

Earnings Review: BNP Paribas S.A. (“BNPP”)

Recommendation

- Earnings pressures for BNPP are consistent with domestic peers, however its scale and diversity, particularly its International Financial Services division, provides some insulation to the credit profile in our view.
- BNPP’s business franchise will remain important given the continuing implementation of its 2017-2020 business development plan which will result in higher one-off transformation costs and investments in order to achieve on-going cost savings. We retain our Neutral (3) Issuer Profile on BNPP.
- We see the BNP 4.3 '25c20s as slightly better value considering fundamentals and spread across domestic peers. We rate BNP Paribas 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
BNP 2.765 '20 (Snr)	03/08/2020	11.6%	2.55%	42
BNP 4.3 '25c20 (T2)	03/12/2020	11.6%	3.25%	108
SOCGEN 4.30 '26c21 (T2)	19/05/2021	11.2%	3.25%	101
BPCEGP 4.50 '26c21 (T2)	03/06/2021	15.4%	3.58%	134
BPCEGP 4.45 '25c20 (T2)	17/12/2020	15.4%	3.52%	134

Indicative prices as at 10 May 2018 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Issuer Profile:
Neutral (3)

Ticker: **BNP**

Background

BNP Paribas S.A. ('BNPP')’s operations span domestic and international retail banking as well as corporate and institutional banking. Concentrated in Europe, its businesses operate in 75 countries. Created in 2000 through a merger of BNP and Paribas, it had total assets of EUR2,150.5bn as at 31 March, 2018. Its largest shareholder at ~8% is the Belgian government.

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Key Considerations

- **Softer headline numbers from multiple sources:** BNPP’s 1Q2018 results continue to reflect somewhat challenging operating conditions for French banks with revenues down 4.4% y/y. Although this was partially due to inclusion of the capital gain from sale of Shinhan shares in 1Q2017, revenues from the operating divisions were also down 1.4% y/y due to unfavourable foreign exchange movements as well as weak markets performance, particularly in fixed income, currencies and commodities. In addition, operating expenses rose 1.7% y/y due to EUR211mn from exceptional business transformation and acquisition restructuring costs as well as the booking of full year anticipated tax increases from application of IFRIC 21. Excluding these exceptional costs, operating expenses actually fell 0.6%. That said, the combination of weaker revenues and higher costs translated to gross operating income down 20.1% y/y. In a change of prior period trends, BNPP’s cost of risk rose 3.9% and this translated to operating income down 25.6% y/y. This was offset by EUR171mn in other non-operating items from sale of a building which moderated the y/y fall in pre-tax income to 18.1% or EUR2.2bn.
- **Q/q comparison is more promising:** Q/q results show more positive trends with revenues up 2.5% and cost of risk down 37.6%. This however was offset by an 8.4% rise in operating expenses (likely due to exceptional items) which resulted in broadly stable operating income of EUR1.9bn q/q. However due to the aforementioned EUR171mn in other non-operating items and stronger q/q performance in ‘Other Activities’ (comprises insurance activities, investment property, assets leased under operating leases, and property development activities), pre-tax income was up 6.3% q/q.
- **Diversification continues to support operating performance:** Operating division performance was slightly better than reported results although still somewhat weak. Operating division revenues were down 1.4% y/y (-4.4% reported), principally due to 9.8% y/y fall in revenues at Corporate and Institutional Banking ('CIB') due to weaker European markets. Mitigating this however was a 0.3% y/y rise in Domestic Markets despite ongoing low interest rates due to business growth (outstanding loans up 5.3% y/y), and a 3.8% y/y rise

International Financial Services ('IFS') which was also from business growth (outstanding loans up 12.1% y/y in Personal Finance and up 3.8% in International Retail Banking). Although cost of risk in IFS rose noticeably y/y and marginally q/q, including share of earnings from equity method entities, pre-tax income from IFS was up 4.8% y/y while Domestic Markets and CIB were down 6.5% and 28.2% respectively y/y. Q/q trends differed with the aforementioned q/q improvement in pre-tax income driven instead by a 13.8% q/q rise in CIB (principally due to a net write-back in provisions). Domestic Market and IFS pre-tax income was weaker q/q by 20.1% and 11.6% respectively. Nevertheless, BNPP's scale and diversity continues to provide support for underlying earnings.

- Capital ratios to remain satisfactory:** BNPP's CET1 ratio at 11.6% as at 31 March 2018 was slightly weaker q/q (11.9% as at 31 December 2017) due to the impact of full implementation of IFRS9. Excluding this impact, CET1 ratios would have been stable as quarterly earnings and a fall in risk weighted assets from foreign exchange impacts were offset by dividend payments. Absent foreign exchange effects, risk weighted assets rose q/q. BNPP's Tier1 and Total Capital ratios were also weaker marginally q/q (13.0%/17.7% as at 31 March 2018 against 13.2%/14.8% as at 31 Dec 2017 respectively). Nevertheless, BNPP's capital ratios remain well above minimum transitional requirements of 9.125%/10.625%/12.625% for 2018 as disclosed in BNPP's 2017 annual report. Although future minimum regulatory requirements will rise, BNPP's capital ratios are expected to remain satisfactory given plans to issue around EUR10bn of senior non-preferred debt until January 2019.

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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.

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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.

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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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