

# Commerzbank AG

## William Hahn

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	Senior Preferred	Senior Non-Preferred	Outlook
Moody's	A1	Baa2	Negative
S&P	BBB+	BBB-	Negative
Fitch	BBB+	BBB	Negative

Source: Moody's, S&P and Fitch

## Background and ownership

Headquartered in Frankfurt, Commerzbank (CBK) is Germany's second largest commercial bank by total assets (€544bn at end-3Q20). Focused on Private and Small Business Customers, as well as Corporate Clients, the bank has a strong franchise among the German Mittelstand (SME sector), transacting almost a third of Germany's foreign trade. Its operations are supplemented by some smaller capital markets activities, an online banking subsidiary in Germany with the brand Comdirect, and the Polish subsidiary mBank. Commerzbank is classified as a domestic systemically important bank (D-SIB).

Commerzbank is listed on the German stock exchange and its largest shareholders are the German government with a stake of 15.6%, followed by Cerberus (5.01%) and Capital Group (5%). The company's senior management structure has seen a shakeup in recent months. In July 2020 both CEO Zielke and Chairman Schmittmann resigned following shareholder pressure to enact significant change to the operations and strategic planning of the bank following years of underperformance. Former CEO of LBBW, Hans-Jörg Vetter, was appointed new Chairman in August while Manfred Knof, who headed Deutsche Bank's retail division, was announced as designated CEO to join in January 2021.

The bank's revenue streams are predominantly reported across its two main business segments for reporting purposes: Private and Small Business Customers (59% of revenues 9M20), and Corporate Clients, which includes investment banking (38%).

## Commerzbank – Key Data

	3Q20
Total Assets (€bn)	544.3
Loan Book (€bn)	269.7
Loans to Deposits (%)	105.1
Cost to Income (%)	74.8
Operating Profit (€m)	168
Net Profit (€m)	-69
LCR (%)	129.8
FL CET1 (%)	13.5
Leverage Ratio (%)	4.8
Market Cap <sup>2</sup> (€bn)	6.31
P/B*	0.22

Source: Bank's statements, Bloomberg. \*As of 14/12/2020

## Restructuring ongoing

In September 2019, CBK announced its strategy update dubbed "Commerzbank 5.0" which sets out to reduce gross expenses by €1bn until 2023 through headcount reductions of 4,300 FTE and the closure of nearly a fifth (200) of its branches in Germany, among other things. The plan also foresees a drive for higher efficiency through digitalization and profitability growth focused on its corporate client base. CBK assumed a total of €1.6bn in expenditure to achieve this, split between restructuring charges of around €850m, of which €101m were already booked during 2019, as well as €750m in IT spending. Commerzbank also intends to maintain a CET1 ratio of ~12.5% and achieve RoTE of >4% by 2023.

Recent efforts to structurally reorganise the bank have not been successful as talks to merge Commerzbank into Deutsche Bank failed in April 2019 due to high execution risk, associated capital requirements and the prospect of politically unpopular job cuts at the time. In May 2020, CBK also shelved plans to sell its 69% majority stake in its Polish subsidiary mBank on the grounds of not being able to execute the transaction on reasonable terms due to the pandemic. The sale was meant to fund the group's restructuring. However, the cancellation of the disposal should not be seen as credit negative as mBank provides revenue diversification to the group and is highly profitable. As of 9M20 it contributed 23% towards CBK's operating income.

A shift in strategy is expected to be announced in 1Q21, after Knof takes charge as CEO. Previous plans have been criticised by major shareholders and the ECB alike for not being sufficiently ambitious, after which CBK displayed willingness for adjustments. We would therefore expect to see deeper cost-saving measures given the pressure on revenues and the likely negative effects of the Coronavirus on credit losses. CBK is also likely to revise its financial targets in light of the new macroeconomic reality caused by the pandemic, but as of today has adequate levels of excess capital to cover expected restructuring charges as well as pandemic-related loan loss provisions.

## Financial strength indicators

**Asset quality** – In line with the group's retail and corporate focus, loans accounted for 49% of the group's total assets which amounted to €544bn as of end-3Q20. Loans are split 43% to private customers and 35% to corporate clients. During the year, the balance sheet grew by €80bn compared to FY19 (+17.4%) mostly due to the participation in the ECB's T-LTRO III programme. The bank's asset-quality metrics remain solid, reflective of balance sheet de-risking that has been carried out in recent years. CBK's NPL and coverage ratios of 1.7% and 58% compare favourably to European banking sector averages of

2.9% and 45.3% respectively, as reported by the EBA. Government guarantee and loan deferral schemes offered during the pandemic have helped support the strong asset quality ratios.

As of 3Q20, €6.8bn loans were subject to government guarantees while loan deferrals only amounted to €3.4bn. Together this makes up a modest 3.8% of the overall loan book. It should be noted that most loan deferrals ended in 3Q20 and CBK reported that of those 96% resumed their payments. Loan loss provisions (LLP) as at 9M20 stood at EUR1.1bn including a single-name charge of €175m. 46% of LLPs are pandemic-related which CBK expects to result in an annual cost of risk of 48-55bps. Expected asset quality weakening over the coming quarters has been accounted for through additional provisioning, however the full effect of the pandemic on bank's balance sheets is yet to be seen when loan moratoria and government guarantee schemes are due to fall away in 2021.

**Profitability** – Top-line revenue performance is the bank's main weakness. It remains under pressure from the historically low interest rate environment, the competitive banking landscape in Germany and Covid related LLPs. Commerzbank reported a net loss of -€163m in 9M20 compared to net profit of €682m over the same period last year. This resulted in a weak net ROE of -1.1% vs 3.2% one year prior. The loss was partially driven by a restructuring charge of €201m booked in 3Q20 which is related to the closure of some 200 branched and headcount reductions of 1000 FTE.

The underwhelming profitability stems from CBK's reliance on interest income, which is expected to continue to strain profitability going forward. However, the retention of its profitable subsidiary mBank will continue to provide some needed earnings diversification that helps offset the banks weak domestic bottom line results. Operational efficiency is deemed low as measured by the cost to income ratio which stood at a high 81% in 9M20 (9M19: 78%). CBK has made some efforts to curb its operating expenses which fell by 3.3% over the course of the last nine months and we expect further reductions under the bank's new business plan, helping the bank achieve its modest 2023 RoTE target of >4% (9M20: -1.2%).

**Capitalisation** – Commerzbank's capital position is robust with CET1 at 13.5% as at 3Q20, which is comfortably above its SREP requirement of 9.78%. Regulatory capital relief measures in response to the pandemic have lowered CBK's capital requirements over the course of the year, resulting in sizeable buffers over SREP and MDA of some €6.9bn (+370bps). The bank's capital base has been strengthened through three transactions in 2020 thus far. A Tier 2 of €750m and two AT1 issuances of €1.25bn and €500m respectively were launched to offset AT1 and Tier 2 shortfalls following the update of the Capital Requirements Regulation (CRR II). The new regulation allows banks to meet Pillar 2 requirements with AT1 and Tier 2 issuances as well as their Pillar 1 requirements.

In 3Q20, CBK's nominal CET1 position fell by €276m to €24.7bn due to FX valuation effects as well as the net loss incurred during the quarter. However, this was offset by sizeable €4bn RWA reductions due to lower precautionary drawings of credit lines by corporate customers, bringing the total to €183bn. We deem the bank's near-term CET1 target of >13% as reasonable. CBK's MREL position is also considered rather comfortable with a ratio of 31.5%, meeting its minimum requirement of 27.66% and its subordination ratio of 26.6% above its 15.82% requirement. This suggests that the need for any subordinated debt issuances that qualify as MREL subordinated instruments (SNP, AT1 and Tier 2) will be limited in the near-term.

**Funding** – Commerzbank's funding consists primarily of €172bn granular retail deposits and €84bn corporate deposits which together account for 49% of the bank's non-equity funding sources as of end-3Q20, highlighting Commerzbank's strong deposit base in Germany. The gross loans-to-deposits ratio amounted to 105%, which together with the bank's limited capital markets activities, reduces its need for wholesale funding. Commerzbank also participated in the ECB's T-LTRO III programme for a total of €32.3bn during the first half of 2020, taking advantage of the recalibrated and favourable funding conditions offered in June. This also reduced the bank's initial funding plan for 2020 from €10bn to €7bn, which included a €500m benchmark SNP green bond. Outstanding debt capital market funds totalled €65bn and are comprised of covered bonds (48%), unsecured bonds (28%), subordinated debt (13%) and promissory notes (11%). Liquidity indicators LCR and NSFR remained adequate and above minimum requirements at 129.8% and >100% respectively.

Commerzbank – Additional Data			
Key Ratios (%)	9M20	FY19	FY18
CET1	13.5	13.4	12.9
Total Capital	18.0	16.8	16.3
Leverage Ratio	4.8	5.1	4.8
LCR	129	132	135
Net RoE	-1.1	2.2	3.1
Cost to Income	81.1	78.3	80.3
Balance sheet (€bn)			
Total assets	544	463	462
Loans and receivables	269	260	247
Customer Deposits	256	246	228
Equity	32.9	30.6	29.5
Total HQLA	90.2	85.9	85.6
Income statement (€m)			
Revenues	6,158	8,643	8,570
Operating Expenses	4,551	6,313	6,459
Impairment losses	1,067	620	446
Restructuring Costs	201	101	0
Net Profit	-162	644	862

Figures as stated by the bank. Source: Commerzbank

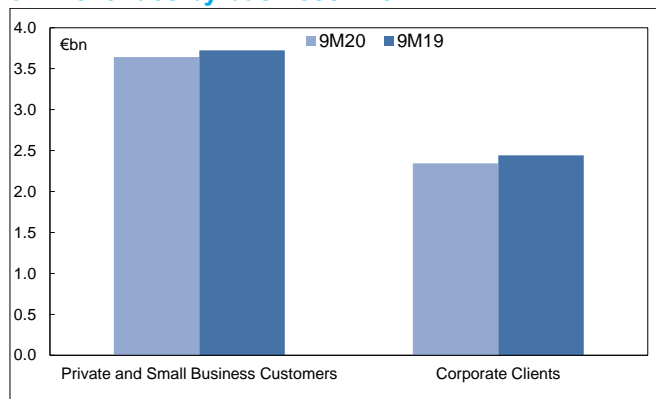
## Rating agencies' views

**Moody's** affirmed Commerzbank's deposit and senior unsecured debt and issuer rating at A1 and changed the outlook to negative from stable. The affirmation and change in outlook reflect (1) the bank's achievements in de-risking and solid asset quality; (2) sound liquidity and adequate capitalisation levels; (3) manageable wholesale funding needs. The ratings are constrained by the bank's low profitability and operational efficiency. The negative outlook reflects uncertainties over the full delivery of its medium-term funding plan, future lending volumes and uncertainty on repayment plan of ECB funding.

**S&P's** negative outlook on Commerzbank acknowledges downside risks that management faces in the coming 12-24 months, including weakened operating conditions amid the COVID-19 pandemic and challenges in executing the restructuring plan. This could derail restructuring initiatives, and the bank's revenue base and asset quality could come under greater strain through 2H20 and 2021 than currently anticipated if an economic recovery is significantly delayed.

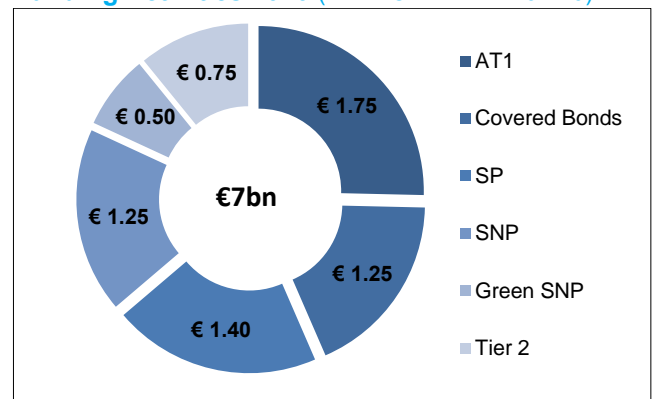
**Fitch** downgraded the ratings of CBK's Long-Term IDR, VR and SNP debt rating to 'BBB' from 'BBB+' because the economic disruption in Germany poses material execution risk for the implementation of the bank's strategic plan, which will negatively affect revenue generation. The bank enters the expected economic downturn from a position of relative weakness given its below-average earnings and profitability, which is of high importance to its VR. The Negative Outlook on CBK's IDR reflects the view that the economic and financial market disruption from the coronavirus outbreak creates additional medium-term downside risks to the assessment of CBK's asset quality, earnings, profitability and capitalisation, which could ultimately affect the bank's company profile.

## 9M Revenues by business line



Source: Company reports

## Funding Activities 2020 (Total: €7bn at end-9M20)



Source: Company reports

## Recent Transactions

Issue Date	Security	Maturity	Currency	Size (m)	Type	Coupon	Yield	Final Spread (bps)
16/09/2020	Senior Non-Preferred Green	5.5NC4.5	EUR	500	Fixed	0.75%	0.861%	MS + 130
08/09/2020	Additional Tier 1	PNC-Apr30	EUR	500	Fixed	6.50%	6.507%	-
24/08/2020	Senior Preferred	7Y	EUR	750	Fixed	0.375%	0.484%	MS + 83
08/06/2020	Additional Tier 1	PNC-Oct25	EUR	1.25	Fixed	6.125%	6.131%	MS + 636.3

Source: Commerzbank, BondRadar

This is an issuer profile and contains factual statements only. All statements are sourced from Commerzbank financial reports, which can be found at

[https://commerzbank.com/en/hauptnavigation/aktionaere/investor\\_relations.html](https://commerzbank.com/en/hauptnavigation/aktionaere/investor_relations.html)

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The statements in the preceding paragraphs are made as of December 2020.

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