STRESS TESTS
IN PERSPECTIVE

ALPHAVALUE
independent equity research

Last Friday European stress tests were a disappointment, but this is not a surprise.

It could take some time for the market to digest the data, and some interesting comments or even actions from banks which passed the exam by a too short margin cannot be ruled out.

Overall, we believe that the tests, combined with Basel III easing announced today, could help loosen in a certain extent tensions in the interbank market since disclosed data increase transparency.

Out of the 39 European listed banks covered by AlphaValue, 30 were stress-tested by the CEBS.

We see three interesting angles that can be derived from the summary data provided for each bank:

1- Post-stress test Tier 1 positioning
2- Earnings generation potential
3- Risk profile

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1/ Post stress test Tier 1 positioning

Company	Stressed Tier 1	Equity shortfall (€m)
Barclays (BARC)	13,7%	-
Royal Bank Of Scotland (RBS)	11,2%	-
Dexia (DEXIA)	10,9%	-
SNS Bank (SNS)	10,5%	-
Skandinaviska Enskilda Bank (SEB)	10,3%	-
Hsbc (HSBC)	10,2%	-
Nordea (NORD)	10,1%	-
Danske Bank (DANSKE)	10,0%	-
Santander (SAN)	10,0%	-
Société Générale (SG)	10,0%	-
Swedbank (SW)	9,9%	-
Deutsche Bank (DBK)	9,7%	-
BNP Paribas (BNPP)	9,6%	-
KBC Bank (KBC)	9,4%	-
BBVA (BBVA)	9,3%	-
Lloyds Banking Group (LBG)	9,2%	650
Commerzbank (CMZ)	9,1%	606
Crédit Agricole Group (CA)	9,0%	1 801
Svenska Handelsbanken (SH)	8,9%	432
Banco Comercial Portugues (BCP)	8,4%	591
Intesa Sanpaolo (ISP)	8,2%	4 152
Erste Group (ERSTE)	8,0%	1 913
Unicredit (UCI)	7,8%	7 068
Banco De Sabadell (SAB)	7,2%	1 217
Bank of Ireland (BOI)	7,1%	1 898
Banco Popular Espanol (POP)	7,0%	2 129
Banco Espirito Santo (BES)	6,9%	1 630
Deutsche Postbank (DPBK)	6,6%	1 675
Allied Irish Banks (AIB)	6,5%	2 066
Banca Monte Dei Paschi Siena (MPS)	6,2%	3 802
Median	9,3%	
Total		€31 628m

The heterogeneity of post-test Tier 1 ratios tends to confirm, if needed, the limits of the Tier 1 concept, its lack of comparability and therefore the limits of a solvency-centric stress test methodology. In an ideal world, should the Tier 1 properly reflect individual risks, banks should have ended up with closer post test ratios. Results raise more questions than they give answers. Is the banking sector over-capitalised? Are BARC, RBS or Dexia over-capitalised? Is Deutsche Bank, with a ratio 40% below BARC's one, under-capitalised?

Although a 6% threshold at a core Tier 1 level makes sense, it is a non-sense at a Tier 1 level. Obviously, under a stress test scenario, the sector cannot appear as over-capitalised! The appropriate minimum threshold is 8%. However, from a market point of view, we tend to think that all banks with a post-test Tier 1 ratio below 9.3% (median) are short of equity. This corresponds to an aggregated equity shortfall of €32bn (€8bn assuming an 8% threshold).

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2/ Earnings generation potential

Banks disclosed 2011 Tier equity forecasts under a so-called benchmark scenario, which computes base case GDP forecasts. In our view, under this scenario, banks likely used their existing business plans, thus providing the market with interesting guidance.

These forecasts must be taken cautiously since some include balance sheet management actions and others seem to diverge from previous official guidance.

Company	**Return on 09 Tier 1 (cumulative 2010/2011)**
Santander	32,3%
Barclays	29,8%
BBVA	29,5%
Svenska Handelsbanken	28,9%
Banco Espirito Santo	26,0%
Deutsche Bank	24,9%
Nordea	23,3%
Hsbc	22,7%
BNP Paribas	20,7%
Unicredit	20,2%
Intesa Sanpaolo	19,6%
Lloyds Banking Group	18,9%
Société Générale	16,2%
Crédit Agricole Group	15,7%
Erste Group	15,7%
KBC Bank	14,7%
Banco De Sabadell	13,7%
Banco Popular Espanol	11,2%
Dexia	6,4%
Deutsche Postbank	5,5%
Banco Comercial Portugues	5,0%
Danske Bank	5,0%
SNS Bank	4,8%
Swedbank	3,2%
Commerzbank	2,6%
Royal Bank Of Scotland	0,9%
Banca Monte Dei Paschi Siena	0,7%
Skandinaviska Enskilda Bank	-2,2%
Allied Irish Banks	-19,9%
Bank of Ireland	-20,0%
Total	€139 604m
Median	15,2%

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3/ Risk Profile

Banks can be sorted out according to the impact of the stress test. This provides a sense of risk sensitivity even if it is likely that the methodology and the assumptions (domestic property prices evolution for instance) are in favor of certain banks and potentially distort the final results.

Company	**GDP impact**	**Sovereign impact**	**Total impact**
Swedbank	-0,2%	-0,6%	-0,8%
Banco Comercial Portugues	-1,0%	0,0%	-1,0%
Santander	-0,8%	-0,2%	-1,0%
Nordea	-1,1%	-0,1%	-1,2%
BBVA	-1,0%	-0,3%	-1,3%
Deutsche Postbank	-1,2%	-0,1%	-1,3%
Svenska Handelsbanken	-1,1%	-0,2%	-1,3%
Banca Monte Dei Paschi Siena	-0,8%	-0,6%	-1,4%
Commerzbank	-1,2%	-0,2%	-1,4%
Skandinaviska Enskilda Bank	-1,1%	-0,4%	-1,5%
SNS Bank	-1,2%	-0,3%	-1,5%
Hsbc	-1,3%	-0,2%	-1,5%
Crédit Agricole Group	-1,4%	-0,2%	-1,6%
Intesa Sanpaolo	-1,0%	-0,6%	-1,6%
Lloyds Banking Group	-1,4%	-0,2%	-1,6%
Danske Bank	-0,9%	-0,8%	-1,7%
BNP Paribas	-1,7%	-0,1%	-1,8%
Société Générale	-1,7%	-0,2%	-1,9%
Bank of Ireland	-1,4%	-0,5%	-1,9%
Barclays	-1,9%	-0,2%	-2,1%
Banco Popular Espanol	-1,7%	-0,5%	-2,2%
Unicredit	-1,9%	-0,3%	-2,2%
Banco Espirito Santo	-1,8%	-0,5%	-2,3%
Erste Group	-2,3%	-0,1%	-2,4%
Banco De Sabadell	-1,9%	-0,5%	-2,4%
Dexia	-2,2%	-0,3%	-2,5%
KBC Bank	-2,4%	-0,4%	-2,8%
Royal Bank Of Scotland	-2,4%	-0,5%	-2,9%
Allied Irish Banks	-2,3%	-0,7%	-3,0%
Deutsche Bank	-2,9%	-0,6%	-3,5%
Median	-1,4%	-0,3%	-1,7%
Aggregated	-0,3%	-0,6%	-0,9%

At an aggregated level, it appears that the impact of the stress test is fairly limited (-90bps) with two-thirds of the impact deriving from the pro cyclical increase of RWAs. Either the assumptions and the methodology are too soft, or the sector is over-provisioned.

Special cases

Barclays is definitely a special case with a sky rocketing post-test Tier 1 ratio reflecting high pre-test ratio, huge earnings generation and surprisingly secured risk profile. We are a little bit skeptical about these results although we believe BARC's regulatory ratios are commensurate to its risk profile (high leverage, strong reliance on wholesale funding, underestimated counterparty risks). At last, the implicit earnings generation looks overstated. However, we continue to believe that the market risk premium is excessive.

SAN and **BBVA** both rank very well in terms of Tier 1 level, risk profile and earnings generation which confirm our positive views. Ditto for **Nordea** and **Svenska Handelsbanken**.

Deutsche Bank's stressed Tier 1 ratio comes only slightly above the median, and significantly below Barclays, thus underlying a potential equity shortfall. The sensitivity analysis confirms, if needed, that the Group's risk profile is significantly above average.

MPS confirms its equity shortage and its inability to generate excess capital organically. We would expect further pressure from the domestic regulator and the market. However, part of this risk is already discounted in the share price.

French banks (**BNPP, SG, CA**) are middle of the pack, nothing to brag about nor to be ashamed of. But the uncertainties lifted today with Basel III easing provide strong upside potentials.

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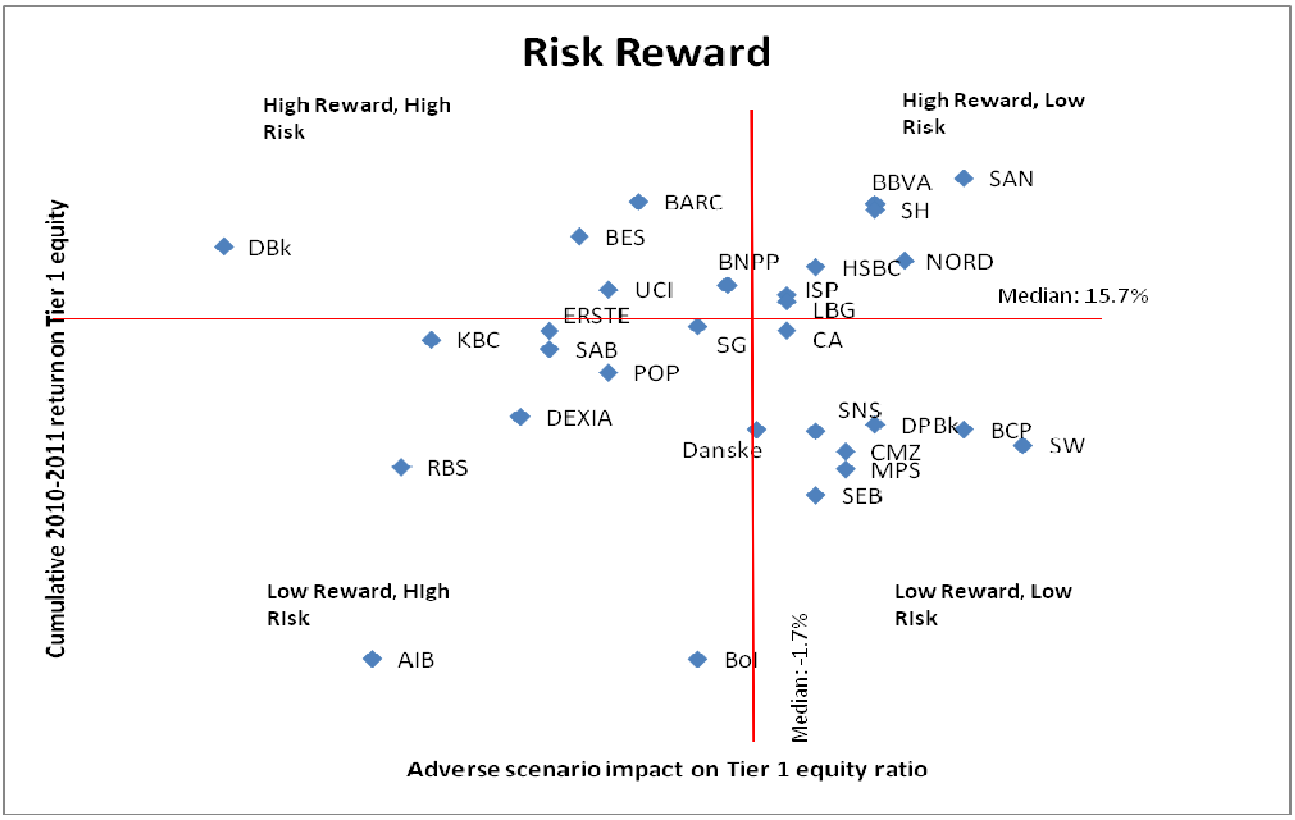

About Alphavalue

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For doing so, AlphaValue has developed a proprietary methodology which is applied to listed companies, and which is based on a consistent and process. The breadth of coverage – about 500 European companies - across 130 sectors and 17 countries AlphaValue to take position on the markets, sectors, highlight the best investment in Europe.

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