A&M Valuation Insights –
German vs. European Banks

May 2023

ALVAREZ & MARSAL
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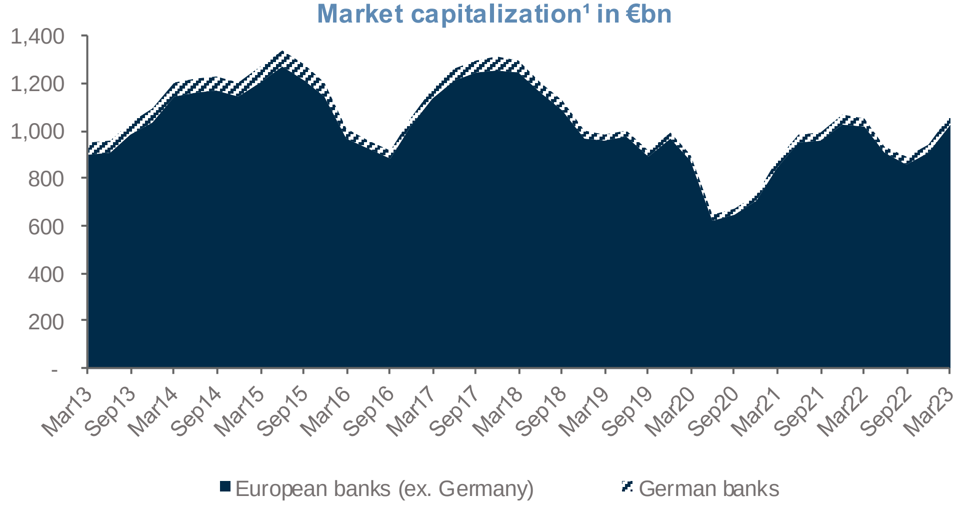
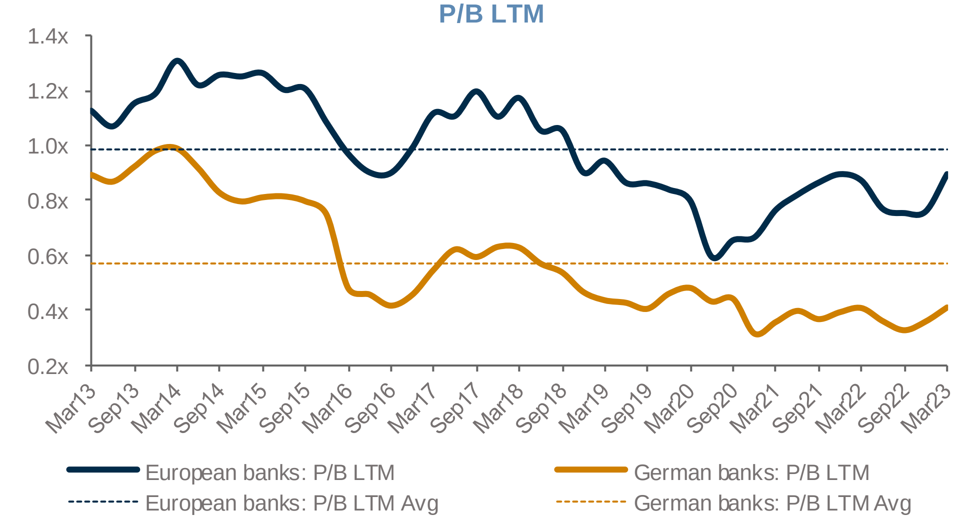
With the surge in bank stocks prior to the collapse of SVB, the implied cost of capital declines and P/B ratios show slight signs of recovery.

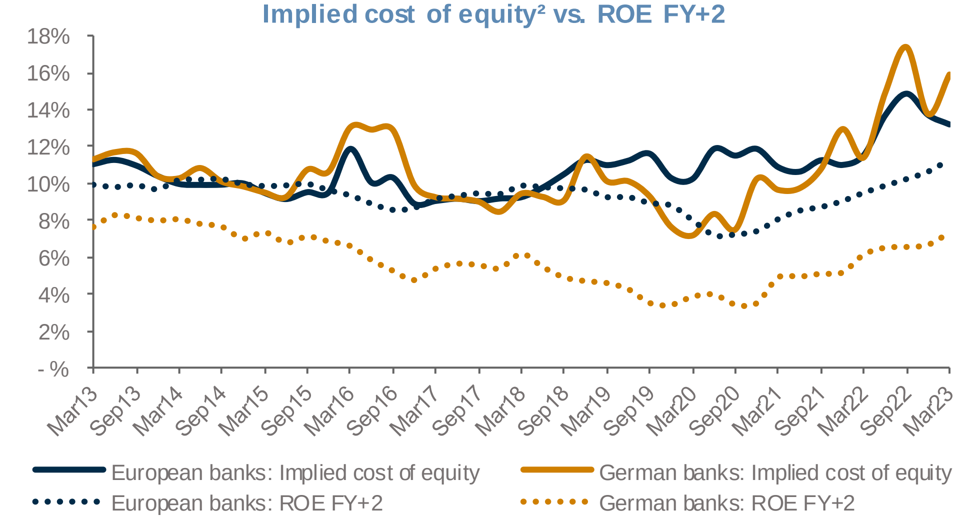
The implied cost of capital of European [German] banks declines to 13.2% [15.9%] and P/B ratios are at 0.90x [0.41x].



Source: S&P Capital IQ; A&M Analysis.
Note: (1) 60TD Avg.



Source: S&P Capital IQ; A&M Analysis.



Source: S&P Capital IQ; A&M Analysis.
Note: (2) Determined by equating market cap (60TD Avg) to consensus earnings forecasts and solving for the IRR.

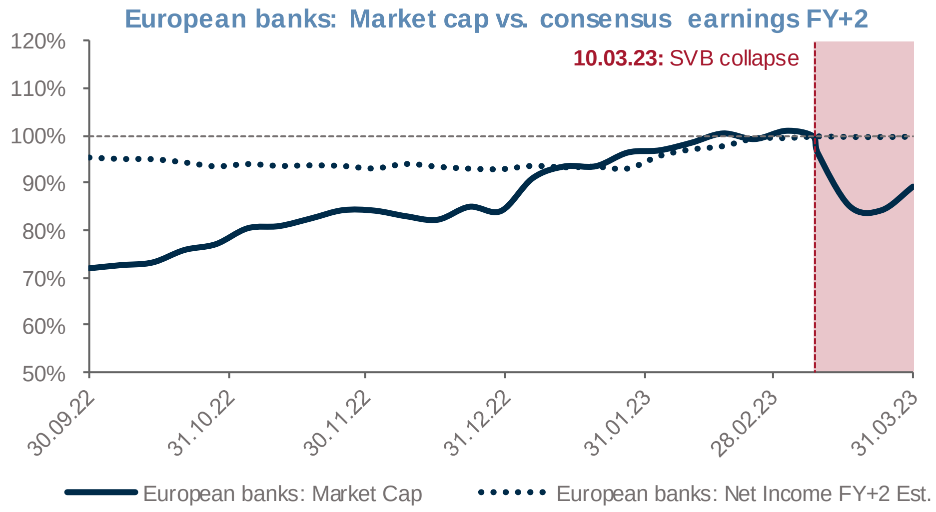
Takeaways

- Total market capitalization (60TD average) of European [German] banks came in at €1,065bn [€39bn] in Mar23, reflecting the surge in bank stocks prior to the bankruptcy of Silicon Valley Bank (SVB). In 4Q22 and 1Q23, European [German] banks outperformed [underperformed] the European [German] equity market with a total shareholder return (TSR)[3] of 26.6% [25.9%] vs. 19.3%[4] [29.2%[5]].
- The recovery in market valuations pushed the implied cost of equity from its peak of 14.8% [17.8%] in Sep22 down to 13.2% [15.9%] in Mar23. Higher ROE forecasts for the next fiscal year (FY+2) of 11.3% [7.3%] p.a. further narrowed the gap to the cost of capital.
- The lower cost of capital and higher profitability forecast translates into higher P/B ratios for European [German] banks of 0.90x [0.41x] as of Mar23, against 0.76x [0.32x] as of Sep22.

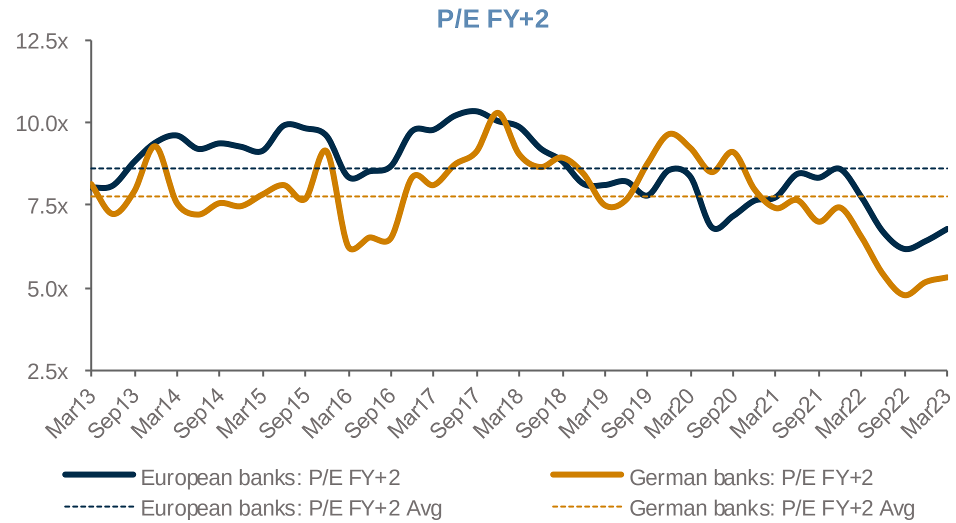
Notes: (3) Based on end-of-quarter spot prices and dividends;
(4) STOXX Europe 600; (5) CDAX.

The SVB bankruptcy resulted in a sharp drop in bank equity values, solidifying the low P/E ratios observed in the last twelve months.

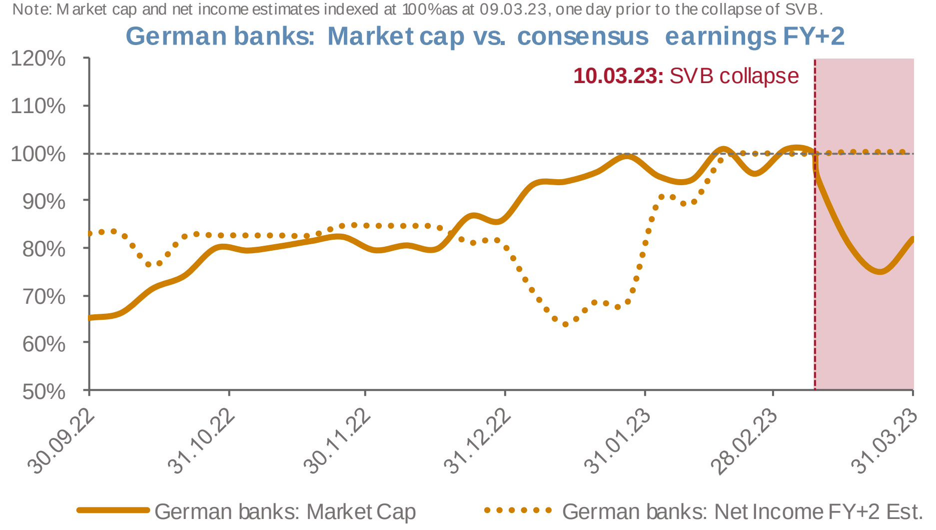
P/E ratios based on next year's earnings (FY+2) of European [German] banks stand currently at 6.8x [5.3x].



Source: S&P Capital IQ; A&M Analysis.
Note: Market cap and net income estimates indexed at 100% as at 09.03.23, one day prior to the collapse of SVB.



Source: S&P Capital IQ; A&M Analysis.



Source: S&P Capital IQ; A&M Analysis.
Note: Market cap and net income estimates indexed at 100% as at 09.03.23, one day prior to the collapse of SVB.

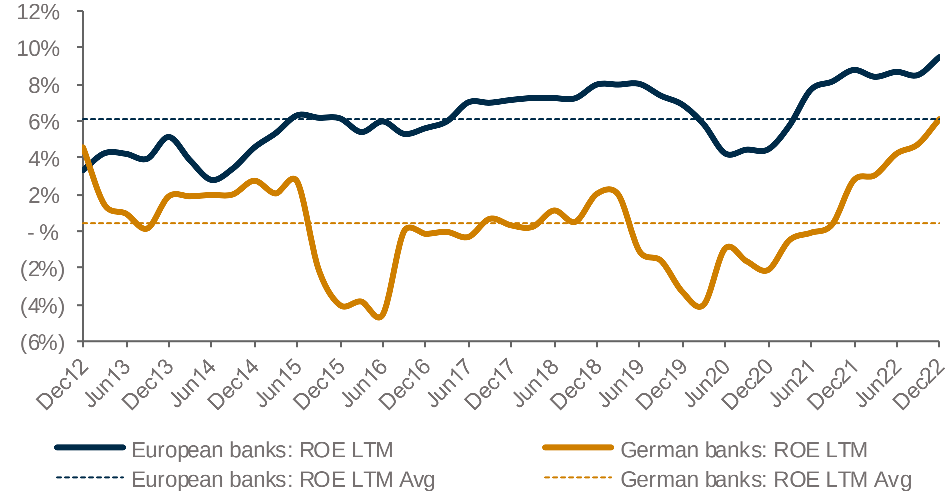
Takeaways

- After the fall of SVB (10 March 2023), European [German] banks lost 10.9% [18.1%] in market value by the end of Mar23. Consensus earnings estimates have not yet processed the recent stock market upheavals, though. Thus far, the earnings outlook for the banking sector has been stable.
- Due to the stock market rally in late 2022 and early 2023, the market cap-weighted P/E ratio based on next year's earnings (FY+2) slightly increased from its 10Y low of 6.2x [4.8x] in Sep22 to 6.8x [5.3x] in Mar23.
- Overall, the risk perception of investors remains high, which is also shown in the current level of the implied cost of capital (see previous page). Investors' fears relate to the looming recession, further losses in bond portfolios (as has been the case with SVB), and losses from banks' commercial property loans.

European banks reported record levels of profitability in Dec22 due to higher interest rates and a decline in operating costs.

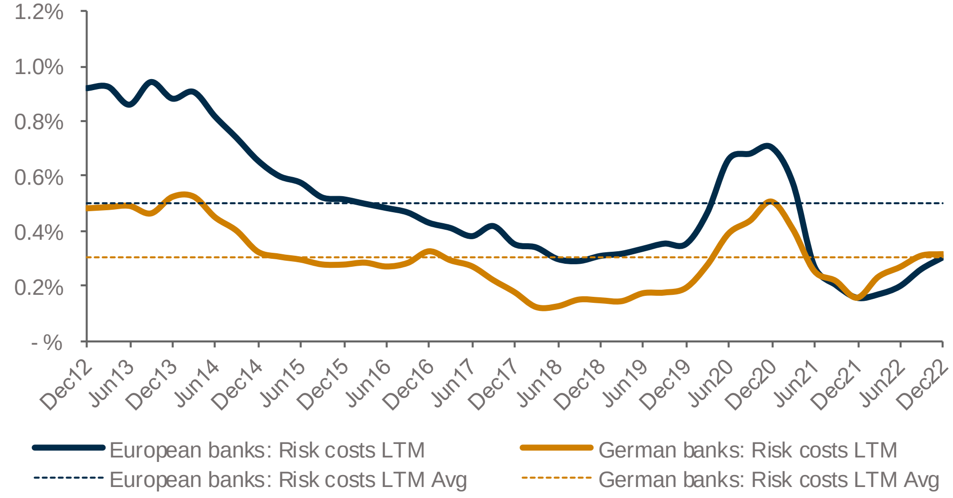
ROE for the last twelve months (LTM) increased to 8.6% [4.2%] for European [German] banks.

ROE[1] LTM



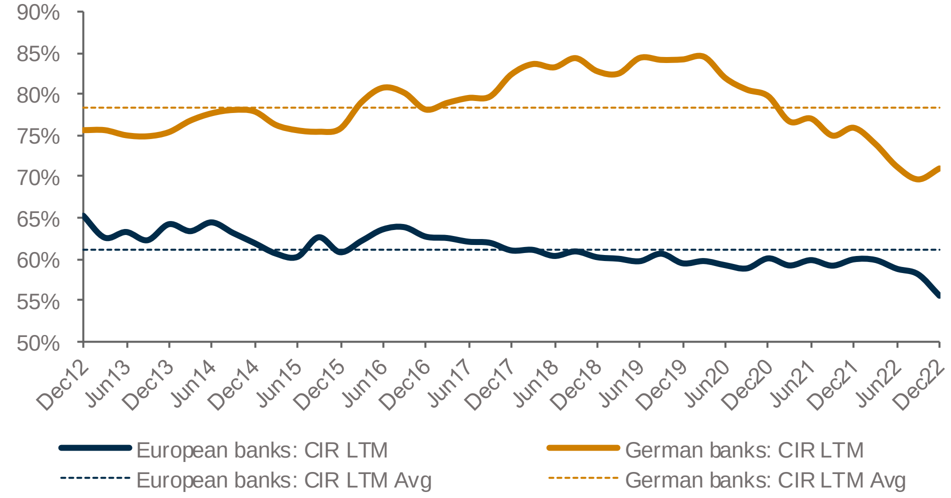
Source: S&P Capital IQ; A&M Analysis.
Note (1): Net income to common divided by average common shareholders' equity.

Risk costs[2] LTM



Source: S&P Capital IQ; A&M Analysis.
Note (2): Provision for credit losses in % of average loans.

CIR LTM



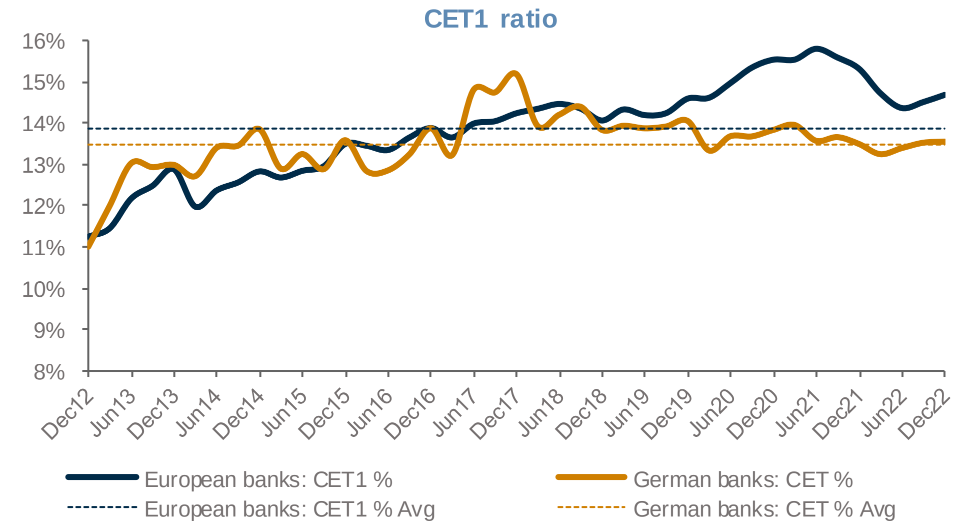
Source: S&P Capital IQ; A&M Analysis.

Takeaways

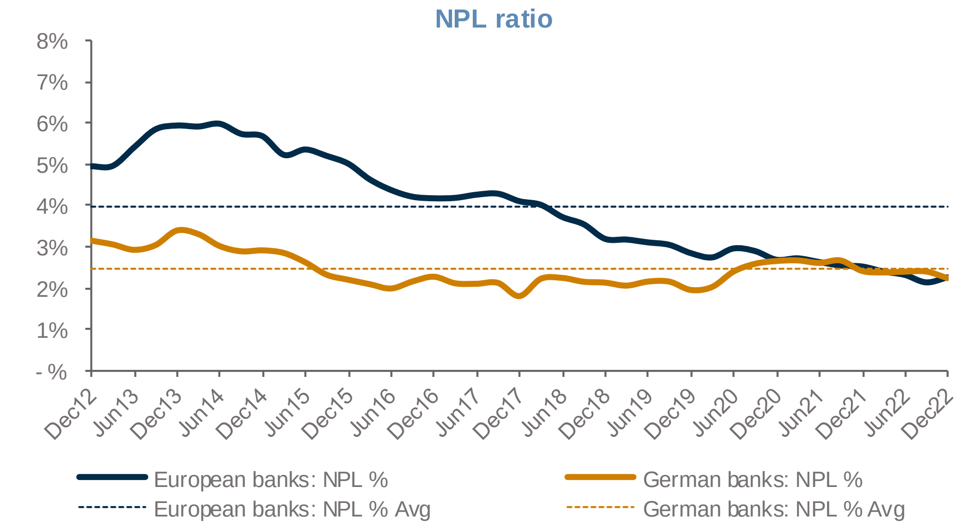
- European [German] banks reported a market cap-weighted ROE for the last twelve months (LTM) of 9.5% [6.1%] in Dec22, withstanding the challenging economic environment in 2022. This is the highest reported ROE level in 10 years.
- Deutsche Bank and Commerzbank posted their best results in 15 years mainly due to further cost savings and higher revenue from the change in the interest rate environment. Going forward, further gains are expected from higher interest rates.
- However, the market cap-weighted CIR of German banks (71.0%) still seriously lags the CIR of European banks (55.5%). Provisions for credit losses are roughly the same with 0.32% for German banks and 0.30% for European institutions. Since the beginning of the war in Ukraine, risk costs have almost doubled, but remain at a manageable level.

Capital ratios remain stable despite pricing pressures on bond portfolios.

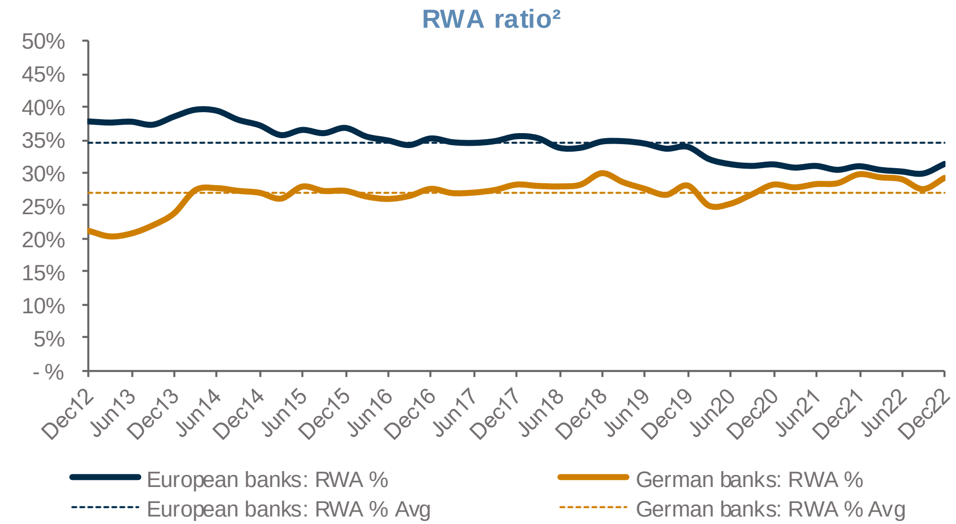
The CET1 ratio of European [German] banks stands at 14.7% [13.5%] in Dez22, slightly up from 14.4% [13.4%] in Jun22.



Source: S&P Capital IQ; A&M Analysis.



Source: S&P Capital IQ; A&M Analysis.



Source: S&P Capital IQ; A&M Analysis.

Note: (2) Risk-weighted asses in %of balance sheet total.

Takeaways

- After taking interest-driven valuation losses[1] in 1H22, the market cap-weighted CET1 ratio of European Banks slightly improved from 14.4% in Jun22 to 15.7%. Many large banks have announced dividend payouts and extensive share buybacks (subject to regulatory approval). Overall, banks' capitalization stays above regulatory and market requirements.
- The RWA ratio (risk-weighted assets in % of the balance sheet total) remained stable, as regulatory changes (IRB modelling requirements and implementation of CRR II rules), changes in securities positions and favorable exchange rate movements had an offsetting effect.

Notes: (1) Reported under other comprehensive income thus not reflected in the ROE (see previous page).

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Study design

The study is based on all listed banks in European developed markets (as defined by S&P) with a market capitalization of ≥€100m at the end of each quarter in the Mar13-Mar23 period. To counter short-term fluctuations in market value, we use the average price from a 60-trading day (TD) period throughout the study. Further criteria have been the availability of industry-specific data and analyst forecasts for the institutions considered. All financial metrics are based on IFRS. Market constituents change over time and an institution is only considered for any given quarter if it meets the selection criteria at that point in time. All data has been sourced from the S&P Capital IQ database. As of Mar23, the dataset includes 96 banks. We performed our calculations on 11 May 2023.

Financial metrics, such as ROE, are market cap-weighted and the top/bottom 5% have been trimmed. If LTM data was not available, we referred to the last FY.

Data is subject to ongoing quality assessment. As a consequence, minor adjustments could be applied to historical data as well as forecasts shown in previous issues of A&M Valuation Insights.