Asia Credit Research

Earnings Review: Barclays PLC (“Barclays”)

Issuer Profile: Neutral (4)

Ticker: **BARC**

Background

Based in the UK, Barclays PLC (‘Barclays’) operates in over 50 countries across two main business segments – Barclays UK and Barclays International. Its scale in the UK and globally makes Barclays systemically important on both a domestic and global level. As at 31 March 2018, it had total assets of GBP1,142.2bn.

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Recommendation

- Barclays’ results indicate some fundamental challenges in our view aside from headline numbers that were impacted by one-offs. Underlying earnings benefited from improvement in volatile earnings and cost reductions.
- Although capital ratios were weaker q/q, management are of the view that the business is now positioned for improved performance going forward with legacy conduct issues resolved. As such, results have not altered our Neutral (4) Issuer Profile.
- We are underweight the BACR 3.75 '30c25 due to its long call date. Although the spread at 175bps over swaps is one of the widest in the Tier 2 space, we think there’s better value in other European names considering duration and fundamentals such as BNP 4.3% ‘25c20 and CMZB 4.875% ‘27c22.

Relative Value:

Bond	Call date	CET1 Ratio	Ask Yield	Spread
BACR 3.75 '30c25	23/05/2025	12.7%	4.29%	175
BNP 4.3 '25c20	03/12/2020	11.9%	3.24%	112
CMZB 4.875 '27c22	01/03/2022	14.1%	4.25%	197

Indicative prices as at 27 April 2018 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Key Considerations

- **Results impacted by higher than expected one-off charges**: Barclays 1Q2018 results were somewhat mixed with supportive underlying performance overshadowed by large litigation and conduct provisions of GBP2.0bn. These resulted in a loss before tax for the quarter of GBP236mn. Excluding litigation and conduct charges, profit before tax was GBP1.73bn, up 1% y/y. The bulk of the charges comprised a GBP1.4bn settlement with the US Department of Justice (’DoJ’) for sales of toxic RMBS from 2005-2007. While this settlement with the DoJ was previously announced, what was unexpected was an additional GBP400mn charge for Payment Protection Insurance (‘PPI’). Nevertheless, with total provisions at GBP3.54bn as at 31 December 2017 (and management’s assertion that PPI provisions remaining to be used until 29 August 2019 as at 31 March 2018 was GBP1.7bn), recent settlement and higher charges can likely be accommodated within existing resources.

- **Solid underlying performance but some challenges remain:** Barclays’ underlying earnings benefited from improved expense performance with a 45% y/y reduction in credit impairment charges from both single name recoveries and a better US economic outlook as well as a 6% y/y fall in operating expenses. These, along with better performance in Barclays International, offset an 8% fall in total income from weaker performance in the UK, USD depreciation and absence of one-off gains from 1Q2017. In particular, Corporate & Institutional Banking (‘CIB’) income improved 1% y/y in 1Q2018 as markets related income growth (equities derivatives and financing from increased client activity and market volatility) of 8% mitigated a 4% fall in banking income from lower fee income and an 11% decline in corporate lending. While we caution that improved underlying performance has come from a somewhat volatile income source, the positive trend in expenses provides comfort for future underlying earnings performance.

- **Balance sheet growth/risk profile change:** Business growth in investment banking (derivatives and securities trading activity) translated into a 2.5% rise in risk weighted assets. This offset the impact on risk weighted assets of USD depreciation against the GBP (-0.6%) and improvements in book quality (-0.3%). Quality improvements largely occurred in Barclays International with the re-allocation of RWAs in CIB and repositioning of the US Cards portfolio in Consumer, Cards and Payments. Such movements also explain the weaker earnings and lower impairment charges in these respective divisions as part of Barclays' on-going restructuring activities which has in general seen RWAs falling over previous quarters.

- **Capital ratios weaker:** Barclays' loss before tax for the quarter of GBP236mn contributed to a reduction in Barclays CET1 ratio to 12.7% as at 31 Mar 2018 (13.3% as at 31 Dec 2017). Capital ratios were also impacted by a GBP4.9bn increase in risk weighted assets. These negative movements offset the positive impact on CET1 capital from the implementation of IFRS9. The CET1 ratio is now just below Barclay's expectation for its end state CET1 ratio of around 13%, but nevertheless above its regulatory minimum requirement of around 11.4% (this level is also what management expects would be the Mandatory Distribution Restrictions hurdle). Its UK leverage ratio of 4.8% is also above the transitional minimum requirement of 3.6% as at 31 March 2018 and expected minimum 4.0% requirement applicable from 2019. Management focus on capital will continue to be high in our view, particularly given their intention to return capital to shareholders through dividends and share buybacks in the future.

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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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