

Financial Institutions

Sector Review – January

1. Sector Overview

- One of the most discussed topics of January was definitely the stress tests that are going to be performed on 128 of Europe's most important banks during this year. The criteria for many of the test's aspects are still being discussed inside the European Central Bank, but there are already general concerns related with the results of the asset quality review. Many of Italy's and Holland's top banks have not been analyzed by external entities, and in these cases tests related with the asset quality may have unexpected results.
- Concerns about the credit expansion that has been taking place in China for the past 8 years have rose, as the Industrial and Commercial bank of China backed away from a \$485 million trust that it had sold to its customers. The credit created in this expansion has already a value equal to \$15 trillion and it continues to grow steadily. On par with this growth in credit, there also exists a huge growth in shadow banking activities in China, which by now are responsible for as many loans in terms of volume as the country's entire mainstream financial system. Many analysts now fear that this debt-fuelled bubble might actually be on the verge of busting.



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Financial Institutions Universe:

- Deutsche Bank
- BCP
- BNP Paribas
- HSBC
- AIG

This month's detailed company review:

- Deutsche Bank



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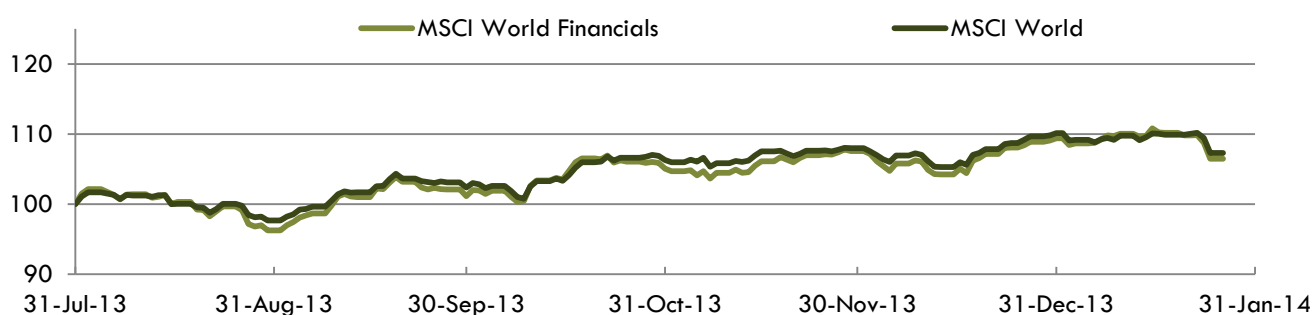


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Financial Institutions Sector vs. Overall market



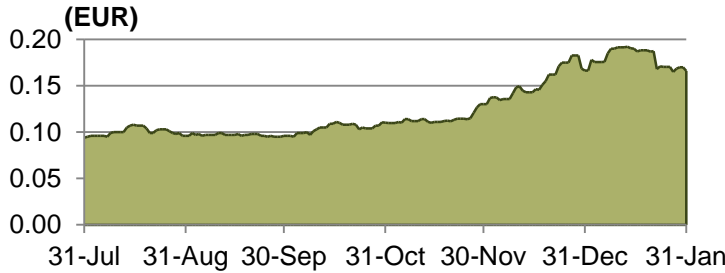
- During the considered six months period, the chosen indexes that represent both the Global Financial Institution's market and Global equity market followed a very similar path. The economic outlook for the next few months remains positive, but many important banks are going to face regulatory pressure as the stress tests to 128 European banks are about to begin. The results of these tests will be fully disclosed in October.

2. Followed Companies

BCP

(Ticker: BCP PL)

- Losses for the Portuguese bank in 2013 have fallen by 39% when compared to 2012. The announced net loss is equal to €740.5 million and it was mainly caused by impairments on bad loans and the high cost of state capitalization support. This result was slightly higher than the €730 million loss forecasted by analysts.

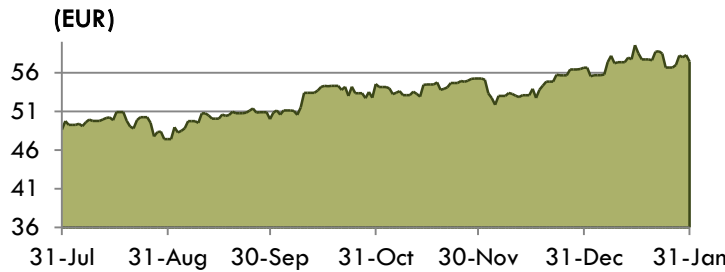


Price (EUR):	↑	0.17
Target Price (EUR):		0.19
Up/downside:		14.5%
Performance 3M:		50.6%
P/E Ratio:		N/A
ROC/WACC:		1.0x

BNP Paribas

(Ticker: BNP FP)

- At the end of January BNP Paribas dismissed a small number of employees who allegedly tried to manipulate the setting of Australia's benchmark interbank borrowing rates. In order to respond to critics coming from the Australian regulators the bank has announced that it will make a A\$ 1 million donation toward promoting financial literacy.



Price (EUR):	↑	57.45
Target Price (EUR):		63.03
Up/downside:		9.7%
Performance 3M:		5.3%
P/E Ratio:		14.1x
ROC/WACC:		0.7x

HSBC

(Ticker: HSBA LN)

- In the last Thursday of January, HSBC's shares briefly surged approximately 9.8%. This jump in price prompted a "circuit-breaker" to kick in and suspend HSBC shares from trading for five minutes, after which an orderly market in its shares resumed. Apparently the cause of this anomaly was a purchase error made by a trader.

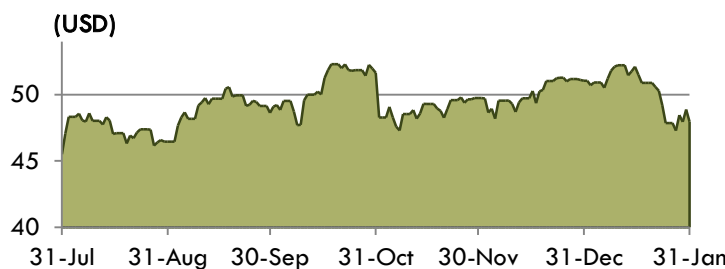


Price (GBP):	↑	6.27
Target Price (GBP):		7.73
Up/downside:		23.2%
Performance 3M:		-8.1%
P/E Ratio:		11.5x
ROC/WACC:		0.8x

AIG

(Ticker: AIG US)

- AIG's shares jumped the most in almost 8 weeks after Bank of America said it expects the insurer to buy back \$10 million of stock during the next two years. AIG expects to benefit from better underwriting and higher prices for commercial coverage and it also expects expenses to decline.

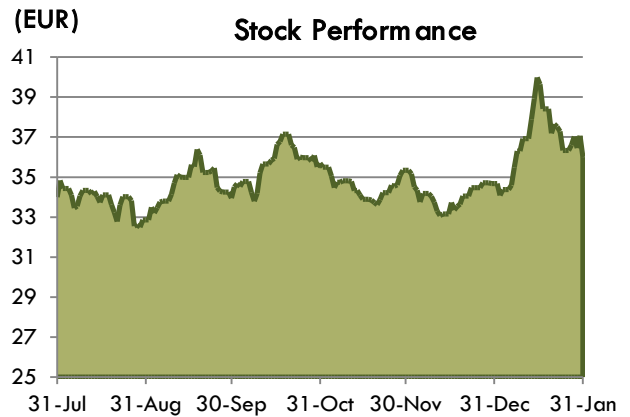


Price (EUR):	↑	47.96
Target Price (EUR):		58.00
Up/downside:		20.9%
Performance 3M:		-7.1%
P/E Ratio:		13.3x
ROC/WACC:		0.3x

3. Stock Analysis: Deutsche Bank

Corporate News

- This month, Deutsche Bank's news were dominated by the litigation concerning the LIBOR scandal and the bank's Q4 earnings. The leader in the global FX market has been under investigation for potential LIBOR rate rigging and led to setting €2.3 bn aside as legal reserves. This can partly explain the bank's €1.15 bn Q4 loss, which came as a surprise given the average analyst estimate of €628.5 million profit. Another factor is the 31% decline in debt trading, which has been one of Deutsche's main profit drivers for the past years.



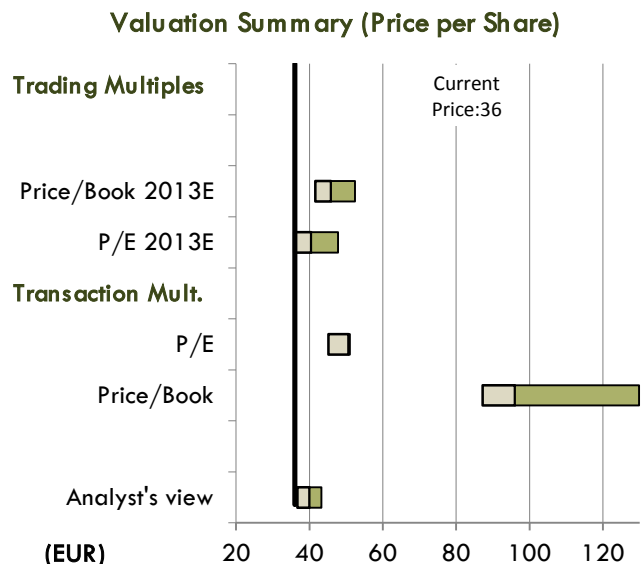
Market Performance

- Over the month of January Deutsche Bank saw its share price increase by 3.82%, from €34.38 to €36. The big surge in the first half of the month, where the stock reached a maximum of €39.98 on the 15th of January, came to a stop when news of the suspension of several employees related to the bank's involvement in the LIBOR scandal.
- The aforementioned surprising losses in the fourth quarter also had a negative impact in the firm's performance. However the 3.82% change in price was still positive when comparing to some of its European peers – HSBC (-5.34%) and BNP (1.41%).

Deutsche Bank (EUR)	
Current Price (31/01/2014)	36.00
52-week high % change	-10.2%
Median Target Price	41.08
Market Capitalisation (mn)	36,702
Return on Common Equity	-0.9%
Dividend Yield	2.1%
Beta (vs. S&P500)	1.3x
Total Debt/Equity	511.9%

Valuation Summary

- Currently priced at €36 Deutsche Bank appears to be somewhat undervalued according to every valuation metric under analysis. If we look at the analysts view we see that the consensus is that the stock is under-priced with most analysts seeing Deutsche has a buy/hold stock and valuing it at €40. When compared with its European peers, that trade at a median of 12.2x earnings and 0.8x book value, Deutsche looks cheaper given a P/E multiple of 10 and Price/Book of 0.6. One possible explanation is that the market overreacted to the negative news of the month since it actually traded at prices closer to €40 in the first half of the month.



Comparable Analysis

Company Name	Currency	MCap (mn)	Enterprise Value (mn)	Price/Book			ROE			P/E		
				LTM	2013E	2014E	LTM	2013E	2014E	LTM	2013E	2014E
Deutsche Bank	EUR	36,702	n/a	0.6x	0.6x	0.6x	-0.9%	6.2%	8.3%	24.3x	10.0x	7.3x
Credit Suisse	CHF	43,715	n/a	1.0x	1.0x	1.0x	6.5%	9.1%	10.6%	18.2x	12.4x	9.9x
UBS	CHF	69,067	191,438	1.4x	1.4x	1.4x	0.7%	6.4%	8.8%	19.6x	16.5x	14.2x
Société Générale	EUR	33,610	n/a	0.7x	0.7x	0.7x	3.1%	4.9%	7.0%	15.4x	13.7x	9.7x
Barclays	GBP	43,909	n/a	0.7x	0.8x	0.8x	1.3%	5.0%	7.9%	7.6x	10.4x	8.8x
Morgan Stanley	USD	57,393	495,510	0.9x	0.9x	0.8x	5.0%	7.5%	8.5%	14.4x	12.0x	10.0x
75th Percentile				1.0x	1.0x	0.9x	4.6%	7.2%	8.7%	19.6x	13.4x	9.9x
Median				0.8x	0.8x	0.8x	2.2%	6.3%	8.4%	18.2x	12.2x	9.8x
25th Percentile				0.7x	0.7x	0.7x	0.9%	5.3%	8.0%	14.4x	10.8x	9.0x

- Taking a closer look at the comparable firms' trading multiples, we can see that Deutsche Bank does appear to be undervalued. This especially true when we examine the P/E multiples. Trading at 10 times earnings Deutsche Bank ranks below the 25th percentile of the analyzed comparable firms (10x vs 10.8x for 2013). This is consistent with most analyst recommendations since this makes Deutsche Bank's stock relatively cheap and therefore a good investment opportunity considering that the price could be reflecting some of the negative news of the past couple of months regarding the interest rate rigging allegations. As for Price/Book ratio analysis, the low ratio could reflect the market's poor outlook on future return on assets. However, if we look at Deutsche Bank's ROE we see that it is in line with the rest of the industry, being that this could support the theory that Deutsche is currently undervalued.

Precedent Transactions

Announced Date	Target		Buyer		EV		
	Company	Country	Company	Country	(EUR mn)	P/E	Price/Book
05-Dec-13	Bank Gospodarki Zynosciowej SA	PL	BNP Paribas SA	FR	1,002	22.5x	1.1x
02-Jul-13	Bank of Ayudhya	TH	Mitsubishi UFJ Financial Group	JP	4,229	14.0x	1.5x
28-Sep-12	Denizbank AS	TR	Sberbank of Russia	RU	2,836	12.4x	1.5x
02-Nov-10	Turkiye Garanti Bankasi AS	TR	BBVA SA	SP	2,690	11.0x	1.7x
09-Oct-10	Bank Zachodni WBK SA	PL	Banco Santander SA	SP	4,207	13.9x	2.3x
09-Jun-10	Grupo Financiero Santander Mexico	MX	Banco Santander SA	SP	2,078	15.3x	2.8x
75th Percentile						14.0x	2.3x
Median						13.9x	1.7x
25th Percentile						12.4x	1.5x

- Comparing the two tables in this page we can point some apparent disparities regarding the P/E and Price/Book multiples. For instance and more interestingly, there seems to be some deviation between the trading and transaction Price/Book multiples with the median Price/Book from past deals at 1.7x while the median for trading companies is 0.8x. This has been a more recent trend in the sector, especially in Europe where most banks trade at Price/Book ratios below 1, reflecting a lack of trust by the market namely in what concerns banks' disclosure. This can be verified by the trend in the Price/Book from past transaction, which has been decreasing for the past few years.
- As mentioned before, Deutsche Bank has been suffering from this problem, being a perfect example for it. For the past two years, Deutsche has posted an average earnings surprises of 187% (absolute values) being that most have been negative. This has obviously reflected in the bank's trading multiples, which explains the relatively high values for the company's stock if we were to value it using deal multiples - €50 using P/E and €96 using Price/Book.