EDISON

UmweltBank

FY18 preliminary results

Awaiting an earnings inflection point

Banks

UmweltBank's (UBK's) preliminary FY18 numbers confirm the continuation of healthy lending business and deposit base growth, but also further interest margin compression. The additional tier 2 capital raised recently (€45m in total) provides a solid foundation for further loan book expansion, which together with gradually diminishing pressure on margins could translate into UBK's earnings momentum turning positive in 2020. The planned launch of new products in 2019 and 2020 (such as the sustainable consumer credit) may provide some additional tailwinds, but may also translate into a temporarily higher cost income ratio (CIR).

Year end	Net interest income (€m)	EPS* (€)	DPS (€)	P/BV* (x)	P/E* (x)	ROE* (%)	Yield (%)
12/17	52.2	0.99	0.32	1.2	8.8	13.7	3.7
12/18e**	50.7	0.90	0.34	1.1	9.7	11.5	3.9
12/19e	50.6	0.85	0.36	1.0	10.3	10.1	4.1
12/20e	52.7	0.88	0.38	1.0	9.9	9.9	4.3

Note: *Based on net profit before allocation to reserves for general banking risks and tangible book value including reserves for general banking risks ** Edison estimate based on preliminary numbers

Continued interest margin pressure in FY18

UBK reported an 8.4% y-o-y decline in net profit before reserves allocation to €25.3m, which is c 3% below our estimates. This has been a function of lower net interest and financial income, which was partially driven by the continued pressure on interest margins in line with the trend seen in recent years across the sector. G&A expenses (ex-D&A) increased by 10.0% y-o-y to €17.8m due to headcount expansion and higher banking tax and deposit insurance costs. This translated into a CIR at 32.9% vs 29.4% in FY17, broadly in line with our expectations (33.0%).

Solid lending activity and strengthened capital base

UBK's new lending volumes improved 26.3% y-o-y to €542m, assisted to a similar extent by renewable energy projects and green construction. In conjunction with the growth in the bank's irrevocable lending commitments, the overall sustainable loan book went up by 8.6% y-o-y to €2.9bn. Meanwhile, UBK was able to raise €45m of fresh tier 2 capital from the ongoing Green Bond Junior issue, as well as a subordinated bond placement to an institutional investor. We believe that UBK now has c €0.4bn balance sheet headroom (in risk-weighted assets terms) for its loan portfolio growth (which represents c 17% of current customer loan book) even without taking into account future profits accumulation and new capital.

Valuation: Trading at par with book value

UBK's shares are trading at a FY19e P/BV ratio of 1.0x (vs peer average of 1.1x), which in our opinion does not fully reflect its earnings potential once the bank returns to its bottom-line growth path. We have slightly lowered our FY19e and FY20e forecasts, but kept our long-term assumptions broadly unchanged. Thus we have retained our fair value estimate of UBK at €11.3 per share, which implies a 30% upside potential. At the current share price, UBK's dividend yield stands at c 4% vs average level for large banks at c 4.4%.

14 February 2019

Price	**€8.74**
Market cap	**€244m**

Total assets (€bn) at end-2018	3.7
Shares in issue	27.9m
Free float	84.4%
Code	UBKX
Primary exchange	Munich
Secondary exchange	Xetra

Share price performance

%	1m	3m	12m
Abs	1.2	0.5	(18.9)
Rel (local)	(1.4)	3.2	(11.4)
52-week high/low		€11.1	€7.7

Business description

UmweltBank is a specialised lender with total assets of €3.7bn, 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.

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FY18 results: Volumes up, interest margin down

UBK's FY18 preliminary results show continued solid lending business and customer deposit base growth, accompanied by persistent earnings pressures translating into a declining net interest margin (NIM). The bank's new lending volumes reached an encouraging €542m in FY18 (of which €311m in H118), up 26.3% from €429m reported in FY17 (see Exhibit 1). Importantly, this has been driven equally by sustainable construction and green projects, in particular smaller solar projects of up to 750kW (which are not subject to the auction system and are still entitled to receive a fixed feed-in tariff), but also wind projects, of which a significant part represent those that participated in the earlier auctions. This is important given that the number of submitted bids in these auctions was higher than in the most recent tenders, when bottlenecks related to prolonged regulatory approval times started to become visible. Consequently, UBK's loan book (including commitments) reached €2.9bn, up c 8.6% vs FY17. Simultaneously, customer deposits increased by a strong 8.0% y-o-y (vs our estimate of 7.5% y-o-y).

Net interest and financial income decreased 5.3% y-o-y in FY18 to €51.9m and was c 6% below our estimates. This figure includes several P&L items, including net interest income, net financial income excluding net trading income and provisions for credit losses and the impact of net valuation changes. UBK has not provided the corresponding breakdown in its press release, but has shared some supplementary information in its announcement, which suggests that the decline in net interest margin was somewhat less pronounced than in FY17 (and slightly stronger versus our expectations). In this context, it is important to note that UBK's H118 results were assisted by early repayment fees on two sizeable loans (we estimate the impact at around €0.5–1.0m). Net commission and fee expense declined by 13% y-o-y to €2.6m in FY18 amid the lack of arrangement fees (as current market conditions make it difficult for UBK to charge those), as well as the change in recognition of distribution fees related to equity funds, now booked under net trading income.

With the ongoing expansion of the team (172 employees at end-2018 compared with 153 at end-2017), personnel expenses grew by 14.1% y-o-y to €9.2m (close to our growth estimate of 11% y-o-y). Other administrative expenses increased by only 5.9% y-o-y to €8.5m, predominantly on the back of higher banking tax and deposit insurance in conjunction with the healthy customer deposits growth. We suspect that some expenses related to the sustainable consumer credit product were pushed beyond 2018, as the product launch was postponed until 2019. As a result, CIR reached 32.9% in FY18 (broadly in line with our forecast at 33.0%). FY18 results were also supported by net other operating income of €571k (compared with net operating expense of €1.4m in FY17), which we understand was driven by provision reversals.

Consequently, pre-tax profit was down 7.4% y-o-y to €37.3m vs our expectations of a 4.2% y-o-y decline to €38.6m. Net income after allocation of reserves for general banking risks stood at €16.9m and was up 1.6% y-o-y. However, it must be noted that the amount allocated to reserves is determined by the management board and usually adjusted to smooth out bottom-line growth in the long term. In fact, earnings before allocation of reserves fell by 8.4% y-o-y to €25.3m.

Exhibit 1: FY18 preliminary results review

€000s, unless otherwise stated	FY18	FY17	change y-o-y	FY18e	diff
Net interest, financial and net valuation income*	51,893	54,819	-5.3%	55,369	-6.3%
Net commissions and fee expense	2,605	2,994	-13.0%	2,253	15.6%
G&A expenses (ex-D&A)	(17,758)	(16,144)	10.0%	(18,303)	-3.0%
Personnel expenses	(9,221)	(8,084)	14.1%	(8,990)	2.6%
Other administrative expenses	(8,537)	(8,060)	5.9%	(9,313)	-8.3%
thereof, banking tax and deposit insurance	(1,849)	(1,387)	33.3%	(1,941)	-4.8%
Other operating income (expense)	571	(1,395)	n.m.	(429)	n.m.
Pre-tax profit	**37,311**	**40,274**	**-7.4%**	**38,565**	**-3.3%**
Income taxes	(11,975)	(12,612)	-5.1%	(12,379)	-3.3%
Effective tax rate	*32.1%*	*31.3%*	*78 bps*	*32.1%*	*0 bps*
Net income (before reserves allocation)	**25,336**	**27,662**	**-8.4%**	**26,186**	**-3.2%**
New lending volume (€m)	542	429	26.3%	N/A	N/A
Business volume (€m)	4,123	3,766	9.5%	4,067	1.4%
Customer deposits (€m)	2,330	2,157	8.0%	2,319	0.5%
Total assets (€m)	3,699	3,485	6.1%	3,687	0.3%
Equity (€m)	333	282	18.1%	332	0.4%
Total capital adequacy ratio (TCR)	14.0%	12.4%	160bp	13.6%	40bp
CET1 ratio	9.3%	8.9%	40bp	9.1%	23bp
Cost Income Ratio (CIR)	32.9%	29.4%	350bp	33.0%	-11bp

Source: UmweltBank, Edison Investment Research. Note: *Including provisions for credit losses, net financial income (excl. net trading income) and the impact of net valuation changes.

New tier 2 capital from €45m of subordinated debt

To strengthen its capital base and facilitate further loan portfolio growth, the bank launched the issue of its 2.0% unsecured subordinated bond (Green Bond Junior) in July last year. So far UBK was able to raise €25m in proceeds (as per the press release dated 4 February). Based on our discussion with the management, we understand that c €13.2m of this amount represents the result of exchange offers to holders of UBK's profit participation rights (Genussrechte) issued in the period 2003–05 and 2006 (see our previous update note for details). This implies that c 70% of the eligible profit participation rights were exchanged, while the remaining securities were already called and redeemed by the bank (as they were about to lose their tier 2 capital status soon anyway). The remaining c €12m was subscribed for by other retail investors. The issue is still ongoing and will be concluded in July 2019, which means UBK may still raise up to €15m of incremental tier 2 capital (we conservatively assume €10m in our forecasts). Moreover, the bank has raised an additional €20m through the issue of subordinated debt to an institutional investor.

As a result, UBK was able to increase its TCR to 14.0% from 12.5% at end-June 2018 and 12.4% at end-2017. We estimate that this translates into c €0.4bn (or c 17% of current customer loan book) of balance sheet headroom for further loan portfolio growth (in risk-weighted asset terms). This does not account for net profit accumulated or new capital issues. Additionally, UBK is strengthening its capital base through scrip dividends introduced in 2017, which contributed €3m of new capital in 2018. Finally, management still considers a share issue to further improve the CET1 ratio and potentially allow for a reduction of UBK's special buffer (1.5%) added by the German regulator on top of the standard Basel III TCR requirement of 10.5% applied in 2019.

Outlook and forecast revisions

Our forecast revisions are summarised in Exhibit 2. As we believe the decline in UBK's net interest margin was only slightly more pronounced than we have originally anticipated, we have marginally reduced our NIM expectations for FY19e and FY20e by 6bp and 5bp, respectively. In our opinion, this translates into relatively conservative estimates, given that the management's neutral scenario assumes that the interest margin should flatten out from FY19e onwards. This is supported by the fact that the interest rate on UBK's loans is usually fixed for 10 years (and subsequently adjusted for market rate movements). As the ECB interest rate cuts were executed over 2008–2012, most of it should be reflected in UBK's interest income by 2020/2021. Moreover, the prospective ECB rate hikes (even if their exact timing is hard to predict) should assist UBK's income on floating rate assets and new sustainable loans.

Similarly, UBK remains on its growth path with respect to loan book and deposit base, even if we acknowledge that a significant proportion of the business volume growth was attributable to irrevocable lending commitments rather than finalised loans. Moreover, the development of onshore wind projects in Germany is subject to bottlenecks related to extended regulatory requirements and approval timelines, a deficit of approved regional plans and an increase in legal actions against capacity allotments during already closed auctions. However, it seems that UBK's pipeline of project financing is full at the moment. Also, we believe the bank's lending activity in the smaller photovoltaic projects segment (which also command a higher interest margin) may potentially offset more muted new lending volumes in the wind segment. The delay in sustainable consumer credit launch (initially planned until end-2018, now expected in 2019) will not impact our forecasts materially, as the proportion of loan book growth attributable to the consumer credit we have pencilled in for FY19e was negligible. Hence, we introduce only minor changes to our forecasts of new lending volumes and new customer deposits.

Based on our discussions with the company, we understand that in 2019 UBK intends to be more active in corporate fixed income securities, where it is experiencing increased customer interest. Consequently, we have raised our net commissions and fee expense estimates accordingly, assuming a few small to mid-sized transactions executed per year. We have increased our G&A expense expectations in FY19e and FY20e by c 6.5% and 2.5%, respectively, assuming that some expenses related to the newly launched products might have been postponed last year. As a result, we expect the CIR ratio to go up to 37.3% in FY19e and 36.0% in FY20e. Our UBK share valuation remains unchanged at €11.3 per share, as our long-term forecasts (i.e. beyond 2020) remain broadly unchanged.

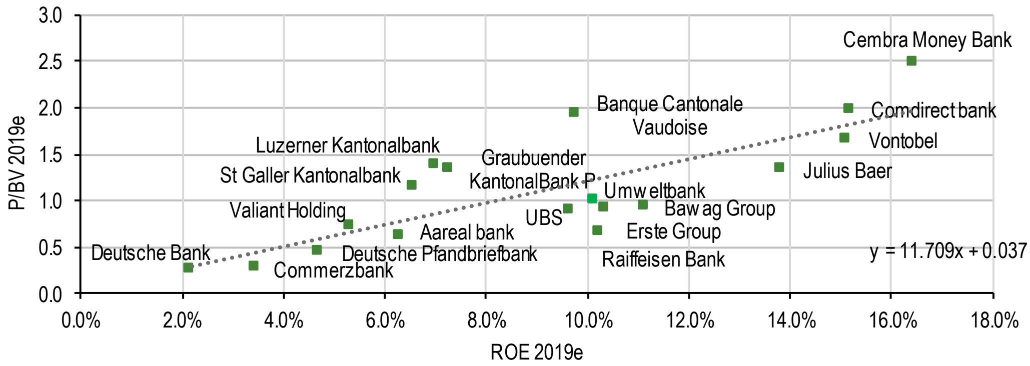
Exhibit 2: Forecast revisions table

€000s	2018	2019e				2020e			
		Old	New	Change	y-o-y	Old	New	Change	y-o-y
Net interest, financial and net valuation income*	51,893	54,294	52,905	*-2.6%*	*2.0%*	55,752	54,719	*-1.9%*	*3.4%*
Net commissions and fee expense**	2,605	2,274	3,374	*48.4%*	*29.5%*	2,341	3,497	*49.4%*	*3.6%*
Pre-tax profit	37,311	36,788	35,465	*-3.6%*	*-4.9%*	37,538	37,386	*-0.4%*	*5.4%*
Net income (before allocation to reserves)	25,336	25,200	24,294	*-3.6%*	*-4.1%*	25,714	25,610	*-0.4%*	*5.4%*
Customer loans (excl. commitments)	N/A	2,554,801	2,540,333	*-0.6%*	N/A	2,672,608	2,697,261	*0.9%*	*6.2%*
Customer deposits	2,330,000	2,434,719	2,446,500	*0.5%*	*5.0%*	2,556,455	2,568,825	*0.5%*	*5.0%*
CET1 ratio (%)	9.3	9.6	9.5	*-11 bps*	*24 bps*	10.0	9.9	*-10 bps*	*36 bps*
Tier-1 ratio (%)	N/A	10.9	10.8	*-11 bps*	N/A	11.1	11.0	*-11 bps*	*26 bps*
TCR (%)	14.0	14.1	14.4	*33 bps*	*41 bps*	14.3	14.6	*31 bps*	*19 bps*
CIR (%)	32.9	34.9	37.3	*232 bps*	*436 bps*	35.4	36.0	*66 bps*	*-123 bps*

Source: UmweltBank, Edison Investment Research; Note: *Including provisions for credit losses, net financial income (excl. net trading income) and the impact of net valuation changes. **Includes net trading income.

We estimate UBK's ROE in FY19e at 10.1%, which compares with an average ratio for listed banks from the DACH region at 9.1% (based on Refinitiv consensus). We note that UBK's FY19e ratio is below our long-term sustainable ROE estimate of c 11.7% due to depressed NIM (which may bottom out soon though as discussed above) and higher OPEX amid the launch of new products. At the same time, UBK's FY19e P/BV stands at 1.0x, slightly below peer average of 1.1x (see Exhibit 3).

Exhibit 3: UmweltBank's P/BV and ROE 2019e comparison versus peers



Source: Refinitiv, Edison Investment Research. Note: Ratios for UmweltBank are based on net profit before reserves allocation and book value including balance sheet value of reserves for general banking risks.

Exhibit 4: 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	50,740	50,560	52,730	56,554	60,275
Net financial income	1,972	4,023	5,937	2,909	2,831	3,396	3,591	3,721	3,851
Net interest and financial income	51,125	56,861	59,537	55,075	53,571	53,957	56,321	60,275	64,126
Provisions (-)	638	443	(2,228)	(355)	(1,368)	(864)	(1,415)	(1,499)	(1,549)
Total administrative expenses	(12,024)	(13,163)	(15,563)	(16,466)	(18,082)	(20,614)	(20,629)	(20,531)	(20,924)
Earnings before administrative costs and taxes	56,130	61,340	61,570	56,739	55,394	56,079	58,015	62,025	65,956
PBT	**44,106**	**48,177**	**46,007**	**40,274**	**37,311**	**35,465**	**37,386**	**41,494**	**45,033**
Net profit after tax	27,542	34,087	32,155	27,661	25,336	24,294	25,610	28,423	30,847
Reported EPS	0.53	0.56	0.58	0.60	0.60	0.62	0.64	0.66	0.68
Adjusted EPS	0.99	1.23	1.16	0.99	0.90	0.85	0.88	0.96	1.03
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	47,017	47,448	59,738	101,412	151,938
Claims on banks	294,248	321,602	149,281	122,622	122,622	100,724	82,737	67,961	55,825
Claims on customers	1,876,476	2,098,150	2,229,817	2,273,561	2,377,999	2,540,333	2,697,261	2,852,625	3,003,741
Bonds and other fixed-interest securities	373,146	288,437	747,214	1,023,677	1,146,518	1,146,518	1,135,053	1,101,001	1,067,971
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**	**3,730,838**	**3,875,705**	**4,017,471**	**4,167,681**	**4,326,156**
Liabilities to banks	572,399	570,938	860,728	1,011,950	1,042,308	1,042,308	1,042,308	1,042,308	1,042,308
Liabilities to customers	1,808,041	1,938,174	2,055,684	2,157,005	2,330,000	2,446,500	2,568,825	2,697,266	2,832,130
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	239,152	256,015	263,578	273,123	284,163
Total liabilities	**2,513,774**	**2,667,647**	**3,107,816**	**3,376,987**	**3,612,447**	**3,745,667**	**3,875,436**	**4,013,324**	**4,159,145**
Total shareholders' equity	**81,638**	**90,025**	**98,426**	**108,013**	**118,390**	**130,038**	**142,034**	**154,357**	**167,011**
BVPS	2.9	3.3	3.6	3.9	4.2	4.5	4.9	5.2	5.5
TNAV per share	5.1	6.0	6.9	7.6	8.1	8.6	9.2	9.7	10.3
Ratios									
NIM	1.98%	2.06%	1.87%	1.62%	1.47%	1.39%	1.40%	1.45%	1.49%
Costs/Income	21.5%	22.0%	26.9%	29.4%	32.9%	37.3%	36.0%	33.5%	32.1%
ROE	21.3%	22.2%	18.0%	13.7%	11.5%	10.1%	9.9%	10.2%	10.3%
CET1 Ratio	7.5%	8.1%	8.5%	8.9%	9.3%	9.5%	9.9%	10.3%	10.7%
Tier 1 ratio	8.2%	8.7%	9.9%	10.4%	10.7%	10.8%	11.0%	11.3%	11.6%
Capital adequacy ratio	10.8%	11.0%	12.0%	12.4%	14.0%	14.4%	14.6%	14.8%	15.0%
Payout ratio (%)	26.1%	22.7%	29.3%	32.3%	38.0%	42.6%	43.4%	41.9%	41.2%
Customer loans/Total assets	72.3%	76.1%	69.5%	65.2%	63.7%	65.5%	67.1%	68.4%	69.4%
Loans/Deposits	103.8%	108.3%	108.5%	105.4%	102.1%	103.8%	105.0%	105.8%	106.1%

Source: UmweltBank, Edison Investment Research. Note: *Edison estimates based on preliminary numbers.

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