Asia Credit Research

Earnings Review: ABN AMRO Bank N.V. (“ABN”)

Recommendation

- Although solid operating income performance for 1Q2018 was dragged down by higher impairment charges, these problems related to specific sectors and are unlikely to continue in management’s view.
- Consistent efforts in cost reduction initiatives, with a focus on digitalisation and reduction of headcounts have helped lower the underlying cost of business. ABN is on track in achieving its 56-58% cost/income target by 2020.
- Higher risk weighted assets led to a fall in capital ratios. That said, ABN’s CET 1 ratio at 17.5% remains well above the minimum requirement of 11.75% and supports the continuation of our Neutral (3) Issuer Profile.
- Compared to similarly rated banks at Neutral (3), we see better value elsewhere against the ABNANV 4.75 ‘26c22, in particular the BNP 4.3 '25c20. We also like the BAERVX 5.75 PERPc22 as we think the spread pick up more than compensates for the smaller but more focused business profile as well as its relatively weaker position within the capital structure.

Issuer Profile: Neutral (3)

Ticker: **ABNANV**

Background

Wholly owned by ABN AMRO Group NV, ABN Amro Bank NV (‘ABN’) is 56.0% owned by the Dutch government through the Ministry of Finance. It was formed on 1 July 2010 through the merger of Fortis Bank (Nederland) NV with the Dutch activities of ABN AMRO Holding NV. In FY2017, ABN derived 78% of operating income from the Netherlands followed by Europe (11%), Asia (6%) and the US (4%). As at 31 March 2018, it had total assets of EUR397.2bn.

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Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask Yield	Spread
ABNANV 4.75 ‘26c22 (T2)	01/04/2021	17.5%	3.10%	90
BNP 4.3 '25c20 (T2)	03/12/2020	11.6%	3.25%	110
BAERVX 5.75 PERPc22 (AT1)	20/04/2022	16.7%	4.62%	229
SOCGEN 4.30 ‘26c21 (T2)	19/05/2021	11.2%	3.25%	102
BPCEGP 4.50 ‘26c21 (T2)	03/06/2021	15.4%	3.58%	135

Indicative prices as at 16 May 2018 Source: Bloomberg
Common Equity Tier 1 (CET1) Ratio based on latest available quarter

Key Considerations

- **Solid underlying performance offset by higher impairments**. ABN announced its 1Q2018 results with operating results up 10% y/y, driven by higher operating income and well-managed operating expenses. 1Q2018 operating income was up 4% y/y on the back of higher net interest income (+5% y/y) and other operating income (+15% y/y). Net interest income grew on the back of loan growth and a higher net interest margin (‘NIM’) of 1.66% (1Q2017: 1.56%). Other operating income was higher due to higher equity participation results and revaluations gains on the stake in equensWordline. Net profit for 1Q2018 however fell 3% y/y to EUR595mn due to higher impairment charges on loans and other advances which totaled EUR208mn (1Q2017: EUR63mn). On a q/q basis, despite higher impairment charges incurred and lower operating income (-4% q/q), net profit was 10% higher q/q due to a decrease in operating expenses (-18% y/y) relative to the higher year-end expenses and incidental cost incurred in 4Q2017.

- **Operating expenses kept in check:** Due to incidental costs such as restructuring provisions and EUR25mn penalty fees from interest averaging, operating expenses remained flat y/y despite an underlying decline in costs as a result cost-saving programs. Personnel expenses were 6% lower y/y due to the reduced workforce while other expenses were broadly stable as IT cost savings were balanced against higher IT expenditure on innovation. Higher income generated coupled with flat operating expenses led to the cost-to-income ratio improving to 57.9% (1Q2016: 60.2%), within ABN’s target cost/income range of 56-58% by 2020.

- **Higher impairments not expected to persist:** Higher impairment charges were incurred for specific sectors (Diamonds & Jewellery, Natural Resources and Global Transportation & Logistics). Impairments in offshore services and shipping clients were elevated as the sector remains challenged despite the recovery in oil prices. Management however stated that the effects of impairments are expected to be temporary and will not continue to be a drag for the rest of the year.

- **Pressures in mortgage loans:** Retail Banking, which contributes~41% to overall operating income, has seen flattish growth due to the competitive landscape in the mortgage lending market. While ABN's market share of new mortgage production was ~20% in 1Q2018 (in line with ABN's market share in the overall mortgage market), some market share has been foregone versus prior periods to maintain the profitability of the mortgage book. New mortgage production in 1Q2018 decreased 24%y/y to EUR4bn. This led to operating income for the Retail Banking segment falling 9% q/q and 2% y/y 1Q2018. Lower income was also attributable to the transfer of clients to Private Banking. As for other segments, better operating income from business growth was over-shadowed by higher impairments in Commercial Banking and Corporate & Institutional Banking, while Private Banking performance benefited from lower operating expenses.

- **Balance sheet remained stable:** ABN's balance sheet grew marginally by 1% due to higher securities financing (seasonal) and an increase in financial investments as well as a rise in financial assets held for trading. Loans and advances to banks fell 7% q/q but this was mitigated by growth in loans and advances to customers (+3.5% q/q) particularly in corporate loans (Commercial Banking +3% q/q and Corporate & Institutional Banking +9% q/q). Growth in demand for credit from corporates continues to indicate solid domestic operating conditions for Dutch banks.

- **Shift of focus in Private banking:** In Nov 2016, ABN sold its private banking operations in Asia and the Middle East to focus on further strengthening its private banking business in Northwest Europe. With ABN's announcement in February 2018 that it will be selling its Luxembourg business to focus even more on its core private banking market in North-West Europe, ABN is hoping to simplify its operations and harmonise its client segment, service offering and platforms to create a single private bank. This initiative is part of ABN's broader strategy to streamline its operations through digitalisation and efficiency improvements, which has so far included a gradual decline in headcount and size of the retail branch network.

- **Capital ratios above minimums:** Despite still decent earnings performance this quarter, an increase in risk-weighted assets ("RWA") (+1.7% y/y) due to the impact of IFRS9 as well as growth in credit RWA from loans growth led to a drop in ABN's capital ratios. ABN's fully loaded CET1 ratio fell 20bps to 17.5% (4Q2017: 17.7%). Although at the lower end of its capital target range for 2018 of 17.5%-18.5%, the ratio is well above its reported 2019 fully-loaded minimum Supervisory Review and Evaluation Process CET1 requirement of 11.75%. ABN's fully loaded leverage ratio also dipped to 4.0% for 1Q2018 (4Q2017: 4.1%), but nevertheless above the 3.0% minimum requirement and in line with ABN's target level.

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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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