OCBC Bank

Issuer Profile:
Neutral (4)

Ticker:
SOCGEN

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Société Générale ("SocGen")

Recommendation

- **Cost efficiencies offset weaker net banking income with 2Q2019 an improvement although 1H2019 performance remains weak due to a challenging 1Q2019 performance.**
- **International Retail Banking and Financial Services are now the driver for segment performance which, along with lower risk weighted assets from restructuring, contributed to better capital ratios and supporting our Neutral (4) issuer profile.**
- **In the Tier 2 space, we think the SOCGEN 4.3% 26c21 presents good value given the relatively short call date. Investors looking for duration may like the longer dated SOCGEN 6.125% PERPc24 Additional Tier 1 given the decent pick up and higher reset spread against the CS 5.625 PERPc24 STANLN 5.375 PERPc24.**

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask YTW	Spread
SOCGEN 4.3 26c21	19/05/2021	12.0%	3.21%	159bps
SOCGEN 6.125 PERPc24	16/04/2024	12.0%	5.32%	374bps
BPCEGP 4.5 26c21	03/06/2021	15.5%	2.90%	129bps
ABNANV 4.75 26c21	01/04/2021	18.0%	2.90%	128bps
CS 5.625 PERPc24	06/06/2024	12.5%	5.14%	355bps
STANLN 5.375 PERPc24	03/10/2024	13.5%	4.92%	333bps

Indicative prices as at 06 August 2019 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Background

- Headquartered in Paris, Société Générale ("SocGen") offers advisory services and financial solutions to individuals, large corporates and institutional investors. As at 30 June, 2019, it had total assets of EUR1,388.6bn.
- It operates across 67 countries through three core businesses covering retail banking, corporate and investment banking, private banking, and wealth management. Its largest shareholders comprise institutional investors including BlackRock Inc.

Key Considerations

- **Reportedly weak but decent underlying 2Q2019 performance:** Trends in SocGen's reported 2Q2019 results were similar to peers with encouraging signs in underlying gross operating income (excluding exceptional items and smoothing out of charges per linearization of IFRIC21 which deals with liabilities arising from government imposed levies) which was up 2.3% y/y to EUR2.1bn. The topline continues to be weak with underlying net banking income down 2.6% y/y to EUR6.3bn due mostly to still difficult market conditions in Global Markets & Investor Services within Global Banking & Investor solutions (net banking income down 6.1% y/y) and to low interest rates in French Retail Banking. Business momentum in International Retail Banking & Financial Services continues to be supportive with International Retail Banking up 1.9% y/y, Insurance up 4.1% y/y and Financial Services to Corporates up 2.8% y/y. However weaker underlying net banking income was more than offset by a 5.0% y/y fall in underlying operating expenses due to cost containment in French Retail Banking and absence of restructuring provisions and integration costs from the acquisition of the Equity Markets & Commodities business (EMC) from Commerzbank AG. Including these and other exceptional costs, reported operating expenses still reduced 3.0% y/y for 2Q2019. For 1H2019, performance was relatively weaker due to the soft 1Q2019 performance with underlying gross operating income down 4.3% y/y to EUR4.0bn on a larger fall in underlying net banking income (-2.1% y/y) than reduction in underlying operating expenses (-1.1% y/y).

- **Cost of risk within tolerance range:** Underlying cost of risk was 74.1% higher y/y in 2Q2019 due to a rise in risk costs in all business segments but mostly in International Retail Banking & Financial Services. According to management, this reflects the normalisation of risk costs from a low base. As a percentage of outstanding loans, the ratio has jumped to 25bps in 2Q2019 from 14bps in 2Q2018 and 21bps in 1Q2019 although is within management guidance of 25-30bps. Due to the higher cost of risk, 2Q2019 underlying operating income fell 4.1% y/y to EUR1.8bn. Reported risk costs were 84.7% higher, driving reported 2Q2019 operating income down 9.6% y/y to EUR1.7bn. Y/y trends in 1H2019 risk costs were not as drastic (+52.9% y/y and +48.1% y/y on a reported and underlying basis) but nevertheless still grew noticeably due to 2Q2019 performance. Combined with the weaker gross operating income performance, 1H2019 reported operating income of EUR2.8bn ended up 12.4% lower y/y. While risk costs have risen, balance sheet quality appears sound with the gross doubtful debts outstanding ratio improving to 3.4% as at 30 June 2019 (3.5% as at 31 March 2019 and 3.9% as at 30 June 2018). This was due to broadly stable loan outstandings and a 4.0% q/q fall in doubtful loans. The doubtful outstandings coverage ratio was stable q/q and y/y at 55%.

- **Net income contributions by operating segment evolving:** Although still weak, net income performance for French Retail Banking improved in 2Q2019 with gross operating income up 2.5% y/y. This was due to better net banking income from higher loan outstandings and a 1.0% fall in operating expenses on higher use of digital services. Weaker reported net income however was driven by a 38.7% rise in the cost of risk. Trends in International Retail Banking and Financial Services were similar with a 0.6% y/y growth in gross operating income (decent growth (+2.4%) in net banking income and a 3.9% y/y rise in operating expenses due to restructuring provisions) overcome by a 77.3% y/y rise in cost of risk leading to 2Q2019 segment reported net income down 4.8% y/y and diluting strong 1Q2019 performance. Finally, Global Banking & Investor Solutions struggled the most in 2Q2019 with gross operating income down 48.7% y/y on a 6.1% y/y fall in net banking income (q/q performance was better however, particularly in Fixed Income, Currencies & Commodities) and 10.8% y/y rise in 2Q2019 operating expenses on restructuring provisions and integration costs. In addition, cost of risk was more than 4x higher y/y leading to reported segment net income falling 46% y/y. This translated to Global Banking & Investor Solutions contribution to 2Q2019 reported group net income (including Corporate Centre) falling to 26.0% from 41.4% in 2Q2018 while French Retail Banking contributed 33.8% (29.8% in 2Q2018). International Retail Banking and Financial Services continue to contribute the most at 48.9% of 2Q2019 reported group net income. For 1H2019, its contribution is higher at 56.3% highlighting the importance of SocGen's international retail banking exposures in Europe, Russia and Africa, which contributed 61% and 59% to International Retail Banking and Financial Services total operating income for 2Q2019 and 1H2019 respectively.

- **But solid pick up in Capital:** SocGen's capital ratios continued to improve with the CET1 ratio at 12.0% as at 30 June 2019 (12.2% on a proforma basis including announced disposals and other impacts). This was driven by lower risk weighted assets due to SocGen's restructuring activities (Global Markets and asset refocusing) along with earnings and 2018 scrip dividends. The CET1 ratio is now in line with its target CET1 ratio of 12% by 2020. Its TLAC ratio of 25.8% continues to exceed the Financial Stability Board's 2019 and 2022 minimum requirements of 19.6% and 21.5% respectively. SocGen's improving capital position is a balancer for the weak y/y operating income performance which nevertheless shows the bank's solid earning capacity. Future earnings from its diversified business segments through revenue or cost efficiency improvements will be critical given the prospects of a weaker operating environment and persisting low interest rates.

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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