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Commerzbank AG

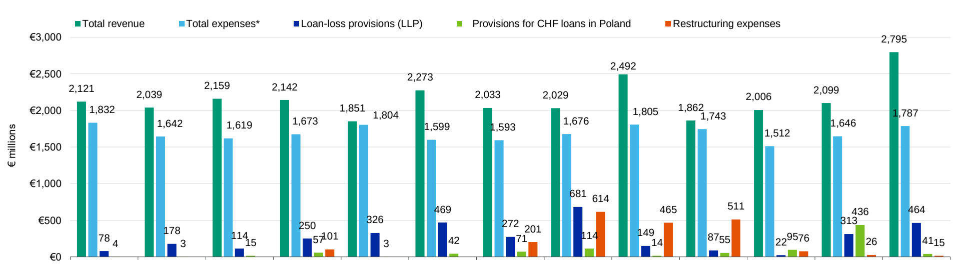
Solid profits in 1Q22 despite provisions for Russia exposure

On 12 May, Commerzbank AG (A1 stable/A1 negative, baa2[1]) announced a €298 million profit for first-quarter 2022, up from €133 million a year ago amid good performance across all segments and tight cost control. The results put Commerzbank on track to achieve its ambitious goals by 2024, a credit positive. The bank also expects to resume dividend payments of 30% of 2022 net income, subject to certain conditions.[2]

Commerzbank reported revenue of €2.8 billion in 1Q22, up 12% from the prior-year period, driven by higher net interest income of €1.4 billion (1Q21: €1.3 billion) and broadly stable net fee income of €972 million (1Q21: €959 million). The bank's subsidiary in Poland, mBank S.A. (A3 stable, baa3), greatly contributed to the increase in net interest income, reflecting the significant increase in local interest rates. However, Commerzbank's domestic retail and corporate activities also reported higher net interest income tied to the introduction of deposit pricing and stable loans. The attractive terms and conditions of the ECB's targeted longer-term refinancing operations (TLTRO) added €45 million to net interest income in 1Q22.

Commerzbank targets operating costs of around €5.3 billion at the end of its transformation by 2024, and €6.3 billion for 2022. Operating expenses of around €1.8 billion in the first quarter included €347 million compulsory expenses for bank levies and deposit insurance fees (see exhibit). Commerzbank only booked additional restructuring charges of €15 million in the quarter because it had already booked around 97% of the total expected restructuring charges by the end of last year.

Exhibit 1
Quarterly revenue exceeded quarterly expenses by around €1 billion in 1Q22, the largest difference since 2019
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 increased credit provisions to €464 million in 1Q22 from €149 million in the prior year after reassessing asset risks, which were largely related to Russia. As of 29 April, the bank had a €1.2 billion net exposure[3] to Russia, around 36% lower than in mid-February and equivalent to around 5% of its Common Equity Tier 1 capital at 31 March 2022.[4] Commerzbank also reported a €41 million provision in 1Q22 for outstanding Swiss franc-denominated mortgages in Poland, which brings its total coverage ratio for unresolved litigation risk at mBank to around 47%.

Weakening credit quality from its Russian exposures prompted specific credit provisions of €159 million, triggered by weaker ratings plus an additional generic reserve (so called top-level-adjustment, TLA) of €334 million, in line with international accounting standard IFRS 9. This brings Commerzbank's total coverage for these exposures to around 41%. The ladder component is included in its total TLA reserve of €713 million at the end of 1Q22 (2021: €523 million), which we consider a substantial buffer to cover unforeseen risks that could arise from a weakening economic recovery, supply shortages and rising inflation. Excluding the effect from direct Russian exposures, Commerzbank's underlying cost of risk[5] dropped to around four basis points (2021: 22 basis points), in line with its nonperforming exposure ratio declining to 0.8% as of 1Q22 from 0.9% as of year-end 2021.

Commerzbank is well capitalized to achieve remaining targets of its transformation. As of 1Q22, its CET1 capital ratio was at 13.5% (2021: 13.6%), reflecting slightly lower capital and stable risk-weighted assets (RWAs) of €175 billion. The bank operates with significant headroom over going-concern Pillar 2 capital requirements, which were around 410 basis points as of 31 March 2022, down from 420 basis points in 2021. In the first quarter, Commerzbank further improved the capital efficiency[6] in its Corporate Clients segment to 5.4% (2021: 5.2%), a focal point of its strategic overhaul.

Commerzbank announced a dividend payout ratio of 30% for 2022, which indicates that the bank is on track to achieve its objectives by 2024. Expected net income of at least €1 billion for 2022 is broadly consistent with a return on assets (ROA) of more than 20 basis points, and compares with an average ROA of 10 basis points during 2016-19.

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Endnotes

1 The ratings shown are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

2 These conditions require achieving the bank's 2022 financial targets, 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.

3 Net exposure reflects the bank's gross exposure and the deduction of guarantees, mainly from state-controlled Export Credit Agencies.

4 In addition to the net exposure, Commerzbank's subsidiary Eurasija holds around €300 million deposits at the Russian central bank and clearing house.

5 Cost of risk is expressed as the ratio of loan loss provisions over gross loans.

6 In 2021, the average corporate client profitability as percent of allocated RWAs increased to 5.2% from 4.6% in 2020.

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