

DANSKE BANK – INTO THE DEEP (VALUE)

Danske's spectacular DKK 120bn crash on the heels of the Baltic AML case warrants a closer look. In doing so, there is nothing but bad news all around.

- The current Chairman seems unable to attract a new CEO.
- A new CEO and his thoughts on how to steer through the legal obstacles, incl capital needs, is sorely needed before investors are willing to revisit.
- A large fine from Danish authorities is in the making.
- The DOJ is probing Danske as we speak. The \$8,9bn fine imposed on BNP looms large on investors' minds.
- Meanwhile, funding costs are increasing...
- While current trading is weak and another PW may well be issued in the q3 report tomorrow.
- Buybacks halted as the bank hikes the capital position.
- It may take years before Danske is completely out of it, leading the analysts to throw in the towel. Even those who like it won't buy it.

Better stay away then, huh?

Well, there's just this one thing: the bank is earning billions every quarter (DKK4-5 now, going 6+ in 18-24mths..), while everybody is waiting..., which not only pays for the fine, but also takes multiples down to an almost unbelievable 5,8x earnings for '20, 0,65x book (!!)) and a divi yield approaching 9pc with the stock trading in the 120's. This is the crux of it – Danske is hoarding cash while the market seem to think it is in distress, and in 6-9mths will probably have paid for the fine, and then some.

GRAB									
DANSKE DC Equity		96) Actions		97) Output to Excel		98) Settings		Consensus Overview	
Danske Bank A/S		Periodicity		Annuals		Source		Standard	
						Broker		Cur DKK	
Estimates for several more measures are available MODL »									
1) Values 2) Growth 3) Financial									
12 Months Ending	FY 2017 Act	FY 2018 Est	#	FY 2019 Est	#	FY 2020 Est	#	FY 2021 Est	#
12/31/2017	12/31/2018			12/31/2019		12/31/2020		12/31/2021	
11) EPS, Adj+	22.100	19.374	17	20.863 ↓	23	21.880 ↓	22	22.867 ↓	3
12) EPS, GAAP	22.100	18.251 ↓	19	20.611 ↓	20	21.472 ↓	17	21.150 ↓	2
13) Revenue	48.149B	45.211B	19	47.759B	19	49.192B	19	50.238B	3
14) Operating Profit	25.722B	21.481B ↓	11	22.886B ↓	11	24.233B ↓	11		
15) Pre-Tax Profit	26.288B	21.585B	18	23.602B ↑	15	24.202B ↓	15	24.324B	3
16) Net Income Adj+	20.900B	16.937B	10	17.016B ↑	17	18.789B	16	19.569B	2
17) Net Income, GAAP	20.900B	15.659B	17	17.550B	17	18.085B	15	18.306B	3
18) Net Debt	1.380T	1.237T	1	1.267T	1	1.298T	1		
19) BPS	172.157	176.001	14	184.873	14	194.449	14	207.000	1
Current Multiples							5) Hide Multiples		
	Last 4 Qtrs Act		Next 4 Qtrs Est		FY 2018	FY 2019	FY 2020		
Price/EPS, Adj+			6.15		6.53	6.07	5.79		
Price/Book	0.75		0.74		0.72	0.68	0.65		
Price/Cash Flow	2.66				5.42	5.18	4.98		
EV/Revenue									
EV/EBITDA									
EV/EBIT									
EV/OPP									
Dividend Yield					7.66	8.56	8.90		
*Period Notes									
<< < More Periods > >> Reported, Estimated Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2018 Bloomberg Finance L.P. SN 760010 G384-4381-3 31-Oct-18 6:56:21 CET GMT+1:00									

Checking funding costs, it looks like they have doubled since the news broke, going from 70 to around 140bps (=120bps in Euro on top of the swap). Funding of approx 300bn will be rolled before 1/1 2022. The impact here is severe and every 10bps hike takes earnings down DKK 1.25/shr. A conservative stance here is probably justified, assuming 20bps over and above consensus still limits the damage to approx a 10pc drag on earnings implying eps at 6.5x or so 2 years out. Other large and lasting effects may be loss of clients, of course. Other effects, like the DKK 1,5bn donation taking q3 down are negligible, in my mind. Meanwhile, the capital position is solid with Danske having lifted its core equity tier 1 ratio to 16pc from 14/15pc and its total capital ratio to 20pc. The Danish FSA ordered it to increase its solvency need to DKK 10bn primo October.

So, with earnings largely fine on negative follow-on effects on its biz, the all-important question that remains is the size of the fine. In particular if there is a US fine. Firstly, despite the hype, I am not so sure one is warranted. After all, Danske has no license in the US, the crimes are not related to the US in any way and the bank has as far as I know not violated any sanctions (which would typically make the yankees go haywire). Assuming the probe concludes with something resembling this, I just can't see any reason for a fine other than to collect some chips from the hyped storm. In case, that means looking towards the \$425m Deutsche Bank settlement as the most probable blueprint, although DB in contrast to Danske had settled \$10bn against their US operations, ie leaving a US angle on it. Next on the blueprint list ought to be the HSBC case resulting in a \$1,9bn fine. Here, matters were much closer to US interests as the bank interfered with the «War on Drugs» through its involvement with Mexican drug cartels. Hard to imagine the Danske case reaching such proportions. Lastly, in a league of its own (and the GFC aftermath fines), the \$8,9bn BNP fine on the heels of sanction breaches against the nice, little bouquet of Iran, Cuba and Sudan... Paranoia has saved the day for many an investor so understandable if some keep even this one on their desk for comparison, however far-fetched it may be with what we currently know.

A final point; Danske is the premier SIFI-bank in Denmark. It is hard to imagine Danish authorities not stepping in front of the bank to «protect national interests» if push comes to shove with the yanks. No fine, or a DB-style fine, is my base case without any breach of US sanctions – taking a meager DKK 2,7bn or DKK 3/shr off Danske's book of 176/shr. Worst case ought to be a HSBC-style fine, which DOJ is happy to let Danske subtract any other fine from, resulting in a DKK 12,5bn or 14/shr one-off hit.

To conclude:

The monster DKK 120bn drop in Danske is overdone. Investor psychology and ESG-rules are such that nobody wants to touch it before visibility on timeline improves, though. That provides a stunning opportunity for those of us who have the liberty to take a multi-year horizon on our investments and look beyond the hype, rather than worry about next quarter's performance numbers and year-end bonuses. Not having a 20-something year old ESG officer telling you to get rid of it also helps.

When checking the issues covering Danske like a wet blanket now, investors with a sufficiently long time horizon ought to ask themselves what they make of the following:

- Will Danske ever have a new Chairman in place?
- Will Danske ever have a new CEO in place?

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- Will Danske's funding ever return to normal?
- Will Danske ever settle the fines riding it like a nightmare, preferably without issuing new equity?
- Will the buyback program in the - at that point - vastly overcapitalized lender be restored?

The answer to all of these questions is in my mind a resounding YES. Danske will remerge from this as a stronger, better and more solid bank. Eventually.

I will buy some now ahead of the widely expected poor q3 report coming out tomorrow, some if the stock drops more on the report/PW and some on news on Chairman/CEO. Targeting a 10-11 multiple on earnings and 1.1-1.2x book post-fine taking the stock back up to DKK 200+.

Meanwhile, I am happy to forgo any buyback yield and settle only for the 8-9pc or so divi while waiting. At 5.8x earnings. And 0.65x book.

Patience is a virtue.



Oslo, 31102018

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