

CHINA
DEVELOPMENT
FINANCIAL

LBBW 3.75% 05/18/27

(LBBW)

Intermediate-Term Carry (SGD)

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Company Background: LBBW provides its services as a mid-sized universal bank to companies, retail and institutional customers and savings banks. The group has over 10,000 employees working at 160 locations throughout Germany, with total assets of EUR 238 billion and is owned by the Savings Bank Association of Baden-Württemberg (40.5%), the Federal State of Baden-Württemberg (25%) and the City of Stuttgart (18.9%).

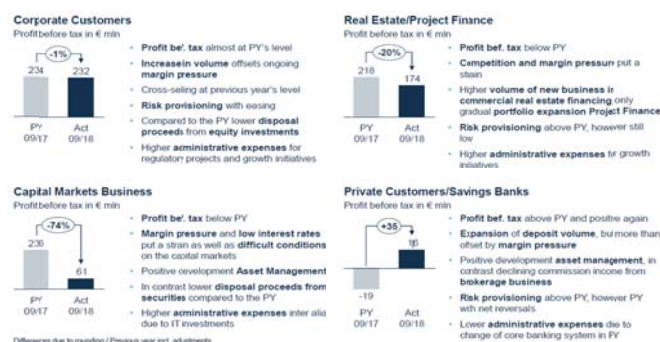
Credit Considerations:

Profit improvement driven by lower administrative expenses despite higher investments in IT. For 9M18, profit before taxes grew 2.2% YoY to EUR 457 mn with administrative expenses falling 1.4% YoY to EUR 1.3bn due to lower personnel expenses and elimination of charges related to the change of the core banking system. Core income segments however, declined (Net Interest Income -0.8%, Net Fee & Commission Income -3.4%) as interest rates remained low while customer demand in the brokerage business remained tepid.

Operating segments continued to face difficult market conditions except for asset management segment. While all operating segments made a contribution to net consolidated profit, profitability fell across segments (Corporate Customers -1%, Real Estate/Project Finance -20%, Capital Markets -74%) except for Private Customers/Savings Banks, which posted profits before taxes of EUR 16mn from losses of EUR 19mn in 9M17.

Headwinds continued to be driven by market volatility and low interest rates. For 9M18, market volatility affected securities sales in the capital markets business while a low interest rates environment offset growth in financing volume with medium-sized and large companies, which rose 12% YoY to EUR 49bn.

Figure 1: Profitability constrained by market volatility and interest rates



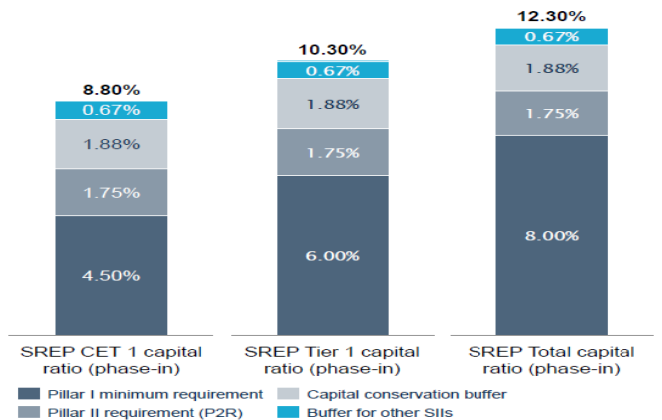
Source: Company Data, KGI Research

On track to meet targets for FY18 with strong capital adequacy. For FY18, the group is targetting profit before tax in a mid three-digit million range, which we think is achievable given 9M18 profit before taxes of EUR 457mn.

Additionally, capital adequacy of the group remains strong with 9M18 CET1 ratio and Total Capital Ratio at 14.7% and 21.2% respectively, which exceeds minimum requirements of 8.8% and 12.3%. The group also performed well in the latest EBA stress tests with CET1 ratio and Total Capital Ratio in an adverse scenario (2020) coming in at 10.69% and 17.41%.

Figure 2: European Banking Authority Minimum Requirements

SREP ratios 2018¹



Source: Bank of England, KGI Research

Credit Recommendations:

While LBBW's 2027 have been rated investment grade by Moody's (Baa2) and Fitch (BBB), the bond is a subordinated issue which may be subject to mandatory write-down or conversion to equity if the issuer becomes subject to a resolution procedure.

Additionally, the issue has an optional redemption date on 18 May 2022 and a coupon reset at the 5-year SGD Swap Offer Rate + 1.780% on 18 May 2022, which can help to mitigate interest rate risks.

While we expect the group's low profitability to continue as a result of intense competition and low interest rates, we expect the group's credit outlook to be well supported by its strong capital adequacy and support from its public-sector owners. We add LBBW 3.75% 2027 to our defensive portfolio. The bond is currently trading at 99.75 with a YTW of 3.8%.

Financials

INCOME STATEMENT (AUD mn)	2016A	2017A	1H18A
Net Interest Income	1,669	1,587	796
Net Fee and Commission Income	527	534	262
Other Operating Income	443	483	193
Operating expenses	(1,814)	(1,824)	(878)
Operating Income	825	780	373
Provisions	51	92	33
Profit Before Tax	142	515	282
Net Income	11	418	205
BALANCE SHEET (AUD mn)	2016A	2017A	1H18A
Total Assets	243,623	237,713	258,530
Total Customer Loans	110,404	107,648	109,213
Total Allowances	828	684	837
Total NPLs	1,181	908	824
Total Liabilities	230,489	224,336	245,435
Total Deposits	70,641	79,415	87,282
Total Equity	13,134	13,377	13,095
KEY RATIOS	2016A	2017A	1H18A
Leverage Ratio (%)	4.60	4.60	4.30
Cost/Income Ratio (%)	74.3	74.8	75.4
Loan/Deposit Ratio (%)	156.3	135.6	125.1
Non Performing Loans (%)	1.06	0.84	0.75
Equity/Assets (%)	5.39	5.63	5.07
CET1 (%)	15.20	15.70	14.20
CAR (%)	21.50	22.20	21.30
ROE (%)	4.1	1.1	6.1

Source: Company Data, KGI Research

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Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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