Asia Credit Research

Earnings Review: Groupe BPCE / BPCE S.A. ("GBPCE")

Issuer Profile: Neutral (4)

Ticker: **BPCEGP**

Background

Established in 2009, BPCE S.A. is the central entity of Groupe BPCE ('GBPCE'). Through its retail cooperative networks and subsidiaries, it provides retail and wholesale financial services to individuals, small and medium-size enterprises (SMEs), and corporate and institutional customers in France and abroad. As at 31 December, 2017, it had total assets of EUR1,259.9bn.

Andrew Wong
+65 6530 4736
WongVKAM@ocbc.com

Recommendation

- Loans growth and a lower cost of risk lifted GBPCE's 1Q2018 PBT by 0.8% y/y despite the impact of low interest rates on Retail Banking & Insurance.
- The reduction in cost of risk was supported by a q/q improvement in the reported ratio of non-performing loans to gross loan outstandings and impaired loans coverage ratio.
- We maintain our Neutral (4) Issuer Profile on the back of ongoing solid capital adequacy, with its CET1 ratio at 15.1% and TLAC ratio at 21.5% as at 31 March 2018.
- The GBPCE Tier 2 papers look attractive in the SGD Tier 2 space in our view given its business profile and sound capital position. Within the BPCEGP curve, we prefer BPCEGP 4.45 '25c20 relative to BPCEGP 4.50 '26c21 given similar spreads albeit having a shorter dated tenor. The pick up against the BNP 4.3 '25c20s also compensates for BNP Paribas' better business profile (we rate BNPP one level higher at Neutral (3)) in view of its more geographically diversified business which protects against domestic pressures.

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask Yield	Spread (bps)
BPCEGP 4.50 '26c21 (T2)	03/06/2021	15.1%	3.59%	136
BPCEGP 4.45 '25c20 (T2)	17/12/2020	15.1%	3.55%	138
STANLN 4.4 '26c21 (T2)	23/01/2021	13.9%	3.12%	95
BNP 4.3 '25c20 (T2)	03/12/2020	11.6%	3.36%	121
SOCGEN 4.30 '26c21 (T2)	19/05/2021	11.2%	3.50%	128
CMZB 4.875 '27c22 (T2)	01/03/2022	13.3%	4.32%	201

Indicative prices as at 23 May 2018 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Key Considerations

- **Growth in underlying business operations, partially dragged by weakness in USD against the EUR:** GBPCE reported its 1Q2018 results with net profit, after restating the impact of IFRIC 21 impact, up 0.9% y/y to EUR955mn. Within these results, 1Q2018 revenue was impacted by weakness in the USD against the EUR, with net banking income down 0.8% y/y. However, at constant exchange rates to better reflect underlying performance, net banking income in fact increased by 0.9% y/y. This was supported by a rise in net banking income in the Asset & Wealth Management (+20.2% y/y), Specialised Financial Services (+5.2% y/y), and Insurance divisions (+7.7% y/y).

- **Volumes and strategic development in Life Insurance & Payment activities helped mitigate soft performance within Retail Banking:** The Retail Banking segment accounted for 71% of aggregate net banking income in 1Q2018 (down from 73% in 1Q2017). The segment has been challenged by the low interest rate operating environment in Europe. However, with the strategic development of fee and commission based activities, namely Specialised Financial Services (SFS) and Insurance within the Retail Banking segment, the decline in net banking income was limited to 3% y/y to EUR4.18bn. The Insurance segment continues to maintain good profitability with its gross operating income (GOI) up 6.7% y/y due to an increase in premiums collected for its Life and Personal Protection insurance. The SFS payment business also enjoyed faster pace of growth with GOI up 5.8% y/y to EUR118mn. That said, while low interest rates have suppressed overall net banking income of the retail banking segment, underlying fundamentals within Retail Banking remain intact with loan outstandings growing 4.8% y/y to EUR548bn. This was driven by a 5.7% y/y rise in home loans and a 7.4% rise in equipment loans.

- **Asset & Wealth management continued to experience robust growth in 1Q2018:** Based on constant exchange rates, GBPCE's Asset & Wealth Management division continued to outperform with net banking income up 20.2% y/y to EUR777mn and GOI up 47.8% y/y to EUR248m due to improved fee rates in Asset Management and 12% y/y growth in Wealth Management net revenues. While Asset & Wealth Management division only contributes to 13% of the group's GOI, the shift in focus towards this segment is expected to help build up the resilience of the group amid headwinds from the Retail Banking segment.

- **Operating expenses kept in check:** 1Q2018 operating expenses were up 1.2% y/y to EUR4.6bn (+2.5% y/y on constant exchange rate basis). As a result, the cost to income ratio has risen to 69% (4Q2017: 68.3%). Excluding the Single Resolution Fund (SRF) contribution which rose 31% y/y, operating expense remained steady at EUR4.2bn (-0.7% on current exchange rates, +0.7% y/y at constant exchange rates) indicating the cost performance of GBPCE remains somewhat controlled despite underlying business growth.

- **Higher loan quality:** Cost of risk, after restating for the impact of IFRIC 21, fell 29.2% y/y to EUR259mn (1Q2017:EUR366mn). This was driven mainly by reduction in the Retail Banking & Insurance division while the cost of risk in Corporate & Investment Banking remained unchanged. Lower impairments this quarter contributed to a marginal rise in the group's PBT (+0.8% y/y) to EUR1.2bn. Improvement in the reported non-performing loan ratio to 3.0% (4Q2017: 3.2%) was driven by both 1.3% y/y growth in gross outstanding loans and a 3.9% fall in reported non-performing loans. This, together with higher reported impaired loans coverage ratio (including guarantees related to impaired outstanding) to 74.2% (4Q2017: 71.4%) points to an overall healthier loan book for GBPCE and supports the lower cost of risk in 1Q2018.

- **Capital adequacy ratios at levels above the minimum requirement:** GBPCE's CET1 ratio remained healthy at 15.1% despite having dipped marginally by 3bps from 15.4% in 4Q2017. The fall in CET1 ratio was attributed to first time application of IFRS 9 (-17 bps) and reductions to regulatory capital due to Single Resolution Fund and irrevocable payment commitments (IPC) (-12bps). SRF contribution this quarter surged 31% y/y to EUR340mn. Absent these one-off impacts, the underlying CET1 ratio was stable as the rise in risk-weighted assets (-17bps q/q) were offset by issues of cooperative shares (+14bps y/y) and retained earnings (+13bps y/y). In addition, GBPCE's Total Loss-Absorbing Capacity (TLAC) ratio, including the impact of deduction of IPC, improved to 21.5% (4Q2017: 20.8%). This is close to the target fixed in its TEC 2020 strategic plan of more than 21.5% by early 2019.

OCBC Global Treasury	
Treasury Advisory **Corporate FX & Structured Products** Tel: 6349-1888 / 1881 **Interest Rate Derivatives** Tel: 6349-1899 **Investments & Structured Products** Tel: 6349-1886 **GT Institutional Sales** Tel: 6349-1810	**Credit Research** **Andrew Wong** +65 6530 4736 WongVKAM@ocbc.com **Nick Wong Liang Mian, CFA** +65 6530 7348 NickWong@ocbc.com **Ezien Hoo, CFA** +65 6722 2215 EzienHoo@ocbc.com **Wong Hong Wei** +65 6722 2533 wonghongwei@ocbc.com

Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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