

# Financial Institutions

## Sector Review – April



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### 1. Sector Overview

- Recently, the release of U.S. economy data has been the main talking point in the markets. The growth rate for the U.S. GDP for Q1 was marginally positive, at 0.1% growth, while most analysts were predicting 1.1%. Behind these numbers came one of the coldest winters on record, being that healthcare spending was the main driver of growth, which puts into question whether output will be able to meet Federal Reserve’s expectations for the rest of 2014 (2.9% growth). This could potentially impact the FED’s monetary policy, in the sense that it could imply a tapering to stop in order to protect the economy. However, the FED ignored these figures, arguing that it still believes that the economy is still on track to recovery and actually reduced its asset purchases by another \$10 billion, to \$45 billion a month.
- In the investment banking sector, global Mergers & Acquisitions activity has been increasing, with deal volume up 33.2% from \$449.6 billion (2013 Q1) to \$599.1 billion. The increase has been led by some large deals, with emphasis on the TMT and Healthcare sectors, (\$10+ billion) that reached \$318.6 billion (2014 YTD), when compared with 2013’s volume of \$182.1 billion (13 vs 7 deals). The technology sector M&A volume has also been following a positive trend, reaching the highest Q1 volume since 2000 (\$93.7 billion), highlighted by Facebook’s \$19.4 billion acquisition of WhatsApp.

#### Financial Institutions Universe:

- Bank of America
- BCP
- BNP Paribas
- AIG
- HSBC

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

- Bank of America



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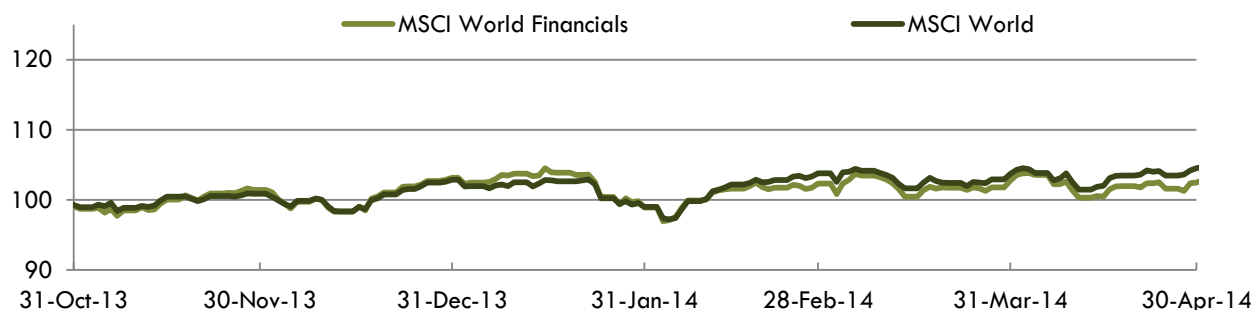


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### 2. Financial Institutions Sector vs. Overall market

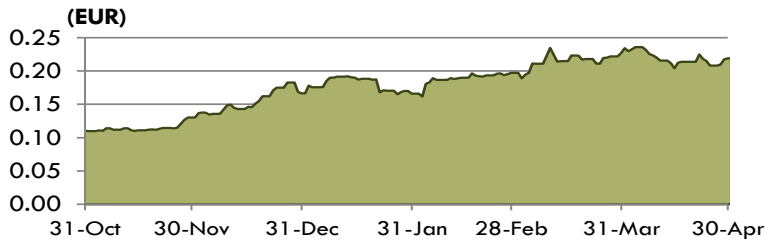


- In the month of April we can observe a slight negative deviation of the MSCI World Financials to the MSCI World Index, which over the past year has closely tracked the broader market. Taking a longer horizon perspective, we can see that, throughout 2014, the financial sector has underperformed, which goes against expectations. One possible reason to explain this is the fact the companies represented by the MSCI World Financials have been under severe regulatory pressure, with multiple lawsuits, fines and sanctions (Credit Suisse, BofA, BNP Paribas, Deutsche, etc.) over the analyzed period, which would reflect in poorer returns.

### 3. Followed Companies

#### BCP (Ticker: BCP PL)

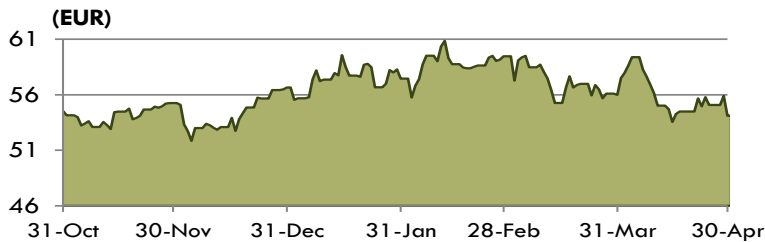
- Bank Millennium, Millennium BCP's most lucrative international unit, has reported earnings of 156.4 million zlotys (€37.2 million) in the first quarter of 2014. This represents an increase of 30% in the first quarter and a slightly positive surprise (0.77%). In this period, the bank's net interest rate spread increased 23.4% (yoy) while net bank fees improved 3.1% (yoy).



Price (EUR):	↓	0.22
Target Price (EUR):		0.20
Up/downside:		-8.7%
Performance 3M:		31.9%
P/E Ratio:		n/a
ROC/WACC:		0.1x

#### BNP Paribas (Ticker: BNP FP)

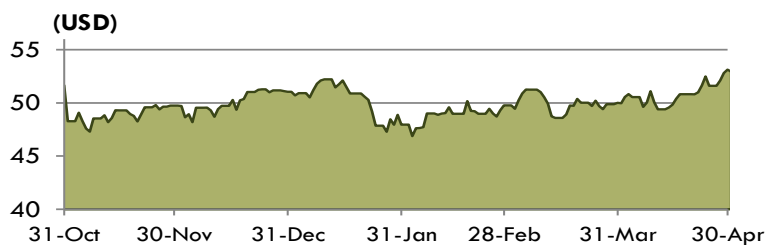
- On Wednesday, April 30th, BNP Paribas announced that penalties for a number of dollar payments involving "countries, persons and entities that could have subject to economic sanctions under U.S. law" for its U.S. branches, could be "far in excess" of the \$1.1 billion provision set in 2009. On these negative news, the bank's stock price fell by 3.4% to €54.



Price (EUR):	↑	54.11
Target Price (EUR):		64.00
Up/downside:		18.3%
Performance 3M:		-5.8%
P/E Ratio:		13.9x
ROC/WACC:		0.4x

#### AIG (Ticker: AIG US)

- In the beginning of April, AIG chairman Steve Miller addressed shareholders saying that the insurance company will have to do more in order to convince Wall Street of its true value and to recapitalize the firm after the 2008 losses. AIG is trading at around 76% of book value, considerably lower than its peers, as we have highlighted in last month's report.



Price (USD):	↑	52.94
Target Price (USD):		56.00
Up/downside:		5.8%
Performance 3M:		10.4%
P/E Ratio:		11.6x
ROC/WACC:		0.3x

#### HSBC (Ticker: HSBA LN)

- Much like BNP Paribas's Bank of the West, HSBC has also been under the U.S. Justice Department's attentive watch. The bank will have to improve its anti-money laundering and sanctions compliance programs, as part of \$1.9 billion agreement to avoid money laundering charges, related to wire transfers and purchases from HSBC Mexico.



Price (GBP):	↑	6.07
Target Price (GBP):		6.90
Up/downside:		13.6%
Performance 3M:		-3.1%
P/E Ratio:		12.2x
ROC/WACC:		0.8x

## 4. Stock Analysis: Bank of America

### Corporate News

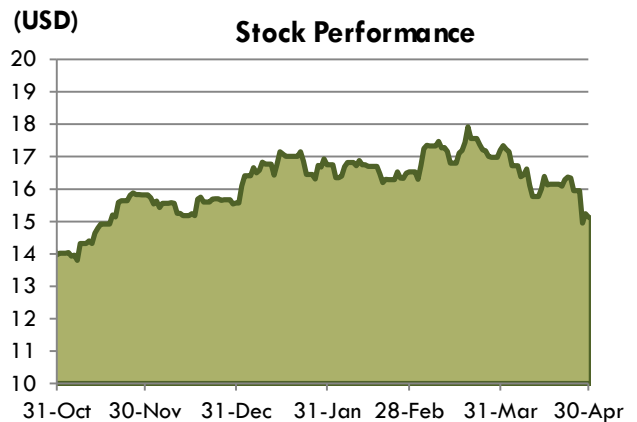
- Bank of America is on the early stages of negotiating a \$22.5 billion settlement with the Justice Department of the United States of America. \$9.5 billion out of this total amount are going to be paid to the Federal Housing Finance Agency as a compensation for the losses created by the issuance of mortgage-backed bonds before the financial crisis. The other \$13 billion are going to be paid as penalties to the U.S. government. The total amount which is potentially going to be paid by Bank of America, far exceeds the total \$16 billion that Wall Street analysts had predicted using J.P. Morgan Chase's settlement.

### Market Performance

- Over the past month, Bank of America's stock price has declined from \$17.34 to \$15.09. Part of this decline can definitely be attributed to the negative news related to the size of the settlement that is going to be reached with the U.S. Justice department. The fact that there still does not exist a final settlement is going to continue creating a negative pressure on the price of the stock.
- Moreover, over the last 52 weeks we can see that the stock is close to 16.3% below its maximum. The decline on the price of the stock can also be explained by the recent embarrassing accounting error that has been discovered at the end of April. Due to a miscalculation on a measure of capital present in its books, Bank of America has reached the conclusion that the capital level is actually \$4 billion lower than what was initially thought.

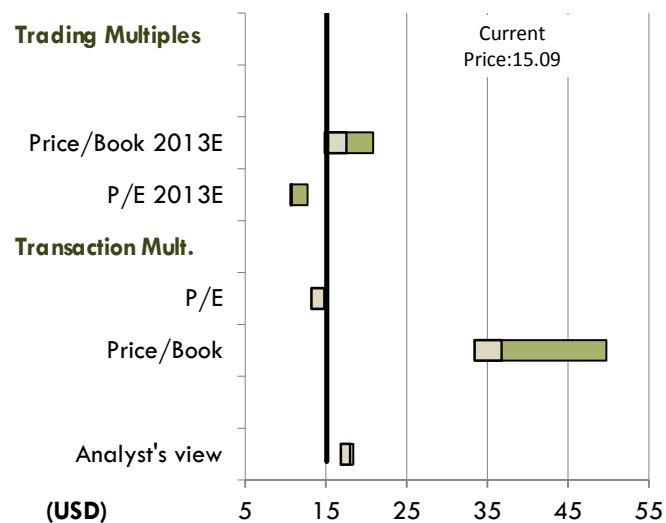
### Valuation Summary

- Bank of America is currently priced at \$15.09, which seems to be somewhat close to its full valuation under the different metrics in analysis. The only metric where this does not seem to be true is for the trading P/E multiples. The analysts in the industry value Bank of America at an average of \$18 per share. The current undervaluation of Bank of America's stock when compared to the price established by analysts may reflect the most recent accounting mistake made by the bank. Although this mistake has led to the suspension of the share buyback and dividend raise, it is still not clear if it is going to have any relevant effect on the earnings of the period.



Bank of America (USD)	
Current Price (01/05/2014)	15.09
52-week high % change	-16.3%
Median Target Price	17.83
Market Capitalisation (mn)	159,207
Return on Common Equity	3.9%
Dividend Yield	0.3%
Beta (vs. S&P500)	1.6x
Total Debt/Equity	248.1%

### Valuation Summary (Price per Share)



## Comparable Analysis

Company Name	Currency	MCap (mn)	Value (mn)	Price / Book			ROE			P / E		
				LTM	2013E	2014E	LTM	2013E	2014E	LTM	2013E	2014E
<b>Bank of America</b>	USD	159,207	n/a	0.7x	0.7x	0.7x	3.9%	4.9%	7.3%	10.2x	14.9x	9.7x
Deutsche Bank	USD	44,695	n/a	n/a	0.6x	0.5x	0.2%	5.1%	7.9%	n/a	9.5x	6.6x
J.P. Morgan	USD	211,732	n/a	1.0x	1.0x	0.9x	7.6%	10.4%	10.6%	8.9x	10.0x	9.1x
Citigroup	USD	145,085	775,836	0.7x	0.7x	0.6x	6.9%	7.2%	7.6%	9.6x	9.9x	8.7x
Goldman Sachs	USD	74,876	518,320	1.1x	1.0x	0.9x	11.0%	10.3%	10.3%	9.7x	10.2x	9.6x
Morgan Stanley	USD	61,733	485,675	1.0x	0.9x	0.9x	4.5%	7.6%	8.6%	14.6x	12.5x	10.6x
75th Percentile				1.0x	1.0x	0.9x	7.4%	9.6%	9.9%	10.2x	11.9x	9.6x
<b>Median</b>				<b>1.0x</b>	<b>0.8x</b>	<b>0.8x</b>	<b>5.7%</b>	<b>7.4%</b>	<b>8.3%</b>	<b>9.7x</b>	<b>10.1x</b>	<b>9.3x</b>
25th Percentile				0.7x	0.7x	0.6x	4.0%	5.6%	7.7%	9.6x	10.0x	8.8x

- The table above shows the appropriate comparable companies for Bank of America. Concerning Price/Book ratios, Bank of America seems undervalued when compared to its peers, trading at 70% of its book value, whereas the comparable banks trade at 80%. This undervaluation may be a consequence of the disruption created by the miscalculation of a measure of capital existent in the books of Bank of America. If we look at P/E multiples we arrive at the contrary conclusion. It is possible that the overvaluation seen in the P/E multiple is being created by a negative expectation for the earnings. The most recent weeks have proven difficult for Bank of America, which as it has already been mentioned is facing the payment of a very significant settlement and has also incurred on a polemic accounting error. Probably these two events have created a negative expectation for the earnings, which is raising the current P/E multiple for the firm.

## Precedent Transactions

Announced Date	Target		Buyer		EV (EUR mn)	P/E	Price/Book
	Company	Country	Company	Country			
05-Dec-13	Bank Gospodarki Zydnowsciovej 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

- Similarly to what happened in the previous months, there have not existed any significant transactions in the sector during April. 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 0.8x. This difference between the two ratios, where most banks trade at Price/Book ratios below 1, may reflect a lack of trust by the market namely in what concerns banks' disclosure.
- Bank of America can be considered a good example of the lack of trust that currently affects financial institutions. The fact that the Bank is going to pay an enormous amount of money due to penalties imposed by the Justice Department and the government of the U.S. allied to the most recent accounting error which had an enormous effect on the level of capital measured in the books, has effectively tarnished the image of the bank and created a negative perception of its transparency and disclosing reliability.