ISSUER COMMENT
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Commerzbank AG

Ambitious 2028 strategy targets 15% net return on tangible equity

On 13 February, Commerzbank AG (A1 positive, baa2)[1] reported full-year 2024 results and hosted its Capital Markets Day, outlining its strategy and targets until 2028. The updated medium-term targets are credit positive and further evolve Commerzbank's bondholder-friendly strategic overhaul that began in 2020. However, successful execution continues to rely on less predictable revenue growth and an improving macroeconomic environment.

Until 2028, Commerzbank aims to grow revenue by a cumulative 17% from 2024 (2024 adjusted for legal risk provisions in Poland) while keeping expense growth contained at a cumulative 9%. The resulting improvement in operating leverage should support the bank's aim to achieve a cost-to-income ratio of 50% by 2028, a significant improvement from 59% in 2024. This improvement will be supported by a further 11% gross reduction in staff[2], aimed at realizing an additional annual €500 million in cost synergies during the planning horizon. Strong cost control and contained loan losses are aimed at supporting a strong improvement of the bank's return on tangible equity (RoTE) to 15% by 2028 (prior 2027 target was 12%). There are no major changes to the bank's payout strategy.

In 2024, revenue grew 6.2% to €11.1 billion, outstripping cost growth of 1.6% and providing solid positive operating leverage. Loan loss charges rose 20% year over year to €743 million, reflecting larger single cases, and represented 27 basis points (bps) of gross loans (2023: 23 bps). The results were further constrained by an additional €1 billion in provisions for legal risks in Poland related to the group's swiss franc-denominated mortgage book held at mBank S.A. (Baa1 positive, ba1), mitigated by higher foreign-exchange valuations. Overall, net profit increased 20% to €2.68 billion, equivalent to a net RoTE of 9.2%, significantly exceeding the bank's 8% target for the year.

First line of defense will be further strengthened. Under its revised strategic plan, Commerzbank aims to grow revenue to around €14.2 billion by 2028 from an adjusted €12.1 billion in 2024[3], while containing costs at around €7.1 billion in 2028 (2024: €6.5 billion). Together with loan loss charges remaining contained at around €850 million for 2025, equivalent to about 29 bps of gross loans and retreating to around 25 bps thereafter, the new targets would set Commerzbank on track to achieve a RoTE of 15% by 2028, a major leap forward from 9.2% in 2024.

Second line of defense softens because of higher payouts. Commerzbank aims to maintain a Common Equity Tier 1 (CET1) capital ratio at or above 13.5% in 2028, providing a good capital base to absorb potential shocks. Although the 2028 target ratio represents a decline from 15.1% in 2024, the bank will continue balancing shareholder and bondholder interests, despite a payout ratio of around 100% over 2025-28. The bank's largely unchanged payout strategy through a combination of dividends and more flexible share buybacks will further help maintain its CET1 capital ratio at or above the target level.

First line of defense will be further strengthened

Commerzbank's revenue guidance of €14.2 billion in 2028 builds on enhancing its strengths in its Corporate Clients (CC) and Private and Small Business Customers (PSBC) segments. Net revenue growth of about €2.1 billion from the 2024 adjusted[4] level of €12.1 billion will likely be supported by a cumulative €600 million net positive effect from the replication investment portfolio and volume growth. Additionally, €1.2 billion in higher fee and commission income generated across the group, stemming from ongoing strategic initiatives, will likely add to revenue. Commerzbank's future revenue growth will be less constrained by higher interest expenses as the repricing effects from its large and stable deposit base fade and lower treasury income stabilises.

At the group level, strong cost control and the resulting improvement in operating leverage, will make Commerzbank more resilient to setbacks in revenue. Moreover, retreating legacy charges from the bank's Polish operations, reducing its dependence on revenue generation, will help the bank progress and likely get close to its target returns by 2028.

Nevertheless, we expect reaching the upwardly revised revenue targets will be ambitious. Achieving the new targets further relies on additional operating expense reductions requiring costly layoffs as well as maintaining solid asset quality in a highly challenging and uncertain macroeconomic environment, particularly in Germany (Aaa stable).

In PSBC Germany, Commerzbank aims to generate higher revenue from growth in payment and asset and wealth management revenue. Together with higher interest income generated from increased reinvestment gains from the growing volume of modeled deposits and resulting higher income from the bank's replication portfolio, should help improve PSBC's underlying revenue by around €1.3 billion to €5.7 billion until 2028, from €4.4 billion in 2024. However, and since client behaviour and market valuations will determine securities volumes and related fee and commission as well as trading income during the outlook period, revenue growth targets in PSBC continue to look ambitious, in particular because they foresee an even higher revenue growth compared with the prior 2027 target level.

Within CC, Commerzbank aims to maintain a favourable cost-to-income ratio of 43% by 2028 (2024: 44%), with revenue growing to €5.6 billion by 2028, up from €5.0 billion in 2024. The bank anticipates its cost-to-income ratio will be supported by revenue growth stemming from significantly higher loan balances, particularly in Germany and (green) transition finance. We believe that Commerzbank's expectation of a cumulative 36% growth in loan volume in CC through 2028 is very ambitious since it ultimately depends on macroeconomic developments within Germany and market share gains. Higher net fee and commission income from increased cash and transaction or trade finance as well as foreign-exchange revenue will help add to growth. These initiatives should help offset the strain on revenue from higher (deposit) refinancing costs.

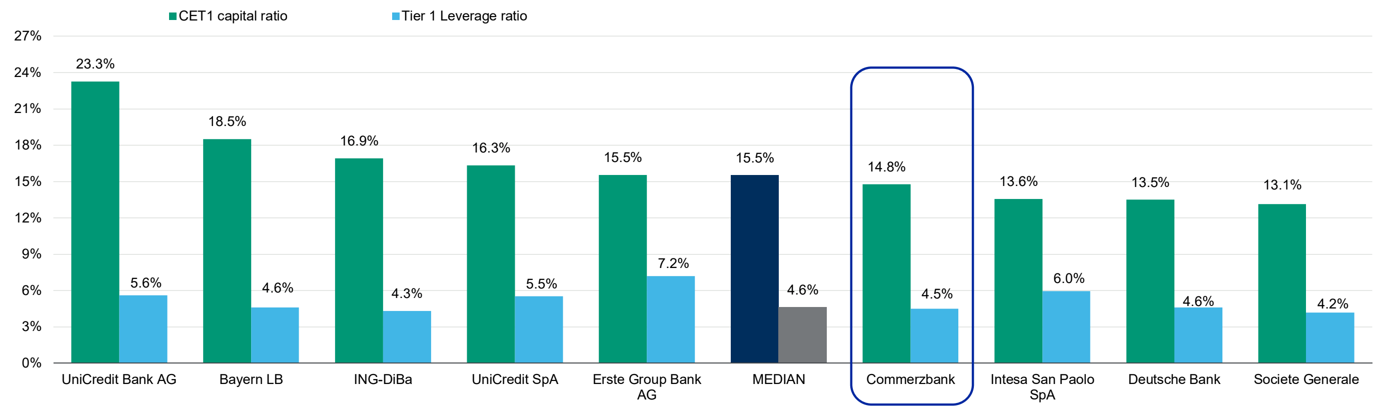
Second line of defense softens because of higher payouts

Commerzbank's CET1 capital ratio was 15.1% at the end of 2024, up 40 bps from year-end 2023 and more than 200 bps higher than 2019 when it initiated its restructuring programme 'Commerzbank 5.0'. Management intends to keep an unchanged capital buffer of at least 250 bps over its regulatory requirements, safeguarding its capital position well above the ECB's regulatory requirements and remaining well-positioned within its peer group (see exhibit).

Exhibit 1

Commerzbank's capital buffers will soften, but will continue protecting bondholders

CET1 capital and Tier 1 leverage ratios, as of 30 June 2024



Calculated per Capital Requirement Regulations (template EU KM1).
Sources: Company's Pillar 3 Disclosures and Moody's Ratings

For 2024, Commerzbank will pay a cash dividend of €0.65 per share, up from €0.35 per share in 2023 and equivalent to around €730 million of dividend payments. Commerzbank also concluded a €1.0 billion share repurchase programme in 2024. For 2025 and beyond, Commerzbank aims to achieve a total payout ratio of 100% through a combination of gradually growing cash dividends and more flexible share buybacks. This capital distribution policy, although potentially paying out more than 100% of net profit in 2025 and likely 100% thereafter, allows for sufficient flexibility by always limiting the anticipated total payout such that the bank would always maintain a CET1 capital ratio of at least 13.5%.

Moody's related publications

Issuer In-Depth:

» Higher profitability supports credit positive restructuring, 26 April 2024

Credit Opinion:

» Update following rating affirmation with a positive outlook, 4 October 2024

Rating actions:

» Moody's Ratings affirms Commerzbank's long-term deposit, issuer and senior unsecured debt ratings, outlook remains positive, 2 October 2024

» Moody's Ratings affirms Commerzbank's long-term deposit, issuer and senior unsecured debt ratings, changes outlook to positive, 27 April 2024

Endnotes

1 The ratings shown here are the bank's deposit rating, outlook and Baseline Credit Assessment.

2 Full-time equivalents.

3 Adjusted for €1.0 billion in legal risk charges in Poland.

4 Adjusted for €1.0 billion in legal risk charges in Poland.

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