Issuer Profile:

Neutral (3)

Ticker:

BNP

BPCEGP

ACAFP

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French Banks – 1H2019 Peer Review

Recommendation

- **Volumes supported income performance, particularly in retail banking to offset low interest rates. At the same time, underlying cost performance is benefitting from ongoing restructuring programs.**
- **Support to capital ratios from earnings generation means our Neutral (3) issuer profile on BNPP, GBPCE and CAG holds.**
- **Shorter dated paper from French banks still looks interesting, in particular SOCGEN 4.3% 26c21 although could be hard to find. Otherwise, the bonds all look to be fairly valued.**

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask YTW	Spread
BNP 4.3 '25c20	03/12/2020	11.9%	2.75%	113bps
BNP 4.35 '29c24	22/01/2024	11.9%	3.33%	178bps
BPCEGP 4.45 '25c20	17/12/2020	15.5%	2.83%	121bps
BPCEGP 4.5 '26c21	03/06/2021	15.5%	2.89%	129bps
ACAFP 3.8 '31c26	30/04/2026	15.4%	3.53%	192bps
SOCGEN 4.3 '26c21	19/05/2021	12.0%	3.20%	160bps
SOCGEN 6.125 PERPc24	16/04/2024	12.0%	5.35%	379bps

Indicative prices as at 07 August 2019 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

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 72 countries. Created in 2000 through a merger of BNP and Paribas, it had total assets of EUR2,372.6bn as at 30 June, 2019. Its largest shareholder at 7.7% is the Belgian government followed by institutional investors including BlackRock Inc.

- 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 30 June, 2019, it had total assets of EUR1,338.6bn.

- Founded in 1894, the **Crédit Agricole Group ("CAG")** has grown steadily through the years from a local farm co-operative to a universal bank operating across 47 countries. Its businesses comprise mostly domestic retail banking through its retail cooperative networks (Regional Banks) as well as international retail banking, asset gathering, specialized financial services and financing of large customers (held in Credit Agricole S.A.). As at 30 June, 2019, CAG had total assets of EUR1,954.1bn. Total assets of Credit Agricole S.A. were EUR1,713.8bn in the same period.

Key Considerations – BNP Paribas S.A. ("BNPP")

- **Underlying performance looks sound:** BNPP announced its 2Q2019 results with reported consolidated pre-tax income down 2.2% y/y to EUR3.38bn. In terms of operating division performance (excludes other activities), pre-tax income was up 1.8% y/y. This was due to growth in operating division revenues (+2.5% y/y) which was higher than growth in operating division expenses (+1.8% y/y). Operating division revenues were supported by decent loans growth in Domestic Markets (retail, specialized businesses and corporate) and stronger loans growth in International Financial Services as well as better performance in

Personal Finance, insurance and international retail banking. The Corporate and Institutional Banking operating division saw revenue growth from Corporate Banking and Securities Services which offset weak Global Markets revenues. As such, 2Q2019 Domestic Markets revenues were broadly stable to slightly weaker as loans growth offset low interest rates, while International Financial Services and Corporate and Institutional Banking revenues grew 3.4% and 4.0% respectively y/y for 2Q2019.

- **Mix of cost containment and business volumes driving segments:** By segment, Domestic Markets performance saw some recovery as weaker operating division revenues (-0.3% y/y from low interest rates that were partially offset by ongoing good business volumes from specialized businesses) were offset by operating expenses which fell 0.5% y/y. Expenses were down mostly in the retail networks (-1.2% y/y) on network optimization and management streamlining but up in specialized businesses to support business growth (although expense growth was lower than revenue growth generating positive jaws). This led to segment pre-tax income rising 1.5% y/y. International Financial Services continues to offset domestic challenges to a degree although growth in operating division revenues was offset by higher operating expense growth (+4.3% y/y) due to unfavourable foreign exchange movements (+0.8% at constant scope and exchange rates) and also to support business volumes growth leading to segment pre-tax income falling 1.1% y/y. Finally, Corporate & Institutional Banking had better performance with the 4.0% y/y operating division revenue growth outshining overall operating expense growth which rose 1.3% y/y and leading to pre-tax income up 6.2% y/y. International Financial Services continues to be the largest contributor to consolidated operating division pre-tax income at 39.5% in 2Q2019 followed by Domestic Markets (31.5%) and Corporate and Institutional Banking (29.0%).

- **Cost performance linked to strategy**: BNPP's focus on cost is part of its 2020 Transformation Plan launched in 2017. This was expected to generate EUR2.7bn in transformation costs over 2017-2020 that was to be funded by cost savings of EUR3.3bn over the same period. So far to 30 June 2019, BNPP has realized around EUR1.5bn in cost savings while recognizing ~EUR2.4bn in transformation costs. Cost savings have been across all operating divisions but focused primarily on Domestic Markets and Corporate & Institutional Banking as seen in segment results. Cost savings are the key reason why BNPP has been able to generate positive underlying JAWS (revenue growth faster than expense growth) in 2Q2019.

- **Loan quality still decent, with rising risk costs in line with loans growth:** Although the reported cost of risk was up 9.5% y/y (+14.3% y/y for operating divisions), the cost of risk in annualized terms (measured by cost of risk as a percentage of customer loans) was broadly consistent y/y at 30bps in 2Q2019 (29bps in 2Q2018) and below 1Q2019 (38bps) and FY2018 levels (35bps). Driving the y/y rise was a writeback in risk costs within Corporate & Institutional Banking in 2Q2018. Other loan quality metrics appear solid and actually improved since 31 December due to loans growth and lower doubtful loans with the non-performing loan ratio at 2.5% as at 30 June 2019 (2.6% as at 31 December 2018). The stage 3 coverage ratio on the other hand was at 74.6%, slightly weaker than 76.2% over the same period. Like peers, the higher cost of risk was ultimately a drag on y/y pre-tax income performance which reduced the 2.2% y/y growth in operating division operating income.

- **Rising to meet its target:** BNPP's reported fully loaded CET1 ratio improved q/q, up 20bps to 11.9% as at 30 June 2019. BNPP's CET1 capital ratio continues to be well above overall minimum fully loaded CET1 requirements of 9.91% for end 2019 as disclosed in BNPP's 2018 annual report. Growth in BNPP's CET1 ratio was due to ongoing earnings generation (excluding exceptional non-operating items and including a 50% dividend pay-out ratio) as well as the positive capital impact from portfolio adjustments (capital gain from the 2.5% sale of SBI Life, deconsolidation of the 5.2% residual stake and partial impairment of BancWest's goodwill). This mitigated a 10bps increase in risk weighted assets from aforementioned volume growth before FX impacts. BNPP intends to target a CET1 ratio of at least 12% in 2020.

Key Considerations – Groupe BPCE ("GBPCE") / BPCE S.A.

- **Not immune to the environment:** GBPCE announced its 1H2019 results with reported income before tax down 12.5% y/y to EUR2.6bn. This was driven by a 1.5% y/y fall in net banking income while operating expenses rose mildly by 0.3% y/y and cost of risk rose 7.7% y/y. For 2Q2019, income before tax was down 2.9% y/y to EUR1.7bn as weaker net banking income (-2.0% y/y) was offset to an extent due to a 1.3% y/y fall in operating expenses while cost of risk rose 2.9% y/y. Results include the impact of exceptional items, in particular transformation and re-organization costs. Excluding these, 1H2019 adjusted income before tax down is down a smaller 6.7% y/y while 2Q2019 adjusted income before tax was down a larger 5.7% y/y reflecting the quantum of transformation and re-organization costs in the respective periods which was lower y/y in 2Q but for the 1H2019 was up 73.6% y/y. Key trends in the income results include better income performance in Retail Banking & Insurance, stable Asset & Wealth Management and a fall in Corporate & Investment Banking against better performance in 1H2018. In terms of operating expenses, escalation is being moderated by ongoing cost reductions in retail banking and Corporate & Investment Banking. Excluding contributions to the Single Resolution Fund which rose 10.7% y/y, adjusted operating expenses were contained and actually fell 0.6% y/y in 1H2019.

- **Retail still leading the way:** By segment, better Retail Banking & Insurance performance was driven by a 7.1% y/y rise in loan outstandings (residential mortgages, equipment loans and consumer loans) and solid insurance and payments performance with net banking income up 7.1% y/y and 10.4% respectively in 1H2019 in these businesses. Operating expenses declined 0.4% y/y from reductions in the retail network that offset expense growth in Insurance and Payments with gross operating income for Retail Banking & Insurance rising 6.0% y/y in 1H2019. All segments within Retail Banking & Insurance performed solidly y/y aside from Financial Solutions & Expertise which generated a 6.5% y/y fall in income before tax due to a rise in the cost of risk from a low base in 1H2018. In particular, GBPCE's core Banque Populaire and Caisse d'Epargne networks continue to show solid growth in loan outstandings up 6.8% and 7.3% y/y respectively as at 30 June 2019. In contrast, weakness in Corporate & Investment Banking (1H2019 gross operating income down 31.3% y/y) was due to global markets performance, particularly in equities, which overshadowed cost reduction initiatives. Together with a rise in the cost of risk, income before tax for Corporate & Investment Banking was down 42.1% y/y in 1H2019. This was the main driver of the weaker y/y consolidated reported income before tax.

- **Localised asset problems, otherwise loan quality improved:** Movements in cost of risk relate to a single exposure within Corporate & Investment Banking and drove the cost of risk as a percentage of gross customer outstandings to 42bps in 1H2019 from 24bps in 1H2018 in Corporate & Investment Banking. Otherwise, overall cost of risk at 18bps in 1H2019 remains within historical norms due to lower cost of risk in retail exposures. Loan quality metrics also appear decent with the ratio of non-performing loans to gross loan outstandings improving to 2.7% as at 30 June 2019 (2.8% as at 31 December 2018) while the impaired loans coverage ratio improved marginally to 75.6% against 74.5% over the same period.

- **Resilient capital position:** GBPCE's capital position remains sound with its estimated CET1 capital ratio at 15.5% as at 30 June 2019, broadly stable against 31 March 2019 and down from 15.8% as at 31 December 2018. Q/q stability in CET1 capital ratios was despite risk weighted asset growth (-15bps) and other changes (-5bps) as these were mitigated by capital generation (+22bps) and issue of co-operative shares (+4bps). GBPCE's ratio remains above GBPCE's minimum 9.77% as defined in the 2018 Supervisory Review and Evaluation Process. This includes Pillar 1 and Pillar 2 requirements as well as buffers for capital conservation and global systemic importance. GBPCE's Total Loss-Absorbing Capacity (TLAC) ratio rose marginally to 23.2% as at 30 June 2019 from 22.6% as at 31 March 2019 and remains above the target level in its TEC 2020 strategic plan of more than 21.5% by early 2019. The leverage ratio also remains solid at 5.1% as at 30 June 2019, above the 3.0% minimum requirement.

Key Considerations – Crédit Agricole Group (“CAG”)

- **Softer results on a reported and underlying basis:** CAG's 2Q2019 and 1H2019 reported net income were down 12.7% and 9.8% y/y to EUR1.81bn and EUR3.16bn respectively. This was driven by weaker performance at main subsidiary Credit Agricole S.A. On an underlying basis (excludes integration costs, fines, changes in goodwill value amongst others), the y/y fall was lower with 2Q2019 underlying net income down 10.2% y/y to EUR1.85bn. For 1H2019, EUR3.28bn in underlying net income was down 3.7% y/y.

- **Localised weakness offset revenue growth in Credit Agricole S.A.:** For Credit Agricole S.A. (“CASA” - comprises asset management and insurance, French retail banking International retail banking, specialized financial services and Large Customers), reported net income for 2Q2019 and 1H2019 was down 14.9% and 13.4% respectively to EUR1.22bn and EUR1.98bn. This was driven by one-off higher cost of risk in Large Customers, reportedly due to exposure to a single name. Cost of risk as a percentage of outstandings rose to 25bps in 2Q2019 as a result however is below the 2Q2018 level (26bps). Elsewhere, 2Q2019 y/y performance was broadly stable (slightly better in asset gathering and retail banking and slightly weaker in specialized financial services). For 1H2019, all segments aside from Large Customers saw y/y growth. A 10% y/y rise in contributions to the Single Resolution Fund (“SRF”) also impacted results. Otherwise, revenue performance was up 1.9% y/y from growth in activity that also impacted operating expenses which rose 2.0% y/y in 2Q2019 (excluding SRF costs). Underlying results fared better with underlying net income down 12.4% y/y and 7.6% y/y to EUR1.24bn and 2.04bn for 2Q2019 and 1H2019.

- **Other businesses faring well for the half:** CAG's Regional Banks generated EUR563mn in net income for 2Q2019, down 7.5% y/y as operating expenses rose faster than revenues on solid volume growth (loans up 6.6% y/y) as well as investments in technology while cost of risk rose 35.6% y/y due to a one-off allocation. For 1H2019, net income was up 2.8% y/y to EUR1.23bn on strong y/y revenue growth which outpaced growth in operating expenses and higher cost of risk. While the relatively performance of CAG's regional banks helped total group performance, it did not completely offset weaker performance at CASA given its comparatively larger contribution to the group at ~60% of underlying group revenues excluding the Corporate Centre. By business segments, retail banking (includes Regional Banks at CAG and International and domestic (LCL) retail banking in CASA) contributed 58% of 1H2019 total underlying revenues (excluding the Corporate Centre), followed by Asset gathering (asset & wealth management and insurance) at 17%, Large customers (Corporate & Investment bank and Asset servicing) at 16% and Specialized financial services (leasing & factoring and consumer finance) at 8%.

- **Capital position maintained against minimums:** CAG's capital ratios remain solid with its CET1 ratio of 15.4% as at 30 June 2019, up 10bps q/q. Earnings generation (+26bps q/q) and favourable market conditions that impacted reserves on securities portfolios (+6bps q/q) offset growth in risk weighted assets in retail banking and Specialized financial services (-8bps q/q) and other movements (-10bps). This remains well above CAG's 9.5% Supervisory Review and Evaluation Process threshold which includes a global systemically important bank buffer of 1.0% and a countercyclical capital buffer. Its leverage ratio of 7.6% (excluding eligible senior preferred debt) also remains above its minimum requirements 6.0%. Finally, its total loss absorbing capital ratio (excluding eligible senior preferred debt) as at 30 June 2019 was 22.7%, above the minimum 19.5% requirement from TLAC debt issues in 1H2019.

- **Also in line with Medium Term Plan:** Ratios are also in line with CAG's new 2022 Medium Term Plan that was unveiled in June 2019. Key financial targets include a cost to income ratio below 60%, group CET1 ratio above 16% (>11% for CA), group minimum requirement for own funds and eligible liabilities ratio of 24-25% and compound annual revenue growth of 2.5% pa spread evenly across business segments. Business targets include a more balanced and equal segment revenue contribution and lower reliance on interest income.

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 scale ("IPS").

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.

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

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. We may also suspend our issuer rating and bond level recommendation in the ordinary course of business if (1) we believe the current issuer profile is incorrect and we have incomplete information to complete a review; or (2) where evolving circumstances and increasingly divergent outcomes for different investors results in less conviction on providing a bond level recommendation.

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.

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