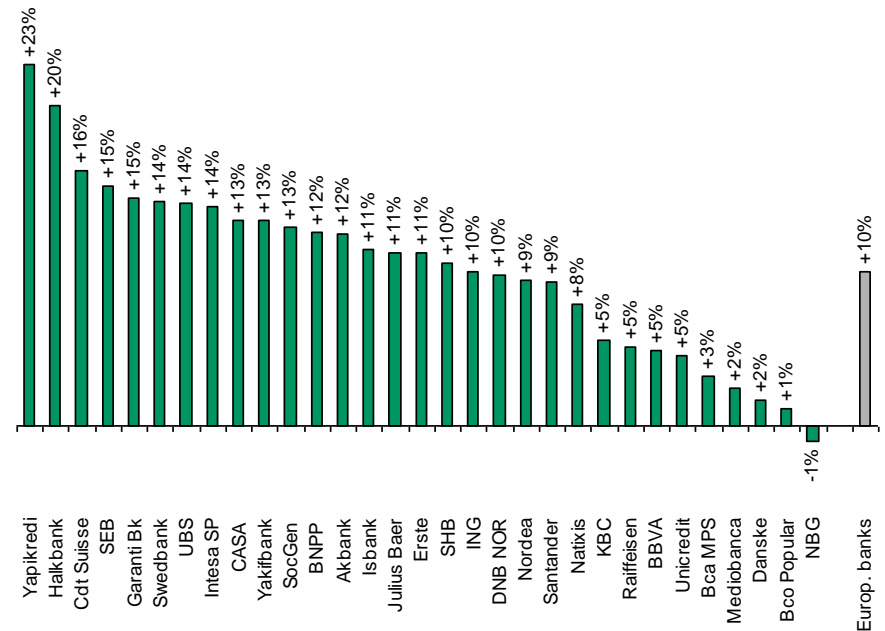
Growth in TBVPS is key (2010-2012E)



European banks: growth in tangible book value per share, CAGR 2010-2012E



Source: Cheuvreux



Source: Cheuvreux

Sovereign Exposures (Stress Tests Disclosure)



Banks (local currency m)	Rating	Portugal	Ireland	Greece	Spain	Italy	Total	Total ex Italy	% of Tangible Equity (*)
Alpha Bank	1/Selected List	0	0	3 700	0	0	3 700	3 700	89%
Banca MPS	3/Underperform	93	3	35	116	27 756	28 003	247	3%
Banco Popular	3/Underperform	657	0	0	7 574	209	8 440	8 231	97%
Banco Popolare	Suspended	0	0	89	151	8 284	8 524	240	3%
Banco Sabadell	4/Sell	105	14	0	1 575	0	1 694	1 694	32%
Banesto	3/Underperform				6 000		6 000	6 000	108%
Bank of Cyprus	1/Selected List	0	0	1 800	0	0	1 800	1 800	80%
Bankinter	Suspended	0	0	0	1 735	69	1 804	1 735	80%
BBVA	3/Underperform	646	16	293	52 131	6 230	59 316	53 086	173%
BNPP	NA	1 733	433	5 018	2 903	22 079	32 166	10 087	19%
Commerzbank	2/Outperform	1 100	100	2 900	3 600	10 000	17 700	7 700	95%
Crédit Agricole Group	No Rating	1 060	111	655	2 241	10 115	14 182	4 067	15%
Credit Suisse (CHFm)	2/Outperform	700	100	550	1 879	5 797	9 026	3 229	13%
Deutsche Bank	NA	463	309	1 682	1 949	10 399	14 802	4 403	
Dexia	NA	2 817	147	3 747	1 823	17 533	26 067	8 534	
EFG Intl (CHFm)	2/Outperform	n.a.	n.a.	<200	n.a.	n.a.	0	0	0%
Erste	2/Outperform	0	100	1 100	0	1 400	2 600	1 200	15%
Eurobank	2/Outperform	0	0	8 000	0	0	8 000	8 000	238%
Garanti Bank	2/Outperform						0	0	0%
Halkbank	2/Outperform						0	0	0%
ING	2/Outperform	1 378	1	2 025	2 175	5 728	11 306	5 579	14%
Intesa	1/Selected List	25	156	828	556	63 681	65 246	1 565	5%
Isbank	2/Outperform						0	0	0%
KBC	3/Underperform	600	600	600	2 400	6 000	10 200	4 200	39%
Komercni	NA	0		316		316	632	316	
Marfin Popular Bank	3/Underperform	0	0	3 000	0	0	3 000	3 000	126%
BPCE	3/Underperform	456	524	1 540	384	7 493	10 397	2 904	20%
National Bank of Greece	2/Outperform	0	0	17 900	0	0	17 900	17 900	278%
Natixis	3/Underperform	3	0	45	3	375	426	51	0%
OTP	NA			1			1	1	
Pekao	NA	n.a.	n.a.	n.a.	n.a.	n.a.	0	0	
Piraeus	3/Underperform	0	0	8 800	0	0	8 800	8 800	351%
PKO BP	NA	222			309		531	531	
Postbank	NA	50	300	1 337	1 186	4 581	7 454	2 873	
Raiffeisen	3/Underperform	437	79	0	1 186	2 553	4 255	1 702	27%
Santander	3/Underperform	5 118	16	513	50 642	1 184	57 473	56 289	114%
Société Générale	1/Selected List	400	200	2 900	2 200	4 500	10 200	5 700	18%
UBI Banca	3/Underperform	0	0	25	0	6 303	6 328	25	0%
UBS (CHFm)	3/Underperform	700	100	550	1 500	8 729	11 579	2 850	8%
Yapi Kredi Bank	2/Outperform						0	0	0%
Unicredit	3/Underperform	186	80	801	560	38 832	40 459	1 627	4%
TOTAL/AVERAGE (EUR m)		18 377	3 339	70 158	145 624	266 198	503 696	237 498	48%

(*) Tangible net equity of Crédit Agricole SA

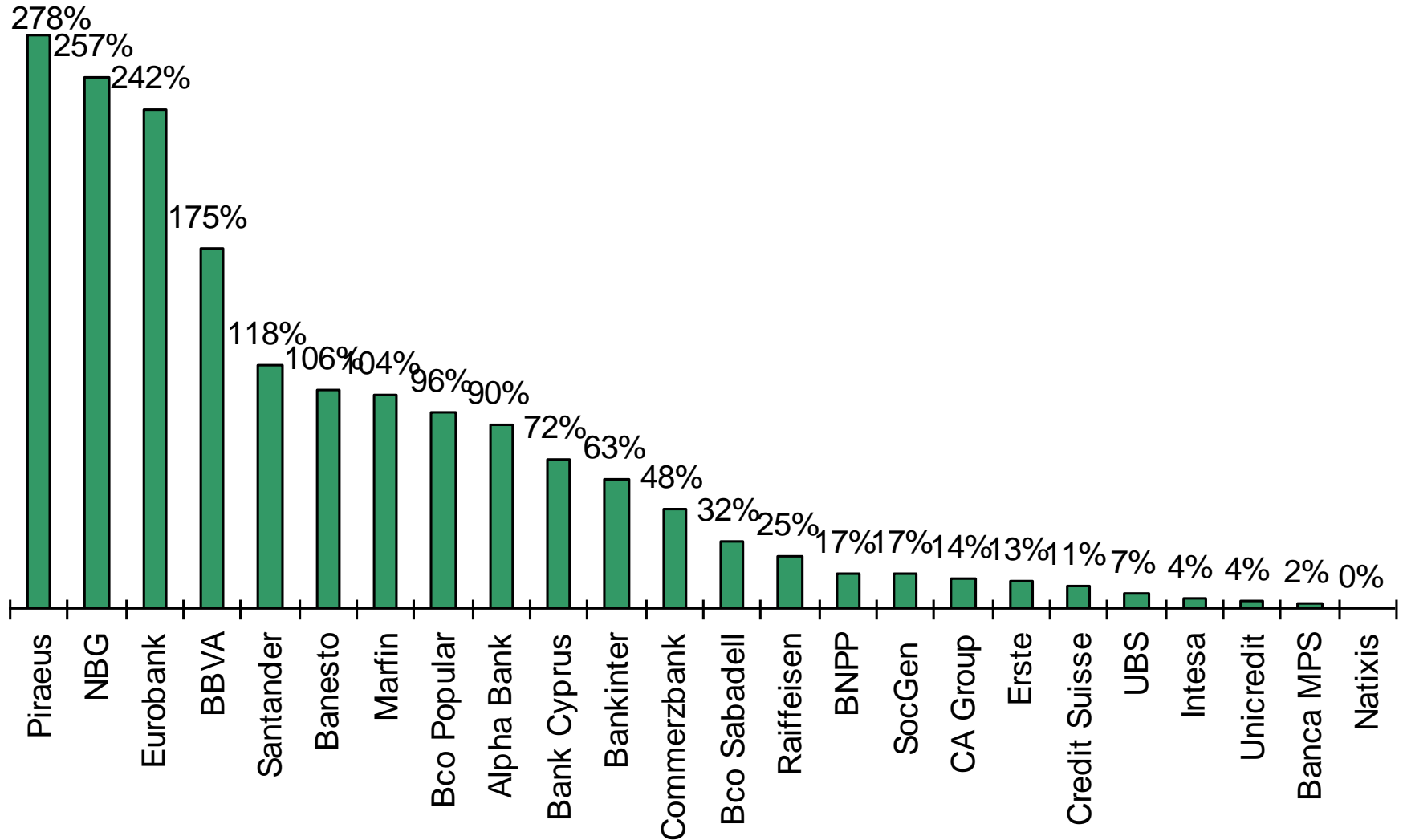
Exposure to sovereign bonds as of end December 2010

Source : CEBS, banks

PIGS exposure as a % of tangible equity



European banks: exposure to Portugal, Ireland, Greece and Spain as a % of tangible equity 2011E

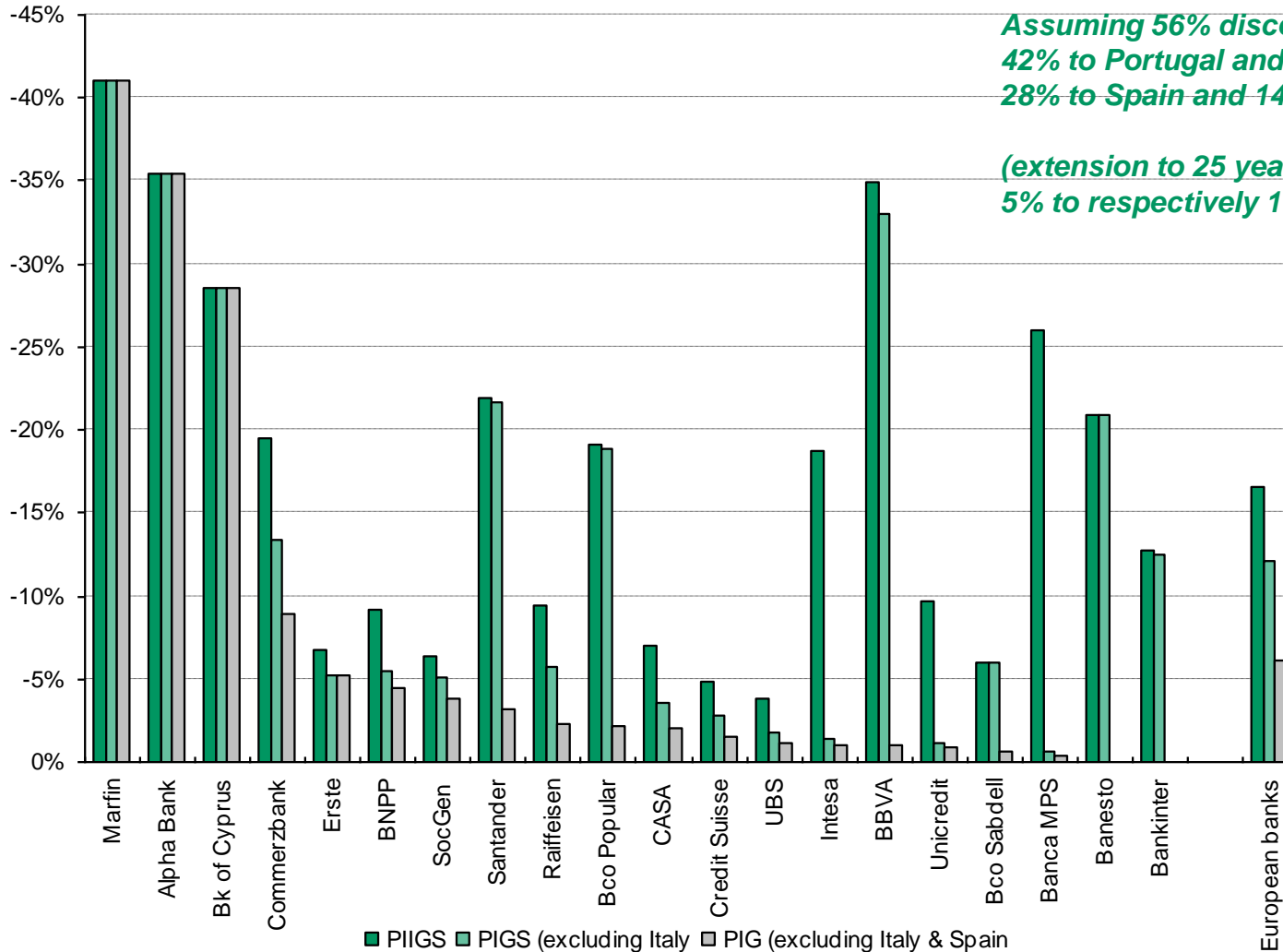


Source: banks, Cheuvreux

Worst case scenario for EZ gvt debt



European banks: worst case scenario on Portugal, Ireland, Greece, Spain and Italy, % of tangible equity 2011E



Source: banks, Cheuvreux

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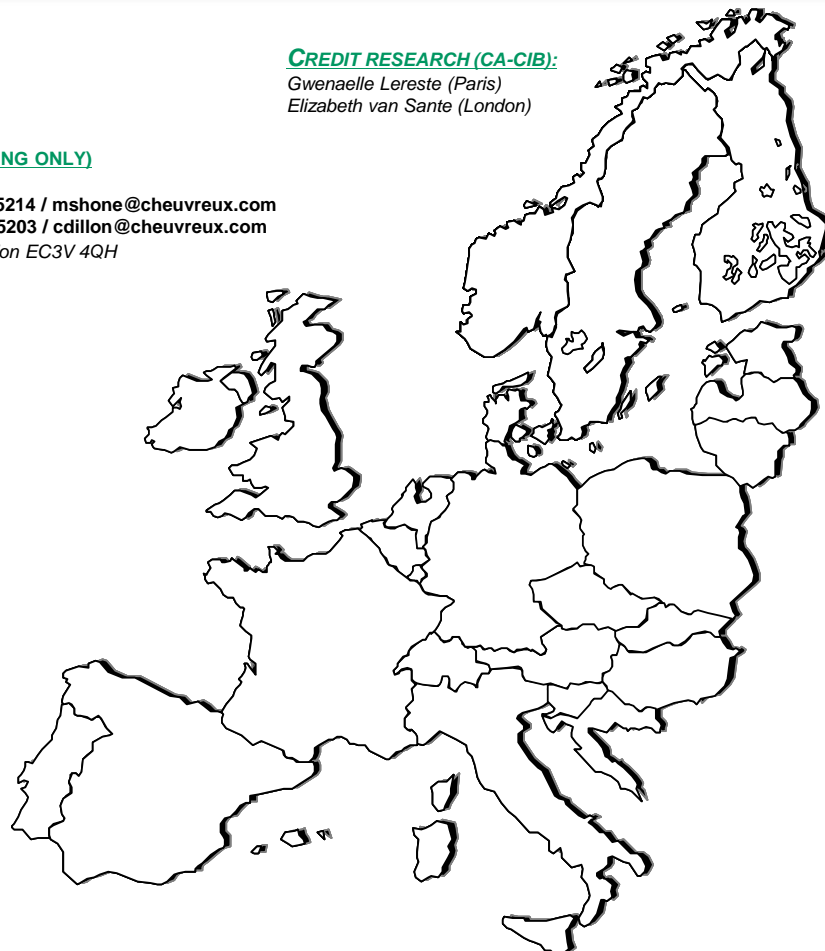
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