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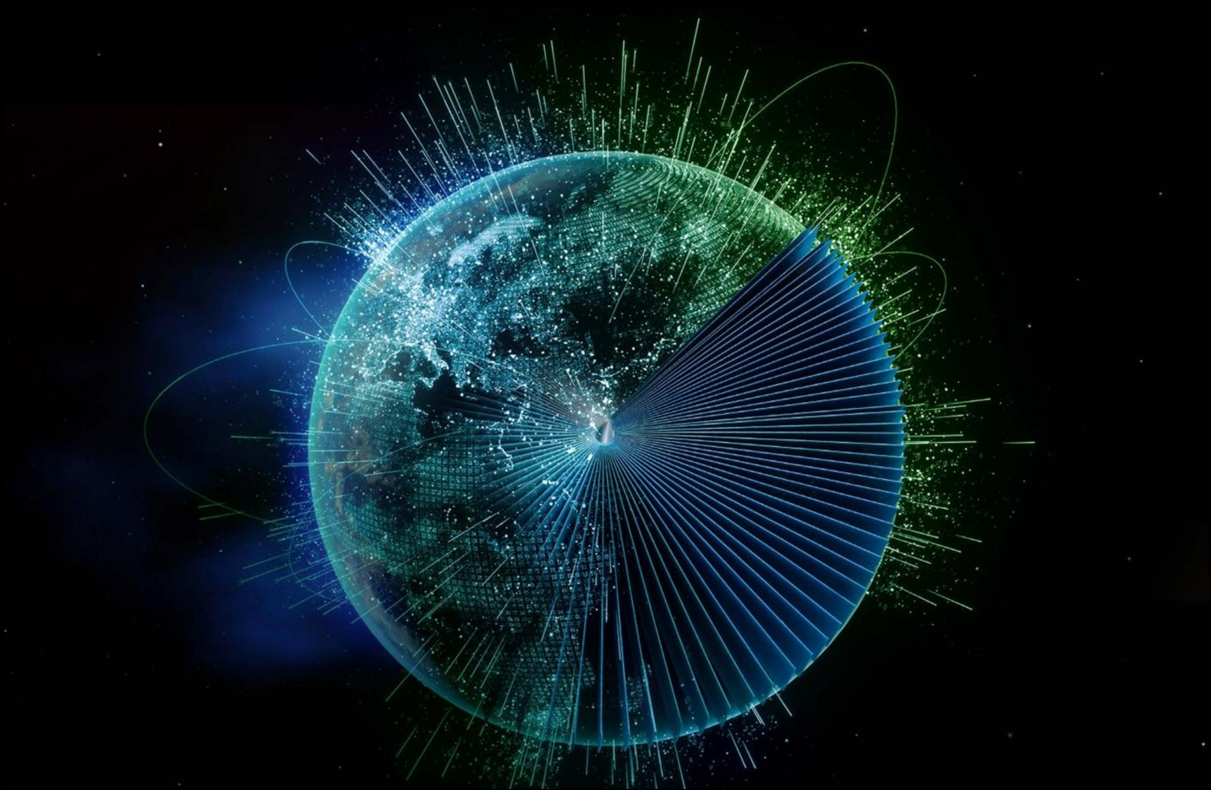

Italian Banks 2023 performances: Does the stock market assign the right value?

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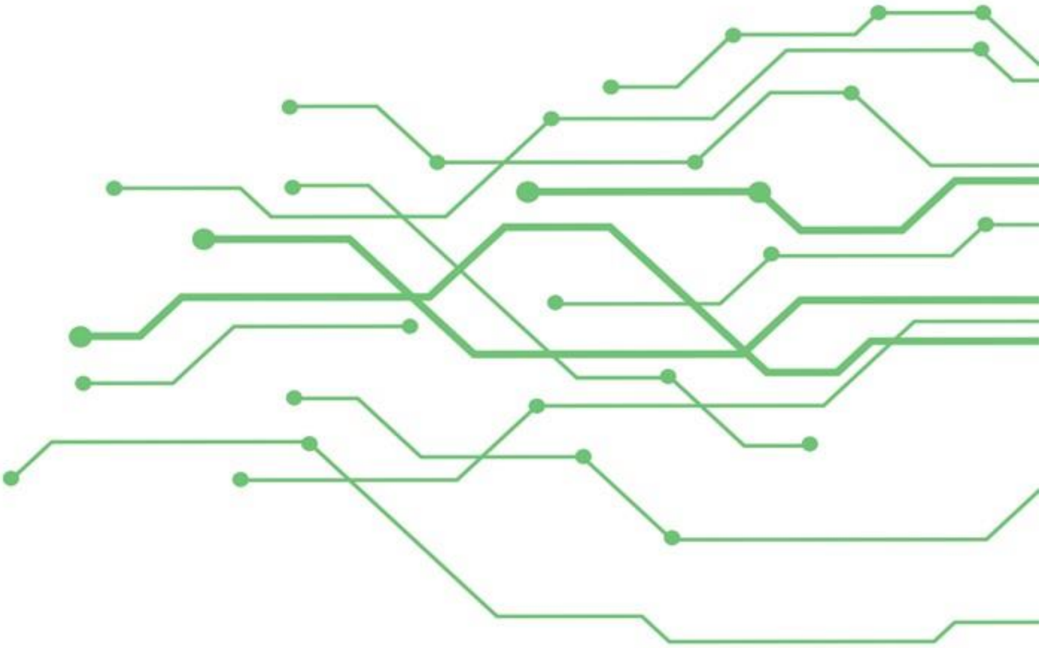

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01 Executive Summary

Executive Summary

Analyzing the key performance indicators of the banking sector between 2022 and 2023, significant changes have been observed that led to an improvement in the profitability of the Italian banking system.

Revenue trends among Italian banks showed growth, particularly in interest income, while variations were noticed in commission income. Despite initial expectations of increased loan loss provisions with the end of the Covid-19 suspension, banks experienced decreases, which in turn resulted in a better performance.

Overall, there was a general increase in Return on Tangible Equity (RoTE), indicating improved profitability across the sector. This growth was attributed to factors such as post-pandemic economic recovery, increase of interest rate by central banks, and improved operational efficiency.

Despite significant growth for Italian banking stock prices in 2023, market valuations did not fully align with banks' profitability growth, suggesting caution among investors. The key challenge was to improve the market valuation and addressing this required the identification and implementation of strategies. Ensuring long-term profit sustainability, encouraging diversification within the banking business, and reducing correlation with central banks' monetary policies could be seen as necessary measures to tackle this challenge.

02 Italian banking market overview

Italian banking system: Key performance indicators of listed Italian banks

During 2022 and 2023, Italian listed banks displayed distinct trends in their revenue streams, as illustrated in Figure 1. Notably, interest income experienced significant growth, indicating strengthened core banking activities, driven by favorable interest rate conditions, and expanded lending activities.

Nine of the fifteen banks recorded an increase in their individual commission income. This result is linked with higher revenues in fee-based banking activities such as asset management and insurance services.

However, notwithstanding fluctuations in individual income streams, the total revenue for fourteen out of the fifteen banks in the sample showed robust growth. This growth underscores the banks' ability to improve the spread between the average yield on loans and the average cost of funding.

Despite previous expectations of an increase in the loan losses provisions potentially linked to the expiration of the Covid-19 moratorium, the values decreased for eight out of the fifteen banks in the sample, of which three decreased by more than 50%.

The cost of risk recorded a slight decrease compared to the 2022 data for 7 banks, explained by the lower LLPs.

When considering net income, it can be noted that the figures increased significantly across the two years under consideration, resulting in a net result of €25,5 billion for the sample of this analysis (+71% vs 2022). This is mostly due to the increase in margins and revenues, thus indicating higher profitability for banks and a favorable environment for the banking sector.

As shown in Figure 1, the Cost/Income indicator recorded a negative trend for 12 banks out of 15. Such results are explained mainly by higher revenues earned throughout the period.

Across 2022 and 2023, 14 out of 15 banks experienced an average increase of 9% in RoTE. Thus, reflecting the higher profitability of credit institutions over tangible shareholder’s equity.

All banks in the sample have been adjusting their capital returns policies, increasing capital distribution in 2023.

Figure 1 | KPI Italian listed banks: FY2023

Banks (€M)	Net Interest Income	Net Commission Income	Other Income	Total revenues	Provisions for loan losses	Net income	Cost of risk (bps)	Cost/income (%)	ROTE (%)	Capital Distribution[4]
December 2023										
UniCredit S.p.A.	14.005	7.463	2.376	23.843	(500)	9.507	12	40%	17%[3]	8.600
Intesa Sanpaolo S.p.A.	14.646	8.558	1.934	25.138	(1.529)	7.724	32	45%	15%	7.062
Banca Monte dei Paschi di Siena S.p.A.	2.292	1.322	184	3.797	(440)	2.052	57	49%	24%[3]	315
BPER Banca S.p.A.	3.252	2.010	232	5.494	(436)	1.519	48	56%	24%[3]	425
Banco BPM S.p.A.	3.289	1.860	192	5.341	(559)	1.264	53	48%	12%[3]	1.400
Banca Mediolanum S.p.A.	752	1.029	17	1.799	(33)	822	19	40%	30%	519
Fineco Bank S.p.A[1]	688	490	60	1.238	(4)	609	5	24%	34%	423
Credito Emiliano S.p.A.	1.091	698	134	1.923	(52)	562	15	44%	19%[3]	221
Banca Popolare di Sondrio S.p.A	937	403	132	1.472	(202)	461	65	40%	14%	254
Banca Generali S.p.A.	304	467	17	788	(1)	326	2	35%	35%	263
Banco di Desio e della Brianza S.p.A.	359	207	16	581	(68)	240	48[2]	58%	22%	35
BFF Bank S.p.A.[1]	284	75	33	392	(5)	183	9	41%	41%[3]	192
Banca Ifis S.p.A.	566	98	40	705	52	160	51[2]	58%	11%	110
Illimity Bank S.p.A.	193	77	90	359	(14)	104	43	63%	15%	0
Banca Sistema S.p.A.	67	20	17	104	(5)	17	17	68%	8%	5

Source: Deloitte elaboration based on Info-provider data and Investor relations data for FY2023 and FY2022

European banks, particularly Italian banks, have achieved outstanding performance during 2023

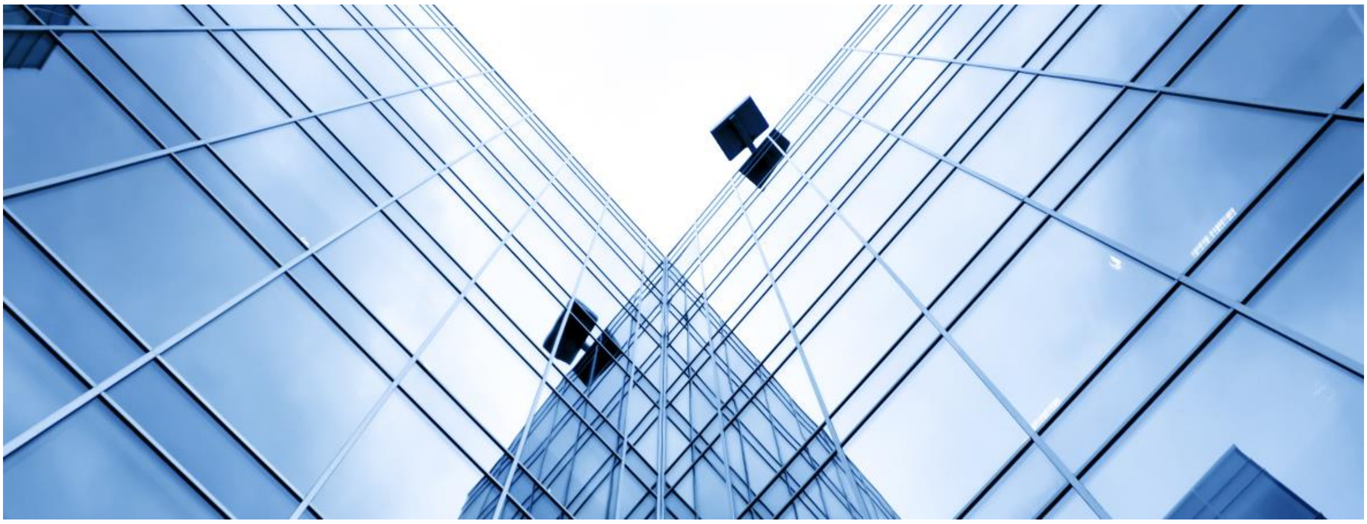


Figure 2 | KPI of listed banks: 2023 vs 2022

Variations compared to December 2022

	Net Interest Income (%)	Net Commission Income (%)	Other Income (%)	Total revenues (%)	Provisions for loan losses (%)	Net income (%)	Cost of risk (bps)	Cost/income (pp)	ROTE (pp)
UniCredit S.p.A.	31%	(2%)	17%	17%	(74%)	47%	(29)	(7%)	6%
Intesa Sanpaolo S.p.A.	54%	(4%)	(36%)	17%	(51%)	76%	2	(6%)	7%
Banca Monte dei Paschi di Siena S.p.A.	49%	(3%)	(16%)	22%	6%	>100%	2	(19%)	26%
BPER Banca S.p.A.	78%	4%	(53%)	29%	(28%)	5%	(16)	(9%)	16%
Banco BPM S.p.A.	42%	(1%)	(59%)	14%	(18%)	85%	(9)	(6%)	5%
Banca Mediolanum S.p.A.	85%	6%	>100%	30%	53%	62%	6	(7%)	11%
Fineco Bank S.p.A	>100%	5%	(57%)	31%	16%	42%	1	(6%)	7%
Credito Emiliano S.p.A.	65%	1%	9%	30%	5%	72%	0	(10%)	8%
Banca Popolare di Sondrio S.p.A	38%	6%	>100%	38%	32%	84%	14	(10%)	6%
Banca Generali S.p.A.	>100%	(1%)	(28%)	23%	(94%)	53%	(2)	(5%)	13%
Banco di Desio e della Brianza S.p.A.	31%	4%	13%	20%	18%	>100%	7	(2%)	14%
BFF Bank S.p.A.	22%	(17%)	30%	13%	(16%)	25%	(2)	(3%)	2%
Banca Ifis S.p.A.	3%	5%	4%	4%	(32%)	13%	(22)	0%	1%
Illimity Bank S.p.A.	19%	24%	(11%)	11%	89%	39%	13	3%	4%
Banca Sistema S.p.A.	(22%)	18%	>100%	(2%)	(46%)	(24%)	(12)	11%	(5%)

Source: Deloitte elaboration based on Info-provider data and Investor relations data for FY2023 and FY2022

[1] Refers to adjusted figures retrieved in the Institution's financial statements [2]Deloitte's elaboration based on financial statements [3]RoTE communicated by the banks in their financial statements/presentation of results [4]Includes buyback programs for 2023. For *BFF Bank S.p.A. and Fineco Bank S.p.A.* includes the maximum amount for the purchase of own shares approved by the Shareholders' meetings.

Italian banking system: Profitability of Italian banks

When analyzing the profitability of Italian banks across recent years, a discernible trend of general growth from 2020 through to 2023 emerges.

Despite the challenges posed by the Covid-19 pandemic, there was consistent growth in profitability metrics during this period. Notably, the highest profits within the analyzed timeframe were recorded in 2023, with the banking system's overall profit reaching €28,3 billion, showing a notable rise compared to previous years.

In addition to the significant increase in net income, 2023 also witnessed a notable improvement in Return on Equity (ROE), reaching 11% compared to 8% recorded in 2022. This increase in ROE may suggest enhanced efficiency in generating profits related to shareholders' equity.

The exceptional performance observed in 2023 can be attributed to several factors. Firstly, proactive management in handling potential consequences arising from the pandemic period was facilitated by the release of public guarantees on granted loans.

Additionally, the monetary policies implemented by central banks may have contributed to favorable market conditions for the banking sector, increasing the average asset yield for banks, further supported by deposits with betas significantly lower than 1.

Overall, the significant improvements in profitability metrics across Italian banks reflect their resilience and adaptability in navigating challenging economic environments. Looking forward, it will be important for banks to maintain this positive momentum by effectively managing risks and controlling funding costs but diversifying into businesses less influenced by interest rate fluctuations will be essential to reduce dependence on monetary policy.

Figure 3 | ROE (%) and Net Income (€bn) 2010-2023

Source: Deloitte elaboration based on Info-provider data

Italian banking system: Interest margin and other revenues (2010-2023)

As shown in Figure 4, there has been a notable increase in the proportion of interest margin compared to other revenue sources. This rise can be analyzed within the context of the broader historical trend of interest margins for banks.

From 2010 to 2012, the incidence of interest margins on intermediation margins exhibited a substantial growth trajectory, rising from 47,5% to 56,8% respectively. However, following this peak, annual percentages gradually decreased, reaching 41,9% in 2021. Remarkably, in 2023, there was a significant increase, reaching the second-highest level recorded during this 13-year period at 54,9%.

This fluctuation in interest margins correlates closely with changes in interest rates observed during the same period. As interest rates have increased, banks have experienced higher interest income, while simultaneously demonstrating adeptness in managing their funding costs.

The strategic management of funding costs has been instrumental in mitigating potential pressures on interest margins, thereby contributing to the overall financial performance of banks, indeed the margin spread of 2023 stands at 1,63, marking the highest since 2010.

Figure 4 | Incidence of the interest margin on the intermediation margin (%) 2010-2023

Source: Deloitte elaboration based on Info-provider data

Italian banking system: Cost of risk and Cost/income

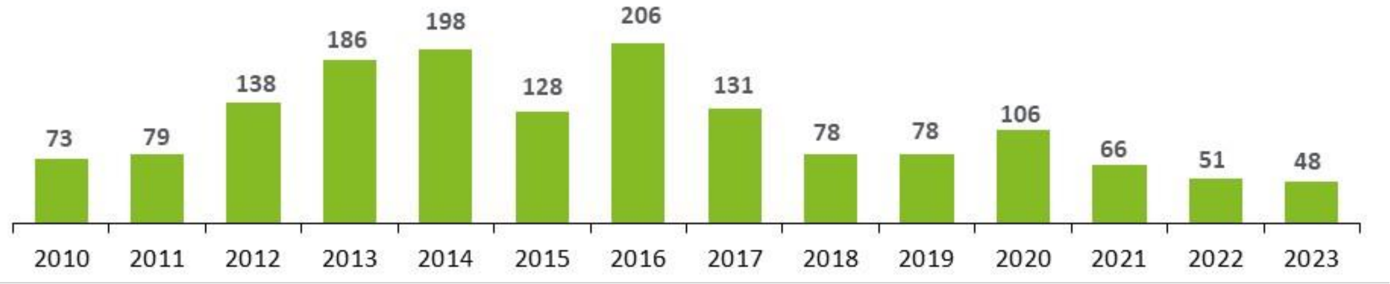
The Italian banking sector has recorded an improvement in the cost of risk over the analyzed timeframe, significantly reducing provisions compared to the years 2012-2016.

The decreasing trend, interrupted in 2020 as a precautionary measure due to the anticipated impact of the pandemic on the deterioration of credit in Italy in the coming months, resumed from 2021 to reach a cost of risk of 48 basis points in 2023 (-3 bps vs 2022) thanks to lower provisions, which contributed to increasing profitability in 2023.

As for operating costs, on one hand, there has been a continued optimization of operational structures and resources in recent years, with a decrease in the number of branches and employees, leading to a subsequent reduction in other administrative expenses.

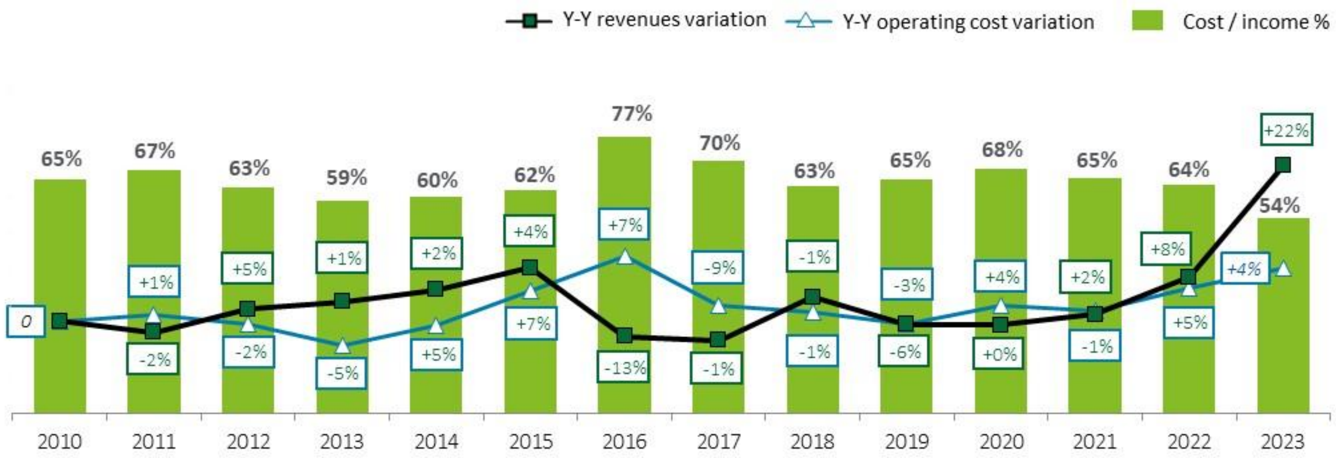
On the other hand, the cost/income ratio, which stood at 54% in 2023 (-10 p.p. compared to 2022), reached a low level due to the increase in revenues (+22% compared to +8% in 2022). However, operating costs still grew by +4% compared to 2022.

Figure 5 | Cost of Risk (bps) 2010-2023



Source: Deloitte elaboration based on Info-provider data

Figure 6| Cost/Income and variation of operating cost (%) 2010-2023



Source: Deloitte elaboration based on Info-provider data

03 In-depth overview of 2023 banking profitability

Profitability trends in banking sector: performance of the banking stock market

Looking at the stock markets, 2023 was a year where the FTSE Mib recorded a growth of +29%, outperforming the S&P 500 index (+25%) and the average European stock markets (Euro Stoxx 50 index at +19%). This growth is particularly attributed to the banking sector, as the FTSE All Share Banks index showed a higher increase compared to the FTSE Mib, registering a +54% growth since January 2023. The increase in bank profitability led to a rise in stock prices, although to a lesser extent than the proportional earnings growth. Therefore, 2023 profitability certainly contributed to driving up stock prices and outperforming the FTSE MIB.

Figure 7| FTSE Italia All-Share Banks vs FTESE MIB Index (Jan 23-Feb 24)

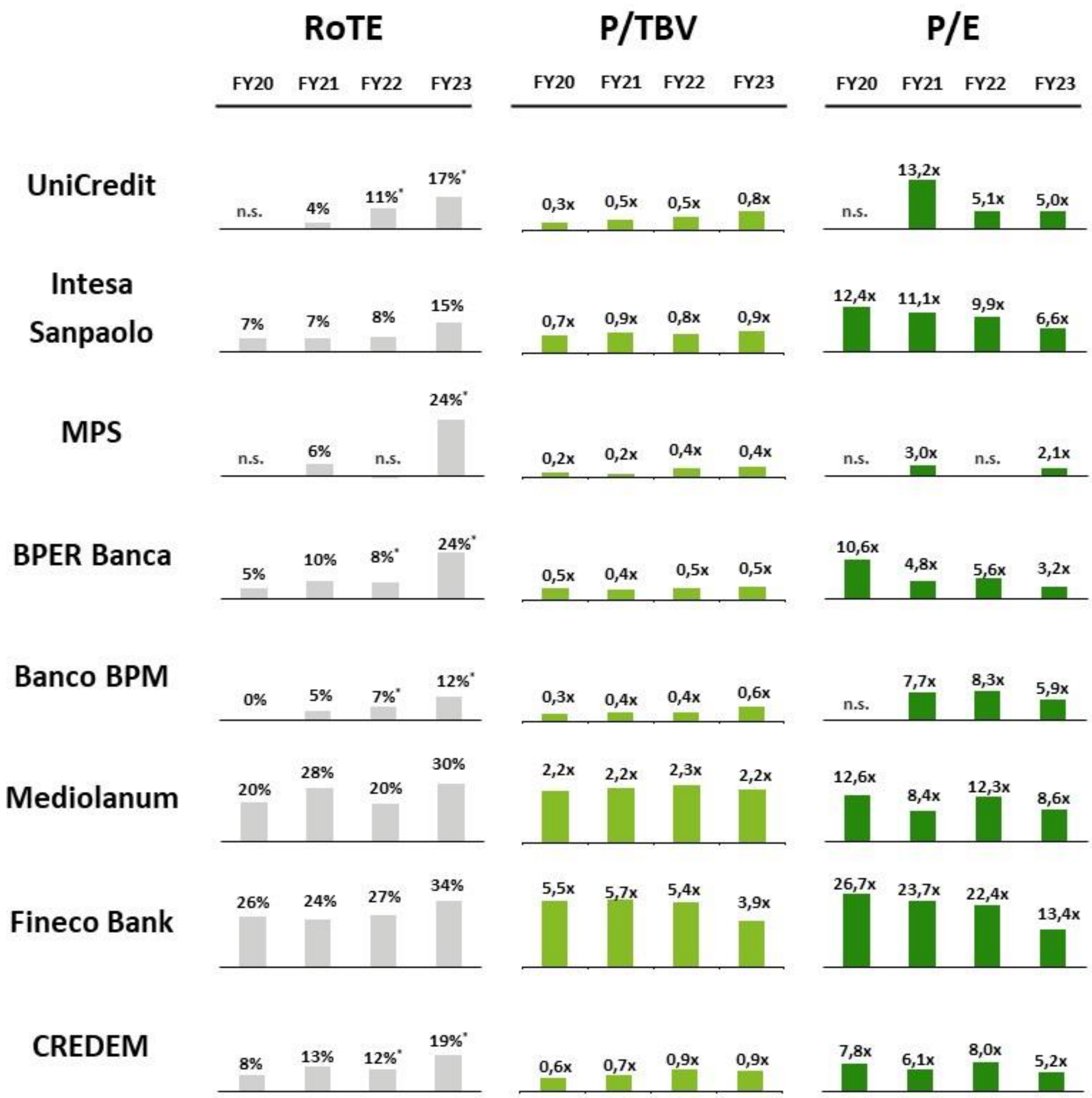
Source: Deloitte elaboration based on info-provider data (Feb 24)

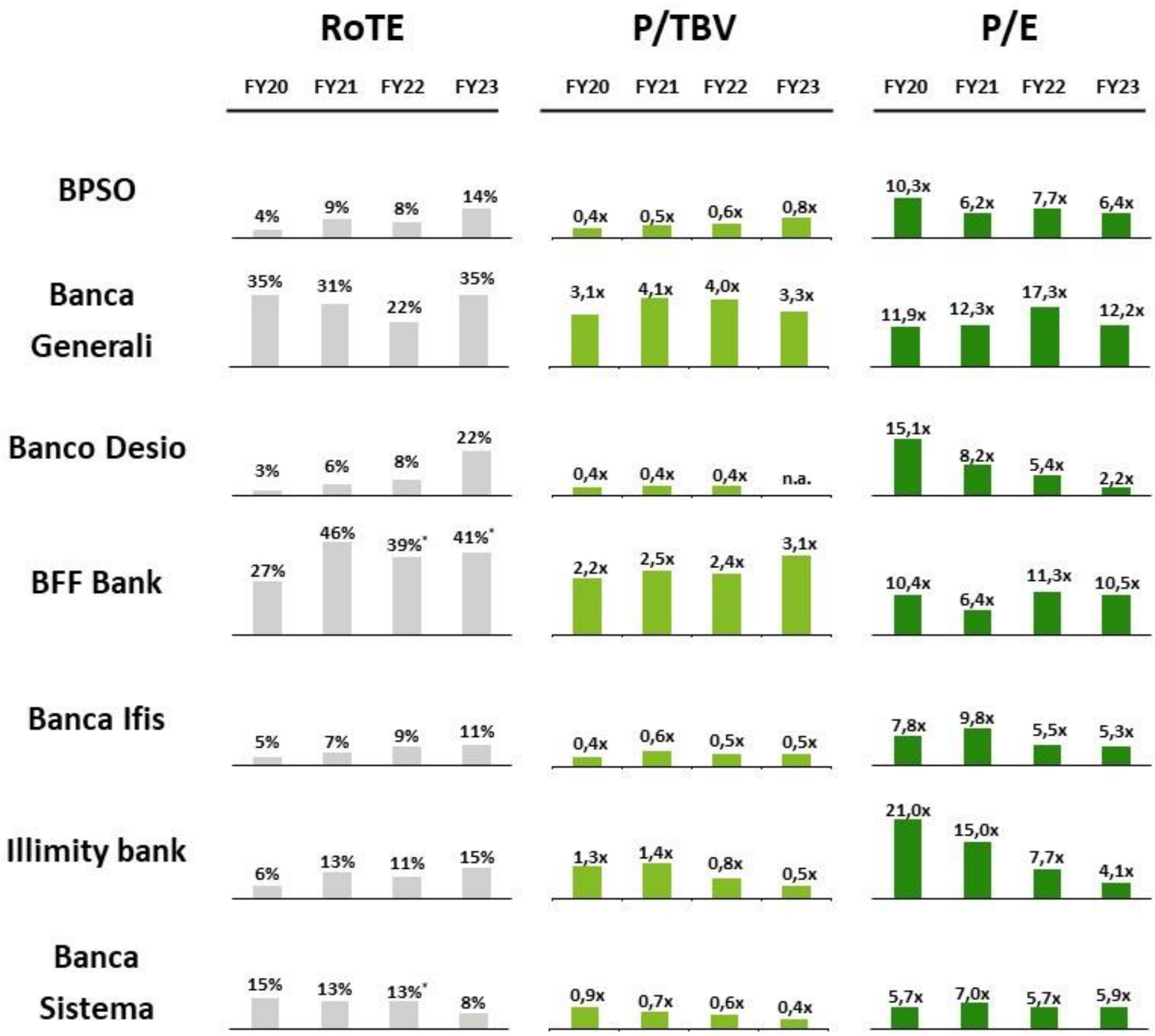
The positive performance of the FTSE MIB has been notably influenced by the valuations of banking stocks that have achieved outstanding performance in the stock markets during 2023

Profitability trends in banking sector: evolution of profitability and valuation of Italian banks

Analyzing the multiples and profitability of the 15 listed Italian banks, it is evident that between 2022 and 2023, the RoTE increased for 14 out of the 15 banks in the sample. However, this growth is not reflected in market appreciation. Despite market valuations for banks growing throughout 2023, looking at the Price/Earnings ratio (P/E), there is a reduction for 13 out of the 15 banks in the sample. In other cases, the P/E ratio slightly increased over the year. Examining the P/TBV, it is evident that only 4 institutions (BFF Bank, Fineco Bank, Banca Mediolanum, Banca Generali) in 2023 have a multiple that prices the tangible book value higher than 1. Furthermore, considering the change between 2022 and 2023, for 10 banks there was a decrease in the P/TBV ratio or no growth in the multiple. This implies that, despite the record profitability in 2023 and the share buyback initiatives implemented by certain banks, the stock markets' valuations do not seem to intercept these results.

Figure 8 | Evolution of P/TBV, P/E, ROTE – Italian banks (2020-2023)





Source: *Deloitte elaboration based on info-provider data (Feb 24)*

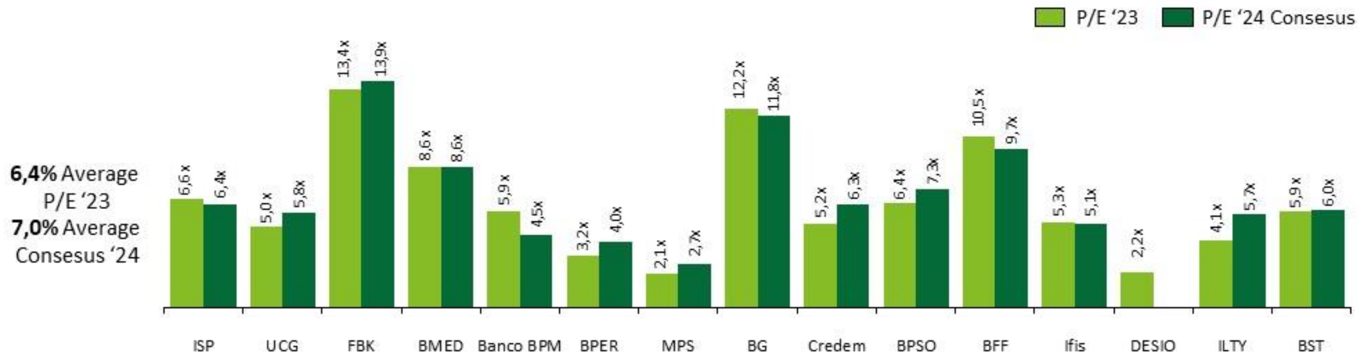
* RoTE communicated by the banks in their financial statements/presentation of financial results

Despite the stronger 2023 profitability, banks seem to be less appreciated by the market compared to 2022

Italian banking system: expected valuation for 2024

When analyzing the expected profitability for 2024, bank valuations remain unfavorable. The Price/Earnings (P/E) ratios for the considered sample in 2023 are essentially in line with the Price/Earnings multiples for 2024. For 8 out of 14 banks (data not available for Banco Desio's consensus), a minor decrease in earnings is expected based on consensus, resulting in a higher P/E for 2024 compared to 2023. For the remaining banks, a slightly lower or in-line P/E is anticipated compared to the previous year, indicating higher earnings in 2024. On average, the Price/Earnings ratio for 2024, based on consensus, is higher than that of 2023. However, the European banking system's profitability is subject to the decisions made by the ECB regarding monetary policy, and the ensuing impact is challenging to accurately estimate due to various influencing factors. Presently, there exists significant uncertainty surrounding both the timing and extent of anticipated interest rate cuts. Consequently, projections for 2024 may persist in reflecting prevailing market conditions, especially throughout the initial half of the year. This supports the claim that the earnings made in 2023 might not be sustainable over the long run.

Figure 9| P/E 2023 vs P/E 2024 Consensus



Source: Deloitte elaboration based on info-provider data (Feb 24)

The profitability of banks shows a downward trend for 2024, resulting in a slight increase in the P/E multiples

04 Conclusions

The year 2023 was noteworthy, characterized by high net incomes that have further supported the already elevated bank profitability.

These results underscore the continued strong correlation of the banking sector with market-related factors, particularly monetary policy, rather than firm-specific ones. Over the years, banks have undertaken actions to optimize their cost structures and have proactively managed the impacts of the pandemic.

However, while the current positive economic environment for banks mainly stems from monetary policies, there is a prevailing market perception that they might not be sustainable in the mid to long term Consequently, banks face the challenge of assessing their resilience and capacity to further enhance fee-based income, which exhibits lower correlation with interest rates. This strategic approach aims to stabilize the top line of the income statement.

Looking ahead, banks need to stay vigilant and take proactive measures in managing risks, capitalizing on emerging opportunities, and sustaining profitability in an increasingly competitive and dynamic banking landscape. It is worth noting that the overall strength of the Italian banking system today surpasses that of the past. This improvement is attributed to various factors, including the gradual reduction of the NPE stock over the years and cost optimization, also facilitated by technological initiatives and digitalization. These developments have proven particularly beneficial during challenging periods such as the pandemic, contributing to enhanced profitability in subsequent years.

The persistent challenge lies in enhancing market valuation. Identifying and implementing strategies to ensure the long-term sustainability of profitability, fostering diversification within the banking business, and reducing correlation with central banks' monetary policies are pivotal measures to address.

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06 Glossary

BBPM: Banco BPM

BDB: Banco Desio e della Brianza

BFF: BFF Bank

BMED: Banca Mediolanum

BPER: Banca Popolare dell’Emilia-Romagna

BPSO: Banca Popolare di Sondrio

BST: Banca Sistema

CREDEM: Credito Emiliano

ECB: European Central Bank

FBK: Fineco Bank

Ilty: ilimity Bank

IFIS: Banca Ifis

ISP: Intesa Sanpaolo

LLP: Loan loss provisions

MPS: Banca Monte dei Paschi di Siena

Market cap: Market capitalization

n.a.: not available

n.s.: not significant

P/TBV: Price to Tangible Book Value

ROE: Return on Equity

RoTE/ROTE: Return on Tangible Equity

UCG: UniCredit

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