

## GREAT ASSET QUALITY, SUBSTANTIAL EXCESS CAPITAL

Svenska Handelsbanken's Q4 2009 results reinforce our view that the bank has a defensive earnings profile and considerable excess capital. In an environment where we see earnings at some of the other banks (notably the Spanish banks BBVA and Santander) being at risk of higher funding costs and loan losses, we reiterate our BUY rating.

The P/TNAV may seem relatively high at 1.3x our 2011E TNAV, but is by no means the highest in the peer group. Importantly, as the credit crisis unfolds and other banks incur higher COEs, we believe the market will rate Handelsbanken more fairly for its low COE (we calculate it as 9.2% in our DCF model), relatively high ROTNAV (we forecast 14.3% in 2011) and early-cycle earnings growth. This underpins our DCF-derived target price of SEK250, indicating 29% upside.

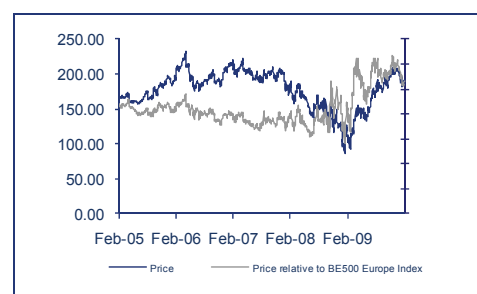
- Handelsbanken's Q4 2009 net income was our 7.5% above our estimate (and 11% higher than consensus). As with the other Nordic banks the main driver was much lower loan losses (33% lower than our own estimate). The loan loss ratio improved to -0.19% from -0.23% in Q3 2009. Asset quality development also looks positive, with the non-performing loan ratio staying stable QoQ at 0.58% and the coverage ratio increasing to 62% from 57%.
- Also as with the other Nordic banks, Handelsbanken's NII showed some weakness, but the QoQ decline of 4.5% is modest in our opinion. Operating revenues were nevertheless in-line with our estimates, due to stronger-than-expected fees and commissions.
- Costs were rather high in Q4 2009, even accounting for the fact that the fourth quarter tends to be marked by seasonally high costs. Management explained that the implementation of a new online log-in facility for the internet bank led to high one-off costs in the quarter. The cost/income ratio increased to 51% from 46% QoQ, but we believe this will normalise as early as Q1 2010.
- As a result of the in-line revenues but higher costs, Q4 2009 operating profit (i.e. before loan losses) was 7% lower than our estimate.
- The dividend per share was SEK8.0, an unexpected increase (by both us and consensus) from SEK7.0 in 2008 and representing a yield of 4.1%.
- The full Basel II Core Tier 1 ratio was very strong, growing 35bps in the quarter. We re-run our Basel III analysis of Handelsbanken and see that it has now been elevated to the strongest capitalised bank in our group of lending banks. We believe substantial excess capital can be released at some point.

### Research

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Rating	BUY
Target price	SEK250.00
Yesterday's closing price	193.10
Upside/downside	29%
Market cap (€bn)	12.2
Sector	Pan-European Banks

SEK/(SEKm)	2009A	2010E	2011E
Net interest income	22,000	22,531	24,383
Net fees & commissions	7,393	7,763	8,151
Trading profits/losses	2,457	2,268	2,336
Other revenue	485	498	508
Total operating revenues	32,335	33,059	35,378
Operating costs	-15,136	-14,917	-15,961
Operating profit	17,199	18,142	19,417
Total provisions	-3,392	-2,678	-2,073
Pre-tax profit	13,727	15,465	17,344
ROA	0.48%	0.52%	0.54%
ROE	12.96%	13.26%	13.70%
ROTNV	14.26%	14.51%	14.95%
Cost/Income	-46.81%	-45.12%	-45.12%
Payout	48.68%	40.00%	40.00%
Net interest margin	1.08%	1.09%	1.10%
LLC % gross loans	-0.23%	-0.18%	-0.13%
NPL ratio	0.58%	0.48%	0.33%
NPL coverage ratio	62.45%	70.00%	70.00%
Loans % deposits	269%	263%	258%
Core tier 1 ratio	11.74%	12.50%	12.95%
EPS	16.44	18.36	20.59
DPS	8.00	7.34	8.24
P/TNAV	1.59	1.47	1.34
Div yield	4.14%	3.80%	4.27%



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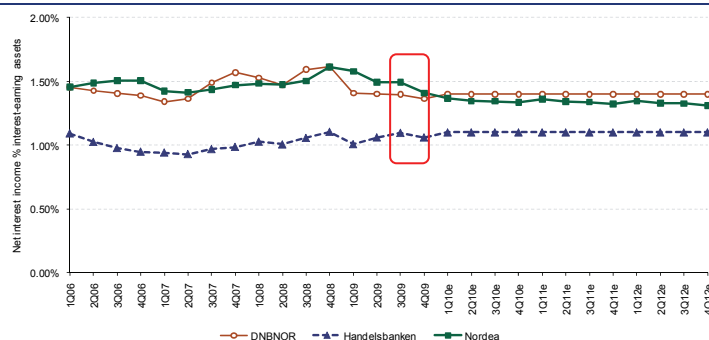
## Further Key Details

### Net Interest Income

Net interest income was weaker than expected, in keeping with the trend seen at the other Nordic banks. The NIM deteriorated to 1.06% in Q4 2009 from 1.10% in Q3 2009, while our expectation was that the margin would be flat. However, it seems to us that for Handelsbanken, there is also a negative mix effect taking place other than just negative pressure on margins. Management commented that there has been a negative impact from the increase in lower margin mortgage loans and a decrease in higher margin corporate loans.

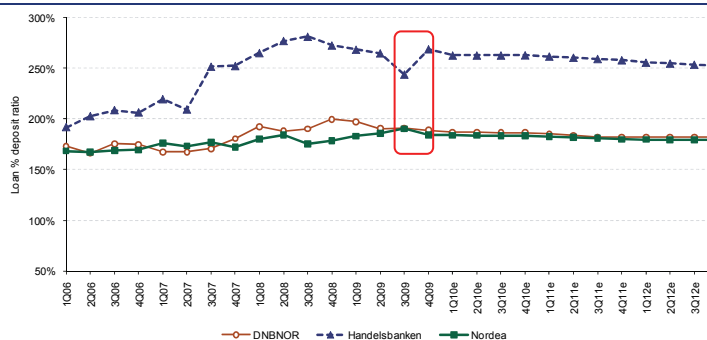
Part of our positive case for Handelsbanken versus Nordea is that the NIM would be more robust because of the relative improvement seen in the loan-to-deposit ratio. The relative robustness in Handelsbanken's NIM versus Nordea is evident in Q4 2009 (as in Figure 1), but we cannot make quite as strong a case for it as we did previously, particularly in light of the fact that Handelsbanken has lost a significant amount of deposits in its Handelsbanken International division (hence the sharp spike in the LTD ratio in Q4 as per Figure 2). It would seem to us, from what was revealed on the conference call, that the fall in deposits is primarily due to more competitive deposit rates offered in the Baltic region, resulting in 'fast-money' outflows.

Figure 1: Net Interest Margin for the Nordic Banks



Source: Matrix Corporate Capital Research

Figure 2: Loan-to-Deposit Ratios for the Nordic Banks

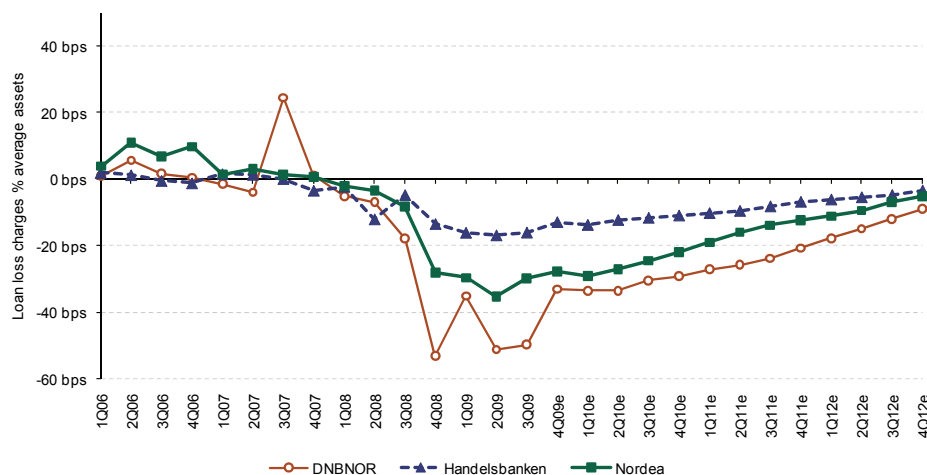


Source: Matrix Corporate Capital Research

### Asset Quality Trends Positive

Again, as with the peer Nordic banks, Handelsbanken demonstrated an improvement in asset quality. The already low loan loss ratio improved to only -0.19% from -0.23% in Q3 2009. The absolute value of NPLs stayed stable QoQ, with the NPL ratio remaining flat over the quarter at 0.58%. Importantly, the coverage ratio increased to 62% in Q4 2009 from 57% in Q3 2009, marking the third quarterly improvement (see Figure 3).

Figure 3: Development of Loan Losses for the Nordic Banks



Source: Matrix Corporate Capital Research

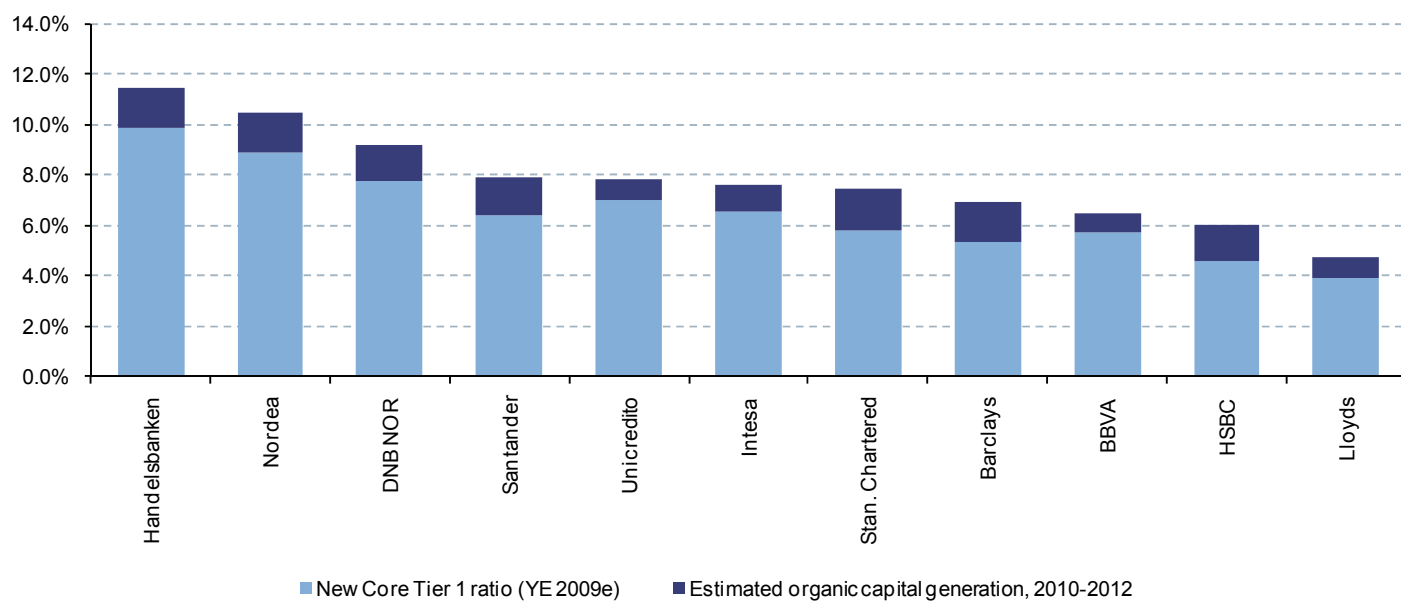
### We See Substantial Excess Capital

Handelsbanken's Core Tier 1 ratio, at 11.7%, was markedly higher than expected. This was mainly because RWA fell by 4% QoQ (we had forecast a 1% decline). It would appear from conversations with management that the increased provisioning for NPLs (the absolute level of provisions increased by 13% QoQ) has resulted in a reduction in RWA.

We have re-run our Basel III analysis of Handelsbanken. We estimate that the Core Tier 1 ratio on a Basel III basis will be 11.2% at the end of 2012, making it now the best capitalised bank in the peer group of European lending banks. The main reason for the relative improvement in its CT1 ratio (it was the second best capitalised before) is that the increased provisioning undertaken in the quarter has reduced the excess of IRB provisions over existing provisions, resulting in a smaller deduction against common equity.

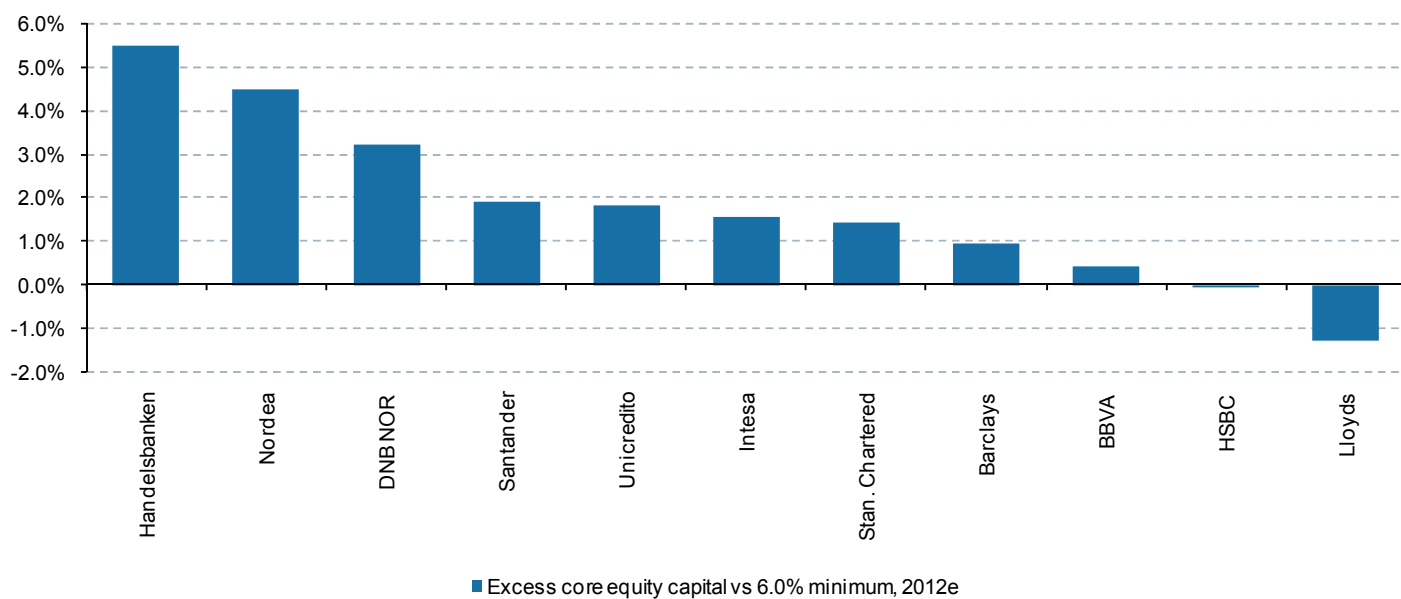
It is clear to us that Handelsbanken has substantial excess capital. Against an anticipated regulatory minimum CT1 ratio of 6.0%, Handelsbanken has excess capital of ~5.5%, equivalent to approximately 35% of shareholders' funds expected at the end of 2012. Management has stated that it would like to maintain its capital ratios at the current levels for the foreseeable future for several reasons: it enables access to cheaper funding; it is prudent to maintain capital ahead of the new Basel III regulations; and it would like to maintain capital for expansion. We believe that as the sector moves towards Basel III, management will gain comfort in being able to release some portion of its substantial excess capital (see Figure 5). This is a key pillar supporting our BUY rating.

Figure 4: Banks Ranked by Expected Core Tier 1 Ratio at the End of 2012



Source: Matrix Corporate Capital Research

Figure 5: Banks Ranked by Expected Excess Capital Against an Anticipated Minimum Core Tier 1 Ratio of 6.0%



Source: Matrix Corporate Capital Research

Figure 6: Svenska Handelsbanken Earnings Table

SVENSKA HAN-A	FY2008	Q4 2009	Q4 2009E	FY 2009	FY 2010E	FY 2011E	FY 2012E
<b>INCOME STATEMENT (SEKm)</b>							
Net interest income	19,223	5,359	5,594	22,000	22,531	24,383	26,534
Net fees & commissions	6,795	1,995	1,779	7,393	7,763	8,151	8,558
Trading profits/losses	3,169	497	446	2,457	2,268	2,336	2,406
Other revenue	975	116	118	485	498	508	519
Total operating revenues	30,162	7,967	7,937	32,335	33,059	35,378	38,018
Operating costs	-13,137	-4,058	-3,744	-15,136	-14,917	-15,961	-17,147
Operating profit	17,025	3,909	4,193	17,199	18,142	19,417	20,871
Total provisions	-1,605	-691	-1,031	-3,392	-2,678	-2,073	-1,275
Impairments on other assets	0	0	0	0	0	0	0
Goodwill impairment	-92	0	0	-84	0	0	0
Other income / (expense)	-2	3	0	4	0	0	0
Pre-tax profit	15,326	3,221	3,162	13,727	15,465	17,344	19,596
Taxes	-3,382	-722	-822	-3,519	-4,021	-4,509	-5,095
Minorities	0	0	0	0	0	0	0
Other non-operating items	0	17	0	36	0	0	0
Net profit	11,944	2,516	2,340	10,244	11,444	12,834	14,501
<b>ASSETS (SEKm)</b>							
Loans to customers	1,481,475	1,477,183	1,461,216	1,477,183	1,562,331	1,692,899	1,833,477
Interbank loans	164,981	168,100	153,809	168,100	178,389	193,094	209,011
Total securities	239,480	183,794	183,002	183,794	198,945	215,344	233,095
Intangible assets	7,057	7,319	7,179	7,319	7,539	8,160	8,160
Total assets	2,158,784	2,122,843	2,183,406	2,122,432	2,292,378	2,494,942	2,715,954
Net interest-earning assets	2,087,556	2,003,929	2,029,115	2,003,929	2,125,640	2,309,730	2,517,344
<b>LIABILITIES (SEKm)</b>							
Interbank borrowings	319,113	239,790	201,203	239,790	254,492	275,470	298,178
Customer deposits	1,439,469	1,515,823	1,594,187	1,515,823	1,640,776	1,788,751	1,950,246
Total shareholders' equity	74,963	83,087	82,118	83,087	89,545	97,801	107,169
Tangible net asset value	67,906	75,768	74,938	75,768	82,006	89,641	99,009
<b>IMPORTANT FINANCIAL RATIOS</b>							
ROA	0.59%	0.47%	0.43%	0.48%	0.52%	0.54%	0.56%
ROE	15.98%	12.36%	11.56%	12.96%	13.26%	13.70%	14.15%
ROTNV	17.55%	13.57%	12.69%	14.26%	14.51%	14.95%	15.37%
Cost/income	-43.55%	-50.94%	-47.17%	-46.81%	-45.12%	-45.12%	-45.10%
Tax rate	-22.07%	-22.42%	-26.00%	-25.64%	-26.00%	-26.00%	-26.00%
Payout	36.54%	198.19%	125.00%	48.68%	40.00%	40.00%	40.00%
Net interest margin	1.03%	1.06%	1.10%	1.08%	1.09%	1.10%	1.10%
LLC % gross loans	-0.12%	-0.19%	-0.28%	-0.23%	-0.18%	-0.13%	-0.07%
Non-performing loans % gross loans	0.36%	0.58%	0.60%	0.58%	0.48%	0.33%	0.25%
NPL coverage ratio	51.07%	62.45%	55.00%	62.45%	70.00%	70.00%	70.00%
Loans % deposits	272.45%	268.70%	238.87%	268.70%	262.55%	257.73%	252.88%
Tier 1 ratio	10.51%	14.21%	13.49%	14.21%	14.90%	15.20%	15.57%
Core tier 1 ratio	8.90%	11.74%	11.11%	11.74%	12.50%	12.95%	13.45%
Equity % total assets	3.47%	3.91%	3.76%	3.91%	3.91%	3.92%	3.95%
RWA % total assets	33.44%	28.37%	28.33%	28.38%	27.07%	26.40%	25.74%

Source: Matrix Corporate Capital Research

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