EDISON

UmweltBank

Interim results

Solid H118 lending volumes stabilising earnings

Banks

UmweltBank's (UBK's) lending activity in H118 illustrates the considerable demand for green construction financing amid high residential demand in Germany. Moreover, the impact of recent regulatory changes in the renewable energy segment so far seems to be less pronounced than initially expected. A successful placement of the junior green bond, which is currently underway, would equip the bank with a capital base allowing it to leverage these favourable trends and further grow its loan portfolio. UBK shares continue to trade at a P/BV of 1.2x in 2018e, which looks low relative to the bank's ROE (which we forecast at 11.8% in FY18).

Year end	Net interest income (€m)	EPS* (€)	DPS (€)	P/BV* (x)	P/E* (x)	ROE* (%)	Yield (%)
12/16	53.6	1.16	0.34	1.4	8.0	18.0	3.7
12/17	52.2	0.99	0.32	1.2	9.4	13.7	3.4
12/18e	52.5	0.93	0.34	1.2	10.0	11.8	3.7
12/19e	52.1	0.87	0.36	1.1	10.7	10.5	3.9
12/20e	53.8	0.86	0.38	1.1	10.8	9.9	4.1

Note: *Based on net profit before allocation to reserves for general banking risks and tangible book value including reserves for general banking risks.

H118 results assisted by sustainable building loans

UBK's new lending volume reached €311m in H118, doubling from €154m in H117, with the key driver being solid expansion of the green construction portfolio. As a result, UBK's loan including commitments increased by a healthy 6.2% ytd and (together with positive one-off items) allowed the bank to report a slight 1.0% y-o-y increase in pre-tax profit to €18.4m. Execution of strategic initiatives led to a headcount increase and investments in IT systems, which (on top of higher banking tax and deposit insurance charges) translated into a G&A expense rise of 14.0% y-o-y and a cost income ratio of 33.5% (vs 29.1% in H117).

Initiatives to strengthen capital base in progress

UBK's management is working towards securing additional capital for future lending business growth. As part of this, the bank has launched a junior green bond issuance programme aimed at raising up to €30.6m of net new tier 2 capital. The offering consists of an exchange offer for holders of UBK's profit participation capital issued in the period 2003-06, as well as a public offer to a wide investor community. Management has also highlighted a possible share issuance over the next few months in line with the current board authorisation. Moreover, 50% of UBK's shareholders accepted a stock dividend instead of a cash payment (compared with 35% last year), which added c €3.0m to the bank's equity.

Valuation: Trading at a discount to peers

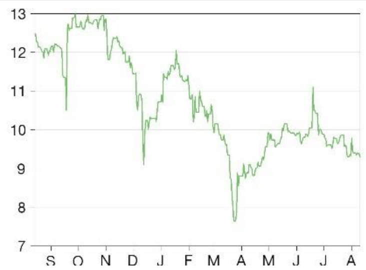
UBK's shares are trading at a P/BV ratio of 1.2x in 2018e (vs a peer average of 1.3x), which in our opinion is not fully reflecting its earnings potential. Our updated P/BV-ROE valuation yields a fair value of €11.3 per share (slightly up from the previous €11.1 per share), implying 21.3% upside potential. UBK offers a dividend yield of c 3.5%, which is above the average level offered by large banks (c 3%).

13 August 2018

Price	**€9.30**
Market cap	**€259m**

Total assets (€bn) at end-June 2018	3.6
Shares in issue	27.9m
Free float	84.4%
Code	UBKX
Primary exchange	Munich
Secondary exchange	Xetra

Share price performance



%	1m	3m	12m
Abs	(2.2)	(3.3)	(25.4)
Rel (local)	(0.7)	1.3	(27.9)
52-week high/low		€13.00	€7.70

Business description

UmweltBank is a specialised lender with total assets of €3.6bn, providing financing of renewable energy projects (solar, wind, hydro and biomass), as well as loans for new construction or renovation of sustainable residential, community and commercial real estate.

Next events

m.access Conference	17 October 2018

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Edison profile page

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H118 results review: Healthy new lending volumes

UBK reported robust H118 results ahead of initial management expectations despite the continued low interest rate environment, with a broadly stable pre-tax profit of €18.4m (up 1.0% y-o-y). UBK's loan portfolio (including commitments) rose by 6.2% ytd to €2.88bn and 8.6% y-o-y, which is ahead of our earlier conservative FY18 growth forecast of 2.1%. This was a result of strong new lending volumes in H118, which reached €311m vs €154m in H117, largely assisted by solid performance in the green construction loans segment, in particular rental housing (which is fuelled by the considerable structural apartment shortage in Germany). However, renewable energy financing (mainly wind and solar) also provided meaningful tailwinds, contributing nearly 40% to new lending volumes, despite recent regulatory changes introducing the auction system for wind projects with a capacity in excess of 750 kilowatts. Importantly, UBK also experienced good business progress in the segment of smaller projects up to 750 kilowatts. The expansion of the lending business was accompanied by solid growth in customer deposits, which rose by 5.0% ytd (or 7.2% y-o-y). Overall, UBK's customer base as at end-June 2018 was broadly comparable with end-2017. Despite the lending business growth, UBK's capital adequacy ratio improved slightly to 12.5 from 12.4 as at end-2017.

Net interest and financial income improved 5.4% y-o-y to €26.1m. Management has highlighted that interest income increased slightly, although it was assisted by one-off effects, in particular early repayment fees achieved on two sizeable loans and the recognition of distribution fees related to equity funds in this line (previously it was booked under net commission and fee income). UBK also benefited from the solid increase in loan commitments, which triggered additional commitment interest. On the other hand, the net commission and fees result was visibly below last year (€1.2m vs €1.6m in H117). The two main factors behind this are the fact that current market conditions do not allow UBK to charge arrangement fees on new loans and the lack of recognition of the above-mentioned distribution fees.

Furthermore, personnel expenses were higher at €4.5m (up 8.6% y-o-y), which is not surprising given UBK's agenda for team expansion (average headcount was up to 161 employees from 149 in FY17). There was also some drag from higher other administrative expenses (€4.5m in H118 vs €3.8m last year), mainly due to higher banking tax and deposit insurance (see Exhibit 1), as well as investments in IT systems as part of UBK's strategic initiative related to the digitalization of processes. As a consequence, the cost income ratio reached 33.5% compared with 29.1% in H117 and our original FY18 expectations at 32.7%. Net income came in at €12.4m, slightly below H117 (€12.6m).

Exhibit 1: UBK's income statement in H118

€'000s	H118	H117	Change y-o-y
Net interest and financial income	26,085	24,750	5.4%
Net commissions and fee expense	1,177	1,574	(25.2%)
G&A expenses (ex-D&A)	(9,067)	(7,951)	14.0%
Personnel expenses	(4,520)	(4,162)	8.6%
Other administrative expenses	(4,547)	(3,789)	20.0%
thereof, banking tax and deposit insurance	(983)	(600)	63.8%
Other operating income (expense)	242	(119)	N/M
Pre-tax profit	**18,437**	**18,254**	**1.0%**
Income taxes	(6,022)	(5,692)	5.8%
effective tax rate	*32.7%*	*31.2%*	*148bp*
Net income	**12,415**	**12,562**	**(1.2%)**
New lending volume (€m)	311	154	101.4%
Cost Income Ratio (CIR)	33.5%	29.1%	440bp

Source: UmweltBank, Edison Investment Research

Exhibit 2: UBK's balance sheet in H118

	H118	FY17	Change ytd
Business volume	4,075	3,776	8.2%
Loans (incl. commitments)	2,877	2,710	6.2%
Customer deposits	2,264	2,157	5.0%
Total assets	3,642	3,485	4.5%
Equity	288	282	2.4%
Total capital adequacy ratio	12.5	12.4	-
CET1 ratio	9.1	8.9	-

Source: UmweltBank, Edison Investment Research

Securing additional capital base to fuel growth

In line with its earlier intentions, UBK recently announced details of a junior green bond offering. The bank plans to issue up to €40m in the form of unsecured subordinated bonds in order to strengthen its capital base and facilitate further loan portfolio growth. The offering consists of: 1) two exchange offers directed to holders of UBK's profit participation rights issued in the period 2003-05 and 2006 of up to €18.8m (with a 1:1 parity); and 2) a public offering for both (semi)professional and retail investors of at least €21.2m and up to €40.0m (as the amount unallocated during the exchange offers will be moved to the public offering). UBK's tier 2 capital increase under different allotment scenarios is presented in Exhibit 3. Please note that in our calculations we assume (in line with management intensions) that the profit participation rights which are not exchanged will be called and redeemed by UBK.

Exhibit 3: UBK's additional tier 2 capital depending on the offering outcome

		Profit participation rights exchange subscription rate					
		0%	20%	40%	60%	80%	100%
Public offering subscription rate	0%	-9.4	-5.6	-1.9	1.9	5.6	9.4
	20%	-1.4	1.6	4.6	7.6	10.6	13.6
	40%	6.6	8.9	11.1	13.4	15.6	17.9
	60%	14.6	16.1	17.6	19.1	20.6	22.1
	80%	22.6	23.3	24.1	24.9	25.6	26.4
	100%	30.6	30.6	30.6	30.6	30.6	30.6

Source: Edison Investment Research

The exchange offer is aimed at refinancing the profit participation capital, which is gradually losing its tier 2 status under the new regulations (as it includes a put option). Consequently, the exchange offer will not translate into additional cash inflow for UBK. The coupon rate will be set at 2.0% (fixed over a period of six years) and constitutes up to 0.75pp of upside to the current interest rate offered by the profit participation rights. After the initial six-year fixed rate period, the interest rate will be set once every five years based on the prevailing five-year swap rate plus the respective margin established during the bond offering. The issuance will be also directed to new retail investors, as the minimum bid price stands at an accessible €2,500.

The bond has no defined maturity, but may be callable after 10 years (or earlier on meeting certain regulatory conditions) on every interest payment date. UBK intends to create a secondary market for the junior bonds by working as an intermediary between potential buyers and sellers, but will not purchase the bonds on its own book for subsequent re-sale. The expected costs of the offering equal c €22,000 (or 0.1% of raised proceeds in the case of full allocation).

The table below shows our projections for UBK's capital adequacy ratio (TCR) as at end-2019 depending on the final volume of the exchange offer and the public offering. We believe that with no additional tier 2 capital raised (and the not exchanged profit participation rights being called and redeemed), UBK's TCR would reach the level of 12.5 (compared to the regulatory requirement of 12.0). Assuming that all holders of the profit participation capital decide to accept the exchange offer and there is no demand for the remaining bonds, UBK's equity capital will increase by €11.3m as at end-2019 and translate into a TCR of 13.2 (but with no cash injection though). If the exchange offer is conducted in full and all remaining bonds are purchased by new investors, the equity base will increase by €32.5m and result in a TCR of 14.1 (as well as gross cash proceeds of €21.2m).

Exhibit 4: UBK's capital adequacy ratio FY19e sensitivity analysis

		Profit participation rights exchange subscription rate					
		0%	**20%**	**40%**	**60%**	**80%**	**100%**
Public offering subscription rate	**0%**	12.5	12.6	12.8	12.9	13.1	13.2
	20%	12.8	12.9	13.0	13.2	13.3	13.4
	40%	13.1	13.2	13.3	13.4	13.5	13.6
	60%	13.4	13.5	13.6	13.6	13.7	13.7
	80%	13.8	13.8	13.8	13.9	13.9	13.9
	100%	14.1	14.1	14.1	14.1	14.1	14.1

Source: Edison Investment Research

In addition to the debt issuance management does not rule out a share issuance over the coming months to broaden the equity base in line with current board authorisations. This could further improve the CET1 ratio and potentially allow for a reduction of UBK's special buffer (1.5%) currently added by the German regulator on top of the standard Basel III TCR requirement of 10.5% by 2019

Finally, some contribution to the strengthening of UBK's capital base comes from the introduction of a stock dividend, which investors may choose as an alternative to a cash dividend. In the case of the dividend paid out of 2017 earnings, the stock dividend adoption rate was 50%, up from 35% last year when it was introduced for the first time. This provides UBK with additional c €3.0m of equity.

GLS Bank as the new shareholder

On 24 April, UmweltVermögen Beteiligungs announced that it had entered into an agreement to sell its 15.6% stake in UmweltBank to GLS Bank, one of UBK's competitors in the sustainable banking sector. It remains to be seen whether GLS intends to be a minority shareholder or decides to acquire a majority stake in UBK at some stage. Irrespective of which scenario materialises in the end, an extension of the supervisory board to accommodate GLS's representative(s) seems quite likely. GLS has already made an unsuccessful attempt to introduce two representatives during the last AGM and UBK's management board is open to prospective discussions on this topic. From a business perspective, closer co-operation between GLS and UBK may translate into certain synergies, eg in the area of investments funds or current account products.

Outlook and forecast revisions

Our forecast revisions are summarised in Exhibit 5. The solid new loan volumes in the green construction segment in H118, coupled with the favourable outlook for the German residential market (most notably in the affordable housing segment), has encouraged us to increase our forecasts for UBK's green construction loan portfolio growth in FY18 and FY19 to 15.0% and 10.0% y-o-y respectively (compared with our earlier assumptions at 7.0% and 8.0% y-o-y, respectively). We have also slightly raised our expectations with respect to wind and solar project portfolio growth in FY18 and FY19. For wind projects, we now forecast growth of c 1% y-o-y in FY18 and FY19 (vs our earlier estimates of -2.5% and -1.3% y-o-y, respectively). The higher average feed-in tariff (FiT) premiums seen during the last onshore wind capacity auction in May (5.73 ct/kWh vs 4.64 ct/kWh on average during prior auctions), coupled with lower average project size (5.4MW vs c 9-16MW during earlier auctions) should support UBK's lending business, as the former improves the creditworthiness of the projects while the latter translates into a growing market niche for projects that are too small to attract the interest of large banks (and which often constitute citizen projects). On the other hand, the fact that the allocated capacity was below the tendered capacity still leaves a degree of uncertainty. We now anticipate UBK's solar project portfolio to post an increase of 3% y-o-y in both FY18 and FY19 (compared with 0.5% y-o-y earlier). On the back of solid customer deposit growth in H118 (5.0% ytd), we increase our expectations for FY18 to 7.5% y-o-y.

The current pressure on UBK's net interest margin seems to be broadly in line with last year, but it is too early to conclude that it is bottoming out. Consequently, we have made only a minor upward revision to our NIM assumptions (+4bp in FY18 and +3bp in FY19), also associated with the fact that the coupon rate offered by UBK's junior green bonds is below our initial assumptions. We have adjusted our net commissions and fee expense forecasts downwards to reflect the lack of arrangement fees and distribution fees mentioned earlier. Finally, we have increased our G&A expense projections, arriving at a cost income ratio in FY18 at 33.0% (compared with 32.7% previously). Consequently, our pre-tax profit forecasts have been moderately revised upwards. Our new lower estimates of capital adequacy ratios shown in Exhibit 5 are largely a function of higher loan portfolio growth expectations. The above revisions resulted in a moderate increase in our UBK share valuation to €11.3 from €11.1 previously.

Exhibit 5: Forecast revisions table

	2018e				2019e			
€000s	**Old**	**New**	**Change**	**y-o-y**	**Old**	**New**	**Change**	**y-o-y**
Net interest and financial income	53,188	55,618	4.6%	1.0%	53,048	55,124	3.9%	-0.9%
Net commissions and fee expense	2,950	2,253	-23.6%	-24.7%	2,957	2,274	-23.1%	0.9%
Pre-tax profit	36,956	38,565	4.4%	-4.2%	35,522	36,788	3.6%	-4.6%
Net income after taxes	25,315	26,186	3.4%	-5.3%	24,333	25,200	3.6%	-3.8%
Customer loans	2,321,028	2,426,195	4.5%	6.7%	2,393,540	2,554,801	6.7%	5.3%
Customer deposits	2,264,855	2,318,780	2.4%	7.5%	2,355,449	2,434,719	3.4%	5.0%
CET1 ratio (pp)	9.6	9.1	-54bp	-	10.0	9.6	-39bps	-
Tier-1 ratio (pp)	11.0	10.4	-63bp	-	11.4	10.9	-46bps	-
TCR (pp)	14.4	13.6	-85bp	-	14.7	14.1	-64bps	-

Source: Edison Investment Research

Exhibit 6: Financial summary

Year Ending	2014	2015	2016	2017	2018e	2019e	2020e	2021e	2022e
Income Statement									
Net interest income	49,153	52,838	53,600	52,166	52,519	52,078	53,753	56,482	60,370
Net financial income	1,972	4,023	5,937	2,909	3,099	3,046	3,241	3,371	3,501
Net interest and financial income	51,125	56,861	59,537	55,075	55,618	55,124	56,994	59,854	63,872
Provisions (-)	638	443	(2,228)	(355)	(365)	(961)	(1,391)	(1,249)	(1,435)
Total administrative expenses	(12,024)	(13,163)	(15,563)	(16,466)	(18,628)	(19,351)	(20,126)	(20,535)	(21,224)
Earnings before administrative costs and taxes	56,130	61,340	61,570	56,739	57,193	56,139	57,664	60,754	64,679
PBT	**44,106**	**48,177**	**46,007**	**40,273**	**38,565**	**36,788**	**37,538**	**40,219**	**43,455**
Net profit after tax	27,542	34,087	32,155	27,661	26,186	25,200	25,714	27,550	29,767
Reported EPS	0.53	0.56	0.58	0.60	0.64	0.64	0.66	0.70	0.71
Adjusted EPS	0.99	1.23	1.16	0.99	0.93	0.87	0.86	0.89	0.93
DPS	0.26	0.28	0.34	0.32	0.34	0.36	0.38	0.40	0.42
Balance sheet									
Cash and balances at Central Banks	36,910	33,171	54,591	32,460	28,281	48,318	94,664	123,430	131,166
Claims on banks	294,248	321,602	149,281	122,622	100,724	82,737	67,961	55,825	45,856
Claims on customers	1,876,476	2,098,150	2,229,817	2,273,561	2,426,195	2,554,801	2,672,608	2,834,270	3,021,793
Bonds and other fixed-interest securities	373,146	288,437	747,214	1,023,677	1,095,334	1,095,334	1,084,381	1,051,849	1,020,294
Tangible assets, Goodwill and Intangible assets	729	759	1,174	1,202	1,202	1,202	1,202	1,202	1,202
Other assets	13,903	15,553	24,165	31,479	35,479	39,479	41,479	43,479	45,479
Total assets	**2,595,412**	**2,757,672**	**3,206,242**	**3,485,001**	**3,687,216**	**3,821,872**	**3,962,296**	**4,110,056**	**4,265,790**
Liabilities to banks	572,399	570,938	860,728	1,011,950	1,011,950	1,011,950	1,011,950	1,011,950	1,011,950
Liabilities to customers	1,808,041	1,938,174	2,055,684	2,157,005	2,318,780	2,434,719	2,556,455	2,684,278	2,818,492
Accruals and deferred expense	510	1,440	1,220	1,012	839	695	577	478	396
Deferred tax liabilities	0	0	231	148	148	148	148	148	148
Other liabilities	132,824	157,095	189,952	206,873	236,069	242,569	248,569	254,569	261,569
Total liabilities	**2,513,774**	**2,667,647**	**3,107,816**	**3,376,987**	**3,567,786**	**3,690,081**	**3,817,698**	**3,951,423**	**4,092,555**
Total shareholders' equity	**81,638**	**90,025**	**98,426**	**108,013**	**119,430**	**131,790**	**144,597**	**158,633**	**173,235**
BVPS	2.9	3.3	3.6	3.9	4.2	4.5	4.8	5.1	5.3
TNAV per share	5.1	6.0	6.9	7.6	8.1	8.5	8.9	9.2	9.6
Ratios									
NIM	1.98%	2.06%	1.87%	1.62%	1.53%	1.45%	1.45%	1.47%	1.51%
Costs/Income	21.5%	22.0%	26.9%	29.4%	33.0%	34.9%	35.4%	34.2%	33.2%
ROE	21.3%	22.2%	18.0%	13.7%	11.8%	10.5%	9.9%	9.9%	9.9%
CET1 Ratio	7.5%	8.1%	8.5%	8.9%	9.1%	9.6%	10.0%	10.2%	10.4%
Tier 1 ratio	8.2%	8.7%	9.9%	10.4%	10.4%	10.9%	11.1%	11.2%	11.3%
Capital adequacy ratio	10.8%	11.0%	12.0%	12.4%	13.6%	14.1%	14.3%	14.2%	14.2%
Payout ratio (%)	26.1%	22.7%	29.3%	32.3%	37.2%	42.1%	44.9%	45.5%	45.7%
Customer loans/Total assets	72.3%	76.1%	69.5%	65.2%	65.8%	66.8%	67.5%	69.0%	70.8%
Loans/Deposits	103.8%	108.3%	108.5%	105.4%	104.6%	104.9%	104.5%	105.6%	107.2%

Source: UmweltBank, Edison Investment Research

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