Axiom Alternative Investments

Investing with a financial sector specialist

Webinar – European Banks, Q3 2024 results

4/12/2024

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This document was prepared by Axiom Alternative Investments Ltd.

Axiom Alternative Investments

MANAGING PARTNER
CIO

DAVID BENAMOU

PORTFOLIO MANAGER

ANTONIO ROMAN

Key takeaways

European Banks earnings expectations are being revised higher for the 18th quarter in a row

- **No bank missed on the bottom-line.**
- **P&L strength was broad-based,** driven by commissions, NII, provisions and costs.
- **Year-to-date, 2 year forward EPS expectations are up by c. 15%.**

Despite a strong performance on the 2024 stock market (+27.21% vs 9.29% for the STOXX Europe 600), political and macro volatility have weighed on the sector

- Weak PMIs, tariffs threats, political instability in France and Germany, etc. **have undermined appetite for European risk.**
- **The valuation gap with US banks has reached an all-time high**: the KBW trades at c.13.5x earnings, close to its post-GFC highs, while the SX7P trades at c. 6.5x, close to its post-GFC lows.
- The discount to the broader European market **has widened to c. 50%.**
- **Multiples are back at the lows of the year.**

We think bank shares will perform well in 2025

- On the earnings front, **NII sensitivity to interest rates has been significantly reduced,** commissions will be supported by **better flows**, costs will be kept in check with **digitization and M&A**, and provisions may benefit from **overlay releases**
- **80%+ payouts will be supported by SRTs, lower capital headwinds, large buffers to minima.**
- All-in-all, we expect **the sector ROE to stay in the 11.5%-12% band,** with an average Basel IV CET1 of 14%.
- Even if multiples stay unchanged at 6.5x, the total return should be around 15%.
- Rerating is subject to the market **clearing (geo)political uncertainties** and **getting confidence on the policy landing rate.**

Source: Axiom Alternative Investments

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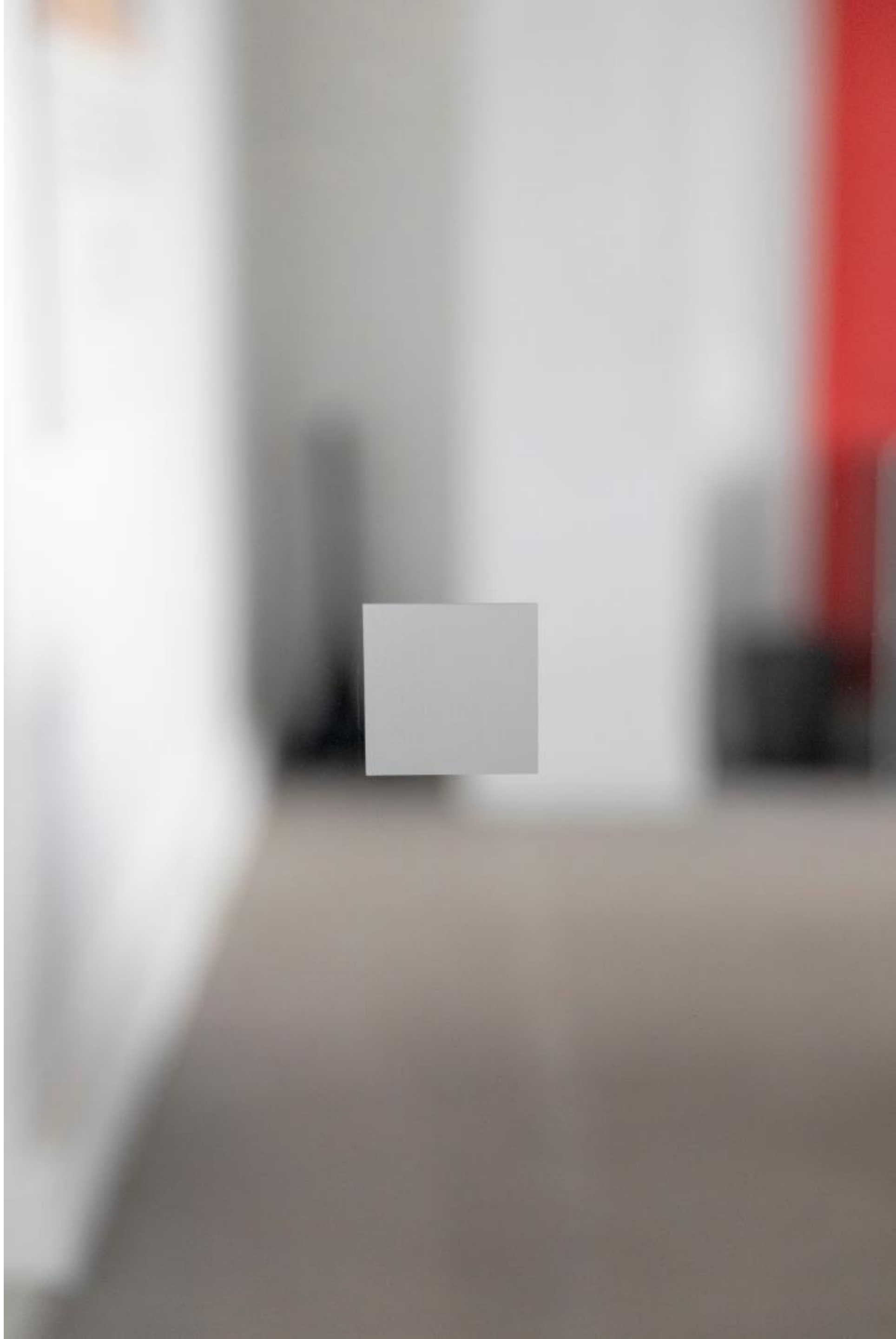
I. Another strong quarter

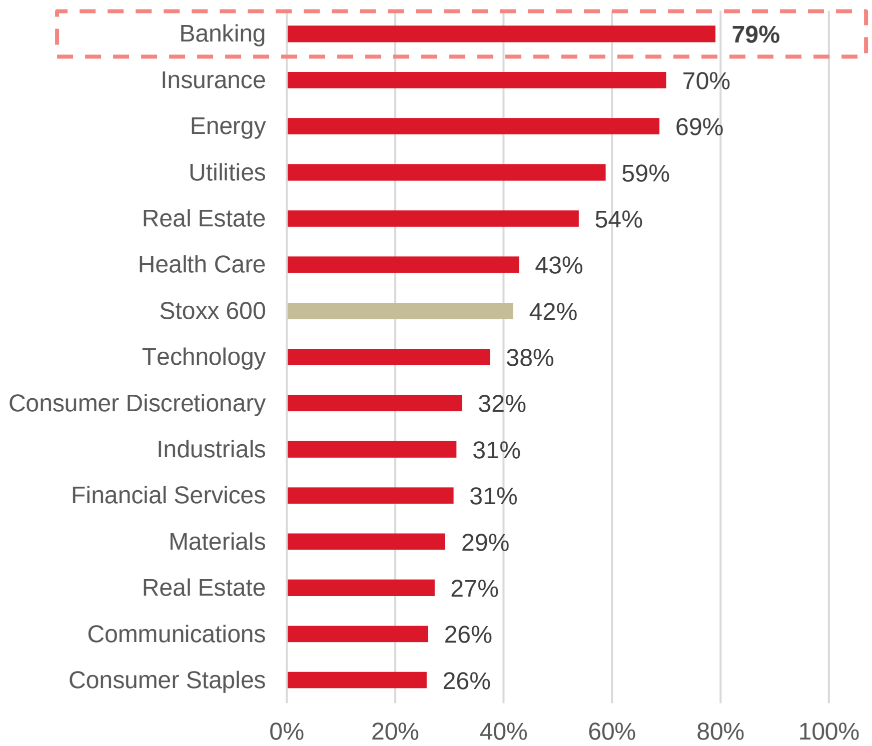
II. An (early) 2024 review

III. 2025 outlook

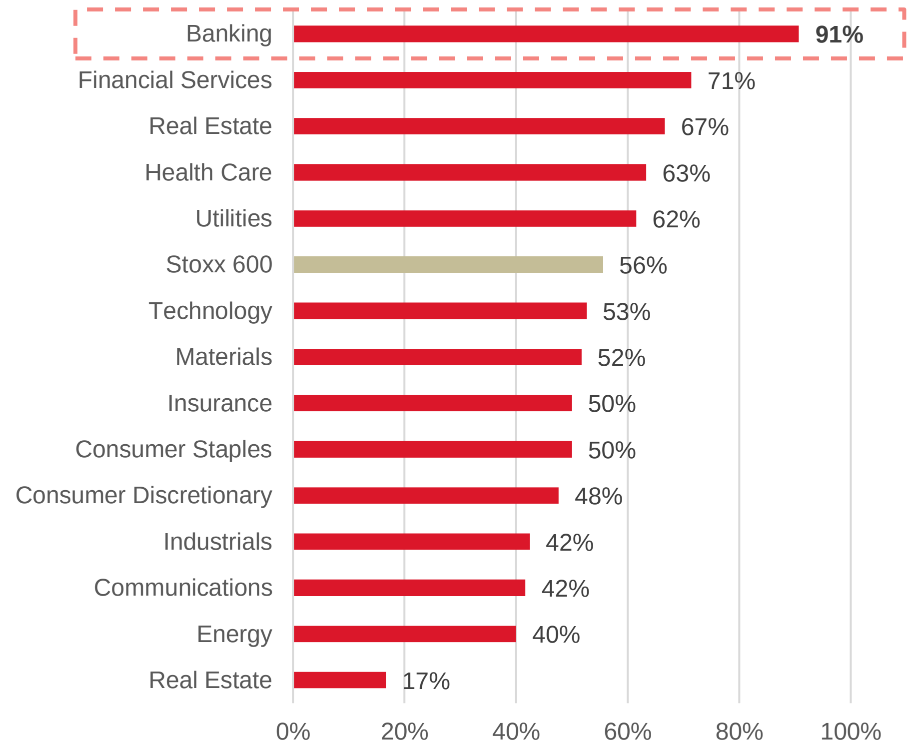


I.1 Another strong quarter

Positive sales surprises



Positive earnings surprises

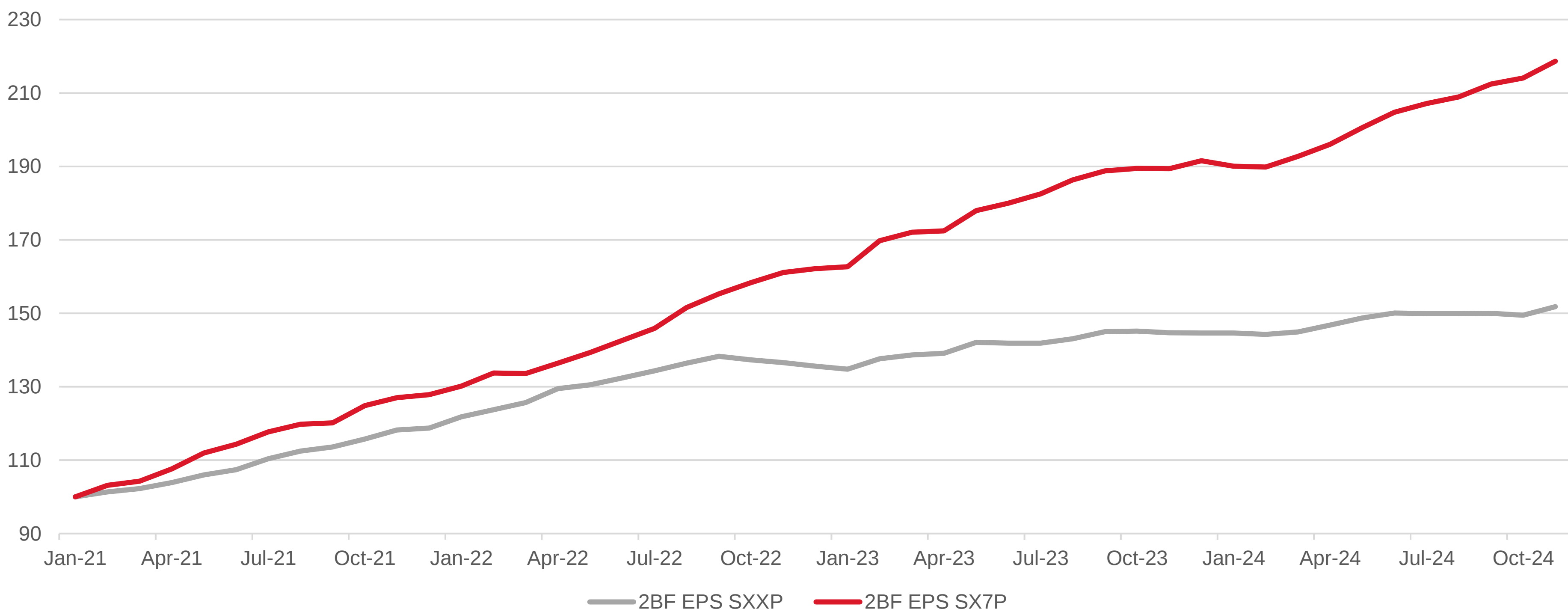


Banks had a convincing quarter in what was a soft print for the Stoxx 600, with both revenues and costs surprising positively.

Data as of 11/26/2024 | Source: Axiom Alternative Investments

I.2 Upgrades continue despite a difficult macro backdrop and rate cuts

Two-year blended EPS expectations: SX7P vs SXXP

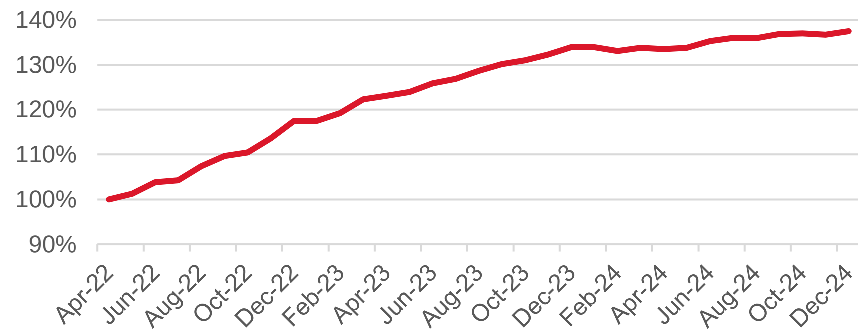


The bank earnings upgrade cycle is almost four-year-old, and contrary to what has happened in other sectors, it has not stalled or even slowed yet.

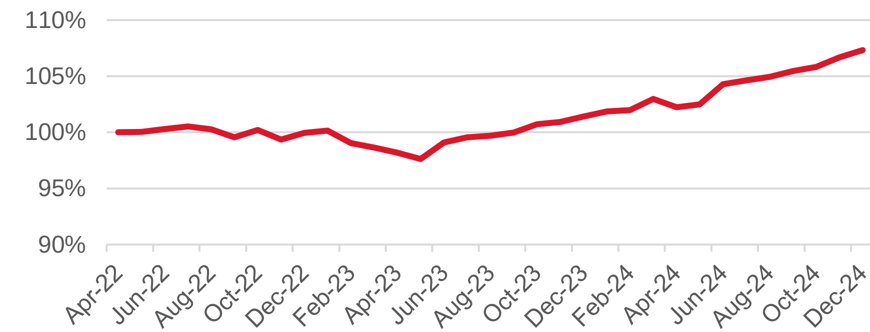
Data as of 11/25/2024 | Source: Axiom Alternative Investments

I.3 Stable NIIs, better commissions, good cost control and lower provisions

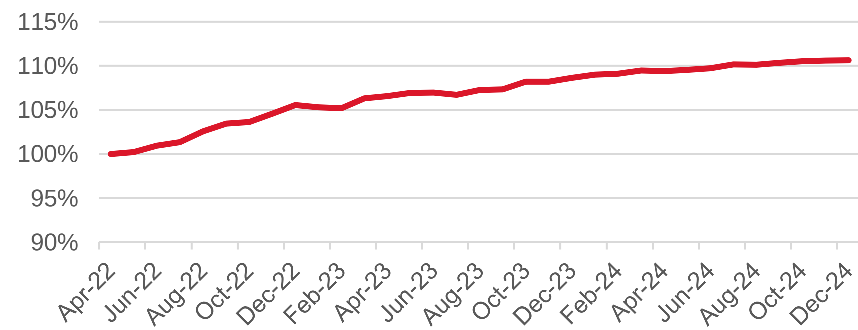
FY24e Net Interest Income (rebased)



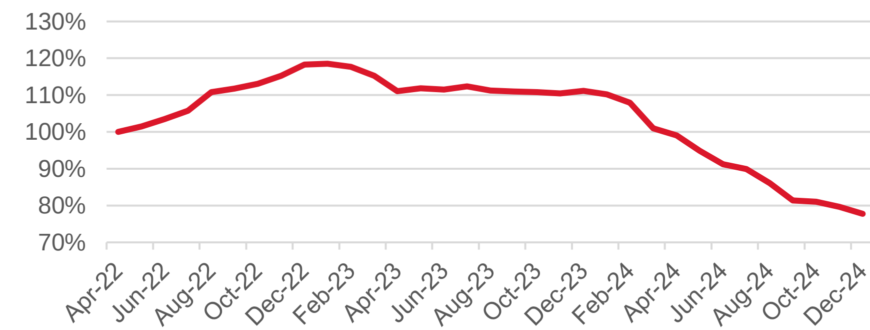
FY24e Fees (rebased)



FY24e Costs (rebased)



FY24e Provisions (rebased)

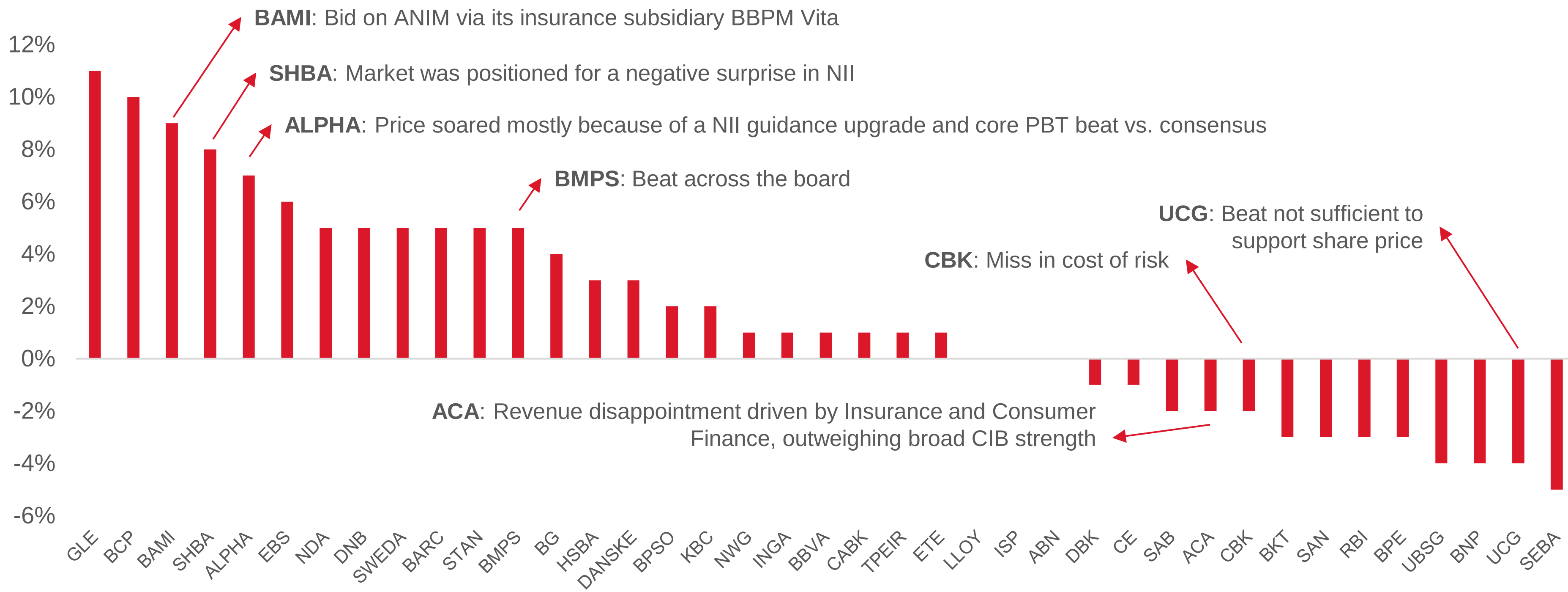


NII expectations have stabilized but are still slightly improving. The rebound in commissions is showing legs. Loan losses have remained below median historical levels, the expected “normalization” is taking longer to play out.

Data as of 11/25/2024 | Source: Axiom Alternative Investments

I.4 Results day share price reaction

Results day share price reaction versus SX7P



Mostly good reactions on the day (from -4% to +9% vs sector)

Past performance is not a reliable indicator of future results. It does not constitute an investment recommendation.

Data as of 11/25/2024 | Source: Axiom Alternative Investments

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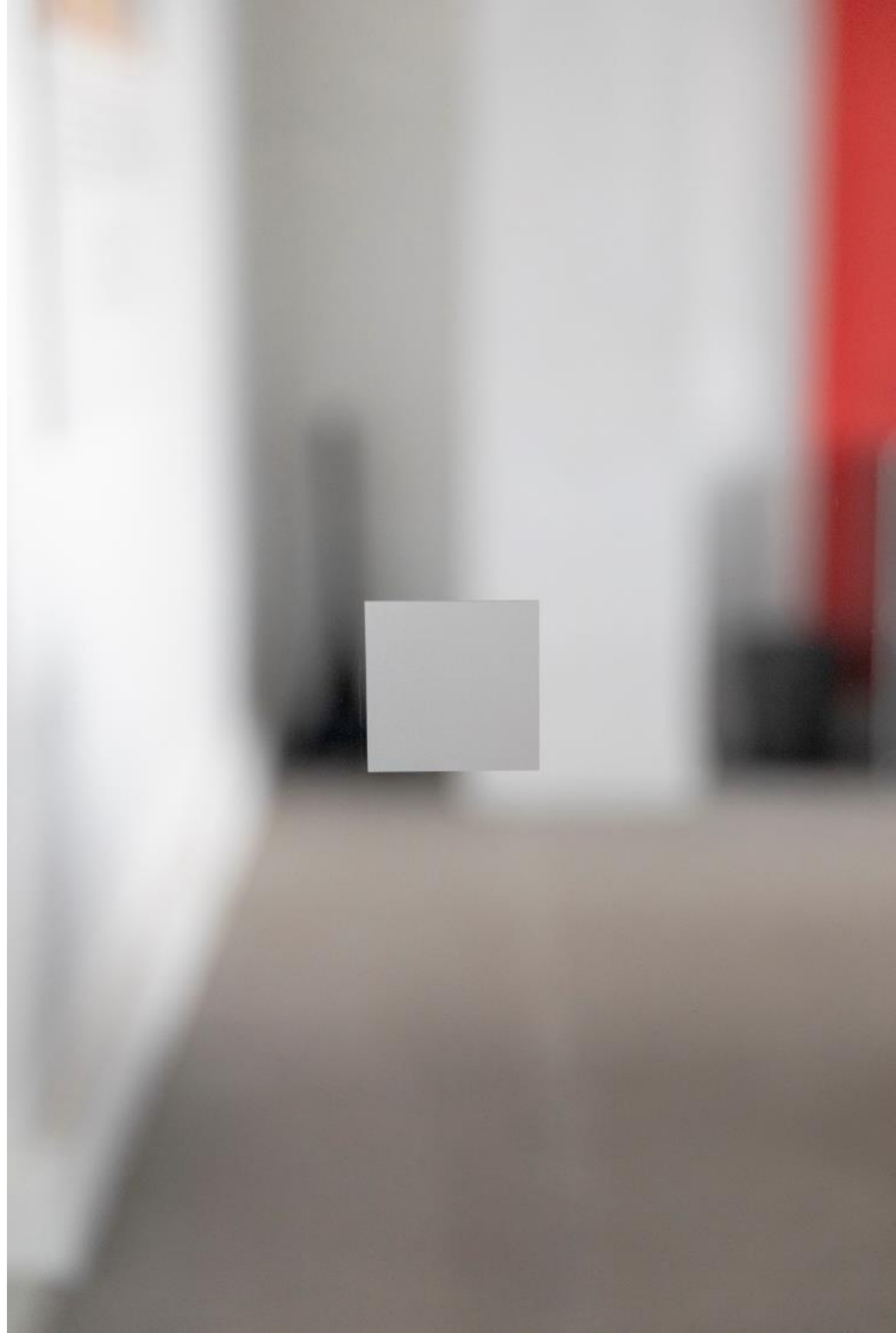
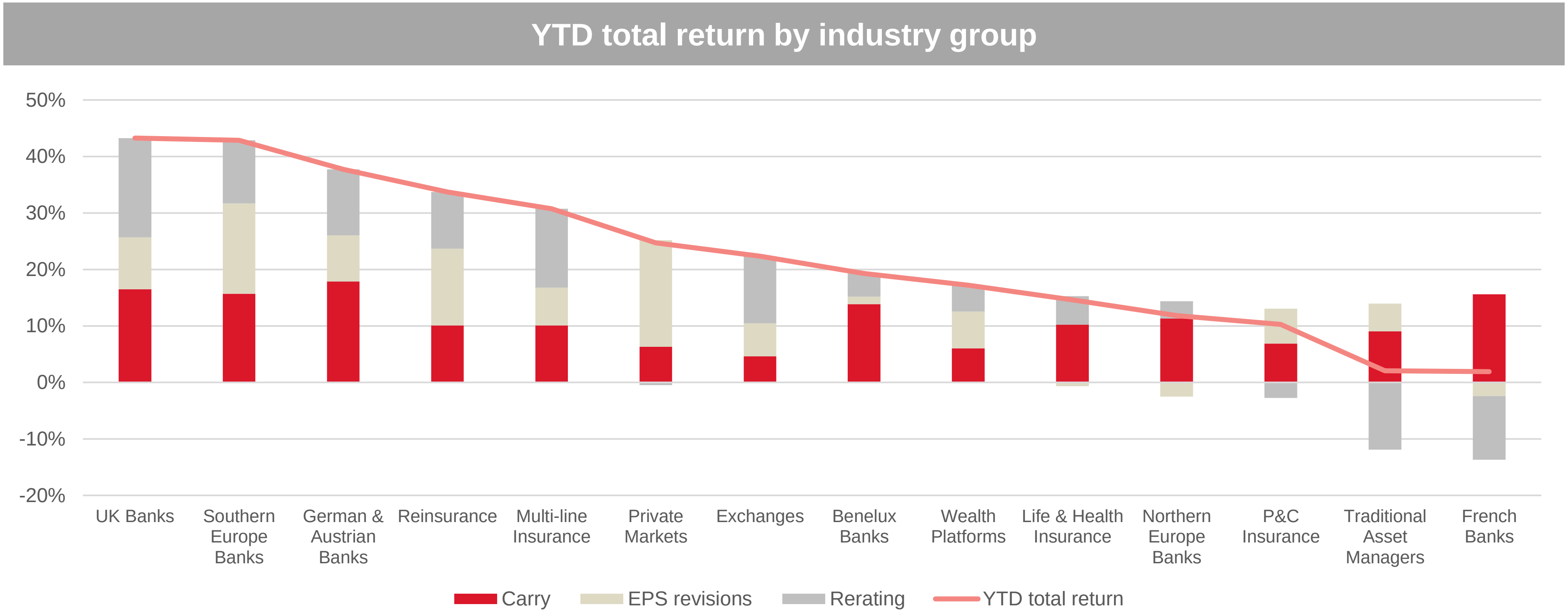


II.1 European financials



Overall, a good year so far for European financials, supported by a high carry and positive revisions. Some pockets have suffered from a heavy derating: traditional asset managers, French banks.

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Data as of 11/25/2024 | Source: Axiom Alternative Investments

II.2 What has worked this year

Long Small Southern Europe Banks	BMPS (+107%), BPER (+100%), SAB (+70%), BAMI (+70%), BCP (+70%) have delivered outlandish returns. Consensus view at the beginning of the year was to avoid the periphery due to rate sensitivity. Well, that call went wrong. Shares were boosted by M&A + low deposit betas + better ALM + strong fees.
Long UK Banks	Natwest (+90%), Barclays (+80%) benefitted from an improved UK sentiment, replicating portfolios tailwinds and good cost control.
Long Reinsurance & Specialty Insurance & Multi-line	Strong pricing trends and better underwriting supported Generali (+52%), Beazley (+50%), Swiss Re (+45%), Munich Re (+36%).
Short Traditional Asset Managers	Schroders (-23%), Ashmore (-15%), Jupiter (-3%), Amundi (5%) suffered from lower net inflows than expected, and poor sentiment with regards to the traditional active management industry.
Short French banks	BNP (-3%), Cred Ag (+6), Socgen (+10%) suffered from a slower than expected recovery in retail NII, a higher complexity premium in CIB and leasing, French taxes and the broader political environment.

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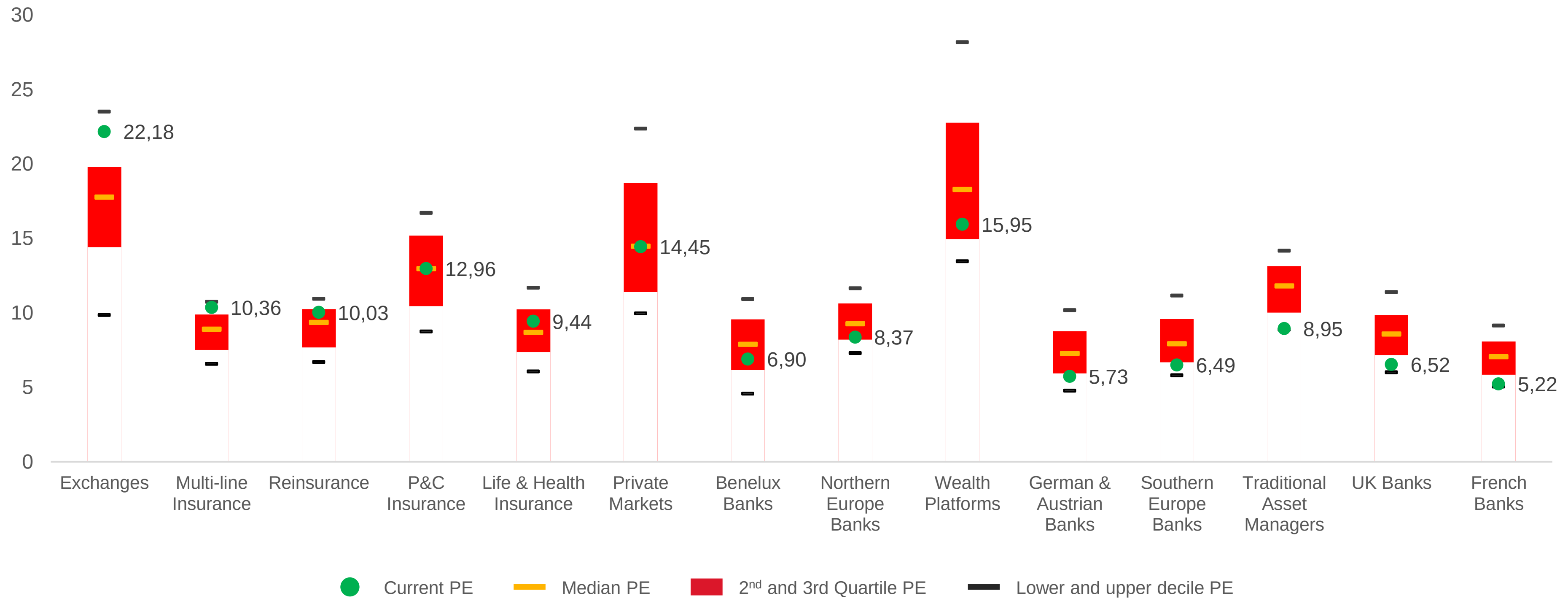
Data as of 11/25/2024 | Source: Axiom Alternative Investments, Bloomberg, Mediobanca Research

II.3 European financials: P/E boxplot by industry group

A noticeable divergence in valuation multiples across European financials



French banks and traditional asset managers are the most unloved. UK, German and Southern Europe banks are still extremely cheap. Wealth platforms and alternative asset managers are affordable. Exchanges and insurance have become expensive.

Data as of 11/25/2024 | Source : Axiom Alternative Investments

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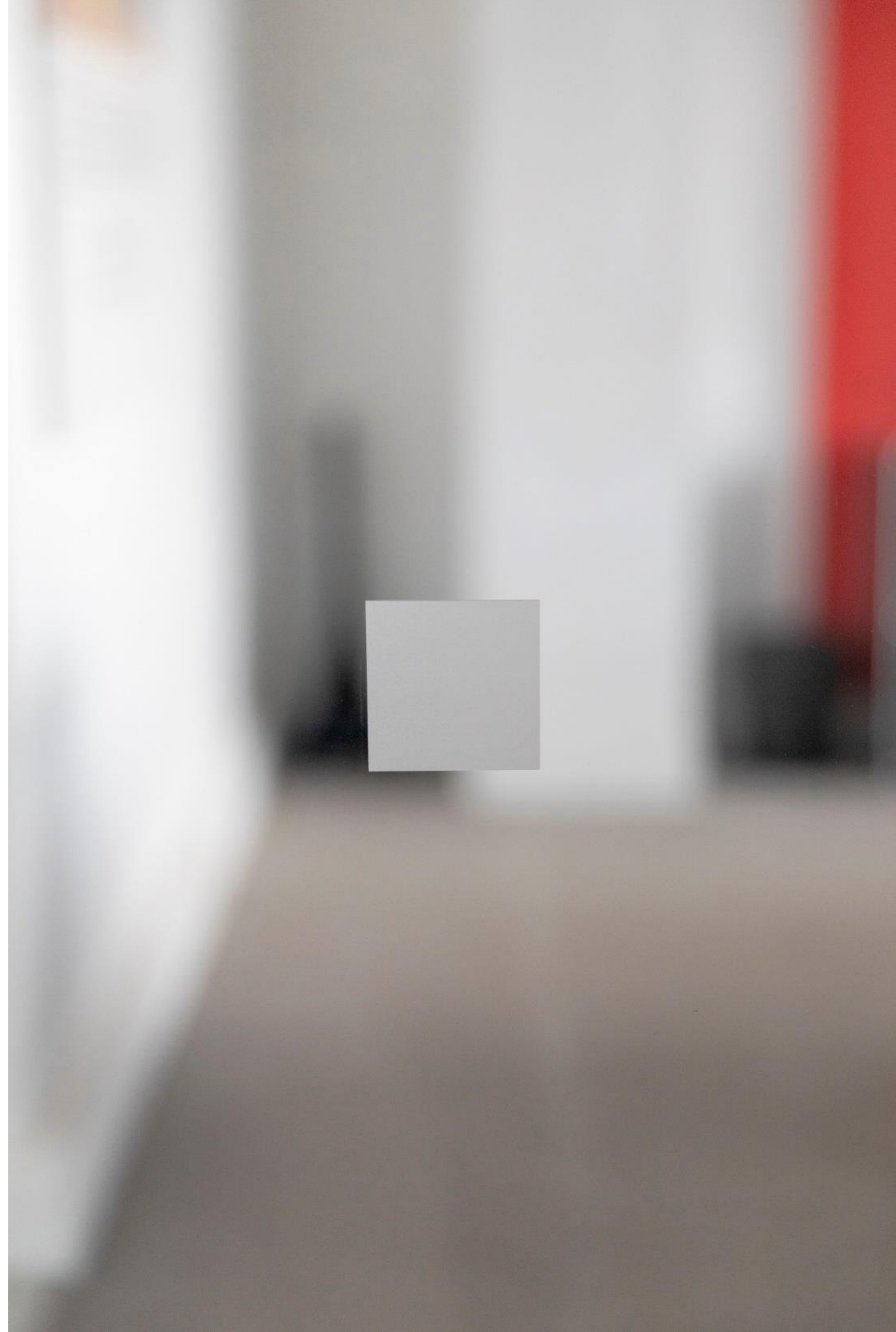


III.1 Where is the analyst consensus standing?

Consensus summary – Europe Aggregate YoY%

	2024	2025	2026
Net Interest Income	1.3%	-0.6%	2.1%
Total Deposits	*3.6%*	*1.7%*	*2.1%*
Total Loans	*2.6%*	*2.8%*	*3.2%*
Fee income	9.6%	3.4%	3.8%
Trading income	-4.4%	-0.8%	2.2%
Total revenues	**4.9%**	**1.1%**	**2.7%**
Total operating expenses	3.0%	1.8%	1.0%
Loan loss provisions	3.5%	11.0%	3.1%
Pre-tax profit	**-2.5%**	**-1.3%**	**5.9%**

Consensus summary – Europe Aggregate ratios

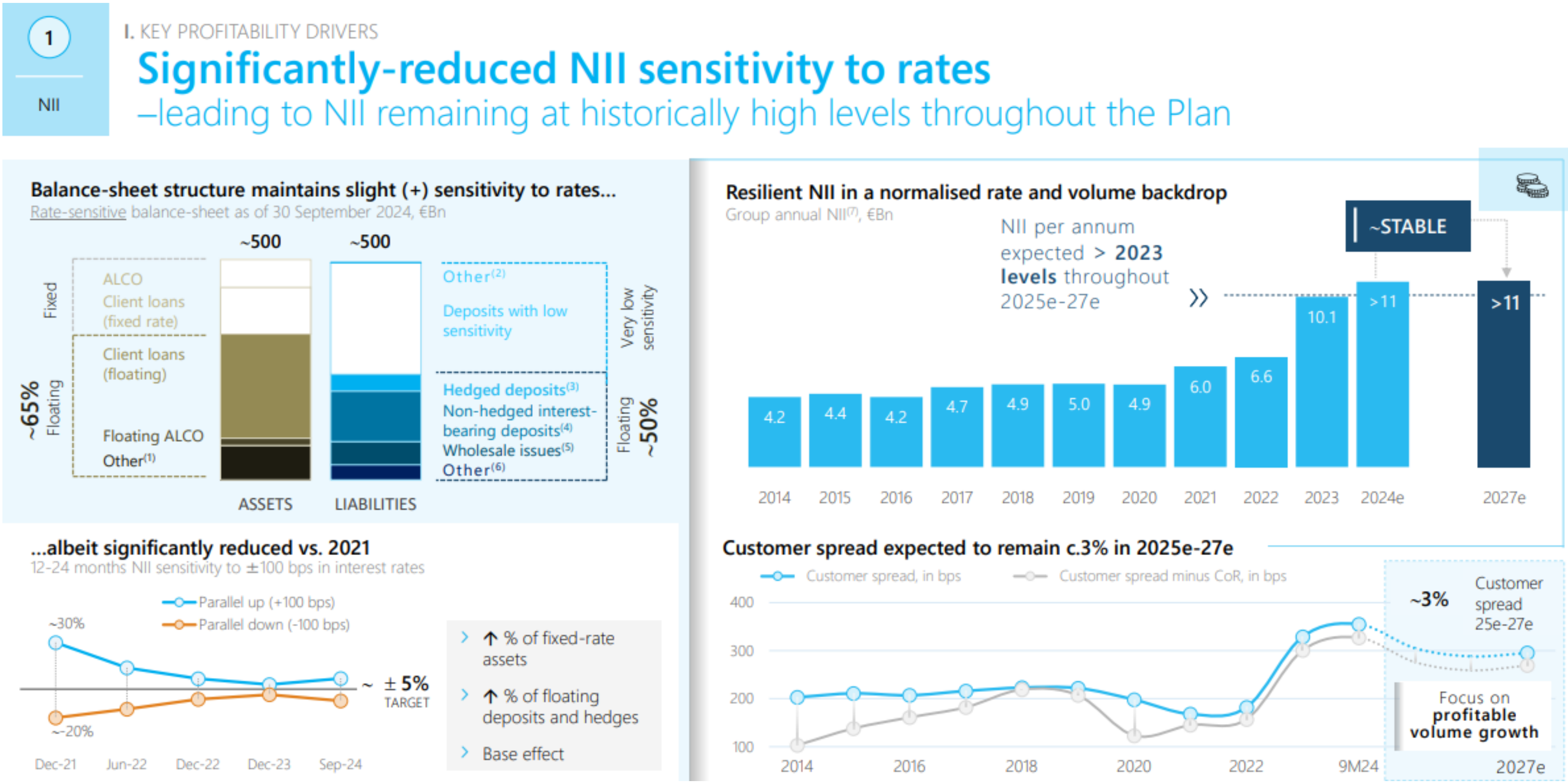
	2024	2025	2026
Net Interest Margin (%)	1.70%	1.66%	1.68%
Cost-income ratio	53.50%	53.90%	52.96%
Provisioning rate (P&L loan loss provision/ stock of loans)	0.38%	0.42%	0.42%
Adjusted ROE (%)	**11.98%**	**11.58%**	**11.82%**
Adjusted RoTBV (%)	13.65%	13.17%	13.43%
Return on RWA (%)	2.18%	2.09%	2.12%
FL Basel IV CET1 ratio	14.2%	14.1%	14.1%
Pre-tax profit	**-2.5%**	**-1.3%**	**5.9%**

Consensus is anticipating stable revenues, with a slight change in mix between NII and commissions, and normalized loan losses.

Data as of 11/25/2024 | Source: Axiom Alternative Investments

III.2 Interest rate sensitivity is lower than generally perceived

Caixa Investor Day: an illustration of the drivers behind NII resilience



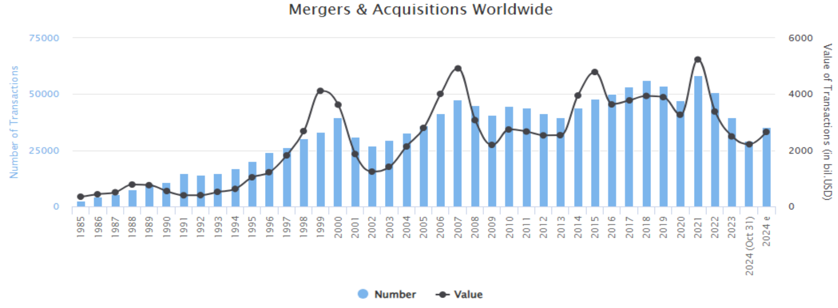
Santander CFO on interest rate sensitivity: “a quarter on the way down of what it was on the way up”.

Data as of 11/25/2024 | Source: Axiom Alternative Investments, Caixa Bank, Santander

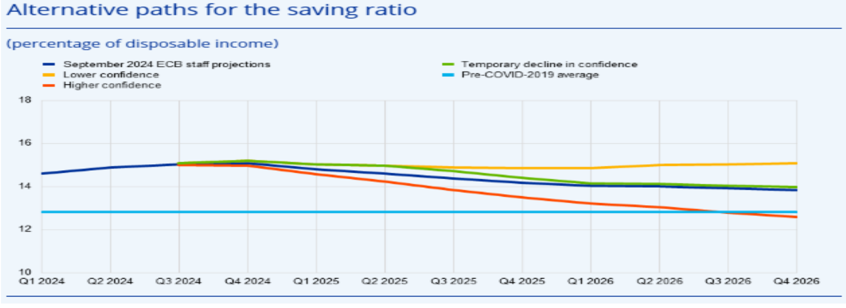
III.3 Cyclical and structural factors underpin a constructive stance for commissions

Cyclical factors	
Lending	• Pick-up in loan demand
Asset & wealth management	• Lower ST rates, steeper curves -> rotation out of term deposits & retail bonds into investments • Higher real wages and saving ratios in Europe -> positive for net flows
Trading	• Continued macro volatility across rates, FX, equities, commodities • Increased demand for hedging and more active repositioning
Investment banking	• Deals still below LT average % GDP despite improved financial conditions • M&A and ECM normalization expected in 2025
Structural trends	
Asset & wealth management	• Shift towards increased "pillar 2" pensions • Growth of premier and private banking • Increased allocation to alternatives
Private markets	• Partnership between banks and private lenders

Global M&A LTV Volume ($T)



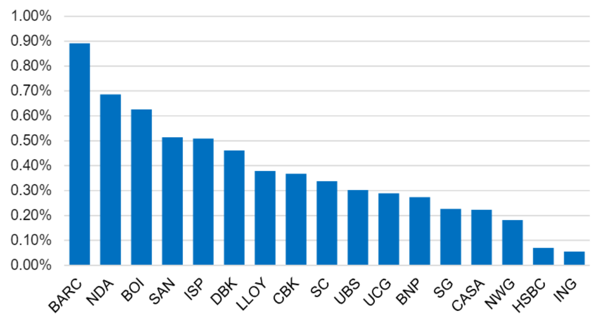
Household saving ratio (% disposable income)



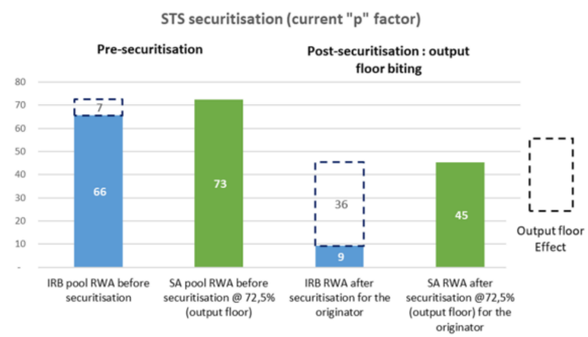
Data as of 11/25/2024 | Source: Axiom Alternative Investments, Dealogic, imaa institute, ECB

III.4 Increased SRT transactions pave the way for higher payouts and ROEs

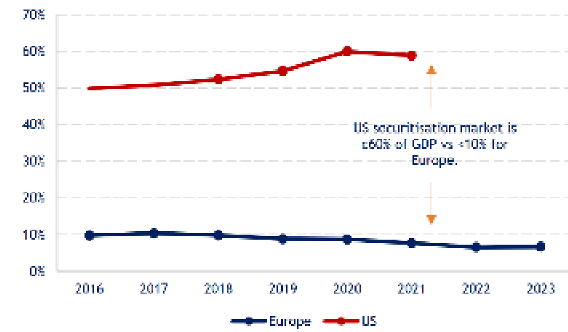
Capital relieved via SRT as of 1H24



Excessive "p" factors reduce the attractivity of SRTs



Size of outstanding securitisations (% GDP)



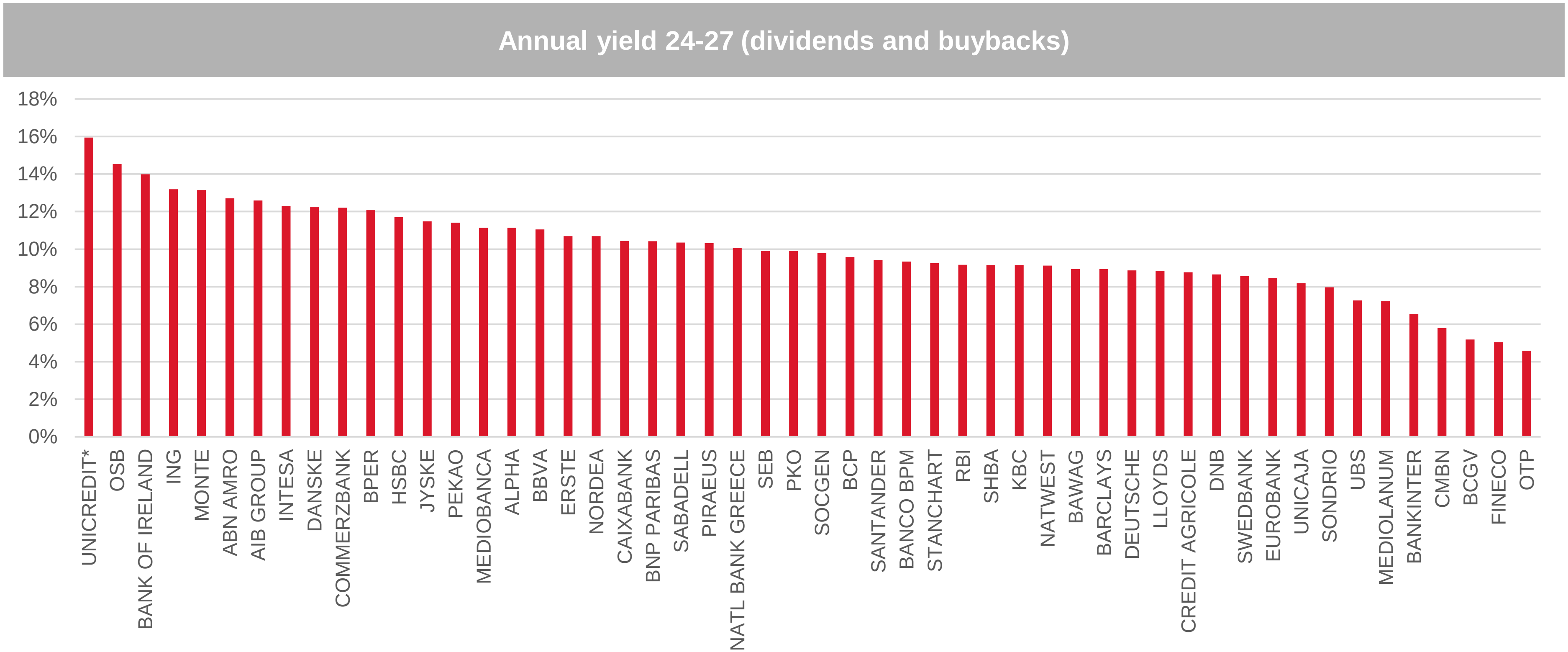
The Commission is looking at ways to boost the credit availability to Euro area corporates. One clearly identified avenue is to improve the economics of SRTs for banks (an area where Europe is lagging):

- Speed of ECB approval: issuers lament the length of the ECB approval process (sometimes 3 months + 1 month)
- RWAs: The capital treatment of SRT transactions is currently punitive
- Extension of the perimeter of portfolios: extending the assets eligible for SRT would broaden the flexibility for banks to tap their balance sheet, following the shifts in the market's demand.
- Conditions for SRT eligibility: current conditions are deemed too rigid, unflexible

While the post-GFC "skin in the game" and "non-neutrality" principles will still apply, a more pragmatic and less punitive SRT framework could boost the sector ROE by c. 0.5 pts and support growth in the Euro area.

Data as of 11/25/2024 | Source: Axiom Alternative Investments, EBF, Mediobanca Research, AFME, World Bank

III.5 Double digit distribution yields will become even more attractive in a falling rate environment

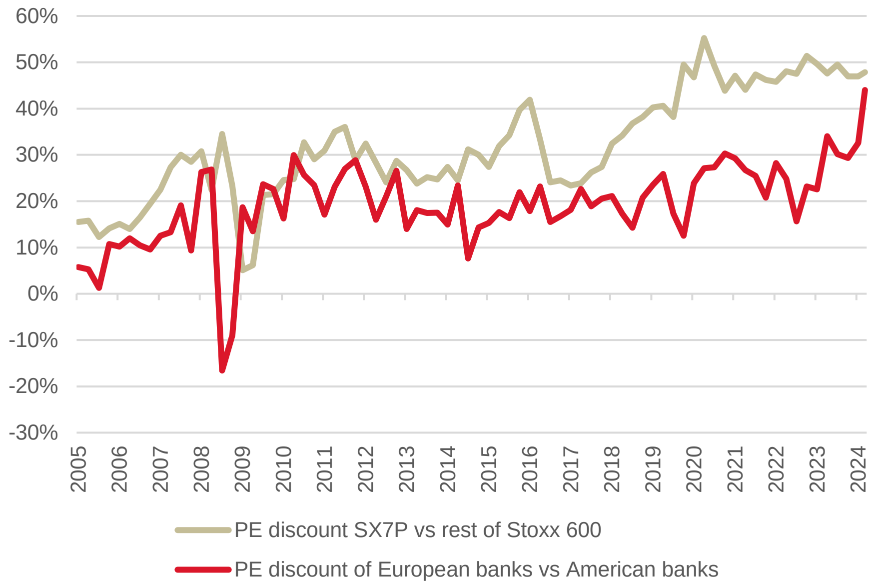


Capital discipline will support the long-term profitability of the sector. We expect management teams to stay selective on M&A, with high ROI thresholds.

Data as of 11/25/2024 | Source: Axiom Alternative Investments

III.6 With multiples close to all-time lows, the upside is considerable

SX7P: discount to the Stoxx 600 and US banks



3 main drivers for a rerating	
Eurozone economic sentiment	• PMIs: recovery needed • Lending surveys: confirmation of the pick-up in loan demand • Politics: French government, German fiscal outlook • Geopolitics: Eastern Europe, EU defence spending
Clarity on interest rates	• Comfort on the level of the "landing rate" • Steepness of the curve
Sector self-help narrative	• Successful M&A transactions • Government interventions: taxes and retail bonds • Regulation: SRT, Capital market union, banking union

The investment case is not very different from what it was at the beginning of the year: double digit carry, good earnings dynamics, and a strong rerating potential make EU banks a compelling investment opportunity.

Data as of 11/25/2024 | Source: Axiom Alternative Investments, HCOB, S&P Global PMI, Eurostat via S&P Global Market Intelligence

III.7 The political narrative has changed: *dividend ban* out, competitiveness in

« Sharing a unique common goal : reversing Europe's declining competitiveness »

Ministero dell'Economia e delle Finanze
Dipartimento del Tesoro
Direzione V
Ufficio II

MINISTÈRE DE L'ÉCONOMIE, DES FINANCES ET DE LA SOUVERAINETÉ INDUSTRIELLE ET NUMÉRIQUE
Direction générale du Trésor

Bundesministerium der Finanzen

To **John Berrigan**
European Commission
Directorate-General for Financial Stability,
Financial Services and Capital Markets Union

and

c.c. **Patricia Reilly**
Head of Cabinet to Commissioner Mairead McGuinness
European Commission
Directorate-General for Financial Stability,
Financial Services and Capital Markets Union

CRR (*Capital Requirement Regulation*) review timetable - 2028:

Request from the German, Italian and French Finance Ministries to the Commission:

On the resilience of the sector (financial stability, anti-money laundering, consumer protection, etc.): « ***…we should refrain from launching new large-scale initiatives in this field in the short to medium term.*** »

«…it is equally important to put stronger emphasis on the ***competitiveness of the financial sector, particularly banking,*** *and its capacity to finance the economy. »*

6 topics: competitiveness of investment banking (FRTB), real estate financing, securitisation (financing the economy), climate risk (more realistic approach), macroprudential rules (application to be considered considering the competitiveness of the sector), improving the functioning of banking supervision.

The competitiveness of the sector is at the heart of political concerns. We believe that there will be regulatory easing in the future. This is a positive factor for the sector's profitability and market sentiment.

Data as of 25/11/2024 | Source : Axiom Alternative Investments

Key takeaways

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Thank you for attending the Axiom Alternative Investments webinar.

See you next quarter.