Nordea

Company report

7/16/2024

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Inderes corporate customer

This report is a summary translation of the report "Vahva tuloskunto kestää" published on 7/15/2024 **at 10:45 pm EEST**

Sustained strong performance

Nordea reported strong Q2 results in line with our expectations, with net interest income and fee and commission income developing as we had forecast. The bank's cost development during the quarter also did not provide any material surprises, and the company's profitability remains top-notch. In fact, we had to make only moderate changes to our estimates after the report. In our view, Nordea is still cheaply priced, in line with the rest of the Nordic banking sector, and the expected return looks attractive. We reiterate our EUR 12.5 target price and Buy recommendation.

Net interest income likely past peak

Nordea's net interest income increased by 4% year-on-year, which was quite in line with our forecasts. At the same time, the quarter-on-quarter growth slowed as net interest income declined slightly from the level in Q1, and it seems that the peak in net interest income is behind us. In fee and commission income, the development was slightly stronger than expected, especially in payments and advisory fees. The bank's operating cost level also developed broadly in line with our expectations, while loan losses were slightly lower than expected. There was a moderate deterioration in the quality of the credit portfolio in Q2, but the overall quality of the credit portfolio remained strong. With income and expenses well in line with our expectations, the net result for the quarter was also within our forecasts. Earnings per share were EUR 0.37 and return on equity was an excellent 17.9%. As expected, Nordea did not change its full-year guidance (ROE > 15%) in the Q2 report.

Forecast changes remain marginal after a quarter that met expectations

We have slightly raised our net interest income forecasts for the coming years, as expectations for the timing of central bank rate cuts have moved a step further into the future. We continue to assume that 3-month Euribor rates will settle between 2–3% in the long term, in line with current market forecasts. Nevertheless, interest rate hedging and the gradual adjustment of reference rates for loans will mitigate this trend and support the bank's profitability development. Our net interest income projections for 2026 should therefore already reflect a fairly sustainable level of net interest income. Correspondingly, our forecasts for operating expenses in the coming years have increased marginally, largely offsetting the effect of the increase in return forecasts. We forecast loan losses to rise above the company's estimated normalized level of 0.1% of the loan portfolio over the remainder of the year and to remain at about the same level for the next few years.

Overall, we expect Nordea's EBIT to decline in line with interest rates in the coming years but return on equity to remain above the target level of 15% throughout the current target period ending in 2025. Thereafter, we forecast ROE to decline to just over 13%, which we consider to be a sustainable level for Nordea even in a lower market rate environment. As the net interest income declines, the bank's results will be supported by an increase in fee and commission income, especially in asset and wealth management.

The share remains very cheaply priced

Based on our 2024–2025 earnings estimates, Nordea is valued at a P/E ratio of ~7–8x, which represents a discount of almost 30% to the bank's historical levels (P/E ~11x). Like the rest of the banking sector, the valuation is low and paints an unnecessarily pessimistic picture of the company's earnings development. We see clear upside in the valuation multiples, which together with the profit distribution of approximately 10% offer investors a very good expected return at the current share price with a moderate risk level.

Recommendation

Buy
(previous Buy)

EUR 12.50
(previous EUR 12.50)

Share price:
10.57

Key figures

	2023	2024e	2025e	2026e
Revenue	11743.0	12144.8	12143.8	12199.2
growth-%	21%	3%	0%	0%
EBIT adj.	6515.0	6648.5	6362.4	6217.4
EBIT-% adj.	55.5 %	54.7 %	52.4 %	51.0 %
Net Income	4934.0	5129.2	4899.1	4787.4
EPS (adj.)	1.44	1.46	1.42	1.40
P/E (adj.)	7.8	7.2	7.5	7.5
P/B	1.3	1.2	1.1	1.0
Dividend yield-%	8.2 %	9.0 %	8.7 %	8.6 %
EV/EBIT (adj.)	7.0	6.2	6.1	5.9
EV/EBITDA	7.2	6.2	6.1	5.9
EV/S	3.9	3.4	3.2	3.0

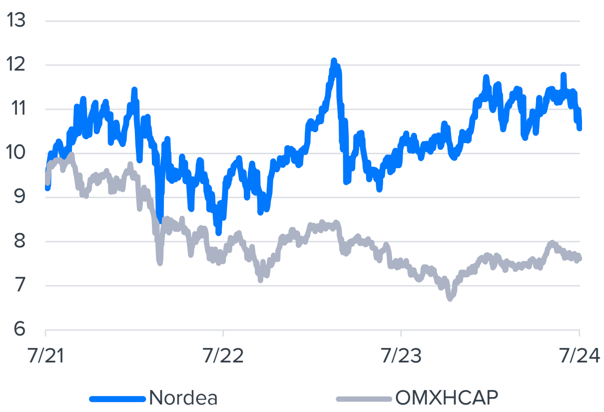
Source: Inderes

Guidance

(Unchanged)

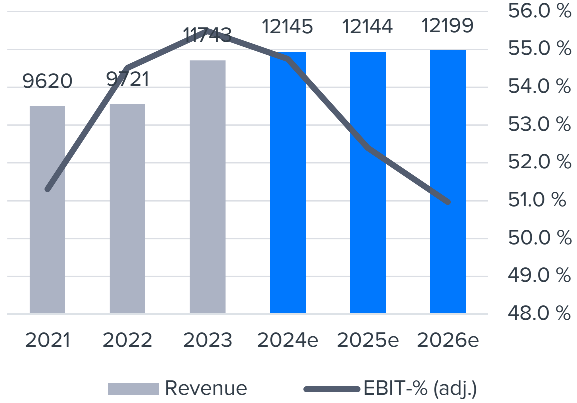
Nordea expects its return on equity to exceed 15 % in 2024.

Share price



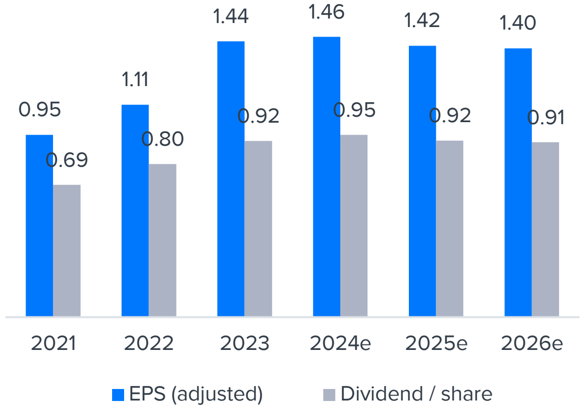
Source: Millistream Market Data AB

Revenue and EBIT-%



Source: Inderes

EPS and dividend



Source: Inderes

Value drivers

- Increased interest rate levels and strong increase in interest income
- Winning market shares
- Growth in asset management
- Retention for improved cost efficiency
- Efficient use of capital and dissolving overcapitalization

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	2024e	2025e	2026e
Share price	10.6	10.6	10.6
Number of shares, millions	3,506	3,459	3,411
Market cap	37,058	36,054	36,054
P/E (adj.)	7.2	7.5	7.5
P/B	1.2	1.1	1.0
Dividend yield-%	9.0 %	8.7 %	8.6 %

Source: Inderes

Strong quarter as expected

Net interest income likely past peak

Nordea's net interest income increased by 4% year-on-year, which was quite in line with our forecasts. At the same time, quarter-on-quarter growth eased as net interest income marginally declined from the Q1 level. This was mainly due to higher deposit costs. It appears that the positive impact of the rise in interest rates is largely behind us, so that in the future net interest income will be gradually set back by the projected fall in market interest rates. Accordingly, the importance of growth of the credit portfolio is becoming more pronounced. In Q2, credit demand remained subdued, with the credit portfolio at the same level as at the end of the previous quarter.

In fee and commission income, the development was stronger than expected, especially in payments and advisory fees. Net fee and commission income from asset and wealth management also continued to grow in Q2, albeit at a slightly slower pace than expected. Assets under management increased mainly as a result of positive value changes. Lending fees, on the other hand, suffered again from continued subdued credit demand.

Nordea's total operating income in Q2 increased by 3% year-on-year to 3,043 MEUR.

Profitability is still top notch

Nordea's overall operating cost level in Q2 was in line with our expectations, as operating expenses increased by 6% year-on-year. Expenses increased in particular due to wage inflation and investments in technology development and risk management.

Loan losses, on the other hand, were slightly below our forecast (68 MEUR vs. 87 MEUR estimate). However, the management judgment buffer was reduced by 30 MEUR during the quarter due to the improved macroeconomic outlook, which had a positive impact on the loan loss entries in the income statement. The size of the buffer is now 464 MEUR. There was a moderate deterioration in the quality of the credit portfolio in Q2, but the overall quality of the credit portfolio remained quite strong in the light of the reported figures.

With income and expenses well in line with our expectations, the net result for the quarter was also within our forecasts. Earnings per share were EUR 0.37 and return on equity was an excellent 17.9%.

Estimates	Q2'23	Q2'24	Q2'24e	Q2'24e	Consensus	Difference (%)	2024e
MEUR / EUR	Comparision	Actualized	Inderes	Consensus	Low High	Act. vs. Inderes	Inderes
Net interest income	1,831	1,904	1,924	1,918	1,874 - 1,958	-1%	7,581
Net commission income	751	795	785	771	751 - 788	1%	3,168
Net result from items at fair value	290	247	291	248	220 - 260	-15%	1,063
Other income	83	21	44	79	97 - 57	-52%	305
Total operating income	2,955	3,030	3,043	3,015	2,942 - 3,063	0%	12,117
Total operating expenses	-1,205	-1,278	-1,276	-1,277	-1,236 - -1,304	0%	-5,152
Net loan losses	-32	-68	-87	-74	-52 - -106	-22%	-317
EPS (reported)	0.37	0.37	0.37		-	0%	1.38
EPS (adj.)	0.37	0.37	0.37	0.36	0.31 - 0.40	0%	1.46

Source: Inderes & Bloomberg (consensus)

See the interview with the CFO:

Outlook unchanged

As expected, no changes to this year's guidance

The key question for Nordea's profitability development is, of course, the outlook for net interest income. In the Q2 report, the bank did not materially change its assessment of the impact on its net interest income of the central bank rate cuts expected by the market. Thanks to interest rate hedging and the gradual adjustment of reference rates, Nordea's interest rate sensitivity is quite moderate in the short term, which supports its profitability development. Therefore, meeting this year's guidance should not pose a challenge. As expected, the guidance was not changed and Nordea still expects its return on equity to exceed 15% this year.

Some additional information on the plans for the use of capital was provided in the results report when the bank announced that it had received approval for the use of capital models for retail exposures. The impact on solvency was in line with Nordea's previously published estimates, which also supports our own profit distribution forecasts. Nordea said it has started a dialog with the European Central Bank regarding a resumption of share buyback programs from early 2025.

Solvency remained strong

Nordea's solvency remained at a strong level with the Common Equity Tier 1 ratio rising to 17.5%. This is 4.4 percentage points above the current regulatory requirement. However, the current level of solvency gives an overly rosy picture of the capitalization of the balance sheet, as the introduction of the new accounting model, the Basel IV regulation that will come into force at the beginning of next year and the acquisition of Danske Bank's personal customer and private banking business in Norway will have a negative impact on Nordea's CET1 ratio. Nevertheless, the bank is strongly capitalized and even after adjusting for the above items, the CET1 ratio is well above the bank's target level.

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Source: Inderes & Bloomberg (consensus)

See Nordea's Q2 webcast:

Changes in forecasts remained marginal

The main income and expense lines in the Q2 report were broadly in line with expectations, so the forecast changes have remained moderate. As a result, our EBIT forecasts for the coming years have remained virtually unchanged.

We expect Nordea's EBIT to decline after this year in line with interest rates, but return on equity to remain above the target level of 15% throughout the current target period ending in 2025. Thereafter, we forecast ROE to decline to just over 13%, which we consider to be a sustainable level for Nordea even in a lower market rate environment.

Net interest income to turn down in our forecasts

We have slightly lowered our net interest income forecast for the current year, with net interest income in Q2 coming in slightly below our forecast. We forecast that interest income will continue to decline moderately in the coming quarters as interest rates fall.

Nevertheless, interest rate hedging and the gradual adjustment of reference rates for loans will mitigate this trend and support Nordea's profitability development.

Meanwhile, our net interest income forecasts for the coming years have risen slightly, as expectations for the timing of central bank rate cuts have moved a step further into the future during the quarter. We expect this, in turn, to have a positive impact on the development of net interest income. In our forecasts, we continue to assume that 3-month Euribor rates will settle in a range of 2–3% over the long term, in line with current market forecasts. Our net interest income projections for 2026 should therefore already reflect a fairly sustainable level of net interest income. From then on, the growth of the credit portfolio will drive the development of the net interest income in our forecasts.

For net fee and commission income, the forecast changes have also remained marginal.

Investments in risk management increase costs

Following the Q2 report, our operating cost forecasts for the coming years have increased slightly, neutralizing the impact of higher earnings on profitability. The majority of the increase in cost forecasts is explained by the bank's investments in risk management and technology development, which will lead to higher IT costs and more staff, among other things.

We expect an increase in loan losses

We have not made any material changes to our loan loss forecasts, even though the development in Q2 was better than expected, similar to the first half of the year. For the rest of the year, we continue to expect loan losses to rise above the normalized level of 0.1% of the loan portfolio estimated by the company.

Estimate revisions MEUR / EUR	2024e Old	2024e New	Change %	2025e Old	2025e New	Change %	2026e Old	2026e New	Change %
Net interest income	7,671	7,612	-1%	7,323	7,447	2%	7,160	7,342	3%
Net commission income	3,147	3,165	1%	3,290	3,309	1%	3,420	3,439	1%
Net result from items at fair value	1,079	1,063	-1%	1,105	1,090	-1%	1,133	1,117	-1%
Total operating income	12,190	12,145	0%	12,006	12,144	1%	12,004	12,199	2%
Total operating expenses	-5,150	-5,170	0%	-5,294	-5,392	2%	-5,434	-5,582	3%
Net loan losses	-371	-326	-12%	-389	-389	0%	-400	-400	0%
Operating profit	6,669	6,648	0%	6,323	6,362	1%	6,171	6,217	1%
Operating profit excl. non-rec. items	6,669	6,648	0%	6,323	6,362	1%	6,171	6,217	1%
EPS (reported)	1.38	1.38	0%	1.47	1.46	0%	1.41	1.42	0%
EPS (adj.)	1.47	1.46	0%	1.41	1.42	0%	1.39	1.40	1%
Dividend per share	0.92	0.92	0%	0.95	0.95	0%	0.92	0.92	0%

Source: Inderes

Our forecast for the profit distribution level in the coming years remain unchanged

Although there has been no significant deterioration in the quality of the credit portfolio, the proportion of loans with the lowest risk has steadily declined over the past year. In our view, this should foreshadow an increase in loan losses towards the end of the year. However, despite the increase, our projected loan loss rates are still very moderate relative to the bank's current profit levels.

Profit distribution to remain substantial

In its Q2 report, Nordea announced that it was planning a new share buyback program for next year. We had expected a new program for the end of this year, so the timing of our profit distribution forecasts has been slightly tweaked. However, our estimate for the size of the program remains unchanged at 1.0 BNEUR. In our projections, the total profit distribution for 2022–2025 is 17.4 BNEUR, which is in line with the company's own estimate (17–18 BNEUR).

In addition to share buybacks, we expect Nordea to distribute 65% of its earnings as dividends, in line with its dividend policy.

Nordea currently has a considerable amount of excess capital on its balance sheet compared to its solvency target. However, the higher systemic risk buffer, the acquisition of Danske Bank's personal customer business in Norway and the entry into force of Basel IV will have a negative impact on the bank's solvency.

Estimate revisions	2024e	2024e	Change	2025e	2025e	Change	2026e	2026e	Change
MEUR / EUR	Old	New	%	Old	New	%	Old	New	%
Net interest income	7,671	7,612	-1%	7,323	7,447	2%	7,160	7,342	3%
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EPS (reported)	1.38	1.38	0%	1.47	1.46	0%	1.41	1.42	0%
EPS (adj.)	1.47	1.46	0%	1.41	1.42	0%	1.39	1.40	1%
Dividend per share	0.92	0.92	0%	0.95	0.95	0%	0.92	0.92	0%

Source: Inderes

Attractive expected returns in the cards

Earnings-based valuation is low

With our 2024–2025 earnings estimates, Nordea is valued at a P/E ratio of ~7–8x, which represent a discount of almost 30% compared to the company's historical levels (P/E ~11x).

The valuation is low like in the rest of the Nordic banking sector, and the stock markets are currently very skeptical about the earnings outlook of the Nordic banking sector. We feel Nordea is well positioned to keep its performance relatively stable in the coming years, as hedging measures stabilize the development of net interest income and we also expect that the systematic decrease in the risk level of the balance sheet made in the past will bear fruit in the weakening economic cycle in terms of credit losses. In view of the relatively stable earnings outlook, we feel the share valuation is still attractive.

Valuation relative to peers not challenging either

Looking at the balance sheet (P/B), Nordea is priced with multiples close to those of its peer group in our projections for the coming years. We do not think this is justified given the company's stronger performance than its peers. The regression model that takes into account company-specific profitability differences (the correlation between the return on equity and the P/B ratio) also tells the same story about moderate pricing. In the light of this market-based model (graph on the right), a P/B ratio of 1.4x could be justified for the company, which would correspond to a price level of just over EUR 12.

Fundamentals based P/B

Nordea's acceptable fundamentals-based P/B valuation can be examined by making assumptions about a sustainable long-term return on equity (ROE), the cost of equity requirement (CoE) and a sustainable growth factor (g). If we assume that Nordea will sustainably reach a long-term ROE level of about 12–14% (cf. current financial target +15%, average over the last 20 years 12.6%) and apply a CoE requirement of 9.75–10.25% and a growth factor of 2.5% (in relation to the normalized earnings level), the acceptable P/B ratio would be around 1.2x–1.6x.

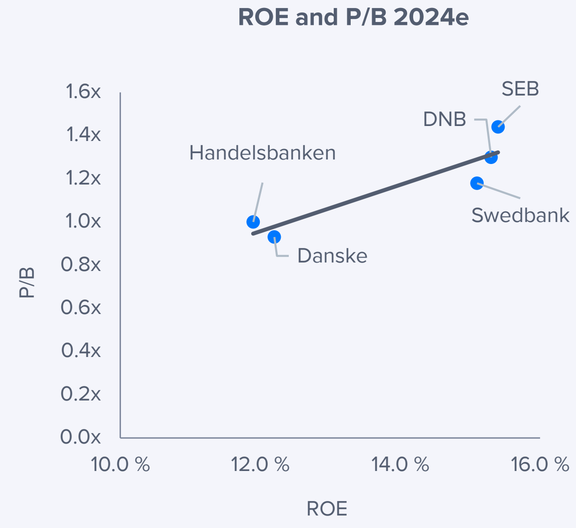
At the equity level of the end of 2023, the value at these multiples would range between EUR 10.7 and EUR 13.8. Conversely, this means that the current share price is burdened with the expectation of a significant deterioration in earnings. We estimate that a corresponding decline in profitability would require both 1) a decline in interest rates to well below 2% and 2) an increase in normalized loan losses above our current projections (~0.11% of the loan portfolio). Although 2023 and 2024 will be the peak years for earnings and return on equity in our forecasts due to falling interest rates, our view on normalized ROE is rosier than current market pricing.

Profit distribution strongly supports the expected return

With our estimates, Nordea's dividend yield rises to 8–9% in the next few years and the total distributed profits that considers share buybacks will rise to over 10%. Distributed profits in itself have no impact on the company's value, but we believe that the strong profit distribution in the coming years is a supportive element for the expected return and the share price.

Valuation	2024e	2025e	2026e
Share price	10.6	10.6	10.6
Number of shares, millions	3,506	3,459	3,411
Market cap	37,058	36,054	36,054
P/E (adj.)	7.2	7.5	7.5
P/B	1.2	1.1	1.0
Dividend yield-%	9.0 %	8.7 %	8.6 %

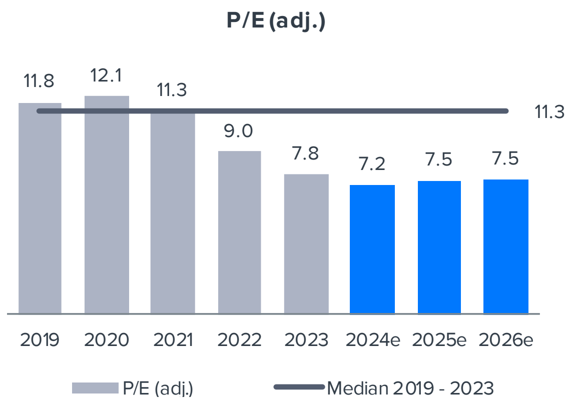
Source: Inderes

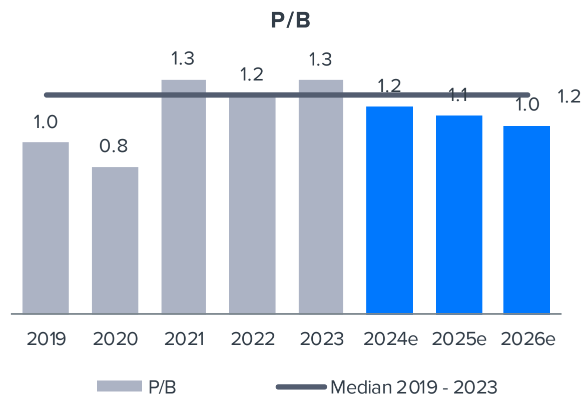


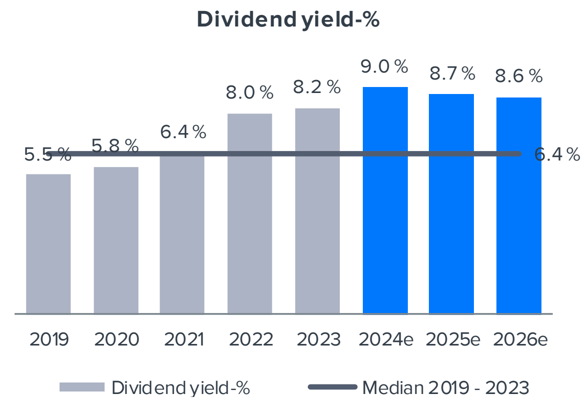
Valuation table

Valuation	2019	2020	2021	2022	2023	2024e	2025e	2026e	2027e
Share price	7.24	6.67	10.8	10.0	11.2	**10.6**	**10.6**	**10.6**	**10.6**
Number of shares, millions	4,102	4,118	4,025	3,721	3,576	**3,506**	**3,459**	**3,411**	**3,411**
Market cap	29,322	27,014	42,793	36,650	39,619	**37,058**	**36,054**	**36,054**	**36,054**
P/E (adj.)	11.8	12.1	11.3	9.0	7.8	**7.2**	**7.5**	**7.5**	**7.6**
P/B	1.0	0.8	1.3	1.2	1.3	**1.2**	**1.1**	**1.0**	**1.0**
Dividend yield-%	5.5 %	5.8 %	6.4 %	8.0 %	8.2 %	**9.0 %**	**8.7 %**	**8.6 %**	**8.6 %**

Source: Inderes







Peer group valuation

Peer group valuation	Market cap	P/E		Dividend yield-%		P/B
Company	**MEUR**	**2024e**	**2025e**	**2024e**	**2025e**	**2024e**
Danske Bank	23805	8.0	8.0	7.7	7.7	0.9
DNB	27841	8.5	9.2	7.5	7.6	1.3
Handelsbanken	17881	8.3	9.5	10.5	9.6	1.0
SEB	29669	9.5	9.8	7.0	6.1	1.4
Swedbank	21735	8.0	8.5	7.2	8.7	1.2
Nordea (Inderes)	**37058**	**7.2**	**7.5**	**9.0**	**8.7**	**1.2**
Average		**8.5**	**9.0**	**8.0**	**7.9**	**1.2**
Median		**8.3**	**9.2**	**7.5**	**7.7**	**1.2**
Diff-% to median		***-13%***	***-19%***	***21%***	***14%***	***-2%***

Source: Refinitiv / Inderes

Income statement

Income statement (MEUR)	2022	Q1'23	Q2'23	Q3'23	Q4'23	2023	Q1'24e	Q2'24e	Q3'24e	Q4'24e	2024e	2025e	2026e	2027e
Net interest income	5,664	1,765	1,831	1,909	1,946	7,451	1,954	1,904	1,886	1,868	7,612	7,447	7,342	7,339
Net fee and commission income	3,186	765	751	742	763	3,021	763	795	801	806	3,165	3,309	3,439	3,575
Net insurance result	173	46	68	63	40	217	61	63	57	57	238	240	243	245
Net result from items at fair value	623	345	290	225	154	1,014	291	247	263	263	1,063	1,090	1,117	1,145
Other income	75	0	15	13	12	40	16	21	15	15	67	58	58	58
Total operating income	**9,721**	**2,921**	**2,955**	**2,952**	**2,915**	**11,743**	**3,085**	**3,030**	**3,022**	**3,008**	**12,145**	**12,144**	**12,199**	**12,363**
Non-recurring items	-537	0	0	0	0	0	0	0	0	0	0	0	0	0
Total operating income excl. non-rec. items	**10,258**	**2,921**	**2,955**	**2,952**	**2,915**	**11,743**	**3,085**	**3,030**	**3,022**	**3,008**	**12,145**	**12,144**	**12,199**	**12,363**
Staff costs	-2,793	-719	-725	-729	-735	-2,908	-749	-761	-781	-787	-3,078	-3,239	-3,370	-3,506
Other expenses	-1,430	-542	-325	-312	-343	-1,522	-401	-379	-347	-409	-1,535	-1,566	-1,598	-1,630
Depreciation tangible and intangible assets	-611	-161	-155	-153	-339	-808	-139	-138	-140	-140	-557	-587	-614	-638
Total operating expenses	**-4,834**	**-1,422**	**-1,205**	**-1,194**	**-1,417**	**-5,238**	**-1,289**	**-1,278**	**-1,267**	**-1,336**	**-5,170**	**-5,392**	**-5,582**	**-5,774**
Non-recurring expenses	0	0	0	0	-177	-177	0	0	0	0	0	0	0	0
Total operating expenses excl. non-rec. expenses	**-4,834**	**-1,422**	**-1,205**	**-1,194**	**-1,240**	**-5,061**	**-1,289**	**-1,278**	**-1,267**	**-1,336**	**-5,170**	**-5,392**	**-5,582**	**-5,774**
Profit before loan losses	**4,887**	**1,499**	**1,750**	**1,758**	**1,498**	**6,505**	**1,796**	**1,752**	**1,755**	**1,672**	**6,975**	**6,752**	**6,617**	**6,589**
Net loan losses	-125	-19	-32	-33	-83	-167	-33	-68	-113	-113	-326	-389	-400	-410
Operating profit	**4,762**	**1,480**	**1,718**	**1,725**	**1,415**	**6,338**	**1,763**	**1,684**	**1,642**	**1,560**	**6,648**	**6,362**	**6,217**	**6,179**
Total non-recurring items	-537	0	0	0	-177	-177	0	0	0	0	0	0	0	0
Operating profit excl. non-rec. items	**5,299**	**1,480**	**1,718**	**1,725**	**1,592**	**6,515**	**1,763**	**1,684**	**1,642**	**1,560**	**6,648**	**6,362**	**6,217**	**6,179**
Taxes	-1,175	-332	-383	-380	-309	-1,404	-402	-381	-378	-359	-1,519	-1,463	-1,430	-1,421
Net profit for the period	**3,587**	**1,148**	**1,335**	**1,345**	**1,106**	**4,934**	**1,361**	**1,303**	**1,264**	**1,201**	**5,129**	**4,899**	**4,787**	**4,758**
Net profit excl. non-rec. Items	**4,186**	**1,148**	**1,335**	**1,345**	**1,244**	**5,072**	**1,361**	**1,303**	**1,264**	**1,201**	**5,129**	**4,899**	**4,787**	**4,758**
EPS (reported)	**0.96**	**0.32**	**0.37**	**0.38**	**0.31**	**1.38**	**0.39**	**0.37**	**0.36**	**0.34**	**1.46**	**1.42**	**1.40**	**1.39**
EPS (adj.)	**1.11**	**0.32**	**0.37**	**0.38**	**0.35**	**1.42**	**0.39**	**0.37**	**0.36**	**0.34**	**1.46**	**1.42**	**1.40**	**1.39**
Dividend per share	**0.80**					**0.92**					**0.95**	**0.92**	**0.91**	**0.91**

Balance sheet

Balance sheet (EURbn)	2022	2023	2024e	2025e	2026e	2027e
Cash and loans to central banks	63	53	53	55	56	57
Loans to credit institutions	5	2	2	2	3	3
Loans to the public	346	345	349	359	368	377
Intangibles	4	4	4	4	4	4
Other assets	178	181	183	189	193	198
Total assets	**595**	**585**	**591**	**609**	**624**	**640**
Equity	31	31	33	33	35	37
Deposits by credit institutions	33	30	23	24	24	24
Deposits and borrowings from the public	217	210	218	224	230	236
Debt securities in issue	180	183	185	190	195	200
Subordinated liabilities	5	6	6	6	6	6
Other liabilities	128	126	127	131	134	137
Total equity and liabilities	**595**	**585**	**591**	**609**	**624**	**640**

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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
6/9/2023	Buy	12.50 €	9.73 €
7/18/2023	Buy	12.50 €	10.33 €
10/20/2023	Buy	12.50 €	10.42 €
2/7/2024	Buy	12.50 €	10.81 €
4/19/2024	Buy	12.50 €	10.74 €
7/16/2024	Buy	12.50 €	10.57 €

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