Asia Credit Research

Earnings Review: Julius Baer Group Ltd ("JBG")

Issuer Profile: Neutral (3)

Ticker: **BAERVX**

Background

Present in over 50 locations, Julius Baer Group Ltd. offers private banking services mainly through Bank Julius Baer & Co. Ltd. Services include wealth management, financial planning and investments and mortgages and other lending. As at 30 June, 2018 it had total client assets of CHF467.4bn and assets under management of CHF400bn.

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Recommendation

- Julius Baer Group Ltd (JBG)'s business structure remains unique amongst our coverage as the only pure play private bank.
- As reported in late July, financial performance in 1H2018 was robust despite the change in management with record high net profit of CHF443.8mn while gross margin remained unchanged y/y and improved h/h.
- With capital adequacy ratios staying well above the minimum regulatory requirement, we retain our Neutral (3) Issuer Profile on JBG.
- In our Monthly Credit View for September, we continue to overweight both the BAERVX 5.75 PERPc22s and BAERVX 5.90 PERPc20s over the HSBC 4.7 PERPc22s as the spread differential more than compensates for the smaller but more focused business profile and lower CET1 ratio in our view. In addition, the reset step-up is higher for the BAERVX AT1s then all other SGD AT1s.

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask Yield	Spread
BAERVX 5.75 PERPc22 (AT1)	20/04/2022	13.7%	4.38%	217bps
BAERVX 5.90 PERPc20 (AT1)	18/11/2020	13.7%	3.89%	181bps
HSBC 4.70 PERPc22 (AT1)	08/06/2022	14.2%	4.26%	204bps

Indicative prices as at 14 Sept 2018 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Key Considerations

- **Continuity of previous strategy:** With new CEO Bernhard Hodler stepping in since the start of the year, the number of relationship managers (RMs) has grown by 79 since the start of 2018 (with the inclusion of 13 RMs from Reliance Group), nearing its target of hiring 80 relationship mangers (RMs) in 2018. In addition, gross margin and growth in assets under management (AuM) were sustained despite the increase in market volatility. Assets under management continued to grow, up by 3% h/h to CHF400mn (FY2017: CHF389mn) albeit slower growth during the same period in 2017 (1H2017: 6% growth). This was driven by net new money inflows, the acquisition of 95% of Reliance Group in Brazil (successfully completed on 4 June 2018) as well as positive currency impact of CHF. This was partially offset by negative market performance in stock markets in Switzerland, Europe and Asia. Overall despite the change in management, JBG's previous expansion strategy continues with net new money inflows of over 5% annualized well within JBG's target range of 4% – 6%.

- **Steady business performance:** Total operating income was notably up by 12.4% y/y to CHF1.79bn (1H2017: CHF1.59bn), mainly driven by the rise in net trading income by 129.2% y/y to CHF206.3mn as a result of the rise in overall FX and structured products-related trading income. Net commission and fee income also grew by 10.2% y/y to CHF1.0bn on the back of rising asset-based fee income and brokerage commissions while net interest and dividend income fell by 2.3% y/y to CHF553.5mn as the decline in dividend income on trading portfolio more than offset the higher loan volumes and rates. Expense performance on the other hand was also up 9.8% y/y due to a rise in personnel expenses following the growth in number of relationship managers as well as performance-related remuneration. Despite the rise in income taxes, net profit rose significantly by 24.4% y/y at CHF443.8mn (1H2017: CHF356.8mn) while gross margin (defined as operating income divided by average AuM) remained relatively stable at 91.5bps (1H2017: 91.6bps) as operating income grew in line with AuM. Adjusted cost/income ratio also improved to 67.3% from 69.1% in 1H2017, achieving its medium term target range of 64%-68% as the strong growth in revenues more than outpaced the higher expenses.

- **Capital ratios remain strong:** Capital ratios continue to be solid with JBG's CET1 ratio up slightly to 13.7% as at 30 June 2018 (2H2017: 13.5%) due to a slight increase in the fully-applied CET1 capital of CHF2.7bn (2H2017: CHF2.6bn) despite the accretive acquisition of Reliance Group (Brazil) in June 2018 as well as the residual 20% stake in Kairos (Italy) in January 2018. At the same time, risk weighted assets were also somewhat lower by 1% h/h to CHF19.5bn. JBG's total capital ratio however fell modestly to 20.2% (2H2017: 21.2%) as a result of the redemption of its CHF250mn Tier 1 bonds in March 2018. Overall, both the CET1 and total capital ratio still remain well above the minimum regulatory requirement of 8.1% and 12.3% respectively and JBG's internal targets of 11.0%/15.0%.

- **Solid operating conditions at home:** While net new money remains well within the target range, future growth could be challenged by both the competitive world of Private Banking (potential staff movements – recent staff departures in Latin and Central America were explained by management as strategic realignment) as well as macro-economic concerns globally (ongoing trade tensions) and in Europe (current political uncertainty in Italy could impact AuM growth from the 100% stake in Kairos). That said, JBG's business remains anchored in JBG's home market of Switzerland (56% of FY2017 operating income) with the economy remaining robust. Q/q economic growth in 2Q2018 was at a better than expected 0.7%, the 5th consecutive quarter of above average growth, and above the Eurozone. Asia is the next highest contributor with 21.3% of FY2017 operating income. Although competition is increasing, growth in private banking opportunities within Asia is expected to outpace growth in Europe with rising Asian private banking wealth.

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

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 ("IPR") into a 7 point Issuer Profile Score ("IPS") 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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