

Nordea

Company report

2/7/2024



Kasper Mellas
+358 45 6717 150
kasper.mellas@inderes.fi

✓ Inderes corporate customer

This report is a summary translation of the report “Vahva vuosi pakettiin” published on 2/6/2024/ at 8:40 pm EET.

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Strong year-end results

On Monday, Nordea published Q4 results that fell short of expectations. The company's net interest income and operating expenses developed in line with our expectations, and the shortfall was mainly explained by quarterly fluctuations in fair value. In the end, we had to make only moderate changes to our estimates after the report. In our view, the company is still cheaply priced and thus the risk/return ratio looks attractive. We reiterate our EUR 12.5 target price and Buy recommendation.

Changes in fair value brought a slight disappointment in Q4

Nordea's operating income grew by 1% to 2,915 MEUR in Q4, which fell slightly short of our estimate of 3,004 MEUR. Supported by higher interest rates, net interest income increased by 19% year-on-year to 1,946 MEUR, which was in line with our forecast. The company's net commission income, on the other hand, was moderately below our forecast. However, the biggest negative surprise came from the quarterly fluctuations in fair value. Nordea's cost development was slightly better than expected, as comparable operating expenses increased by only 2% from the comparison period. Credit losses were 10 basis points of the credit portfolio, exceeding our forecast of 8 basis points. As a result, Nordea's Q4 revenue fell to 1,415 MEUR, missing our forecast by approximately 7%. EPS was also lower than expected at EUR 0.31 (Q4'23e: 0.33). However, due to the strong accumulated income, the return on equity adjusted from non-recurring costs stood at a strong level of 15.9%. For the full year, the return on equity was an impressive 16.7%. The management proposed a dividend of EUR 0.92 per share, which meant a slightly lower payout ratio than we expected.

New financial objectives in line with our forecasts

In connection with the results report, Nordea also announced its new financial objectives. Of these, particular interest was focused on the return on equity, for which the company set a target level of over 15% for the next two years. The updated ROE target reflects management's expectation that, in line with current market expectations, interest rates will settle at around 2% following the end of the interest rate cycle. Our own current forecasts and the consensus also expect an ROE of just over 15% for 2024–2025. Consequently, the new profitability objectives did not provide any major surprises.

Forecast changes mainly in profit distribution

We have made only minor revisions to our earnings forecasts for the coming years, and at group level the impact has been relatively modest. The biggest changes occurred in our profit distribution forecasts. Nordea estimates its cumulative profit distribution for 2022–2025 at 17–18 BNEUR, which is slightly below our estimate (18.5 BNEUR). Thus, we have lowered our dividend estimate for 2024–2025 by 7–8%. We have also lowered our estimate for the number of share buybacks. We now expect the new programs to total 1.5 BNEUR for the years 2024–2025 (was 2.0 BNEUR).

The share remains very cheaply priced

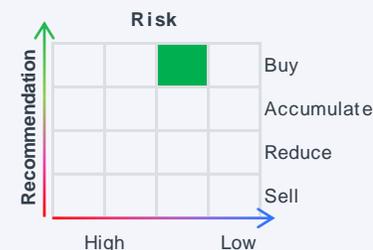
We have looked at Nordea's valuation through valuation multiples and a peer group. Nordea, like the rest of the banking sector, is currently priced exceptionally low (2023e: P/E 7x and P/B 1.2x) and the valuation paints an overly pessimistic picture of the company's earnings development in the coming years. We therefore feel that the upside in the valuation multiples and the profit distribution of 11–12% 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:
10.81



Key figures

	2023	2024e	2025e	2026e
Total operating income	11,743	11,991	11,887	11,792
growth-%	21%	2%	-1%	-1%
Total operating expenses	5,238	5,243	5,307	5,446
Cost/income ratio	45%	44%	45%	46%
Adjusted operating profit	6,515	6,298	6,192	5,946
Net profit	4,934	4,850	4,767	4,578
EPS (adj.)	1.42	1.40	1.41	1.36
Dividend per share	0.92	0.91	0.92	0.89
Payout ratio	65%	65%	65%	65%
ROE-%	17%	16%	15%	14%
P/E (adj.)	7.7	7.7	7.9	7.6
P/B	1.2	1.1	1.1	1.0
Dividend yield	8.4 %	8.5 %	8.2 %	8.5 %

Guidance

(New guidance)

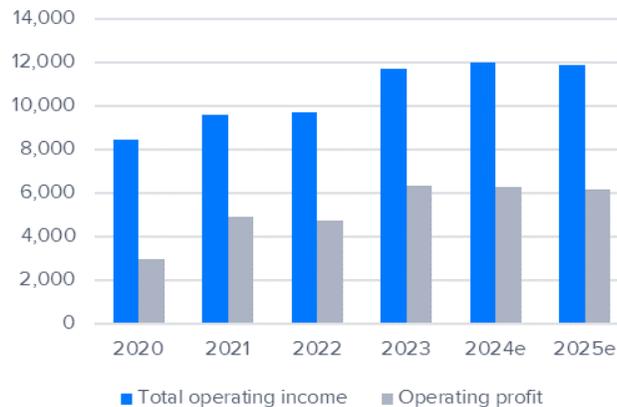
Nordea expects its return on equity to exceed 15 % in 2024.

Share price

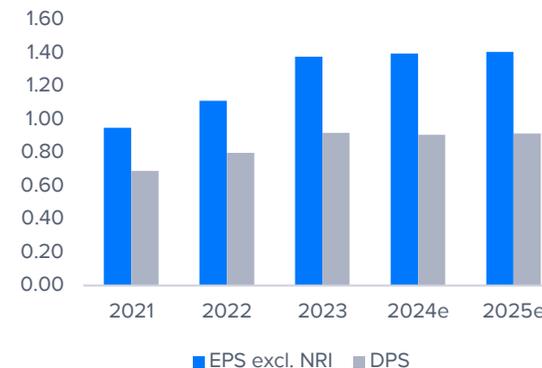


Source: Millstream Market Data AB

Operating income and EBIT



EPS and dividend



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	10.8	10.8	10.8
Number of shares, millions	3,469	3,386	3,361
Market cap	36,861	36,321	36,321
P/E (adj.)	7.7	7.7	7.9
P/B	1.2	1.1	1.1
Dividend yield-%	8.4 %	8.5 %	8.2 %

Source: Inderes

Net interest income strengthened, but results were weaker than expected

On Monday, Nordea published Q4 results that fell short of expectations. The company's net interest income and operating expenses developed in line with our expectations, and the shortfall was mainly explained by quarterly fluctuations in fair value. In connection with the Q4 report, Nordea also updated its financial objectives, where return on equity was the preliminary main area of interest. For the next two financial years, the company is aiming for a ROE of more than 15%, which corresponds fairly well to current consensus expectations. The guidance for the current year also offered few surprises, with a predicted return on equity of over 15%.

Net interest income continues to trend upwards

Nordea's operating income grew by 1% to 2,915 MEUR in Q4, which was slightly below our estimate of 3,004 MEUR. Supported by higher

interest rates, net interest income increased by 19% year-on-year to 1,946 MEUR and was in line with our expectations. The company's net commission income, on the other hand, was modestly below our forecast. Other income decreased as expected from the strong levels of the last quarter, but were, however, slightly below our expectations. The biggest negative surprise came from the quarterly fluctuations in fair value.

Q4 result was below expectations

Nordea's cost development offered no surprises during the quarter, and comparable operating expenses increased by 6% to 1,287 MEUR from the comparison period. In addition, as previously announced, the company made a write-down of 130 MEUR on capitalized development costs. Meanwhile, credit losses were 10 basis points of the

credit portfolio, exceeding our forecast of 8 basis points. Yet there was no material deterioration in the quality of the credit portfolio during the quarter, even though the proportion of non-performing loans increased slightly.

With moderately stable fee development and rising cost levels, Nordea's Q4 operating profit decreased to 1,415 MEUR, about 7% below our forecast. Earnings per share were also below our forecast at EUR 0.31 (Q4'23e: 0.33). However, due to the strong accumulated income, the return on equity adjusted from non-recurring costs remained strong at 15.9%. The bank's CET1 ratio was 17.0% at the end of the year (Q4'23: 16.4%), which exceeded the minimum requirement by 4.9 percentage points. The management proposed a dividend of EUR 0.92 per share, which was slightly below our expectations (EUR 0.97).

Estimates MEUR / EUR	Q4'22	Q4'23	Q4'23e	Q4'23e	Consensus		Difference (%)	2023
	Comparison	Actualized	Inderes	Consensus	Low	High	Act. vs. Inderes	Inderes
Net interest income	1,641	1,946	1,919	1,937	1,904 - 1,975		1%	7,451
Net commission income	785	763	780	776	754 - 845		-2%	3,021
Net result from items at fair value	396	154	235		-		-34%	1,014
Other income	75	52	70		-		-26%	257
Total operating income	2,897	2,915	3,004	3,034	2,980 - 3,106		-3%	11,743
Total operating expenses	-1,212	-1,417	-1,408	-1,356	-1,253 - -1,446		1%	-5,238
Net loan losses	-59	-83	-69	-94	-43 - -188		20%	-167
Operating profit	1,626	1,415	1,527	1,595	1,453 - 1,715		-7%	6,338
EPS (reported)	0.35	0.31	0.33		-		-6%	1.38
Dividend per share	0.80	0.92	0.96	0.93	0.30 - 1.02		-4%	0.92

Source: Inderes & Bloomberg (consensus)

See the interview with the CFO in the link below:



New financial objectives pave way for continued strong profitability

Return on equity target updated to 15%

In connection with the results report, Nordea also announced its new financial objectives. The most important of these was the return on equity target, which the company set at over 15% for the next two years. In order to support this goal, Nordea reduced its target cost/income ratio to 44–46% (was 45–47%).

The updated ROE target reflects management's expectation that, in line with current market expectations, interest rates will settle at around 2% following the end of the interest rate cycle. Our own current forecasts and the consensus also expect an ROE of just over 15% for 2024–2025.

In addition to this target, Nordea's guidance for the current year also expects a return on equity above 15%. Therefore, the profitability targets did not provide any material surprises.

Interest rate sensitivity slightly lower than before

Nordea also updated its estimate of the impact of central bank interest rates on net interest income. Based on a new sensitivity analysis, the company expects the rise in interest rates to strengthen the net interest income by 285 MEUR in the first year (was 300 MEUR), suggesting an increase in the use of interest rate hedges by the bank. This, in turn, should dampen the impact of interest rate cuts on net interest income.

In practice, the central bank's interest rate cuts and the subsequent fall in market interest rates will thus have a delayed impact on Nordea's net interest income. As a result, our own forecasts indicate that the bank's net interest income will decline only moderately in the coming years, even though market forecasts predict a fall of almost 2 percentage points in reference rates by 2026.

Estimates MEUR / EUR	Q4'22	Q4'23	Q4'23e	Q4'23e	Consensus		Difference (%)	2023
	Comparison	Actualized	Inderes	Consensus	Low	High	Act. vs. Inderes	Inderes
Net interest income	1,641	1,946	1,919	1,937	1,904 - 1,975		1%	7,451
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EPS (reported)	0.35	0.31	0.33		-		-6%	1.38
Dividend per share	0.80	0.92	0.96	0.93	0.30 - 1.02		-4%	0.92

Source: Inderes & Bloomberg (consensus)

Only moderate changes to earnings forecasts

Earnings forecasts nearly unchanged

We have made only minor revisions to our earnings forecasts for the coming years, and at group level the forecast changes are relatively modest.

In commission income, we have slightly lowered the average level of asset management fees based on the 2023 outcome. However, due to better-than-expected growth in AUM, our forecasts for commission income forecasts for the coming years are virtually unchanged.

Our forecast for operating expenses, on the other hand, have decreased slightly as a result of a lower-than-expected outcome at the end of last year.

We did not make any substantial changes to our net interest income estimates. We continue to forecast a moderate increase in the net interest income for the

current year, followed by a moderate decline in line with interest rates. The decline in the net interest income will, however, be slowed down by the interest rate hedges used by the bank.

We also have not touched on our loan loss forecasts, which anticipate an increase in write-downs in the coming years as a result of the slowing economy. For the current year, we expect loan losses to be around 13 basis points of the credit portfolio, compared to Nordea's guidance of a normalized level of around 10 basis points.

Most significant changes in profit distribution forecasts

Nordea estimates its cumulative profit distribution for 2022–2025 at 17–18 BNEUR, which is slightly below our own estimate. Thus, we have lowered our dividend estimate for 2024–2025 by 7–8%. We have

also revised downwards our estimate for the number of purchases of own shares. We now expect the new programs to total 1.5 BNEUR for the years 2024–2025 (was 2.0 BNEUR).

Estimate revisions	2023	2023	Change	2024e	2024e	Change	2025e	2025e	Change
MEUR / EUR	Old	New	%	Old	New	%	Old	New	%
Net interest income	7,424	7,451	0%	7,498	7,527	0%	7,295	7,278	0%
Net commission income	3,015	3,021	0%	3,149	3,128	-1%	3,270	3,244	-1%
Net result from items at fair value	1,095	1,014	-7%	1,050	1,050	0%	1,076	1,076	0%
Total operating income	11,809	11,743	-1%	11,984	11,991	0%	11,931	11,887	0%
Total operating expenses	-5,099	-5,238	3%	-5,233	-5,243	0%	-5,369	-5,307	-1%
Net loan losses	-153	-167	9%	-450	-450	0%	-389	-389	0%
Operating profit	6,556	6,338	-3%	6,301	6,298	0%	6,173	6,192	0%
EPS (reported)	1.42	1.38	-3%	1.40	1.40	0%	1.42	1.41	-1%
Dividend per share	0.95	0.92	-3%	0.98	0.91	-7%	0.99	0.92	-8%

Source: Inderes

Valuation remains moderate

Earnings-based valuation is low

With our 2024–2025 earnings estimates, Nordea is valued at a P/E ratio of ~8x, which represent a discount of almost 30% compared to the company's historical levels (P/E 10.7x). The valuation is low like for 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.

The company is also priced at a discount to the low-valued peer group

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 around EUR 12.7.

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 12–13% (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%, the acceptable P/B ratio would be around 1.2x–1.5x. With the 2023 figures, the value of the share with these multiples would be EUR 11.0–13.0.

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 loan losses above the normalized level estimated by management (0.1% of the loan portfolio). Although 2024 will be the peak year 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.

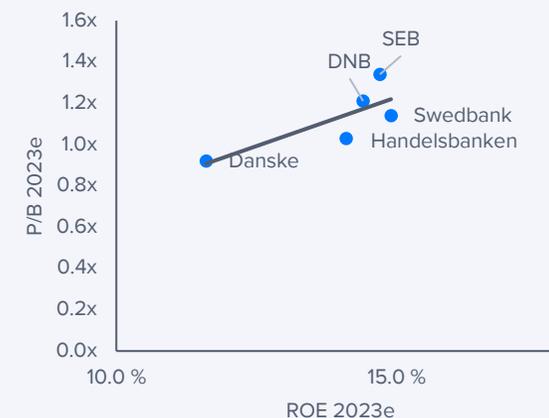
Profit distribution strongly supports the expected return

With our estimates, Nordea's dividend yield rises to over 8% in the next few years and the total distributed profits that considers share buybacks will rise to 11–12%. Distributed profits in itself has 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.

Nordea's total yield



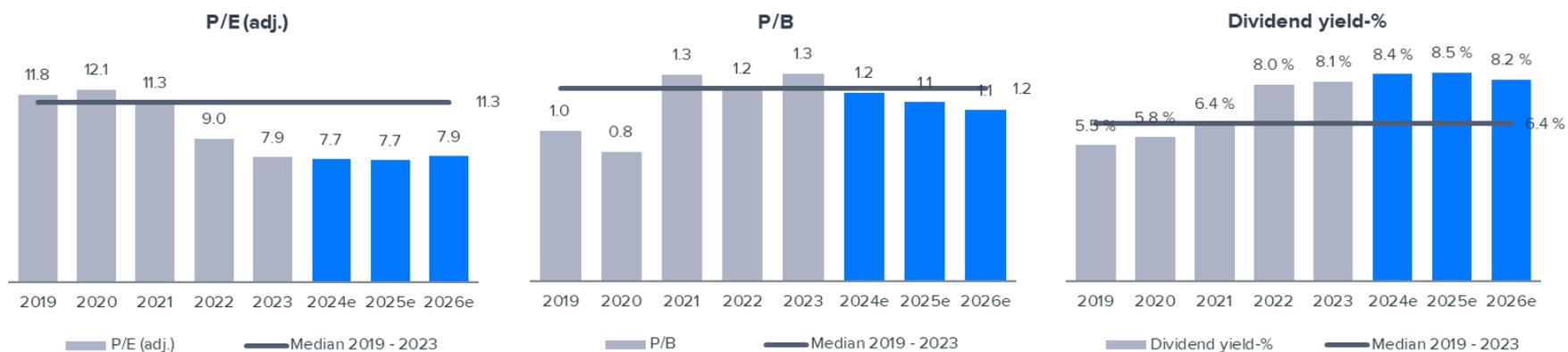
ROE and P/B 2023e



Valuation table

Valuation	2019	2020	2021	2022	2023	2024e	2025e	2026e	2027e
Share price	7.24	6.67	10.8	10.0	11.3	10.8	10.8	10.8	10.8
Number of shares, millions	4,102	4,118	4,025	3,721	3,576	3,469	3,386	3,361	3,361
Market cap	29,322	27,014	42,793	36,650	40,008	36,861	36,321	36,321	36,321
P/E (adj.)	11.8	12.1	11.3	9.0	7.9	7.7	7.7	7.9	7.6
P/B	1.0	0.8	1.3	1.2	1.3	1.2	1.1	1.1	1.0
Dividend yield-%	5.5 %	5.8 %	6.4 %	8.0 %	8.1 %	8.4 %	8.5 %	8.2 %	8.5 %

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	23054	8.0	7.7	7.5	8.2	0.9
DNB	27617	8.4	8.8	7.5	7.7	1.2
Handelsbanken	19413	8.8	9.6	8.2	8.2	1.0
SEB	27718	9.1	9.4	7.4	6.8	1.3
Swedbank	21063	7.6	7.9	8.7	8.7	1.1
Nordea (Inderes)	36861	7.7	7.7	8.4	8.5	1.2
Average		8.4	8.7	7.9	7.9	1.1
Median		8.4	8.8	7.5	8.2	1.1
Diff-% to median		-8%	-12%	12%	3%	5%

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	1,922	1,907	1,868	1,829	7,527	7,278	7,024	7,200
Net fee and commission income	3,186	765	751	742	763	3,021	771	776	789	792	3,128	3,244	3,373	3,507
Net insurance result	173	46	68	63	40	217	56	57	57	57	227	229	232	234
Net result from items at fair value	623	345	290	225	154	1,014	263	263	263	263	1,050	1,076	1,103	1,131
Other income	75	0	15	13	12	40	15	15	15	15	60	60	60	60
Total operating income	9,721	2,921	2,955	2,952	2,915	11,743	3,027	3,017	2,992	2,956	11,991	11,887	11,792	12,131
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	3,027	3,017	2,992	2,956	11,991	11,887	11,792	12,131
Staff costs	-2,793	-719	-725	-729	-735	-2,908	-763	-769	-766	-772	-3,070	-3,146	-3,241	-3,339
Other expenses	-1,430	-542	-325	-312	-343	-1,522	-510	-343	-307	-371	-1,529	-1,560	-1,591	-1,623
Depreciation tangible and intangible assets	-611	-161	-155	-153	-339	-808	-161	-161	-161	-161	-644	-601	-614	-627
Total operating expenses	-4,834	-1,422	-1,205	-1,194	-1,417	-5,238	-1,433	-1,273	-1,233	-1,304	-5,243	-5,307	-5,446	-5,588
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	-1,433	-1,273	-1,233	-1,304	-5,243	-5,307	-5,446	-5,588
Profit before loan losses	4,887	1,499	1,750	1,758	1,498	6,505	1,594	1,744	1,759	1,652	6,749	6,580	6,345	6,543
Net loan losses	-125	-19	-32	-33	-83	-167	-113	-113	-113	-113	-450	-389	-399	-409
Operating profit	4,762	1,480	1,718	1,725	1,415	6,338	1,481	1,632	1,646	1,540	6,298	6,192	5,946	6,134
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	1,481	1,632	1,646	1,540	6,298	6,192	5,946	6,134
Taxes	-1,175	-332	-383	-380	-309	-1,404	-341	-375	-379	-354	-1,449	-1,424	-1,368	-1,411
Net profit for the period	3,587	1,148	1,335	1,345	1,106	4,934	1,141	1,256	1,267	1,185	4,850	4,767	4,578	4,723
Net profit excl. non-rec. Items	4,186	1,148	1,335	1,345	1,244	5,072	1,141	1,256	1,267	1,185	4,850	4,767	4,578	4,723
EPS (reported)	0.96	0.32	0.37	0.38	0.31	1.38	0.32	0.36	0.37	0.35	1.40	1.41	1.36	1.41
EPS (adj.)	1.11	0.32	0.37	0.38	0.35	1.42	0.32	0.36	0.37	0.35	1.40	1.41	1.36	1.41
Dividend per share	0.80					0.92					0.91	0.92	0.89	0.91

Balance sheet

Balance sheet (BNEUR)	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	348	359	367	377
Intangibles	4	4	4	4	4	4
Other assets	178	181	183	188	193	198
Total assets	595	585	591	608	623	639
Equity	31	31	32	33	34	36
Deposits by credit institutions	33	30	30	31	31	30
Deposits and borrowings from the public	217	210	212	218	224	229
Debt securities in issue	180	183	184	190	195	199
Subordinated liabilities	5	6	6	6	6	6
Other liabilities	128	126	127	131	134	137
Total equity and liabilities	595	585	591	608	623	639

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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 €



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Inderes Oyj

Itämerentori 2

FI-00180 Helsinki, Finland

+358 10 219 4690

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