

ISSUER COMMENT

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Rabobank

Full-year 2017 results: higher profits driven by provision releases and lower exceptional items

All figures in this report relate to full year 2017 and comparisons are made year-on-year unless otherwise indicated.

Summary opinion

On 15 February, Rabobank (Aa2/Aa2 negative, a2)¹ reported full-year 2017 net income of €2,674 million, up 32% from 2016. The improvement was driven by lower exceptional items and a negative cost of risk. Excluding the impact of one-off items (–€833 million in 2017 versus –€1,261 million in 2016), the underlying profit before tax increased to €4,465 million in 2017 from €3,979 million in 2016 owing to a €500 million decline in cost of risk (–€190 million in 2017; €310 million in 2016). The efficiency of the bank deteriorated slightly in 2017, as reflected by the underlying cost-to-income ratio increase to 65.3% from 64.8%.

The bank reported an estimated impact of the recently agreed Basel III rules (commonly referred to as Basel IV) of 30%-35% of increase in risk-weighted assets (RWA). Overall, these results are in line with our expectations and are credit neutral for bondholders.

Negative loan loss provisions and lower exceptional charges compensate still high operating expenses

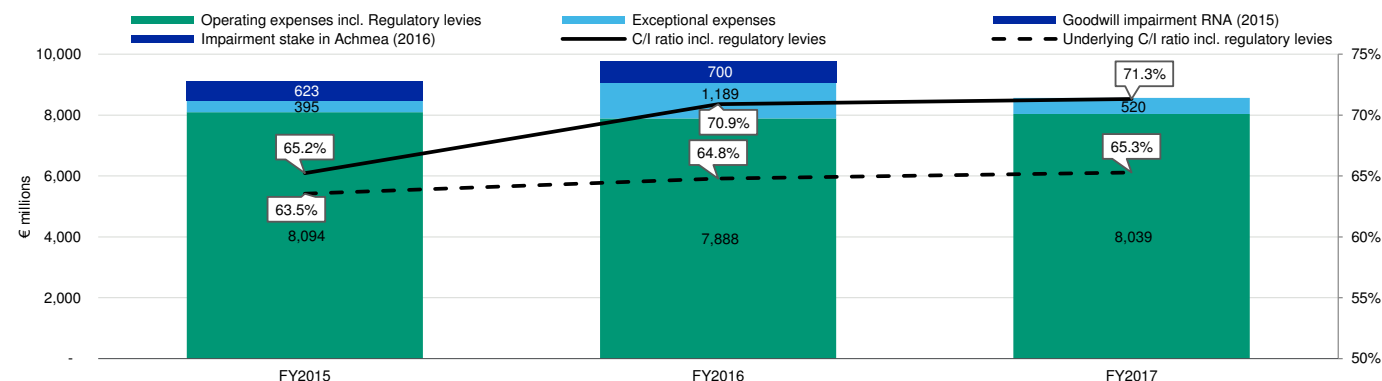
Despite higher fees and commissions, net banking income declined to €12,001 million (–6.3%) in 2017 due to negative fair value items and the fact that 2016 revenues were boosted by the presence of Athlon and the exceptional gains from the sale of this subsidiary. Net interest income was broadly stable at €8,843 million, supported by increasing net interest margins² that mitigated the effects of a shrinkage in the private-sector loan portfolio. The private-sector loan portfolio decreased by 3.3% due to foreign currency movements and the sale of parts of the residential mortgage and commercial real estate portfolios, as well as early repayments on mortgages. Despite the reduction of its mortgage loan portfolio and the repricing of new lending, Rabobank's market shares in the domestic mortgage sector progressed to 22% from 21% in 2016, attesting the bank's robust lending franchise in the Netherlands.

Operating expenses declined by –6% to €8,054 million, owing to lower exceptional items (such as restructuring costs and provisions for interest rate derivatives compensation) and a fall of 2% in staff costs. However, underlying operating expenses increased by 2% driven by higher pension guarantees costs and project expenses related to regulatory alignment. The efficiency of the bank further deteriorated in 2017, as reflected by the underlying cost-to-income ratio that increased to 65.3% (including regulatory levies, 2016: 64.8%, 2015: 63.5%). The ratio is still far away from the bank's internal target of 53%-54% for 2020.

Exhibit 1

Rabobank's cost-to-income ratios are still far from the bank's 2020 internal target of 53%-54%

Operating expenses (€ million; LHS) and cost-to-income ratio (%; RHS)



Source: Company reports

Credit costs were negative with a net release of -€190 million (or -5 basis points of average loan portfolio; 2016: €310 million or 7 bps), mainly provision releases in the sectors that have previously experienced a downturn, such as transport and commercial real estate. The residential mortgage portfolio also registered no loan loss provisions in 2017, illustrating the prolonged recovery of both the Dutch economy and the housing market.

Rabobank's capital position further strengthened as reflected by the fully loaded CET1 ratio of 15.5% at the end of December 2017 (13.5% the previous year), owing to a 6% decrease in the bank's risk-weighted assets (RWAs) and a €1.6 billion certificate issuance in January 2017. The bank largely complies with the minimum CET1 requirement of 10.375% for 2018, which is made up of 8.125% of capital requirement imposed by the European Central Bank through the Supervisory Review and Evaluation Process (SREP) and 2.25% of systemic risk buffer imposed by the Dutch central bank.

The bank estimated a significant impact of Basel IV (please also see [Basel Committee's agreement on risk weights is credit positive](#)) that would amount in a 30%-35% increase in RWAs ³. Considering Rabobank's strong capitalization and the time frame for the implementation of the new rules (up to 2027 for the full output floor), we expect the impact to be manageable for the bank. Regarding the implementation of IFRS 9, the bank indicated an expected negative impact of 15 bps on the CET1 capital, mainly driven by the adoption of new classification and measurement rules. This impact, which we consider as small, is net of the pre-existing regulatory deduction due to Expected Loss shortfall.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Endnotes

- [1](#) The ratings shown are the long-term deposit and senior unsecured debt ratings, their outlook and the bank's baseline credit assessment (BCA).
- [2](#) Average net interest margins increased to 1.39% from 1.30% in 2016, mainly owing to positive accounting effects from the decrease in size of derivatives in the balance sheet. However, underlying margins still increased slightly due to the repricing in mortgage and SME lending and robust commercial margins in the Wholesale, Rural & Retail (WRR) business that offset the costs of customer deposits and the high liquidity buffer.
- [3](#) This is an initial estimation based on pro forma calculations and a balance sheet at the end of December 2017. The estimation does not take into account future developments, such as management actions and other potential regulatory adjustments.

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