

Equity Research  
Europe

Industry

## Greek Banks

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Industry Overview

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### *Getting Better All the Time?*

#### COMPANIES FEATURED

Alpha Bank (ACBr.AT)	Neutral
National Bank of Greece (NBGr.AT)	Neutral

- **Income quality has continued to improve this year ...**  
... following strong growth in interest income. But the banks still face the challenge of diversifying non-interest income earnings. Returns here may continue to be weaker than in 2000, due to capital markets exposure.
- **Adjusting our 2001 forecasts following 1H results**  
Interest income has performed better than we expected at NBG and has met our expectations at Alpha. Fee income at both banks, however, came in less than our (already below consensus) forecasts.
- **Valuation: not demanding, but the outlook for fees may hold shares back**  
Alpha Bank and NBG are trading on 2002 P/E of 13.1x and 15.3x and 2002 P/BV of 1.6x and 1.8x, on our estimates. We think an improved outlook in non-interest income is required to spark a rally in the shares.

## Getting Better All the Time?

### Summary and investment conclusion

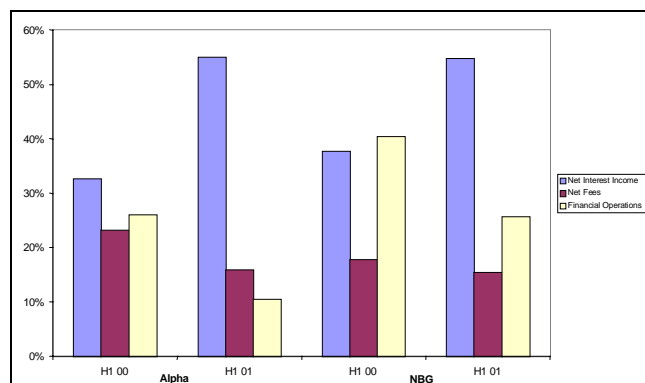
#### The Greek banks have faced a challenging 18 months.

In 2000, capital markets earnings began to tail off from 1999 highs and the banks became focused on improving returns from the lending business by shifting their asset mix towards higher-margin consumer products. However, as this shift was accompanied by a contraction in spreads ahead of Greece's entry into the single currency in January 2001, earnings growth from increased lending volumes didn't immediately offset margin pressure to compensate sufficiently for the loss of earnings on the trading book. The continued presence of non-recurring exceptional gains (from equity disposals, for example), although enhancing to the bottom line in the short term, also contributed to a cloudy outlook for long-term sustainable ROE.

2001 has seen the Greek banks improve income quality through healthy interest income growth (Exhibit 1). This should, in theory, be good news for the shares. We believe the reason it hasn't is that the performance of non-interest income continues to take centre stage. Although fee generation on the back of retail activities has picked up, lower earnings from capital markets activities have held back total fee and commission income growth. Weaker earnings are in line with the performance of the Greek stock market. We believe investors' surprise at precisely how weak the market (and hence Greek banks' earnings in this area) could be this year may partially be an expression of disappointment at the fact that Greece's move to pan Europe

Exhibit 1

### Greek Banks: Income quality continues to improve



Source: Company Data, Morgan Stanley Research

has attracted less attention from pan European investors than might have assumed, given falling share prices.

**Revisiting our year-end 2001 forecasts and valuation following 1H results.** Interest income has performed better than we expected at NBG and has met our expectations at Alpha. Fee income at both banks, however, came in less than our (already below consensus) forecasts. We have revised our estimates for both NBG (Neutral; Current Price: EUR 31.1) and Alpha Bank (Neutral; Current Price: 23.2) to reflect this.

At NBG, we have reduced 2001E net profits by overall 1.5% (from Dr. 138 billion to Dr. 136 billion), with EPS moving from EUR 1.74 to 1.71.

Exhibit 2

### Greek Banks: Current Valuation

	Price	P/E				P/BV (x)				
		99	00	01E	02E	99	00	01E	02E	
ALPHA BANK	EUR 23.2	6.7	15.1	16.6	13.1	2.22	2.37	1.62	1.62	
NBG	EUR 31.1	23.6	33.3	18.2	15.3	2.62	2.25	2.03	1.79	
			<b>Sus ROE</b>	<b>Implied ROE on g:</b>			<b>Cost of Eq (%)</b>	<b>Implied P/BV on g:</b>		
				<b>0%</b>	<b>3%</b>	<b>5%</b>		<b>0%</b>	<b>3%</b>	<b>5%</b>
ALPHA BANK	EUR 23.2	2001E	12	15.3	10.5	7.2	9.4	1.27	1.40	1.58
		2002E		15.3	10.4	7.2	9.4			
NBG	EUR 31.1	2001E	14	19.7	13.6	9.5	9.7	1.44	1.64	1.91
		2002E		17.3	12.0	8.4	9.7			
				<b>Implied Price (ZI) on g:</b>			<b>Implied upside (%), g of:</b>			
				<b>0%</b>	<b>3%</b>	<b>5%</b>	<b>0%</b>	<b>3%</b>	<b>5%</b>	
ALPHA BANK	23.2	2001E		18	20	23	(21.7)	(13.9)	(2.8)	
		2002E		18	20	23	(21.5)	(13.7)	(2.6)	
NBG	31.1	2001E		22	25	29	(4.7)	(19.1)	(5.7)	
		2002E		25	29	33.5	8.3	(8.1)	7.1	

E = Morgan Stanley Research Estimates

Source: Company Data, Morgan Stanley Research

Given that we are now less optimistic about a recovery in capital markets earnings in 2002, we have also brought our estimates down for 2002 and 2003 (Net profits down 8% in 2002 and around 1% in 2003).

At **Alpha**, we note that we will now be driving our valuation from our Greek GAAP model instead of IAS. This is due to timeliness issues, as IAS reports continue to lag behind Greek GAAP data, and enhanced comparability with NBG (which reports quarterly data in Greek GAAP only). The two key areas of difference between IAS reporting and Greek GAAP accounts lie in the area of financial operations and in leasing income. The widest variation is in income from financial operations. On our new Greek GAAP model, we expect Net Profits in 2001 to be Dr. 76.8 billion, with EPS (fully diluted) of EUR 1.26. We forecast net profits of Dr. 100.7 billion in 2002 (EPS EUR 1.6) and Dr. 123 billion in 2003 (EPS EUR 1.95).

Alpha Bank and NBG are currently trading on 2002 P/E of 13.1x and 14.9x and 2002 P/BV of 1.6x and 1.8x, on our estimates. We see fair value for Alpha at EUR 23 and EUR 33.5 for NBG. Although the outlook for interest income growth (and hence improving income quality) continues to be bright, we think improved prospects for fees may be required to sustain a long-term rally in the shares. **We are maintaining our neutral rating on both banks.**

#### **1H 01: Interest income remains strong, capital markets earnings still weak**

**Both NBG and Alpha Bank have been successfully repositioning their asset mix** towards higher margin consumer products this year, which is one of the factors that has accounted for the growth in net interest income. At NBG, **Net interest income** at 1H 01 came in at Dr. 193 billion drachmas, up 42% YoY, on the back of 17% YoY growth in lending and an improvement in the NIM to 2.5% vs. 1.8% in 1H 2000. We have revised up our year-end 2001 forecast by 12% to Dr. 388 billion from Dr. 347 billion.

Like NBG, Alpha has also shown strong **interest income** growth in 1H 01—total net interest income was Dr. 120 billion, up 38% YoY. The improvement followed on from 24% YoY growth in customer lending and a 40 basis point improvement in the Net Interest Margin was 2.4% (vs 2.1% at 1H 2000). This was in line with our previous IAS forecast of Dr. 240 billion. Our current year-end estimate under Greek GAAP is for Dr. 236 billion. (The IAS result

includes reclassified leasing income, and the Greek GAAP result does not.)

Overall, we think the outlook for continued growth in interest income should remain strong. Our interest income forecasts at both Alpha and NBG (see Exhibits 2 and 3) assume steady margin attrition out to 2003, due to increased competition in these areas. However, ‘price wars’ (such as the one kicked off by Alpha last year, when the lending rate in one consumer loan was cut by 700 basis points) remain a recurring feature in the Greek market. We note that further aggressive cuts could mean that the erosion in the net interest margin turns out to be more severe than we have forecast.

Further reductions in lending restrictions by the Bank of Greece later this year should provide an additional boost to lending volume growth. However, we note that consumer confidence levels in Greece, which are closely correlated to the performance of the Greek stock market, waned in 1H. This tends to show a lagged effect—should consumer spending show signs of tailing off, consumer lending growth may soften in 2H. To date, the aggregate growth rate in customer lending has remained around 27% YoY.

**Within non-interest income**, fees and commissions came in below our expectations at both NBG and Alpha. At NBG, net fees were Dr. 54.7 billion, down 15% YoY. We have reduced income from **Fees and Commissions** by 16% at NBG for 2001, to Dr. 120 billion. We remain pessimistic over the outlook for a recovery of capital markets earnings 1H 2002 as the global outlook remains challenging. We have also reduced our 2002 estimate for NBG by 14% (to Dr. 150 from Dr. 175 billion) and by 5.1% in 2003 (to Dr. 202 billion from Dr. 213 billion.) At Alpha, 1H 01, fees came in at Dr. 34 billion, down 44% YoY. We have reduced our year-end estimates by 27% to Dr. 68 billion. Despite the lack of visibility on the outlook for capital markets earnings in the short term, over the long term, we note that deposit disintermediation is likely to remain a feature of the Greek market. We believe that both NBG and Alpha through their capital markets businesses are well placed to benefit from this trend.

**Within fees both Alpha and NBG continue to see growth in retail related products (ie credit cards, loan arrangement fees.)** We expect this to continue as the retail businesses develop further. These low capital intensive, high-annuity value (hence, EVA enhancing) earnings from service charges continue to represent a small percentage of

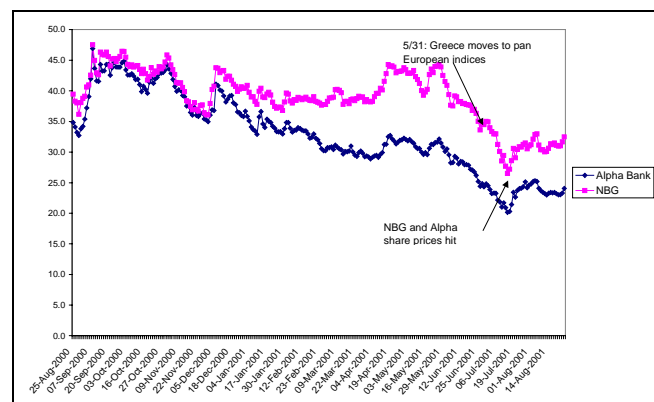
non-interest income. There appears to us to be an opportunity to extend these fees throughout the customer base, particularly through the SME franchise. The ability to diversify earnings in this way would significantly enhance our view of sustainable ROE.

Within **Financial Operations**, our estimates at NBG have proved too pessimistic. NBG earned Dr. 90 billion in H101. We have revised our estimate up from Dr. 132 billion to Dr. 170 billion. The 1H result incorporates Dr. 30 billion in non-repeatable trading gains (Dr. 30 billion in bonds.) We don't expect further exceptional gains in the core business this year. Lower earnings in this area in 2002 and 2003 reflects the lack of gains from the historical portfolio going forward. At Alpha, income from financial operations came in at Dr. 23 billion, which is in line with our Greek GAAP estimates of Dr. 45.7 billion at year-end. We note that under IAS, financial operations income would come in significantly below this.

**On the cost side**, both banks would appear to have opportunities to continue to improve operating efficiency—this would enable the banks to support margins if the outlook for revenue growth gets tighter. The cost/income ratio at Alpha is 58%, at NBG it is 52%. Costs were up 6.6% at NBG YoY; however, we note that last year's results do not include costs relating to the bank's Bulgarian subsidiary, UBB, as they do in 1H 01. The 3Q results should show a more accurate picture of organic cost growth at the bank. We believe that the bank will be able to continue to exploit opportunities to extend the branch network restructuring further.

Exhibit 3

### Alpha and NBG: Recent Price Performance



Source: Factset, Morgan Stanley Research

Exhibit 4

### 2001: MS vs IBES Consensus Earnings Estimates

EUR m	MS	Consensus Range		EPS
	Net Profits	EPS	Net Profits	
Alpha Bank	261	1.26	210-470	.80-2.3
NBG	544	1.71	544-830	1.71-3.56

Source: Morgan Stanley Research, IBES consensus estimates.

Costs were down 14% YoY at Alpha. Alpha should continue to see cost synergies from the Ionian merger feeding through this year. However, we believe that there may be increased pension liabilities in 2002 and 2003. Staff costs were down 26% YoY, which is partially a reflection of a lower contribution to the pension fund. The bank has said that it will increase its contributions to the fund when revenue growth prospects improve.

Neither bank has reported a deterioration in NPL's this year (even in the part of the corporate loan book potentially most exposed to the global economic downturn, ie shipping)—Alpha's NPL ratio is 3.3% of gross loans, NBG's 7.8% (thanks to numerous historical loans). **Provisioning** charges currently represent 40 basis points of total gross loans at both Alpha and NBG. Following the tremendous growth in customer lending over the past two years, we would anticipate that charges could trend upward, potentially beyond our forecasts, in 2003.

**Net Profits:** The changes to our forecasts mean that 2001E net profits at **NBG** are reduced by 1.5% (from Dr. 138 billion to Dr. 136 billion). 2001 Core EPS moves to EUR 1.71 from EUR 1.74. In 2002, Net Profits move to Dr. 160 billion in 2002 and Dr. 206.4 billion in 2003. Our new 2001 net profits estimate for **Alpha** is for Dr. 76.8 billion, with EPS (fully diluted) at EUR 1.26. This is 10% lower than our previous published forecast of Dr. 86.8 billion.

**Following the changes to our forecasts, we remain at the lower end of consensus earnings estimates for both banks**, as we have been for some time (Exhibit 3). Nevertheless we think that following recent price corrections this year, the valuation of both shares is starting to look more attractive (Exhibit 2). We are maintaining our neutral rating but note that an improvement in the outlook for non-interest income could, we think, spark a re-rating in the shares.

## Exhibit 5

**NBG: Summary of Earnings Forecasts**

Dr. billion	2000	1Q 01	1H 2001	2001E	2002E	2003E
Net Interest Income	394.5	93.2	193.5	388.7	390.1	410.5
NIM (%)	2.8	2.46	2.5	2.5	2.3	2.2
Fee Income	126.6	26.7	54.6	120.0	150.0	202.5
Financial Operations	176.9	54.0	90.5	170.0	147.9	165.0
Securities	16.2	4.1	8.2	17.0	25.0	30.0
Other	20.2	7.8	6.6	13.3	13.9	15.4
Total Operating Revenue	734.5	185.8	353.6	709.0	727.0	823.3
Adj for Bond Trading Gains	(92.0)	(15.0)	(30.0)	(30.0)		
Adj. for Equity Disposals	(94.7)	(7.0)	(14.0)	(14.0)		
Continuing Business Revenue	547.8	163.8	309.6	665.0	727.0	823.4
Continuing Business Costs	(366.3)	(89.8)	(185.1)	(381.7)	(400.8)	(420.8)
Total Core Operating Profit	181.6	74.0	124.4	283.3	326.2	402.5
Provisioning	(48.8)	(12.4)	(26.3)	(53.7)	(59.1)	(65.0)
Reported Pretax Profit	319.4	83.5	142.1	273.6		
Underlying Pretax Profit	132.7	61.5	98.0	229.5	267.0	337.4
Minorities	(12.9)	(2.1)	(3.3)	(12.9)	(12.9)	(12.9)
Reported Tax	(89.5)	(20.8)	(33.2)	(80.3)	(93.5)	(118.1)
<b>Reported Profit</b>	<b>244.6</b>			<b>180.3</b>		
<b>Underlying Profit</b>	<b>73.3</b>			<b>136.3</b>	<b>160.7</b>	<b>206.4</b>
DPS — EUR	1.09			0.60	0.71	0.91
Core EURO EPS	0.93			1.71	2.02	2.59
Core ROE	7.3			12.3	12.9	14.6

E = Morgan Stanley Research Estimates

Source: Company Data, Morgan Stanley Research

## Exhibit 6

**Alpha Bank: Summary of Earnings Forecasts (Greek GAAP)**

Dr. billion	2000	Q101	H101	2001E	2002E	2003E
Net Interest Income	179.0	60.2	120.0	236.5	250.9	256.2
NIM (%)	1.9	2.7	2.4	2.2	2.0	1.8
Dividend Income	6.9	1.2	5.0	9.1	11.4	14.2
Net Commission Income	91.7	15.4	34.5	68.7	89.4	116.2
Profit on Fin. Ops	90.9	15.7	22.7	45.5	54.5	68.2
Other Operating Income	83.1	20.6	36.4	74.8	82.3	90.5
Total Core Revenues	451.8	113.1	218.7	434.6	488.5	545.3
General Expenses	53.5	14.8	34.8	190.4	199.9	213.8
Deprec. & Amort.	67.0	18.4	35.2	69.0	75.9	80.5
Provisions-Credit Risk	36.2	10.4	21.1	40.5	46.6	53.6
Staff Retirement	.930	.250	.792	.977	1.0	1.1
Other Provisions	3.9	2.7	4.6	9.2	9.7	10.1
Operating Profits	150.2	33.2	61.9	124.7	155.8	186.7
Pretax Profit <sup>1</sup>	154.3	34.4	69.9	124.7	155.8	186.7
Income Tax	(46.2)	(10.6)	(20.0)	(34.9)	(43.6)	(52.3)
Minorities	(27.2)	(2.5)	(5.7)	(11.4)	(11.4)	(11.4)
Net Profit	80.8	21.3	44.2	78.4	100.8	123.1
DPS	182.25	—	—	166.62	210.86	257.47
DPS — EUR	0.54			0.49	0.62	0.76
Fully Diluted EPS -DR				429.4	544.2	664.5
Fully Diluted EPS — EUR				1.26	1.60	1.95
ROE	15.2			11.0	11.3	13.5

1 = Including extraordinary

E = Morgan Stanley Research Estimates

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Source: Company Data, Morgan Stanley Research

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