MOODY'S INVESTORS SERVICE

ISSUER COMMENT
17 February 2023

Send Your Feedback

Contacts

Swen Metzler, CFA +49.69.70730.762
VP-Sr Credit Officer
swen.metzler@moodys.com

Alexander Hendricks, CFA +49.69.70730.779
Associate Managing Director
alexander.hendricks@moodys.com

Carola Schuler +49.69.70730.766
MD-Banking
carola.schuler@moodys.com

» *Contacts continued on last page*

Commerzbank AG

Decade-high profit supports ambitious strategic and financial targets

On 16 February, Commerzbank AG (A1/A2 stable, baa2[1]) reported decade-high profits of €1.4 billion for 2022 versus €430 million in 2021. The results indicate that Commerzbank restored its earnings capacity, which allows it to absorb unexpected risks without weakening capital, a credit positive.

For 2023, we believe Commerzbank can achieve net income well above last year's level[2], and thus approach a return on assets (ROA) of more than 40 basis points. The bank is well on track to achieve its targeted 7.3% return on tangible equity by 2024 compared with 4.9% for 2022. Increased revenue last year, supported by strong net interest income growth and tight cost control, offset higher credit costs and extraordinary provisions related to unresolved litigation risk in Poland.[3]

Commerzbank will return capital to shareholders for the first time since 2018 and pay out 30% of its 2022 net income, including a dividend of €0.20 per share and a €122 million buyback program. This year, the bank expects to increase shareholder payments to 50% (subject to various conditions)[4], given additional earnings upside mainly tied to interest rate increases this year and the delayed pass-through of higher rates for deposits (so-called deposit beta).

Now in the second year of its four-year Strategy 2024 transformation plan, Commerzbank has booked nearly all of the €2.1 billion total restructuring charges, reduced its domestic workforce by around one third and closed around half of its domestic branches. For the rest of the four-year strategic overhaul, Commerzbank will intensify its focus on profitable customer businesses and maintain strong cost discipline to achieve a 60% cost-to-income ratio by 2024, down from 69% in 2022.

Commerzbank improved its capitalization amid the challenges of the pandemic and energy crisis. At year-end 2022, its Common Equity Tier 1 (CET1) capital ratio was 14.1%, up from 13.6% in 2021 and 13.4% at the end of 2019, driven by retained earnings and a 3.4% year-over-year decline in risk-weighted assets (RWAs) to €169 billion from €175 billion in 2021 and €182 billion in 2019. Better capital efficiency in the corporate client segment, which is a focal point of its strategic overhaul, supported the improvement. In 2022, the average corporate client profitability as a percent of allocated RWAs increased to 6.1% from 5.2% in 2021 and 4.6% in 2020.

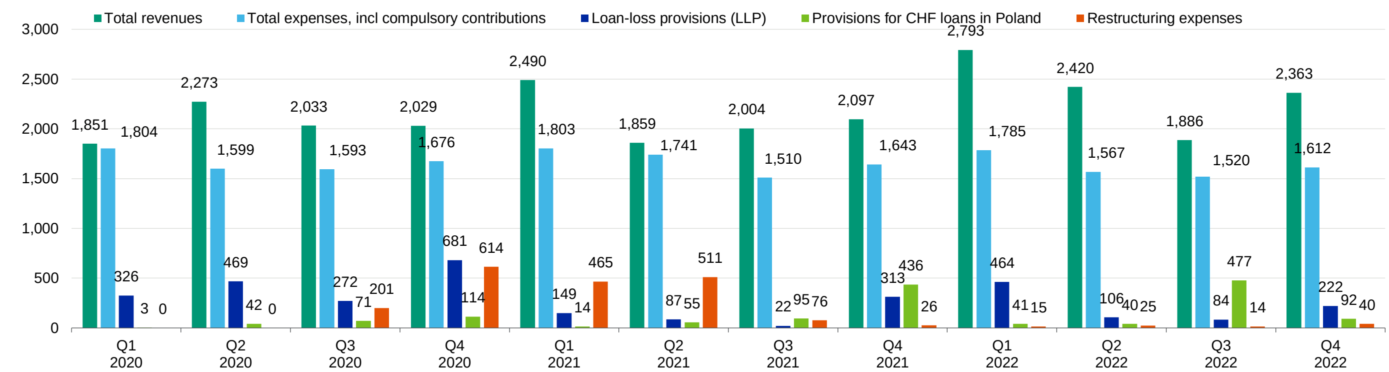
We expect that Commerzbank will continue operating with a CET1 capital ratio of more than 14% and maintain a significant capital cushion over going-concern Pillar 2 requirements, which were 466 basis points at the end of 2022. Germany's new capital requirements, applicable since 1 February, increased the bank's minimum required capital by around 55 basis points, from a total CET1 requirement of 9.48% at year-end 2022. The regulatory requirement will increase by an additional 6 basis points once the UK countercyclical buffer requirement becomes effective in July.

For 2022, Commerzbank reported around 12% higher revenues of €9.5 billion, up from €8.5 billion in 2021, which helped to digest extraordinary expenses of around €1 billion.[5] The improvement was mainly driven by higher net interest income which increased by 36% to €6.3 billion from €4.8 billion over the same period, reflecting strong growth in all business segments as a result of higher loans and net interest margins.

Commerzbank targets total operating costs of around €6 billion at the end of its transformation by 2024. For 2022, the bank reported total expenses of €6.5 billion versus €6.7 billion in 2021, reflecting the balance of around 6% lower operating expenses of €5.8 billion, offset by around 37% higher compulsory contributions (including bank levies, depositor and institutional protection schemes) of €642 million. We expect Commerzbank to maintain strong cost discipline to balance upward pressure on operating expenses, including the bank's 4Q 2022 reintroduction of variable compensation and continued digital investment needs.

Exhibit 1

Barring extraordinary charges, Commerzbank's higher revenue and lower expenses improved its earnings capacity
Data in € millions



*Total expenses include operating costs and compulsory contributions such as bank levy and contributions to deposit guarantee schemes.
Sources: Commerzbank and Moody's Investors Service

Commerzbank's 2022 results were also supported by moderate cost of risk (i.e., loan loss provisions/gross loans). More than 40% of the cost-of-risk increase to 33 basis points from 22 basis points in 2021 reflected the bank's direct exposure to Russia. For 2022, Commerzbank reported loan loss provision of €876 million, up from €570 million in 2021. At year-end 2022, Commerzbank reduced its direct exposure to Russia by around 60% to €744 million at the end of 2022, compared with around €1.87 billion as of 18 February 2022. Commerzbank's nonperforming exposure ratio increased to 1.1% from 0.9% over the same period, largely driven by its corporate lending activities, including automotive and energy/utility firm exposures that are most vulnerable to higher energy costs, and accounted for 2.7% and 2.1% of its total loan portfolio at year-end 2022. We believe that the bank's generic reserve of €482 million in accordance with international accounting standard IFRS9 (so called top-level adjustment) provides additional cover for future uncertainties.

Moody's related publications

Issuer Comments

» Commerzbank's strategic transformation on track to achieve ambitious goals by 2024, 18 February 2022

» Additional provision on Swiss franc mortgage loans in Poland will burden 2021 earnings, 25 January 2022

» Restructuring charge aims to improve long-term profitability, but will burden 2020 earnings, 5 January 2021

Issuer In-Depth

» Digital overhaul is pivotal to improving profitability, 22 March 2021

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 The ratings shown are Commerzbank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

2 Assuming no significant additional charges at Commerzbank's majority-owned subsidiary in Poland, mBank S.A. (A3 review for downgrade, baa3).

3 At the end of 2022, mBank set aside €1.4 billion provisions for legal risks on €2.5 billion of Swiss-franc-denominated mortgage loans, translating into a coverage ratio of 54%.

4 These include positive net income in accordance with international accounting standards after coupon payment for Additional Tier 1 (AT1) debt securities and minorities, and maintaining a capital buffer of more than 200 basis points above its minimum CET1 capital ratio.

5 These relate to mBank and include around €650 million extraordinary provisions for Swiss franc-denominated mortgages and €278 million credit charges reflecting the economic impact of the Polish government's support package for retail borrowers, also termed as credit holidays.

REPORT NUMBER 1356623

Contacts

Vasil Mrachkov +49.69.70730.867
Associate Analyst
vasil.mrachkov@moodys.com