

# Graubündner KB

## Suddenly the Capricorn starts to gallop

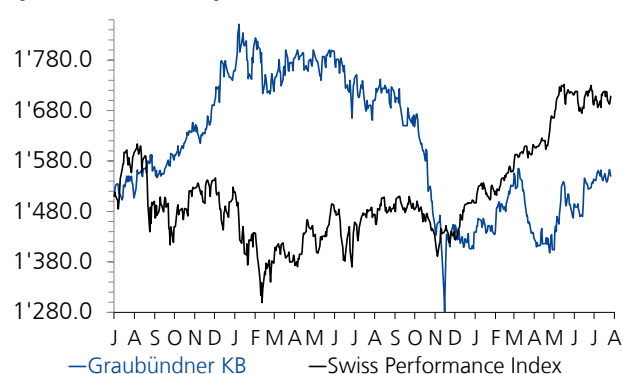
Regional banks | 27 July 2017

Price PC: CHF 1 550      ZKB Issuer Rating: AA+  
 Bloomberg: GRKP SE      TK-Symbol: GRKP  
 Market Capitalisation: CHF 1.16 bn      Free Float: 100%  
 Sustainable Investment Universe: Yes

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### Rating neu: Outperform

Expected relative performance: +8%



### Key Figures

in CHF	2016	2017E	2018E		2016	2017E	2018E
EPS (adj.)	67.3	75.2	72.0	P/E	23.0x	20.6x	21.5x
– Change	–2.13%	11.7%	–4.26%	ROE (adj.)	7.02%	7.57%	6.98%
Dividend Yield	2.45%	2.45%	2.45%	Cost/Income Ratio	51.8%	48.8%	48.9%

Source: Zürcher Kantonalbank

### First visible signs of operating momentum in years

Graubündner Kantonalbank provided a positive surprise in all revenue components of its first half-year result. The bank's cost and risk containment turned out to be stronger than anticipated. Consequently, GRKB also revised upward its guidance for the full year, but we deem the outlook still too conservative in view of the current reported results. The income statement exhibited operating momentum for the first time in years, which could not have been anticipated amid the current market environment. GRKB has apparently positioned itself precisely at the right time with its initiatives in the wealth management business in order to reap rewards from the stepped-up client activity at present. The participation certificate, with a relatively limited market free float, is still valued at the upper end of the peer group, but has lost a significant proportion of its extreme overvaluation since the beginning of 2016. The current P/E multiple of 21x on a three-year perspective is hovering at nearly 20% below the value at that time. Although this is not exactly bargain character, the good results coupled with the raised guidance should provide ample tailwind to the share price, resulting in an outperformance versus the market in the near term.

### Robust set of results noticeably above expectations

GRKB managed to slightly increase net interest income despite the prevailing negative interest rates through expanding volumes and exploiting market opportunities in treasury. Net commission income benefited from the positive market trend, a good contribution from Bellerive Private Bank, new advisory mandates and the launch of the bank's own fund products. The downtrend following elimination of retrocessions now seems to have stopped here. Net trading income reaped benefits from stepped-up securities transactions in foreign currencies, while other income benefited from realised gains on financial investments and particularly a very good contribution from the 25% stake in Albin Kistler. The operating result increased additionally through an inevitable release of provisions for loan impairments amounting to CHF 9 million, because provisioned loans were surprisingly repaid by the borrower or refinanced by competitors. Overall, the net operating result therefore surpassed our estimate by 18%. Accordingly, the bank indulged in cushioning the reserves for general banking risks with CHF 9 million. Due to this, the increase in reported profit turned out to be somewhat more moderate than that of the net operating profit.

## First half-year 2017 results

In CHF mn	ZKB E	Reported	Δ in % YoY
Total revenues*	179.0	187.5	+6.9%
- Net interest income*	119.0	120.8	+1.3%
- Net commission income	46.0	46.5	+4.3%
- Net trading income	10.0	10.4	+28.2%
- Other operating income	4.0	9.8	+172.3%
Costs including depreciation*	90.0	88.3	+0.9%
New risk provisions	1.0	-8.9	–
Net operating profit**	88.0	108.0	+17.8%
Group net profit before minorities	85.5	98.7	+9.2%
Extraordinary result	-1.0	-8.4	–
Group profit adjusted	85.0	105.5	+16%
Cost/income ratio incl. deprec.	50.3%	47.1%	-2.8 pp

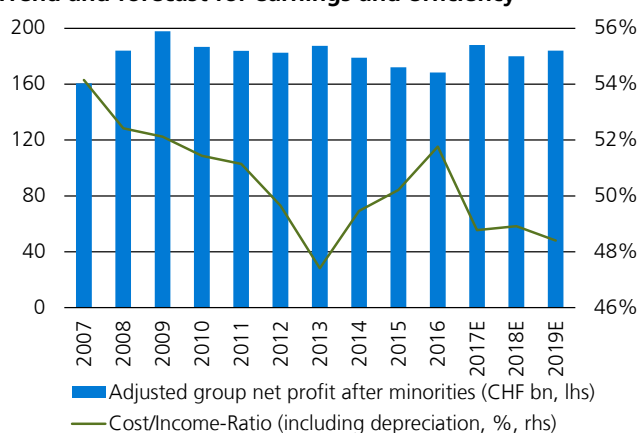
\*before risk provisions; \*\* before goodwill amortisation

Source: Zürcher Kantonalbank

## Guidance for the full year very cautiously raised

In view of the strong first half-year, the management also revised upward its forecasts for the full year. Business profit (the figure defined by the bank after goodwill amortisation) should now amount to CHF 178-183 million (old forecast: CHF 156-160 million). Even though the CHF 9 million release of risk provisions won't repeat in the second half-year, this forecast seems fairly understated given a business profit of CHF 105 million reported in the first half-year. Net profit after contributions to reserves should now amount to up to CHF 173 million (previously: up to CHF 170 million), of which the bank has already realised 54% even though the reserves had been strengthened with CHF 9 million. Assuming no further contributions in the second half-year, it would take quite a market slump to prevent Graubündner Kantonalbank from reaping its harvest. Hence, we derive a forecast for reported group profit of CHF 177 million, with which we still feel pretty conservative. Given the contribution to reserves, the adjusted profit is even higher this year. Expectations for 2018 point to a decline at the operating level because another significant release of risk provisions cannot be anticipated.

## Trend and forecast for earnings and efficiency



Source: Zürcher Kantonalbank

## A cantonal bank with performance fees

Fairly close to the peak of the lament regarding inactive private banking clients, Graubündner Kantonalbank last summer acquired a 25% stake in wealth manager Albin Kistler (currently holding roughly CHF 4.5 billion in assets). One year later this at-equity consolidated investment has already contributed revenues of CHF 2.4 million to the operating result. Thanks to the strong performance, Albin Kistler was able to garner performance-based fees. Sticking to its strategy in the wealth management business has generally paid off for Graubündner Kantonalbank. It aims to increase its perception even more strongly as an address for wealth management going forward.

## Forging ahead with digitalisation

According to the opinion expressed by CEO Alois Vinzens at the analysts' conference, the future lies in a hybrid approach. Processes are undergoing 100% digitalisation, but are supported by advisors, in any case given more complex enquiries such as first mortgages. Extensions, renewals, changes in interest rates etc. will probably be carried out entirely online. The online-only mortgage market is assessed as being smaller, but GRKB aims to increase its footprint here, too. According to the CEO, the digital signature will become a key element too, enabling paper-free contracts, e.g. facilitating signing the vast array of new advisory documents for clients, with which bank advisors are confronted amid the heightened regulatory frenzy. One advantage of digitalisation in the cross-border private banking business is also that as soon as an advisor, e.g., selects a residence in Germany, the computer (tablet) provides only those products that are approved for this domicile.

## Bank counters are becoming relics of the past

Graubündner Kantonalbank has tested a new type of branch office in Ilanz without traditional bank counters, only with advisors. Clients have embraced the model so well that GRKB aims to now roll out the concept to other locations. Even though local politicians and media often utter howls of protest when banks shut down counters, fact is that the number of transactions at counters declined by 10% in 2016. Since bank employees working at counters practically have nothing to do any longer, it is becoming increasingly more difficult to find personnel here. For the first time since the introduction of ATMs, the number of transactions here has decreased as well. New means of payment such as NFC credit cards (even for the smallest amounts) or via mobile phones have reduced the demand for cash withdrawals. However, Graubündner Kantonalbank does not intend to go as far as Valiant has. Advisors will continue to have a personal presence at bank branch offices rather than appear via video. We suspect some cost-cutting potential here in the medium term. Furthermore, we anticipate that of the current roughly 60 GRKB branch offices some will face complete closure, because the demand for advisory services is probably insufficient at smaller locations to be able to justify operating the branch.

## New type of branch office without bank counter



Source: Graubündner Kantonalbank

## Valuation premium versus peer group diminished

The decline in the share price during the second half of 2016 abated the valuation premium of the thinly traded participation certificate sharply toward the peer group. A certain premium is partially attributable to the superior efficiency of Graubündner Kantonalbank. In addition, the P/E multiple on a three-year per-

spective is currently hovering at nearly 20% below the 2016 level. The excellent first half-year 2017 results coupled with the raised guidance sparks expectations that the price of the participation certificate should somewhat outperform the overall market in the near term. We are therefore upgrading our rating on GRKB stock from "Market Perform" to "Outperform."

## 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 4.5bn, domiciled in Zurich) and Albin Kistler AG (25% stake with option for another 26%, assets under management of around CHF 4.5bn, 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 controls
- Far-sighted 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 investments with favourable positioning in wealth management because of the focus on Swiss clients
- Results would strongly benefit from improvement in the environment (interest rates, markets)

### Weaknesses

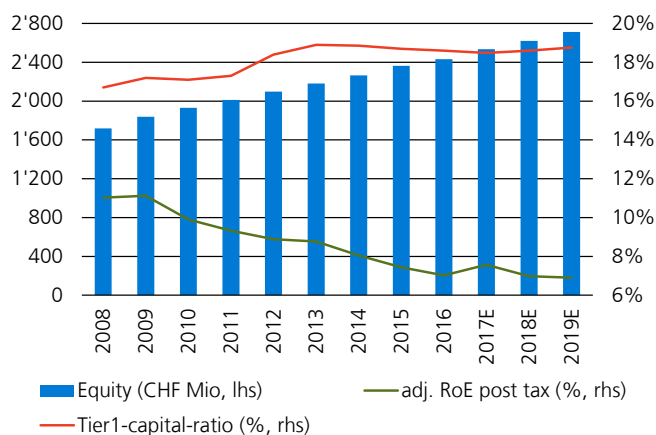
- High dependency on interest rate business (over 60% of revenues)
- Trading volume for participation certificate is low
- Opportunities for cost reductions are declining
- Growth in the canton appears to be exhausted at the moment

### Threats

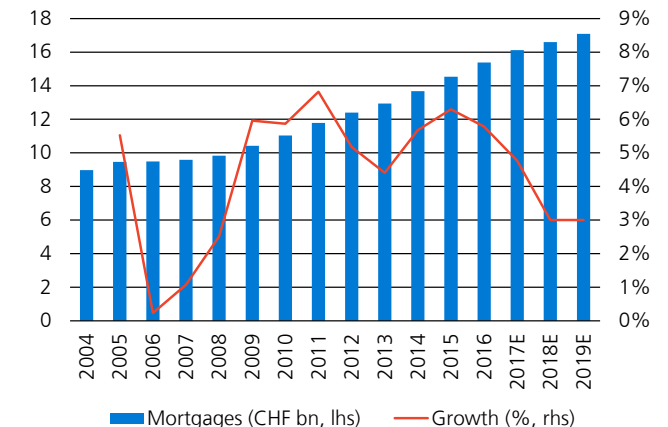
- Asset outflows in GKB parent company due to taxation changes
- Fall in real estate prices in overheated regions of the Canton of Grisons
- Collapse in the overall economy of the Canton of Grisons, resulting in higher loan defaults

Source: Zürcher Kantonalbank

## Trend in shareholders' equity and profitability



## Trend in growth of mortgage loan book



## Financial Data

Graubündner Kantonalbank	2014	2015	2016	2017E	2018E	2019E
<b>Balance sheet in CHF mn</b>						
Total assets	20 588	23 284	23 918	24 322	24 815	25 325
– Change in %	2.94%	13.09%	2.72%	1.69%	2.03%	2.06%
Shareholders' equity	2 264	2 363	2 431	2 535	2 621	2 713
– Change in %	3.79%	4.38%	2.87%	4.25%	3.39%	3.51%
BIS Tier 1 ratio in %	18.9%	18.7%	18.6%	18.5%	18.6%	18.8%
Total loans to customers	16 181	17 520	18 046	18 861	19 394	19 942
– Change in %	2.1%	8.3%	3.0%	4.5%	2.8%	2.8%
Risk costs in %	0.04%	0.03%	0.00%	–0.03%	0.02%	0.02%
<b>Assets under Management in CHF bn</b>						
Total Assets under Management	30.2	30.1	27.9	29.2	30.1	31.1
– Change in %	2.19%	–0.26%	–7.32%	4.82%	3.04%	3.32%
<b>Income statement in CHF mn</b>						
Net interest income	237.4	230.4	239.8	242.0	243.0	244.0
– Change in %	–2.6%	–3.0%	4.1%	0.9%	0.4%	0.4%
– in % of operating income	62.2%	62.4%	67.4%	65.9%	65.7%	64.9%
Net fee and commission income	113.2	106.0	89.8	94.0	96.0	99.0
– Change in %	0.1%	–6.4%	–15.2%	4.7%	2.1%	3.1%
– in % of operating income	29.7%	28.7%	25.2%	25.6%	25.9%	26.3%
Net trading income	19.7	22.3	17.6	18.0	20.0	20.0
– Change in %	4.88%	13.17%	–20.98%	2.06%	11.11%	0.00%
– in % of operating income	5.2%	6.0%	5.0%	4.9%	5.4%	5.3%
Net other income	11.5	10.4	8.5	13.0	11.0	13.0
– in % of operating income	3.00%	2.82%	2.93%	2.31%	3.51%	2.93%
Operating income	381.8	369.1	355.7	367.0	370.0	376.0
– Change in %	–1.24%	–3.34%	–3.62%	3.18%	0.82%	1.62%
Operating expenses incl. depreciation and amortization	–188.8	–185.3	–184.1	–179.0	–181.0	–182.0
– Change in %	3.04%	–1.86%	–0.64%	–2.79%	1.12%	0.55%
– Cost/income ratio in %	49.5%	50.2%	51.8%	48.8%	48.9%	48.4%
Valuation adjustments, provisions and losses	–6.6	–4.7	0.7	5.0	–3.0	–4.0
Net operating result	186.3	179.1	172.2	193.0	186.0	190.0
– Change in %	–4.0%	–3.9%	–3.8%	12.1%	–3.6%	2.2%
Appropriation to reserves for general banking risks	–22.7	–24.6	–9.8	–14.0	0.0	0.0
Other extraordinary items	0.0	16.7	7.6	0.0	–2.0	0.0
Taxes	–2.5	–3.0	–1.5	–2.0	–3.0	–3.0
Profit before minorities	161.1	168.2	168.5	177.0	181.0	187.0
Minorities	–4.9	–4.0	–2.4	–3.0	–3.0	–3.0
Net profit	156.2	164.1	166.1	174.0	178.0	184.0
– Change in %	–0.1%	5.1%	1.2%	4.7%	2.3%	3.4%
Adjusted net profit	178.9	172.0	168.4	188.0	180.0	184.0
– Change in %	–4.6%	–3.8%	–2.1%	11.7%	–4.3%	2.2%
– Return on equity adjusted in %	8.0%	7.4%	7.0%	7.6%	7.0%	6.9%
– Net interest margin in %	1.2%	1.1%	1.0%	1.0%	1.0%	0.9%
<b>Valuation</b>						
P/E			23.0x	20.6x	21.5x	21.1x
Price/book			1.6x	1.5x	1.5x	1.4x
Price/tangible book			1.6x	1.5x	1.5x	1.4x
Dividend yield			2.5%	2.5%	2.5%	2.5%
<b>Per share data in CHF</b>						
Shareholders' equity	905.8	945.4	972.5	1013.9	1048.3	1085.1
Tangible shareholders' equity	905.8	945.4	968.4	1011.9	1048.3	1085.1
Net profit	62.5	65.7	66.4	69.6	71.2	73.6
– Change in %	–0.1%	5.1%	1.2%	4.7%	2.3%	3.4%
Adjusted net profit	71.6	68.8	67.3	75.2	72.0	73.6
– Change in %	–4.6%	–3.8%	–2.1%	11.7%	–4.3%	2.2%
Dividend	38.0	38.0	38.0	38.0	38.0	38.0
Payout ratio in %	60.8%	57.9%	57.2%	54.6%	53.4%	51.6%
<b>Capital structure</b>						
Participation certificates	CHF 1 000	750 000	CHF 1 163 mn	100%	GRKP	134 020

Source: Zürcher Kantonalbank

## Disclosures & Disclaimer

### Recommendations made in the last twelve months

27.07.2017 old: Market Perform new: Outperform

### List of all publications of the last twelve months

A list of all reports/publications that have been published on any issuer or financial instrument within the last twelve months is available at the following address: <https://zkb-finance.mdgms.com/user/login/index.html>.

### Methodology

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### Expected frequency

As a general rule, and unless otherwise stated, the Research department of Zürcher Kantonalbank will update publications on issuers and/or financial instruments as new company figures or information impacting the price or the rating are being released.

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