

# Financial Institutions

## Sector Review – March



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### 1. Sector Overview

- In the past few weeks, more concerns have been raised concerning the size of the credit expansion in China, which does not show any significant signs to slow down. These concerns have been sparked by the recent spike in bad loans, which has led the bad-loans ratio to hit a two-year high. The loans which are being considered more problematic are the ones that are being conceded to the local government and to troubled industries. In order to assess the size of the risks that are being created by this issue, the China Banking Regulatory Commission (CBRC) has already stated the intent to perform bank stress tests. All the supervisory departments of this organization are going to have the task of organizing banking stress tests in a timely manner so that the impact of unfavorable situations in individual banks and on the banking system as a whole can be evaluated. The Chinese regulator has also urged banks operating in the country, to make emergency plans.
- The world's \$87 trillion asset management industry has also recently started to generate concerns. According to Andy Haldane, director of financial stability at the Bank of England, this industry is getting riskier and is starting to show some of the "too big to fail" risks that are already being addressed at banks. Despite this fact, the sector is already lobbying against possible rules that may subject funds over \$100 billion to extra supervisory requirements.

#### Financial Institutions Universe:

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

#### This month's detailed company review:

- AIG



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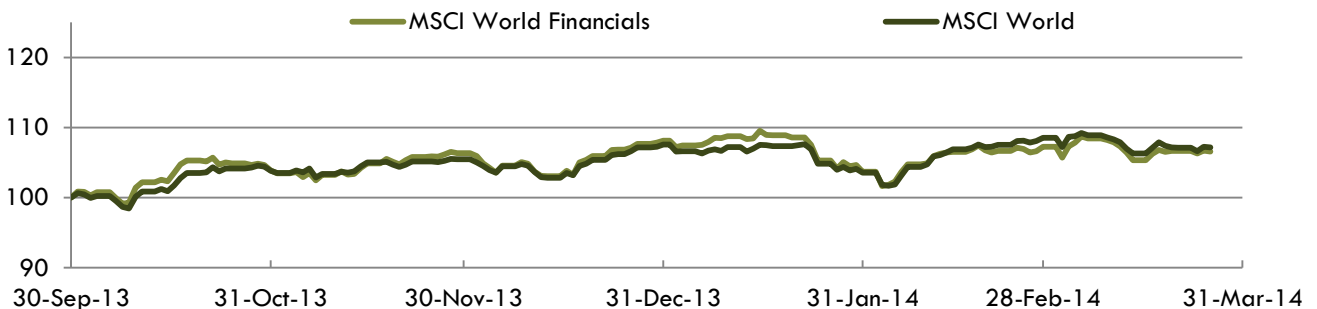


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### Financial Institutions Sector vs. Overall market



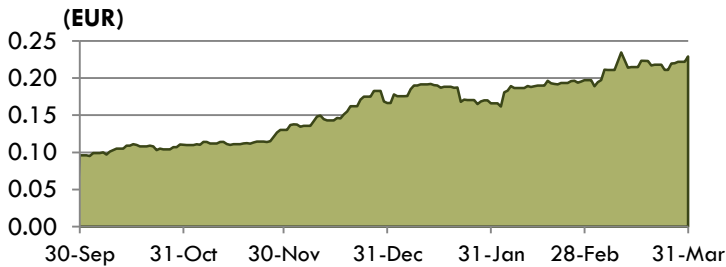
- The tendency observed in the end of last year and on the beginning of 2014 seems to have continued in March. The MSCI World Financials, the chosen benchmark for the covered companies, has continued to closely track the broader market, represented by the MSCI World. The balance sheets of most financial institutions finally seem to be stable and revenues in many different industries have started to pick, which means that there seems to exist opportunities for the financial institutions sector as a whole to grow in the near future.

## 2. Followed Companies

### BCP

(Ticker: BCP PL)

- In the past month there have been rumors that the Portuguese Finance Minister, Maria Albuquerque, is seriously pondering on allowing Portuguese banks aided by funds provided by the state, to convert deferred taxes into fiscal credit. This conversion would result in a significant increase of BCP's core capital.

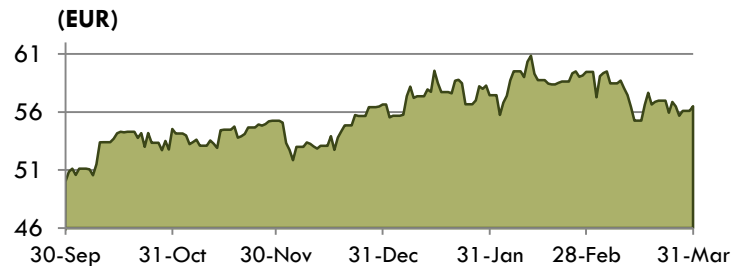


Price (EUR):	↓	0,23
Target Price (EUR):		0,20
Up/downside:		-14,0%
Performance 3M:		37,7%
P/E Ratio:		n/a
ROC/WACC:		0,1x

### BNP Paribas

(Ticker: BNP FP)

- In response to the recent crisis in Ukraine, BNP Paribas has announced the intention to shut down 84 of its branches in that country until 2015. Although the bank is effectively pulling back from Ukraine, it still maintains its interest towards the region of Central and Western Europe. Future expansions in Poland and Turkey are already being planned.



Price (EUR):	↑	56,50
Target Price (EUR):		65,00
Up/downside:		15,0%
Performance 3M:		-0,3%
P/E Ratio:		15,3x
ROC/WACC:		0,5x

### Deutsche Bank

(Ticker: DB GR)

- Regulator pressure created by the recent interest rate scandal in which Deutsche Bank was directly involved, has led the bank's global head of compliance Andrew Procter to leave the institution. Although this departure has appeased the German regulator Bafin, this entity still thinks that consequences for the senior personnel of the bank following the scandal were too small.

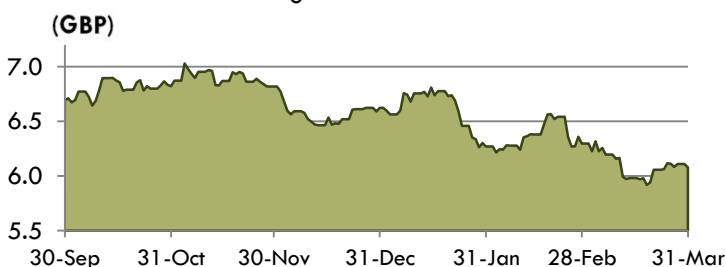


Price (EUR):	↑	32,82
Target Price (EUR):		40,00
Up/downside:		21,9%
Performance 3M:		-4,8%
P/E Ratio:		42,5x
ROC/WACC:		0,5x

### HSBC

(Ticker: HSBA LN)

- Right before the end of the month, a U.S. independent compliance monitor has warned HSBC that it needs to further upgrade its anti-money laundering systems. This assessment comes two years after HSBC entered into a deferred prosecution agreement as part of the \$1.9 billion settlement over allegations that involved the violation of anti-money laundering laws.



Price (GBP):	↑	6,08
Target Price (GBP):		7,00
Up/downside:		15,2%
Performance 3M:		-8,2%
P/E Ratio:		12,0x
ROC/WACC:		0,7x

### 3. Stock Analysis: AIG

#### Corporate News

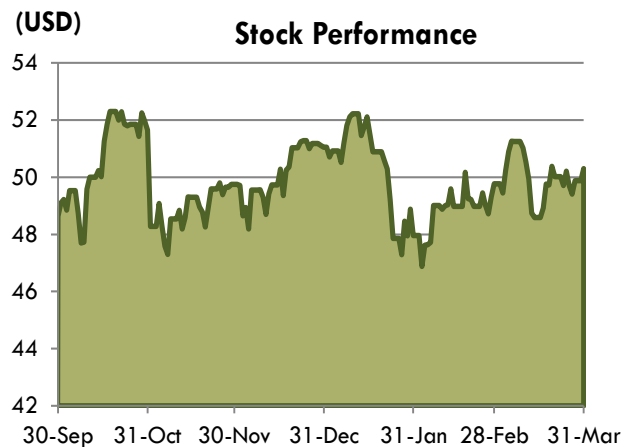
- On the 13<sup>th</sup> of February, AIG posted its \$2 billion earnings, representing \$1.34 EPS (diluted), a significant improvement on last year's \$4 billion loss (2.68 EPS loss). This represented a positive surprise of 5.01% on the analysts predictions, which may have been due to some expectations management done by AIG, in the sense that Bob Benmosche hinted that AIG might not reach some of its goals some time ago. AIG is an interesting case in this last aspect, given that it has consistently reported positive surprises over the last two years, indicating that market expectations still reflect a negative sentiment due to the mismanagement during the financial crisis, which could also explain its relative undervaluation.

#### Market Performance

- Over the past month, AIG's stock price has remained mostly unchanged at around \$50 per share. However, if we take a wider time horizon we can see a surge from the end of January (\$48) until mid-march when it reached a maximum of \$51.71, translating the positive earnings announcement.
- Moreover, over the last 52 weeks we can see that the stock is close to 6% below its maximum, and if we look to the stock performance chart, we quickly see the tendency in the price movement of not straying too far from the \$49.29 average, with the spikes revealing the earning announcements and the market consistently lowering the valuation back to the average, or even lower to \$48.

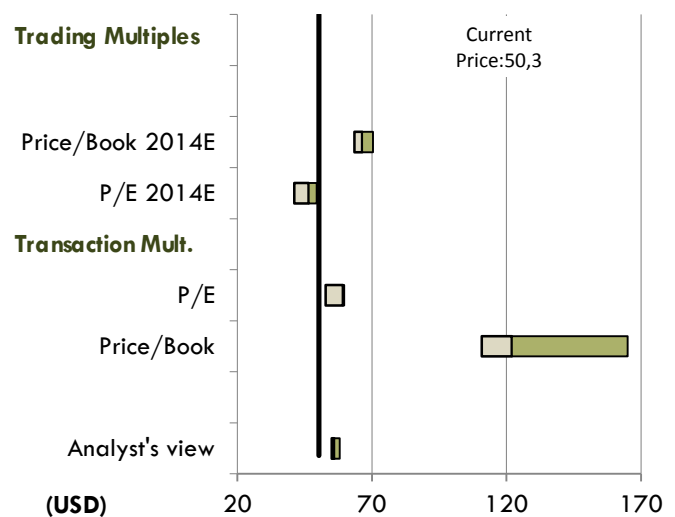
#### Valuation Summary

- AIG is currently priced at \$50.3, which seems to be somewhat close to its full valuation under the different metrics in analysis, but is still undervalued. The only metric where this does not seem to be true is for the trading P/E multiples. Nevertheless, this may indicate a possible underestimation of future earnings, as AIG has consistently shown over the past two years. The analysts in the industry value AIG at an average of \$56 per share. This goes back to the question of the possible remnants of the effect of the financial crisis on the price, pushing it down, but also the positive effect of an increasing interest rate environment on insurance companies, due to the effect on future claims, improving ROE.



AIG (USD)	
Current Price (31/03/2014)	50,30
52-week high % change	-5,7%
Median Target Price	56,39
Market Capitalisation (mn)	73.643
Return on Common Equity	9,2%
Dividend Yield	0,6%
Beta (vs. S&P500)	1,6x
Total Debt/Equity	41,2%

#### Valuation Summary (Price per Share)



## Comparable Analysis

Company Name	Currency	MCap (mn)	Enterprise Value (mn)	Price/Book			ROE			P/E		
				LTM	2013E	2014E	LTM	2013E	2014E	LTM	2013E	2014E
<b>AIG</b>	USD	73.643	113.736	0,7x	0,7x	0,7x	9,2%	6,5%	7,0%	11,0x	11,7x	10,1x
Metlife	USD	59.920	82.082	1,0x	0,9x	0,9x	5,3%	11,4%	11,4%	9,5x	9,3x	8,7x
AXA	EUR	45.968	37.178	0,9x	0,9x	0,8x	8,3%	9,6%	9,8%	10,0x	9,0x	8,5x
Zurich	CHF	40.130	52.851	1,4x	1,4x	1,3x	12,0%	12,1%	12,5%	11,3x	11,2x	10,4x
Goldman Sachs	USD	76.574	520.018	1,1x	1,0x	0,9x	11,0%	10,1%	10,2%	9,6x	10,6x	9,8x
Morgan Stanley	USD	60.968	484.910	1,0x	0,9x	0,8x	4,5%	7,4%	8,5%	15,0x	12,7x	10,6x
75th Percentile				1,1x	1,0x	0,9x	10,5%	11,1%	11,1%	11,2x	11,6x	10,4x
<b>Median</b>				<b>1,0x</b>	<b>0,9x</b>	<b>0,9x</b>	<b>8,7%</b>	<b>9,9%</b>	<b>10,0%</b>	<b>10,5x</b>	<b>10,9x</b>	<b>10,0x</b>
25th Percentile				0,9x	0,9x	0,8x	6,1%	8,0%	8,8%	9,7x	9,7x	9,0x

- The table above shows the appropriate comparable companies for AIG. As you can see, these include other insurance companies such as Metlife, AXA and Zurich. In a general sense, the multiples in this sector do not vary that much from the rest of the financials industry. Concerning Price/Book ratios, the main valuation metric for insurance companies, AIG seems somewhat undervalued when compared to its peers, trading at 70% of its book value, whereas the comparable firms trade at 90%. The benefits of the aforementioned interest rate environment, management's ability to cut expenses and improve profit margins on the P&C segment and the regaining of the market's confidence should bring its valuation up. If we look at P/E multiples we arrive at the contrary conclusion. However, as we have pointed out before this can be attributed the low earnings expectations of the market for the firm – AIG 11,0x earnings vs 10,5x of average of its peers.

## 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

- Before we analyze the precedent transaction multiple table we should note that, much like in the previous reports it did not suffer a lot of alterations, despite having technically changed industry from banking to insurance. However, we searched for relevant deals in the sector and found that the multiples were actually not that different (e.g. Travelers-Dominion of Canada deal) and therefore could use the multiples presented above, since the P/E and Price/Book multiples of transactions are quite difficult to obtain. Nevertheless, in order to avoid the extrapolation and misuse of data we will not perform a detailed analysis of the figures above.