

Nordea

Company report

07/18/2023



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✓ Inderes corporate customer

This report is a summary translation of the report “Vakuuttavaa tekemistä” published on 07/18/2023 at 8:25 am.

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Convincing performance

Nordea's Q2 was the 10th consecutive quarter in which the bank's earnings level continued to improve and the Q2 result was also stronger than market expectations. Although we expect Nordea's earnings level to be close to its peak, we forecast profitability to remain strong in the coming years (2024-2026e: ROE ~15 %). In our view, the company is still exceptionally cheaply priced and thus the expected return looks attractive. We reiterate our Buy recommendation and EUR 12.5 target price.

Lower-than-expected loan loss provisions led to an earnings beat

In Q2, Nordea's total income increased by 22% to EUR 2,955 million, slightly above our expectations (2,924 MEUR). Among the main income lines, net interest income grew slightly more strongly than we had forecast, but fee and commission income was around 3% below our estimates. However, the net result from items at fair value and insurance result exceeded our expectations. Nordea's costs developed broadly in line with expectations and the biggest deviation in the Q2 result from both our and consensus estimates was seen in loan loss provisions, which were significantly lower than expected (Q2'23: -32 MEUR vs. Q2'23e: -86 MEUR). No major changes were seen in the quality of the loan portfolio and management judgment buffer in local currencies remained unchanged. Ultimately, the company's Q2 operating profit came in at EUR 1,718 million and exceeded our estimate by 5% due to lower-than-expected loan loss provisions.

Outlook revised upwards as expected, long-term ROE target to be updated with Q4 results

With the Q2 report, Nordea revised its full-year outlook upwards and now guides ROE for 2023 to be above 15% (was above 13%). The previous guidance was very conservative and in our preliminary comments, we considered it very likely that the guidance would be upgraded. Nordea also announced that it will update its current long-term ROE target (above 13%) in the Q4 results report. Our own estimates see Nordea's return on equity to settle at around 15% in the coming years and we believe that the updated long-term ROE target could indicate a level above 14%.

Only minor revisions to estimates

We have made only minor revisions to our estimates with the Q2 report. For 2024-2025, we have revised our projections for fee income downwards by around 2%. In addition, we made minor revisions to our net interest income estimates for the coming years, mainly in light of the projected interest rate development and the hedging measures taken by the company. As a result, our net interest income projections have fallen by around 2% for 2024 and increased by around 2% for 2025. In addition to the changes mentioned above, we made small positive revisions to our estimates for cost development and loan loss provisions in the coming years. Overall, our EPS estimates for the current year have increased by around 3%, mainly due to a stronger-than-forecast Q2 result. For 2024, our EPS estimate decreased by around 3%, while our forecast for 2025 increased by around 2%.

The share remains very cheaply priced

We have looked at Nordea's valuation through valuation multiples and a peer group. Nordea, like the rest of the banking sector, is currently priced exceptionally low (2023e: P/E 7x and P/B 1.2x) and the valuation paints an overly pessimistic picture of earnings in the coming years. Thus, we feel that the upside in the valuation multiples and the profit distribution of 12-13% offer investors a very good expected return at the current share price.

Recommendation

Buy
(previous Buy)

EUR 12.50
(previous EUR 12.50)

Share price:
10.33



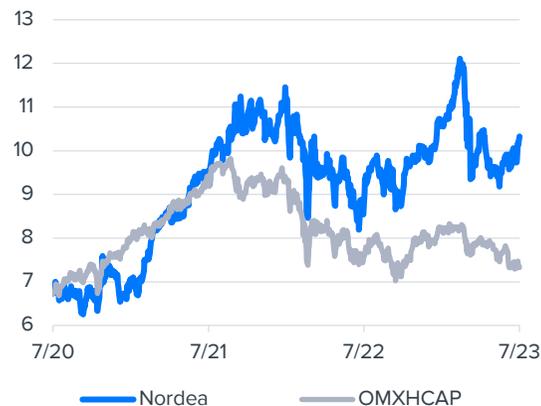
Key indicators

	2022	2023e	2024e	2025e
Total operating income	9 721	11 835	11 719	11 774
growth-%	1 %	22 %	-1 %	0 %
Total operating expenses	4 834	5 076	5 166	5 298
Cost/income ratio	50 %	43 %	44 %	45 %
Adjusted operating profit	5 299	6 528	6 069	6 051
Net profit	3 587	5 047	4 673	4 659
EPS (adj.)	1,11	1,41	1,35	1,38
Dividend per share	0,80	0,95	0,95	0,97
Payout ratio	72 %	67 %	70 %	70 %
ROE-%	12 %	17 %	15 %	15 %
P/E (adj.)	9,0	7,3	7,7	7,5
P/B	1,2	1,2	1,1	1,1
Dividend yield	8,0 %	9,2 %	9,1 %	9,4 %

Guidance (Upgraded)

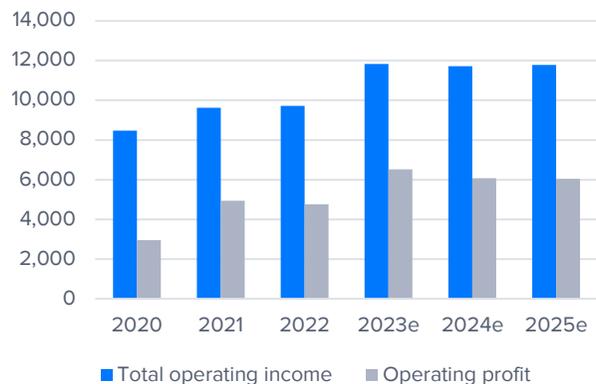
Return on equity increased to above 15% from above 13%.

Share price

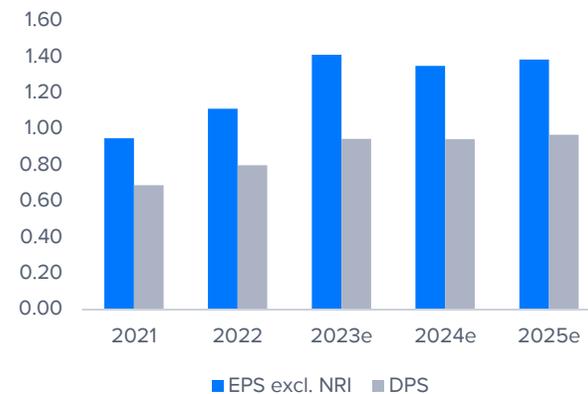


Lähde: Millistream Market Data AB

Operating income and EBIT



EPS and dividend



Value drivers

- Increased interest rate levels and strong growth in net interest income
- Winning market shares
- Growth in asset management
- Retention for improved cost efficiency
- Efficient use of capital and distribution of excess capital



Risk factors

- Risks related to general economic development in the Nordic region
- Decrease in interest rates
- Development of housing and real estate markets
- Regulatory risks
- General capital market development

Valuation	2023e	2024e	2025e
Share price	10,3	10,3	10,3
Number of shares, millions	3 576	3 461	3 364
Market cap	36 265	35 262	34 259
P/E (adj.)	7,3	7,7	7,5
P/B	1,2	1,1	1,1
Dividend yield-%	9,2 %	9,1 %	9,4 %

Source: Inderes

Lower-than-expected loan loss provisions led to an earnings beat

Operating income slightly above estimates

In Q2, Nordea's operating income increased by 22% to EUR 2,955 million (+28% y/y in local currencies), slightly exceeding both our (2,924 MEUR) and consensus (2,913 MEUR) expectations. Among the main income lines, net interest income increased by 40% to EUR 1,831 million and exceeded our estimate by about 1%. The growth in the net interest income continued to be supported by wider deposit margins and volume growth in corporate lending. As in previous quarters, the net interest income was held back by lending margins, which are under pressure from the fierce competition in the Swedish mortgage market in particular.

Nordea's net fee and commission income (Q2'23: 751 MEUR) decreased by about 6% year-on-year and missed our forecast by about 3%. The shortfall in net fee and commission income is explained by lower-

than-expected card and lending-related commissions, as well as significantly lower-than-expected life insurance fees. However, Nordea's net insurance result in Q2 was clearly stronger than our estimates (68 MEUR vs. 44 MEUR). Nordea's fair value changes remained at a strong level in Q2, supported by changes in the value of Treasury investment portfolio, and also exceeded our estimate (290 MEUR vs. 271 MEUR).

Lower-than-expected loan loss provisions led to an earnings beat

The bank's cost development in Q2 was in line with expectations and expenses increased by around 7% year-on-year (+13% in local currencies). As expected, costs reflected an increase in risk management resources and staff numbers were up 7% compared to last year. In Nordea's Q2 results, the biggest

deviation from both our and consensus forecasts was seen in loan loss provisions, which were clearly lower than expected. Nordea's net loan losses in Q2 were only EUR -32 million (loan loss ratio of 4 basis points) and well below our forecasts (Q2'23e: -86 MEUR). No major changes were seen in the quality of the loan portfolio quarter-on-quarter and management judgment buffer in local currencies remained unchanged (572 MEUR).

Ultimately, Nordea's Q2 operating profit came in at EUR 1,718 million and exceeded both our and consensus forecasts due to lower-than-expected loan loss provisions. In line with this, EPS exceeded market expectations by 2 cents and stood at EUR 0.37. The strong result pushed Nordea's ROE to a dazzling >18% in Q2.

Estimates MEUR / EUR	Q2'22	Q2'23	Q2'23e	Q2'23e	Consensus		Difference (%)	2023e
	Comparison	Actualized	Inderes	Consensus	Low	High	Act. vs. Inderes	Inderes
Net interest income	1 308	1 831	1 816	1 821	1 776	1 888	1 %	7 317
Net commission income	797	751	772	783	740	837	-3 %	3 100
Net result from items at fair value	254	290	271	-	-	-	7 %	1 142
Other income	69	83	64	-	-	-	30 %	277
Total operating income	2 428	2 955	2 924	2 913	2 861	2 981	1 %	11 835
Total operating expenses	-1 122	-1 205	-1 197	-1 238	-1 180	-1 481	1 %	-5 076
Net loan losses	56	-32	-86	-88	-42	-118	-63 %	-231
Operating profit	1 362	1 718	1 641	1 652	1 536	1 748	5 %	6 528
EPS (reported)	0,28	0,37	0,35	0,35	0,34	0,37	6 %	1,41

Source: Inderes & Bloomberg
(consensus)

Full-year outlook upgraded as expected, updated ROE target to come with Q4 results

Full-year outlook revised upwards as expected

In its Q2 report, Nordea revised its full-year outlook upwards and now guides the ROE level for 2023 to be above 15% (was above 13%). The company's previous guidance was very conservative and in our preliminary comments, we considered it very likely that the guidance would be upgraded. Nordea also announced that it will update its current long-term (until the end of 2025) ROE target (above 13%) in the Q4 results report. Our own estimates see Nordea's return on equity to settle at around 15% in the coming years and we believe that the updated long-term ROE target could indicate a level above 14%.

In the Q2 report, Nordea also made minor revisions to its assessment of the impact of a rise in central bank interest rates on interest margins. The 2023 estimate of the impact of central bank interest rates remained unchanged at EUR 1.2-1.6 billion, but for

2024 the estimate was revised to EUR 100-200 million (was ~100 MEUR). In its Q2 results presentation, the company also disclosed the impact of its hedging activities on interest rate sensitivity. According to the company, a +50 basis point change in interest rates will improve the bank's net interest margin by approximately EUR 300 million in the first year, around EUR 100 million in the second and around EUR 50 million in the third. In practice, Nordea's hedges will continue to absorb some of the positive effects of rising interest rates but will stabilize the interest margin in view of the projected fall in interest rates.

Danske Bank's Norwegian operations up for sale, Nordea could be a potential buyer

Danske Bank announced in June that it will exit its retail banking activities in Norway (loan portfolio of around NOK 200 billion or EUR ~17.8 billion) and Nordea has been considered in the market as one of the potential buyers of the business. Nordea's loan portfolio in Norway stood at EUR 69.9 billion at the end of June and the arrangement, if implemented, would increase Nordea's loan book in Norway by more than 25%.

Nordea did not take a strong stance on the issue on the earnings call and management said that in Norway the company's main focus is on organic growth. In general, however, the company said that acquisitions are possible if the target fits in with existing businesses and is available at a reasonable valuation.

Q2 webcast



Q2 interview with Nordea's CFO



Only minor revisions to estimates

Only minor revisions to estimates

We have made only minor revisions to our estimates with the Q2 report. For 2024-2025, we have revised our projections for net fee income downwards by around 2%. In addition, we made minor revisions to our net interest income estimates for the coming years, mainly in light of the projected interest rate development and the hedging measures taken by the company. As a result, our net interest income projections have fallen by around 2% for 2024 and increased by around 2% for 2025.

On costs, we slightly lowered our expectations for headcount growth in the coming years, as management believes that the strongest growth phase in personnel should be behind. Nordea's headcount has recently been boosted by investments in IT and risk management in particular.

As a result, our cost estimates for the coming years have fallen by around 1%.

We also revised our estimate of Nordea's loan loss ratios for the coming years slightly downwards and now forecast annual loan loss ratios of around 0.07% for the current year and around 0.12-0.14% for 2024-2025. In our view, Nordea's management judgment buffers (Q2'23: 572 MEUR) will act as a strong precautionary tool against credit risks and it is possible that loan losses will ultimately be lower than our current projections. However, the economic cycle is currently characterized by a high degree of uncertainty, which justifies a cautious approach to forecasting in this respect.

Overall, our earnings estimates for the current year have increased by around 3%, mainly due to a stronger-than-forecast Q2 result. For 2024, our EPS

estimate was revised downwards by around 3% and for 2025, our EPS estimate has increased by around 2%.

Our still topical initiation of coverage report is available [here](#).

Estimate revisions MEUR / EUR	2023e			2024e			2025e		
	Old	New	Change %	Old	New	Change %	Old	New	Change %
Net interest income	7 291	7 317	0 %	7 324	7 141	-2 %	6 919	7 040	2 %
Net commission income	3 143	3 100	-1 %	3 306	3 243	-2 %	3 436	3 372	-2 %
Net result from items at fair value	1 098	1 142	4 %	1 040	1 050	1 %	1 066	1 076	1 %
Total operating income	11 770	11 835	1 %	11 910	11 719	-2 %	11 663	11 774	1 %
Total operating expenses	-5 068	-5 076	0 %	-5 192	-5 166	-1 %	-5 355	-5 298	-1 %
Net loan losses	-346	-231	-33 %	-519	-484	-7 %	-444	-426	-4 %
Operating profit	6 356	6 528	3 %	6 199	6 069	-2 %	5 864	6 051	3 %
EPS (reported)	1,37	1,41	3 %	1,39	1,35	-3 %	1,35	1,38	2 %
Dividend per share	0,92	0,95	3 %	0,97	0,95	-3 %	0,95	0,97	2 %

Source: Inderes

The share remains very cheaply priced 1/2

We have examined Nordea's valuation through earnings and balance sheet-based valuation multiples and the framework provided by the peer group. Just like the rest of the banking sector, Nordea's share is priced exceptionally favorably (2023e: P/E 7.3x and P/B 1.2x) and we believe the valuation paints an unnecessarily gloomy picture of the bank's earnings prospects in the coming years. We see clear upside in Nordea's valuation multiples as concerns about the near-term economic development and the company's profitability will sooner or later disappear from the pricing of the stock. We feel the upside in the valuation multiples together with the total yield (dividends and buybacks) of 12-13% in the next few years offer investors a very good expected return. We reiterate our EUR 12.5 target price and Buy recommendation.

Equity markets are skeptical about the outlook for earnings and profitability in the coming years

With our 2023-2024 earnings estimates, Nordea is valued at P/E multiples of 7.3x-7.7x. The valuation multiples are exceptionally low, representing a discount of around 28-31% compared to the average valuation level of the last 10 years (P/E 10.7x). In our view, the valuation multiples paint a very gloomy picture of Nordea's earnings outlook for the coming years and unjustifiably price in a significant earnings downside.

[We have estimated that](#), in terms of historical earnings multiples, justifying the current market value would require circumstances in which either 1) Nordea's loan losses would rise to financial crisis levels or 2) a situation in which the bank's net interest income would decline significantly (and a return to effectively zero interest rates). We consider both scenarios to be

very pessimistic, as we see Nordea's credit risks as much more moderate than in previous years, and there are no market expectations for a rapid decline in interest rates.

Looking at the balance sheet, Nordea is valued at a P/B ratio of 1.2x in our 2023 projections. The valuation level is not demanding, given that we expect Nordea's ROE to be around 15% in the coming years. It is also noteworthy that for example, Nordea was priced with P/B multiples of 1.2-1.3x in 2018 and 2021, while 12-month consensus forecasts expected the company to achieve a ROE of 10-11% at that time (see next page).

The current P/B valuation, like other earnings multiples, reflects the stock market's skepticism about Nordea's profitability forecasts for the coming years. We see the upward update of financial targets at the beginning of next year (Q4 results) as a catalyst for a correction in valuations.

Valuation in line with the low-priced peer group

Nordea's P/E ratios for 2023-2024 are broadly in line with other major Nordic banks. However, it's worth noting that like Nordea the peer group is valued at exceptionally low levels, about a third below historical levels. On a P/B basis, Nordea is valued around 5% above the peer group median, but the valuation level is justified by a stronger return on equity than peers and a lower risk profile than the peer group average. We also generally view the Nordic banking sector's P/B-based valuation multiples as low relative to projected ROE levels and believe there is upside potential in valuation levels across the sector.

Valuation	2023e	2024e	2025e
Share price	10,3	10,3	10,3
Number of shares, millions	3 576	3 461	3 364
Market cap	36 265	35 262	34 259
P/E (adj.)	7,3	7,7	7,5
P/B	1,2	1,1	1,1
Dividend yield-%	9,2 %	9,1 %	9,4 %

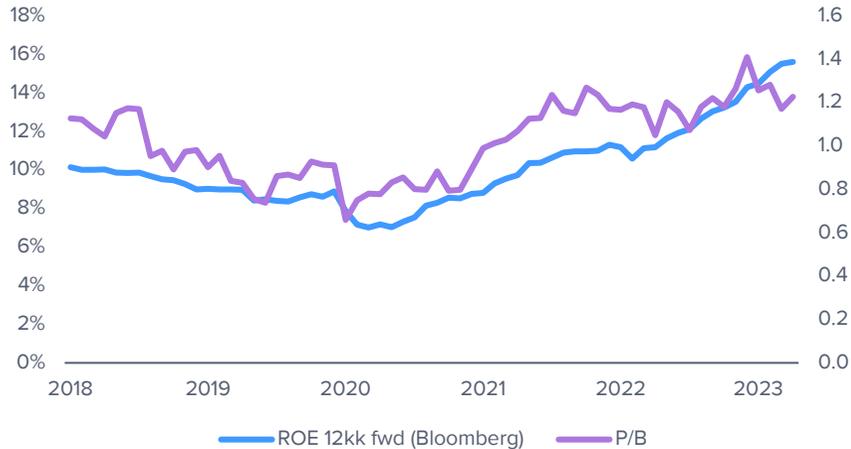
Source: Inderes

Nordea's total yield

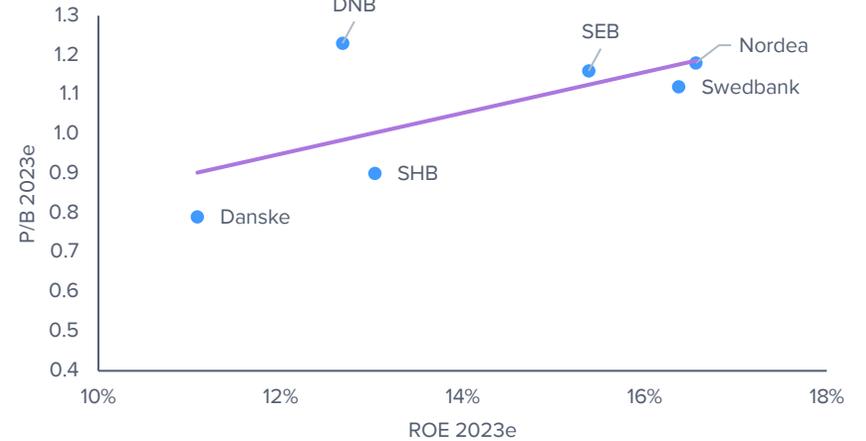


The share remains very cheaply priced 2/2

Nordea's 12mo fwd ROE and P/B



ROE and P/B 2023e



Development of Nordea's share price and EPS consensus estimate (2023)



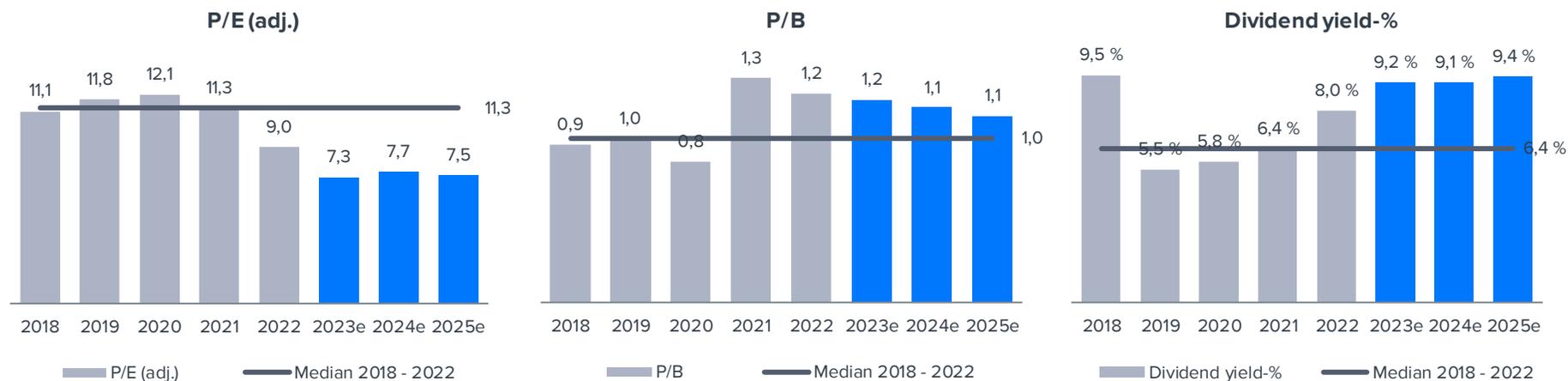
12mo fwd P/E of Nordic banks



Valuation table

Valuation	2018	2019	2020	2021	2022	2023e	2024e	2025e	2026e
Share price	7,30	7,24	6,67	10,8	10,0	10,3	10,3	10,3	10,3
Number of shares, millions	4 037	4 102	4 118	4 025	3 721	3 576	3 461	3 364	3 316
Market cap	29 565	29 322	27 014	42 793	36 650	36 265	35 262	34 259	34 259
P/E (adj.)	11,1	11,8	12,1	11,3	9,0	7,3	7,7	7,5	7,3
P/B	0,9	1,0	0,8	1,3	1,2	1,2	1,1	1,1	1,0
Dividend yield-%	9,5 %	5,5 %	5,8 %	6,4 %	8,0 %	9,2 %	9,1 %	9,4 %	9,6 %

Source: Inderes



Peer group

Peer group valuation Company	Market cap MEUR	P/E		Dividend yield-%		P/B
		2023e	2024e	2023e	2024e	2023e
Danske Bank	18966	7,4	7,2	8,0	8,1	0,8
DNB	27290	8,3	8,4	7,1	7,4	1,2
Handelsbanken	15854	7,1	7,6	8,6	9,5	0,9
SEB	22918	7,6	8,3	6,5	6,7	1,2
Swedbank	18501	6,8	7,2	7,4	8,7	1,1
Nordea (Inderes)	36265	7,3	7,7	9,2	9,1	1,2
Average		7,4	7,7	7,5	8,1	1,0
Median		7,4	7,6	7,4	8,1	1,1
Diff-% to median		-1 %	1 %	24 %	13 %	5 %

Source: Refinitiv / Inderes

Income statement

Income statement (MEUR)	2021	Q1'22	Q2'22	Q3'22	Q4'22	2022	Q1'23	Q2'23	Q3'23e	Q4'23e	2023e	2024e	2025e	2026e
Net interest income	4 925	1 308	1 308	1 407	1 641	5 664	1 765	1 831	1 863	1 858	7 317	7 141	7 040	7 087
Net fee and commission income	3 495	829	797	775	785	3 186	765	751	773	810	3 100	3 243	3 372	3 504
Net insurance result	0	35	53	38	47	173	46	68	60	48	222	224	226	229
Net result from items at fair value	1 119	-265	254	238	396	623	345	290	252	255	1 142	1 050	1 076	1 103
Other income	81	17	16	14	28	75	0	15	18	22	55	60	60	60
Total operating income	9 620	1 924	2 428	2 472	2 897	9 721	2 921	2 955	2 966	2 993	11 835	11 719	11 774	11 984
Non-recurring items	0	-537	0	0	0	-537	0	0	0	0	0	0	0	0
Total operating income excl. non-rec. items	9 620	2 461	2 428	2 472	2 897	10 258	2 921	2 955	2 966	2 993	11 835	11 719	11 774	11 984
Staff costs	-2 759	-692	-689	-691	-721	-2 793	-719	-725	-732	-742	-2 918	-3 036	-3 128	-3 222
Other expenses	-1 226	-532	-275	-292	-331	-1 430	-542	-325	-304	-346	-1 517	-1 478	-1 508	-1 538
Depreciation tangible and intangible assets	-664	-146	-158	-147	-160	-611	-161	-155	-162	-163	-641	-652	-662	-673
Total operating expenses	-4 649	-1 370	-1 122	-1 130	-1 212	-4 834	-1 422	-1 205	-1 198	-1 251	-5 076	-5 166	-5 298	-5 433
Non-recurring expenses	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total operating expenses excl. non-rec. expenses	-4 649	-1 370	-1 122	-1 130	-1 212	-4 834	-1 422	-1 205	-1 198	-1 251	-5 076	-5 166	-5 298	-5 433
Profit before loan losses	4 971	554	1 306	1 342	1 685	4 887	1 499	1 750	1 768	1 742	6 759	6 553	6 477	6 551
Net loan losses	-35	-64	56	-58	-59	-125	-19	-32	-77	-103	-231	-484	-426	-438
Operating profit	4 936	490	1 362	1 284	1 626	4 762	1 480	1 718	1 691	1 639	6 528	6 069	6 051	6 113
Total non-recurring items	0	-537	0	0	0	-537	0	0	0	0	0	0	0	0
Operating profit excl. non-rec. items	4 936	1 027	1 362	1 284	1 626	5 299	1 480	1 718	1 691	1 639	6 528	6 069	6 051	6 113
Taxes	-1 105	-231	-308	-283	-353	-1 175	-332	-383	-389	-377	-1 481	-1 396	-1 392	-1 406
Net profit for the period	3 831	259	1 054	1 001	1 273	3 587	1 148	1 335	1 302	1 262	5 047	4 673	4 659	4 707
Net profit excl. non-rec. Items	3 831	858	1 054	1 001	1 273	4 186	1 148	1 335	1 302	1 262	5 047	4 673	4 659	4 707
EPS (reported)	0,95	0,07	0,28	0,27	0,35	0,96	0,32	0,37	0,36	0,36	1,41	1,35	1,38	1,42
EPS (adj.)	0,95	0,22	0,28	0,27	0,35	1,11	0,32	0,37	0,36	0,36	1,41	1,35	1,38	1,42
Dividend per share	0,69					0,80					0,95	0,95	0,97	0,99

Balance sheet

Balance sheet (EURbn)	2021	2022	2023e	2024e	2025e
Cash and loans to central banks	48	63	62	63	65
Loans to credit institutions	2	5	5	5	5
Loans to the public	345	346	341	350	360
Intangibles	4	4	4	4	4
Other assets	172	178	175	180	185
Total assets	570	595	587	602	620
Equity	34	31	31	32	32
Deposits by credit institutions	27	33	32	33	34
Deposits and borrowings from the public	206	217	215	220	227
Debt securities in issue	176	180	177	182	187
Subordinated liabilities	7	5	5	5	6
Other liabilities	122	128	127	130	134
Total equity and liabilities	570	595	587	602	620

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Inderes' recommendation policy is based on the following distribution relative to the 12-month risk-adjusted expected total shareholder return.

Buy	The 12-month risk-adjusted expected shareholder return of the share is very attractive
Accumulate	The 12-month risk-adjusted expected shareholder return of the share is attractive
Reduce	The 12-month risk-adjusted expected shareholder return of the share is weak
Sell	The 12-month risk-adjusted expected shareholder return of the share is very weak

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Recommendation history (>12 mo)

Date	Recommendation	Target	Share price
06/09/2023	Buy	12.50 €	9.73 €
07/18/2023	Buy	12.50 €	10.33 €



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