

Graubündner Kantonalbank

Armed for adverse winds

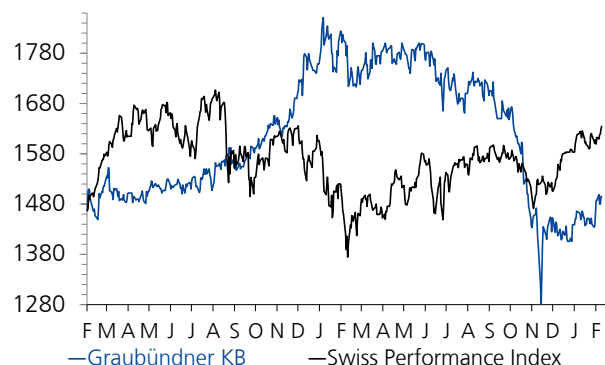
Banks | 13 February 2017

Price PC: CHF 1 495
Bloomberg: GRKP SE
Market Capitalisation: CHF 1.12 bn
Sustainable Investment Universe: Yes

ZKB Issuer Rating: AA+
TK-Symbol: GRKP
Free Float: 100%

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Rating: Market Perform



Key Figures

in CHF	2016	2017E	2018E		2016	2017E	2018E
EPS (adj.)	67.3	68.2	68.6	P/E	22.2x	21.9x	21.8x
– Change	–2.13%	1.28%	0.59%	ROE (adj.)	7.02%	6.89%	6.72%
Dividend Yield	2.54%	2.54%	2.54%	Cost/Income Ratio	51.8%	50.4%	50.3%

Source: Zürcher Kantonalbank

Well equipped to weather mixed prospects

Graubündner Kantonalbank posted results for 2016 which once again underscored that the bank is run in a solid and reasonable manner and that it is adequately prepared for the future. But as there is no tailwind from either the interest rate front or from Grisons' economy, net profit probably won't rise significantly over the next several years. In addition, the participation certificate's valuation – at a P/E 2018E of nearly 22x – still remains quite ambitious even though the share price lost ground in the second half of 2016. This high valuation makes it unlikely, in our view, that the stock can outperform the overall Swiss market. On the other hand, we don't see any catalysts for a negative assessment, either. Hence, our rating is "Market Perform."

Solid set of figures for 2016 in line with expectations

The bank posted a decline in revenues that was in line with expectations. The decrease was due to the deconsolidation of Private Client Bank (PCB) because the stake was sold in the first half of 2016. This triggered a reduction in costs, too. This decline, though, was overshadowed by a one-time contribution of CHF 5.5 million to the pension fund, an expense which we did not anticipate. As a result, the cost/income ratio also came in

higher than forecast. The variances to our projections for the annual results were otherwise negligible.

Annual results 2016

In CHF mn	ZKB E	Reported	Δ as % YoY
Operating revenues	354.0	355.7	-3.6%
Costs including depreciation	179.0	184.1	-0.6%
Additions to risk provisions	0.0	-0.7	n.a.
Net operating income	175.0	172.2	-3.8%
Net profit before minorities	172.0	168.5	+0.2%
Extraordinary result	0.0	-2.2	n.a.
Net profit adjusted*	169.0	168.4	-2.1%
Cost/income ratio incl. deprec.	50.6%	51.8%	+1.6 pp

*After minorities

Source: Zürcher Kantonalbank

Extraordinary factors balance each other out

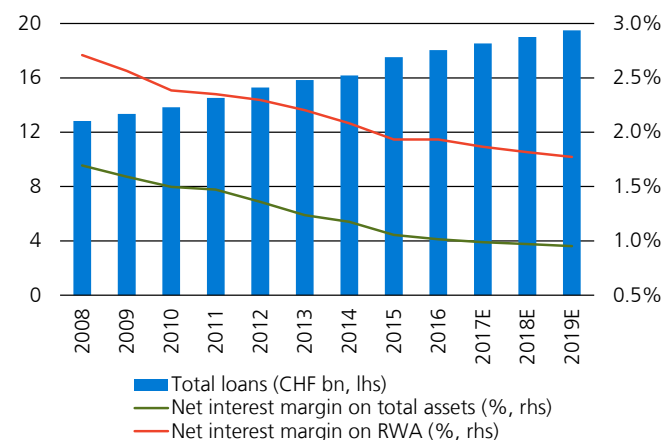
The bank posted extraordinary income totalling CHF 23 million associated with the restructuring of its Private Banking participations plus the Swisscanto earn-out. This gain was nearly fully offset by a CHF 10 million new allocation to the reserve for general banking risks and an impairment charge of more than CHF 15 million on the goodwill associated with last year's acquisition of Albin Kistler AG. The auditors were evidently persuaded that the CHF 10 million goodwill for the "exclusivity of

the transaction" and the option to acquire a majority stake three years down the road could be written off immediately. CFO Andreas Lötscher says that an additional CHF 5 million in goodwill amortisation will be expensed in 2017 and 2018 each.

A few shadows over net interest income

Management expects it will be difficult to maintain the current level of net interest income. After all, the ongoing low interest rates are burrowing their way deeper into the loan book, and the growth in mortgage lending can offset this negative effect to only a limited degree. To achieve this growth Graubündner Kantonalbank is focusing, in particular, on partnerships with external asset managers as well as on consortium business with other banks and refinancing transactions with real estate funds. In 2016 these three factors constituted the driving forces behind the 5.8% growth in mortgage volume. Negative interest rates are being passed on in some cases, but only to clients with more than CHF 1 million in cash deposits. In contrast to other retail banks the Chur-based institution demands no more than the 75 basis points that it itself must pay to the SNB. To quote CEO Alois Vinzens: "that is enough, particularly when the clients have a history with you." However, you also have to ensure that in this market environment you don't become the "depository of last resort" (our wording) – a concern you could not even imagine in the banking industry just a few years ago. All in all, additional pressure on interest margins is likely.

Trajectory of loan book and interest margins



Blurred prospects on the loan front

During the analyst conference in Chur the bank's management pointed out once again that the bank's exposure to the tourism sector is less than CHF 1 billion. They added that their mortgages are deliberately capped at CHF 10,000 per square meter, which is not even 50% of what is being paid in the hot spots of the canton. The projects in these places, however, are primarily financed via private banking structures, according to CFO Andreas Lötscher. The bank establishes loan-loss provisions for both typical default risks as well as for so-called exposed loans. These include loans in which the borrower is exposed to exter-

nal factors such as the weather, the exchange rate and fickle holidaymakers, but does not have any perceivable financial difficulties. In agreement with the regulator, the bank has reclassified to this type of exposure the general loan-loss provisions that are no longer permitted under the new accounting requirements. This makes management confident that the bank is adequately equipped if the outlook for some borrowers turns saturnine.

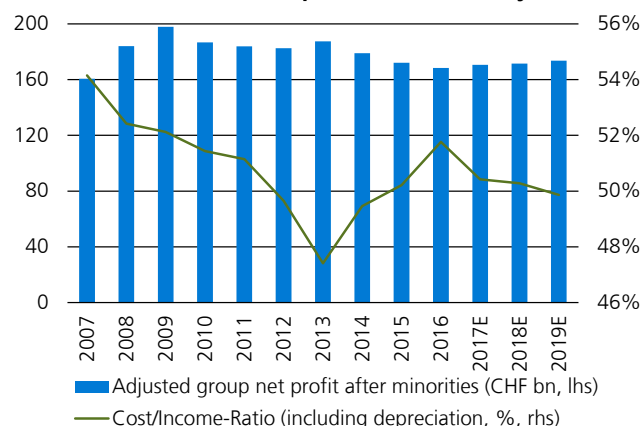
All in all, mixed prospects for Graubündner KB



Source: Michael Kunz

Long story short, large increases are unlikely over the next several years at virtually all levels of profit. Management's outlook reflects this, too, which is guiding for net profit 2017 to remain stable versus the previous year.

Trend and forecast for net profit and efficiency



Valuation premium to peer group diminished

The decline in the share price during the second half of 2016 has abated the valuation of the (admittedly thinly traded) participation certificate considerably towards the peer group, although it still trades at a certain premium. This premium can be partially explained by the superior efficiency of Graubündner Kantonalbank. The set of figures the bank posted for 2016 and its outlook for 2017 make it unlikely that the share price and the valuation will change significantly. We are therefore sticking to our "Market Perform" rating.

Peer group comparison*

Name	P/B P/E 2018		Div. yield 2018	CIR 2018**	RoE 2018
BCV	1.7x	18.0x	4.9%	57.0%	9.5%
Glärner KB	0.9x	15.1x	3.3%	67.7%	5.7%
Graubündner KB	1.4x	21.8x	2.5%	50.3%	6.7%
Luzerner KB	1.4x	19.6x	3.0%	51.9%	7.0%
St. Galler KB	1.0x	15.8x	3.7%	61.0%	6.5%
Thurgauer KB	0.8x	14.6x	3.1%	55.8%	5.9%
Valiant	0.7x	15.8x	3.7%	62.5%	5.1%
Average	1.1x	17.2x	3.5%	58.0%	6.6%

*ZKB-E ** Cost/Income ratio incl. depreciation

Source: Zürcher Kantonalbank

Company Description

Graubündner Kantonalbank is a medium-sized cantonal bank. The parent company focuses on private and corporate client business in the Canton of Grisons. The bank also engages in private banking through its stake in Privatbank Bellerive (55% stake, assets under management of roughly CHF 4bn, domiciled in Zurich) and Albin Kistler AG (25% stake with option for another 26%, assets under management of around CHF 4bn, in Zurich, too). The Canton of Grisons holds 84.3% of the capital in the bank.

SWOT analysis

Strengths

- Above-average capitalisation
- Good cost and risk control
- Anticipatory and conservative management
- Relatively limited dependency on short-term market fluctuations
- State guarantee and a solid rating (ZKB debtor rating: AA+)

Opportunities

- Capital strength allows flexibility in capital measures
- Further expansion of participations with a good positioning in wealth management because of their focus on Swiss clients
- Results would strongly benefit from an improvement in the environment (markets, interest rates)

Weaknesses

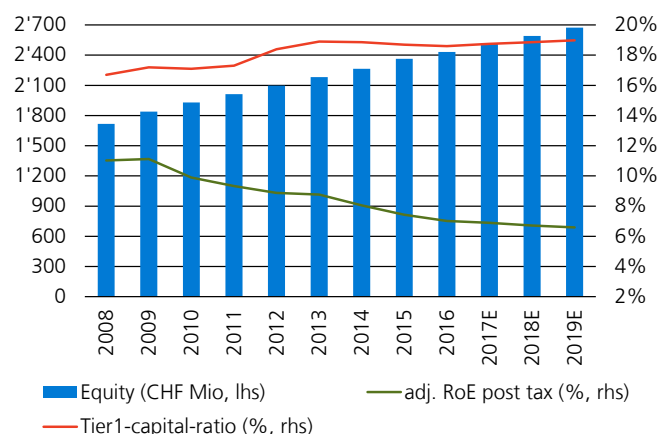
- High dependency on interest rate environment (over 60% of revenues)
- Trading volume for participation certificate is low
- Opportunities for cost reductions are declining
- Growth in the canton appears to be exhausted at the moment

Threats

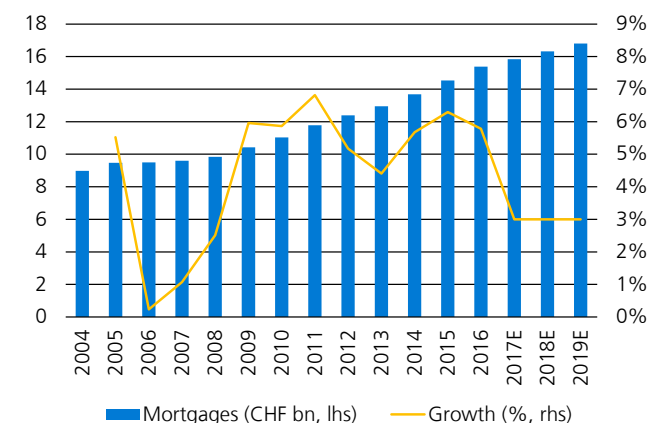
- Cash outflows in GKB parent company due to taxation changes
- Plummeting real estate prices in overheated regions of the Canton of Grisons
- Severe economic downturn in the Canton of Grisons, triggering higher loan defaults

Source: Zürcher Kantonalbank

Development of shareholders' equity and profitability



Development and growth of mortgage loan book



Source: Zürcher Kantonalbank

Financial Data

Graubündner Kantonalbank	2014	2015	2016	2017E	2018E	2019E
Balance sheet in CHF mn						
Total assets	20 588	23 284	23 918	24 302	24 786	25 285
– Change in %	2.94%	13.09%	2.72%	1.61%	1.99%	2.01%
Shareholders' equity	2 264	2 363	2 431	2 515	2 592	2 673
– Change in %	3.79%	4.38%	2.87%	3.43%	3.06%	3.13%
BIS Tier 1 ratio in %	18.9%	18.7%	18.6%	18.7%	18.9%	19.0%
Total loans to customers	16 181	17 520	18 046	18 540	19 015	19 505
– Change in %	2.1%	8.3%	3.0%	2.7%	2.6%	2.6%
– Risk costs in %	0.04%	0.03%	0.00%	0.01%	0.02%	0.02%
Assets under Management in CHF bn						
Total Assets under Management	30.2	30.1	27.9	28.4	28.9	29.7
– Change in %	2.19%	–0.26%	–7.32%	2.03%	1.56%	2.69%
Income statement in CHF mn						
Net interest income	237.4	230.4	239.8	238.0	238.0	238.0
– Change in %	–2.6%	–3.0%	4.1%	–0.7%	0.0%	0.0%
– in % of operating income	62.2%	62.4%	67.4%	66.3%	65.7%	65.2%
Net fee and commission income	113.2	106.0	89.8	93.0	96.0	99.0
– Change in %	0.1%	–6.4%	–15.2%	3.6%	3.2%	3.1%
– in % of operating income	29.7%	28.7%	25.2%	25.9%	26.5%	27.1%
Net trading income	19.7	22.3	17.6	20.0	20.0	20.0
– Change in %	4.88%	13.17%	–20.98%	13.40%	0.00%	0.00%
– in % of operating income	5.2%	6.0%	5.0%	5.6%	5.5%	5.5%
Net other income	11.5	10.4	8.5	8.0	8.0	8.0
– in % of operating income	3.00%	2.82%	2.93%	2.37%	2.21%	2.19%
Operating income	381.8	369.1	355.7	359.0	362.0	365.0
– Change in %	–1.24%	–3.34%	–3.62%	0.93%	0.84%	0.83%
Operating expenses incl. depreciation and amortization	–188.8	–185.3	–184.1	–181.0	–182.0	–182.0
– Change in %	3.04%	–1.86%	–0.64%	–1.70%	0.55%	0.00%
– Cost/income ratio in %	49.5%	50.2%	51.8%	50.4%	50.3%	49.9%
Valuation adjustments, provisions and losses	–6.6	–4.7	0.7	–2.0	–3.0	–4.0
Net operating result	186.3	179.1	172.2	176.0	177.0	179.0
– Change in %	–4.0%	–3.9%	–3.8%	2.2%	0.6%	1.1%
Appropriation to reserves for general banking risks	–22.7	–24.6	–9.8	0.0	0.0	0.0
Other extraordinary items	0.0	16.7	7.6	–2.0	–2.0	0.0
Taxes	–2.5	–3.0	–1.5	–3.0	–3.0	–3.0
Profit before minorities	161.1	168.2	168.5	171.0	172.0	176.0
Minorities	–4.9	–4.0	–2.4	–2.5	–2.5	–2.5
Net profit	156.2	164.1	166.1	168.5	169.5	173.5
– Change in %	–0.1%	5.1%	1.2%	1.4%	0.6%	2.4%
Adjusted net profit	178.9	172.0	168.4	170.5	171.5	173.5
– Change in %	–4.6%	–3.8%	–2.1%	1.3%	0.6%	1.2%
– Return on equity adjusted in %	8.0%	7.4%	7.0%	6.9%	6.7%	6.6%
– Net interest margin in %	1.2%	1.1%	1.0%	1.0%	1.0%	1.0%
Valuation						
P/E			22.2x	21.9x	21.8x	21.5x
Price/book			1.5x	1.5x	1.4x	1.4x
Price/tangible book			1.5x	1.5x	1.4x	1.4x
Dividend yield			2.5%	2.5%	2.5%	2.5%
Per share data in CHF						
Shareholders' equity	905.8	945.4	972.5	1005.9	1036.7	1069.1
Tangible shareholders' equity	905.8	945.4	968.4	1003.9	1036.7	1069.1
Net profit	62.5	65.7	66.4	67.4	67.8	69.4
– Change in %	–0.1%	5.1%	1.2%	1.4%	0.6%	2.4%
Adjusted net profit	71.6	68.8	67.3	68.2	68.6	69.4
– Change in %	–4.6%	–3.8%	–2.1%	1.3%	0.6%	1.2%
Dividend	38.0	38.0	38.0	38.0	38.0	38.0
Payout ratio in %	60.8%	57.9%	57.2%	56.4%	56.0%	54.8%
Capital structure						
Participation certificates	CHF 1 000	750 000	CHF 1 121 mn	100%	GRKP	134 020

Source: Zürcher Kantonalbank

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