

# Financial Institutions

## Sector Review – February



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### Financial Institutions Universe:

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

### This month's detailed company review:

- HSBC



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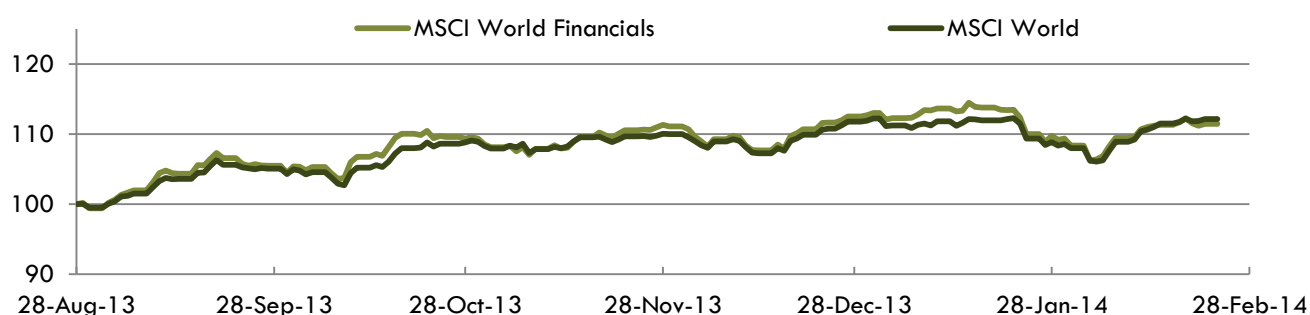
## 1. Sector Overview

- The Q4 earnings season, despite being slightly positive, has identified a few problems in the financial institutions sector. The lack of transparency regarding bank's risk exposures and financial reporting, highlighted by some very negative earnings surprises, has taken a toll on banks' valuations as investors require higher risk premia. When added to significant volatility in earnings, this also hinders analyst's ability to assess risk resulting in lower valuation multiples. Moreover, litigation, which has also contributed to lower earnings, has increased operational risk for these institutions. For instance, J.P. Morgan has increased its capital buffers – related to operational risk – from 6% in 2010 to 23% of total risk weighted assets by the end of 2013.
- Nevertheless, the efforts to meet and converge with Basel III capital requirements have undeniably strengthen investment bank's balance sheets. Problematic assets continue to decrease and some banks have significantly downsized their investment banking units. Secondly, despite the expected tapering in the US, the monetary policies being applied by central banks are still very accommodative, which has translated into more robust capital markets with more activity and significant growth. Lastly, another positive aspect may be the opportunities for long term growth in emerging markets since, for instance, equity market capitalizations are still relatively low.

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## Financial Institutions Sector vs. Overall market



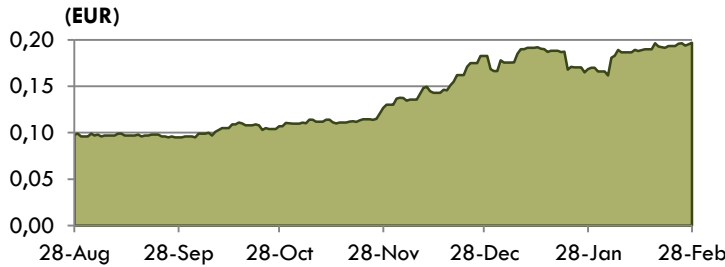
- The observed tendency in 2013 seems to have continued into 2014. The MSCI World Financials, the chosen benchmark for the covered companies, has continued to closely track the broader market, represented by the MSCI World. This has happened while the sector has undergone some pressure from the litigation trend and further capital regulation that has affected all financial institutions. However, earnings in the banking sector have increased by 26%, rebounding from Q3's poor results. Finally, the outlook for 2014 does seem positive, with loan growth and long term interest rates continuing to increase.

## 2. Followed Companies

### BCP

(Ticker: BCP PL)

- By mid-February, Millennium BCP issued a three-year €500 million senior unsecured bond, with a 3.375% coupon. The issue, the first in over 4 years, is part of the bank's financing strategy for the next couple of years and was oversubscribed by 450%, reflecting the market's positive sentiment towards the firm following BCP's Q4 earnings.

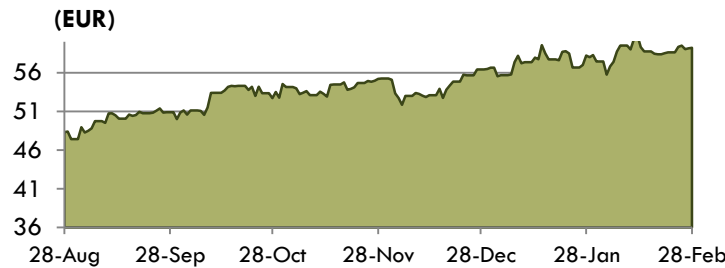


Price (EUR):	→	0,20
Target Price (EUR):		0,19
Up/downside:		-3,5%
Performance 3M:		55,4%
P/E Ratio:		N/A
ROC/WACC:		1,0x

### BNP Paribas

(Ticker: BNP FP)

- RBS announced the sale of its structured products and equity derivatives business to BNP Paribas (terms were not announced) in a deal that would transfer £15 bn of liabilities and its risk to BNP. RBS is said to be refocusing on its U.K. retail banking business while BNP continues to bet on this type of products after taking over SocGen's equity derivatives portfolio back in October.



Price (EUR):	↑	59,22
Target Price (EUR):		65,50
Up/downside:		10,6%
Performance 3M:		7,3%
P/E Ratio:		16,1x
ROC/WACC:		0,5x

### Deutsche Bank

(Ticker: DB GR)

- Litigation was still a pressing matter for DB in the month of February, this time the German bank settled a 12 year old dispute with the Kirch family for €925 million. On a different note, DB is also facing some pressure from the tighter capital rules imposed by the Fed on foreign lenders' operations in the US, which could threaten its US fixed income business.

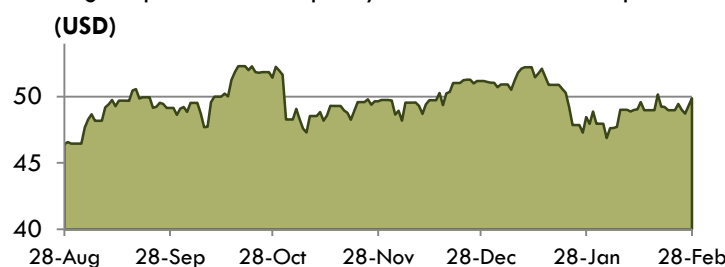


Price (EUR):	↑	35,06
Target Price (EUR):		40,70
Up/downside:		16,1%
Performance 3M:		2,4%
P/E Ratio:		32,8x
ROC/WACC:		1,4x

### AIG

(Ticker: AIG US)

- On the 14<sup>th</sup> of January, AIG reported its Q4 2013 earnings. Results were quite positive as the company announced a net income of \$1.98 bn (\$1.34 per share) for a 18.49% positive surprise. This positive figures were driven in part by AIG's Life & Retirement business, due to higher premiums and policy fees while AIG P&C performance was a bit underwhelming.



Price (USD):	↑	49,88
Target Price (USD):		58,00
Up/downside:		16,3%
Performance 3M:		0,5%
P/E Ratio:		10,9x
ROC/WACC:		0,3x

### 3. Stock Analysis: HSBC

#### Corporate News

- HSBC's full-year profit for 2013 was equal to \$22.6 billion, which represents a 9% rise when compared to the previous year (\$20.7 billion). However, this profit missed the median estimate of 30 analysts surveyed by Bloomberg. The estimate produced by this survey was \$24.6 bn and it was missed due to the fact that the cost-cutting program implemented by the bank fell short of the established targets for the year. HSBC, which gets most of its profit from Asia, is currently focusing on the most lucrative markets amid increased regulation and compliance costs.

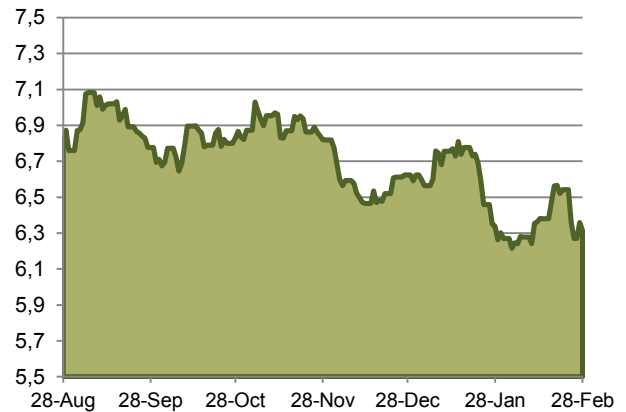
#### Market Performance

- Over the month of February HSBC saw its share price increase slightly by 0.7%, from £6.27 to £6.31. The surge that can be observed in the first 23 days of the month, where the stock reached a maximum of £6.54 on the 23<sup>rd</sup> of February, came to a stop on the following day when full year results for 2013 were released.
- The price of HSCB's stock was affected negatively by the fact that the bank missed earnings estimates posted by analysts of the sector. The 0.7% change in price is better than the negative change registered by Deutsche Bank (-2.63%) but is worst than the positive change registered by BNP Paribas (3.08%).

#### Valuation Summary

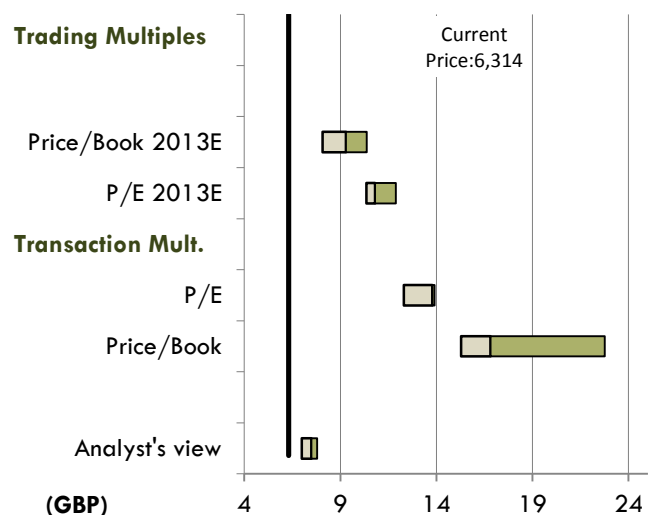
- Currently priced at £6.31 HSBC appears to be somewhat undervalued according to every valuation metric under analysis. If we look at the analysts view we see that the consensus is that the stock is slightly under-priced, with most analysts seeing HSBC has a buy/hold stock and valuing it at £7.5. When compared with its peers, that trade at a median of 10.9x earnings and 0.9x book value, HSBC looks to be almost adequately valued if it is taken into consideration its P/E multiple of 10.8x, and Price/Book multiple of 1.1x. Given the fact that HSBC's profitability is growing fairly fast due to the implementation of the cost-cutting program, the value of its shares should adjust in the near future to reflect the correct valuation.

#### (GBP) Stock Performance



HSBC (GBP)	
Current Price (28/02/2014)	6,31
52-week high % change	-99,2%
Median Target Price	7,28
Market Capitalisation (mn)	119.047
Return on Common Equity	8,9%
Dividend Yield	5,5%
Beta (vs. S & P 500)	1,3x
Total Debt/Equity	201,5%

#### Valuation Summary (Price per Share)



## Comparable Analysis

Company Name	Currency	MCap (m n)	e Value (m n)	Price/Book			ROE			P/E		
				LTM	2013E	2014E	LTM	2013E	2014E	LTM	2013E	2014E
HSBC	GBP	119.047	n/a	1,1x	1,1x	1,0x	8,9%	10,3%	10,8%	11,9x	10,8x	9,6x
Credit Suisse	CHF	44.497	n/a	1,0x	1,0x	0,9x	6,2%	9,8%	11,0%	14,3x	10,3x	8,8x
UBS	CHF	72.369	181.076	1,5x	1,4x	1,4x	8,2%	8,5%	11,1%	16,6x	15,8x	12,0x
Société Générale	EUR	38.642	n/a	0,8x	0,8x	0,7x	4,1%	7,2%	8,0%	15,4x	11,0x	9,3x
Barclays	GBP	40.593	n/a	0,8x	0,7x	0,7x	1,0%	7,9%	9,7%	13,2x	8,7x	7,1x
Morgan Stanley	USD	60.442	484.384	0,9x	0,9x	0,8x	4,5%	7,5%	8,6%	14,9x	12,3x	10,3x
75th Percentile				1,1x	1,0x	1,0x	7,7%	9,5%	10,9%	14,9x	12,0x	10,1x
<b>Median</b>				<b>1,0x</b>	<b>0,9x</b>	<b>0,9x</b>	<b>5,3%</b>	<b>8,2%</b>	<b>10,2%</b>	<b>14,3x</b>	<b>10,9x</b>	<b>9,5x</b>
25th Percentile				0,9x	0,8x	0,8x	4,2%	7,6%	8,8%	13,2x	10,4x	9,0x

- Taking a closer look at the comparable firms' trading multiples, we can see that HSBC's valuation is in the same range of its most direct competitors. Trading at 10.8 times earnings HSBC is very close to the rest of the analyzed comparable firms (10.8x vs. 10.9x for 2013). The same conclusion can be reached if a Price/Book ratio analysis is performed. The biggest discrepancy between HSBC and its counterparts can be observed in the value of ROE. The value of ROE for HSBC is equal to 10.3%, which is moderately higher than the median value of the industry, which is 8.2%. The observed discrepancy can be explained by the now well-known cost cutting program that is being implemented. As part of this program, the bank has already cut approximately 40000 jobs and disposed of 60 businesses, which operated on non-core areas of the firm. In the near future HSBC's ROE is expected to grow to values ranging between 12% and 15%.

## Precedent Transactions

Announced Date	Target		Buyer		EV (EUR mn)	P/E	Price/Book
	Company	Country	Company	Country			
05-Dec-13	Bank Gospodarki Zydnościowej 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
<b>Median</b>						<b>13.9x</b>	<b>1.7x</b>
25th Percentile						12.4x	1.5x

- By comparing the two tables in this page we can point some apparent disparities regarding the P/E and Price/Book multiples. More interestingly, there seems to exist a significant deviation between the trading and transaction Price/Book multiples. The median Price/Book from past deals is equal to 1.7x while the median for trading companies is only 0.9x. This difference between the two ratios 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. Probably this lack of trust has been created by recent scandals in the sector and persistent negative surprises related with earnings announcements.
- HSBC can be considered a good example of this recent trend. The bank has had lower profitability than expected mainly due to the European business, which has been a drag in the past year. This has obviously been 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 – £13.8 using P/E and £16.8 using Price/Book.