

ING Groep N.V. (INGA NA)

Better Visibility Ahead?

Key Takeaway

We maintain a Buy rating as we expect positive triggers in Q4 results due to the Belgium integration, then further positive jaw effects in most activities by 2019. The early investments in digital banking made ING the most advanced leader, in our view. ING trades on 7.8x 2019E earnings or 0.9x 2019E PTNAV with an 11.3% 2020 RoTE, a 2.4% discount to the European average.

ING is one of the worst performers within European banks: YTD, it is down 25% and has underperformed the sector by 12.4% due to a number of factors: (1) delays in the expected crystallization of cost savings in domestic retail; (2) the expected earnings hit from a litigation fine due to issues with its client onboarding process; and (3) the group's exposure to Turkey. We think this is all priced in and, going forward, Q2 results and the legal settlement should bring better visibility on the group's earnings dynamic.

On the Q2 call, management was clear on cost synergies and time horizons. In Belgium, improvements are expected by Q4-18 with positive jaws to be delivered in most activities by 2019. Although the cost trajectory differs, the costs should increase in G&C to support revenue growth. In wholesale, if profitability increases, the front office costs could grow but should be offset by savings from further digitalisation.

On the litigation side, the €775m bill is higher than expected, but no cost increase is expected as regulatory cost is already factored in. The fine is a post-tax item for Q3-18, with a 24bp impact on CET1. In terms of dividend, the group stated that it will stick to its policy of provisioning for one-third of the previous dividend per quarter and, overall, it aims to increase the dividend gradually. We estimate management could keep the dividend flat at €0.67 (62% payout), slightly below consensus at €0.68 for 2018.

ING's exposure to Turkey is €15bn; €10bn is the balance sheet of the local subsidiary and the rest is from wholesale banking and treasury activities. The Turkish subsidiary accounted for 4% of 2017 group profits. In case of default or forced departure, ING Turkey's equity of €951m and €3.5bn of inter-group funding accounts for 9% of the group's TNAV and implies a capital hit of c.110bps. For details of the Turkish local operations of banks in our coverage, see our recent "[Turkey comes home to roost](#)" note.

We upgrade our underlying NI forecasts by 3.1% for 2018, 2.4% for 2019 and 2020 is broadly unchanged. Post the litigation cost of €775m, our 2018E net income is actually down -12.3%. We are -1.4% below consensus for 2018, and +12.8% & +20.5% ahead in 2019 & 2020. **PT maintained at €19.2 offering 66% potential upside.**

EUR	Prev.	2017A	Prev.	2018E	Prev.	2019E	Prev.	2020E
Rev. (MM)	--	17,704.0	17,829.0	17,877.0	18,735.0	19,047.0	20,455.0	20,550.0
Dividend	--	0.67	0.68	0.67	0.81	0.83	--	0.97
Div. Yield		5.73%		5.73%		7.10%		8.30%

EPS	Prev.	2017A	Prev.	2018E	Prev.	2019E	Prev.	2020E
FY Dec	--	1.22	1.24	1.09	1.45	1.49	1.68	1.67
FY P/E		9.6x		10.7x		7.8x		7.0x

Rev: Bank only

BUY

Price target €19.20

Price €11.69^

Financial Summary

Net Debt (MM): €0.0

Market Data

52 Week Range: €16.69 - €11.60

Total Entprs. Value: €45.4B

Market Cap.: €45.4B

Shares Out. (MM): 3,885.0

Float (MM): 3,891.2

Avg. Daily Vol.: 14,921,070

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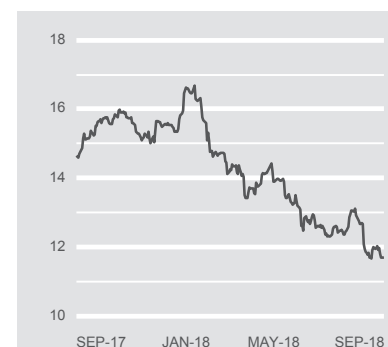
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Price Performance



^Prior trading day's closing price unless otherwise noted.

Scenarios**Base Case**

- 2020E EPS €1.67 with 11% CAGR 2017E/2020E
- Growth breakdown: Retail 10%, Wholesale 8.7%, CC-5.5%, Group 10.4%
- 2020E underlying C/I ratio 51.5%
- 2020E Dividend €0.97 assuming a 58% payout ratio
- 2020E group RoTE 12.1%
- 2020E Retail RoE 20%, Wholesale 12%
- 2020E CET1 ratio = 14%
- 2020E RWA €364bn
- Price target = €17.4 by 2019, 51% upside

Weighted PT in 12 months: €19.2, 66% upside

(10% Bear case, 50% Base case, 40% Bull case)

Bull Case

- 2020E EPS €2.56 with 28% CAGR
- Growth breakdown: Retail 24.7%, Wholesale 25.9%, CC-6.9%, Group 26.9%
- 2020E underlying C/I ratio 43.5%
- 2020E Dividend €1.48 assuming a 58% payout ratio
- 2020E group RoTE 17.6%
- 2020E Retail RoE 29.6%, Wholesale 15.9%
- 2020E CET1 ratio = 13.7%
- 2020E RWA €391bn
- Price target = €23.4 by 2019, 103% upside

Bear Case

- 2020E adj EPS €1.28 with 1.6% CAGR
- 2020E underlying C/I ratio 53.6%
- 2020E Dividend €0.74 assuming a 58% payout ratio
- 2020E group RoTE 9.6%
- 2020E Retail RoE 14.4%, Wholesale 8.5%
- 2020E CET1 ratio = 12%
- 2020E RWA €394bn
- Price target = €10.8 by 2019, 7% downside

Investment Thesis / Where We Differ

- We expect the digital option to crystalize by 2019 and 2020 with the revenues accelerating on increased cross-buy potential; we also expect a C/I ratio of 48% by 2020; as such we are 12.8% and 20.5% ahead of consensus for 2019 and 2020 on the net income line
- We see a number of capital options ING can utilize post Basel IV clarity: organic growth, a dividend hike and some external growth. With a pro-forma CET1 of 13.9% in Q2-18 and an optimal cap of 14% by 2020, we have a payout to 58% by 2020 as we see no large distribution due to regulatory and public opinion pressures

Catalysts

- Progress with the investment program achieving cost synergies
- Q3 results – 1 November

Long Term Analysis**Long Term Financial Model Drivers**

B3 CET1 Ratio (2020e)	14%
Adjusted Revenue Growth (2017E-2020e)	5.3%
Adjusted Cost Income Ratio (2020e)	51.5%
Loan Growth (2017E-2020e)	3.6%

ING P&L

Table 1: ING – P&L, data per share and key financial ratios

ING Summary	2015	2016	2017	2018E	2019E	2020E
Condensed P&L (€m)						
Total income	16,552	17,458	17,706	17,877	19,047	20,550
ow Domestic retail activities	6,949	7,010	6,942	6,796	7,114	7,589
ow Others retail activities	4,318	4,782	4,919	5,280	5,813	6,410
ow Wholesale activities	5,570	5,608	5,923	5,756	6,109	6,534
ow Corporate Line	- 285	59	- 78	65	11	17
- Clean Revenues	16,401	17,345	17,622	17,857	19,047	20,550
Operating expenses	- 9,246	- 9,456	- 9,829	- 9,969	- 9,705	- 9,967
Gross operating income	7,306	8,002	7,877	7,907	9,341	10,583
Cost of risk	- 1,347	- 974	- 678	- 674	- 1,021	- 1,425
Operating income	5,959	7,029	7,198	7,233	8,320	9,158
Others non-operating items	0	0	0	0	0	0
Pre-tax income	5,959	7,029	7,198	7,233	8,320	9,158
- Clean pre-tax income	6,428	7,859	8,160	8,246	8,852	9,573
NET INCOME	4,529	4,177	4,957	4,364	5,971	6,675
Hybrid costs	- 90	- 135	- 170	- 185	- 185	- 185
Non-Bank contribution	- 520	475	- 52	33	-	-
ING GROUP NET INCOME	3,919	4,517	4,735	4,212	5,786	6,490
- ING Group Net income Clean	4,136	4,966	5,098	5,017	5,453	6,030
GROUP Data per share						
Stated EPS (EUR)	1.01	1.17	1.22	1.09	1.49	1.67
Clean EPS (EUR)	1.07	1.28	1.31	1.29	1.40	1.55
Net DPS (EUR)	0.65	0.66	0.67	0.67	0.83	0.97
Pay-out ratio	64%	57%	55%	62%	56%	58%
Dividend Yield	6.4%	4.9%	4.4%	5.8%	7.2%	8.4%
BVPS (EUR)	12.4	12.9	13.0	13.1	13.8	14.6
TBVPs (EUR)	12.0	12.5	12.6	12.6	13.4	14.2
GROUP Equity						
Stated RoE	8.0%	9.3%	9.5%	8.3%	11.1%	11.8%
Clean RoE	8.4%	10.2%	10.2%	9.9%	10.5%	10.9%
Stated RoTE	8.4%	9.6%	9.8%	8.6%	11.5%	12.1%
Clean RoTE	8.9%	10.5%	10.5%	10.3%	10.8%	11.3%
GROUP Capital & Solvency (€ bn)						
CET1 capital FL B3	40.8	44.6	45.6	45.5	48.1	50.8
CET1 ratio FL B3	13.0%	14.2%	14.7%	14.1%	14.0%	14.0%
FL B3 RWAs	313.8	314.3	309.9	322.4	343.1	364.3
Tier 1 FL B3 Capital	47.4	52.3	50.7	50.9	53.4	56.1
Tier 1 FL B3 ratio	15.1%	16.6%	16.4%	15.8%	15.6%	15.4%
Capital Rotation (Rev./CET 1 Cap)	40.6%	39.2%	38.9%	39.2%	39.6%	40.4%
Group Key financial ratios						
Stated Revenues/average assets	1.83%	1.92%	2.05%	2.09%	2.16%	2.25%
Clean Revenues/average Assets	1.81%	1.90%	2.04%	2.09%	2.16%	2.25%
Stated Revenues/average RWA	5.28%	5.52%	5.71%	5.65%	5.72%	5.81%
Clean Revenues/average RWA	5.23%	5.49%	5.68%	5.65%	5.72%	5.81%
Stated Cost/Income	55.9%	54.2%	55.5%	55.8%	51.0%	48.5%
Clean Cost/Income	56.4%	54.0%	55.0%	55.5%	53.5%	51.5%
Stated LLP/avg loans	0.25%	0.18%	0.12%	0.12%	0.17%	0.23%
Stated LLP/avg RWA	0.43%	0.31%	0.22%	0.21%	0.31%	0.40%
Loss absorption ratio vs Avg loans	1.73%	1.72%	1.73%	1.71%	1.60%	1.57%
NII/average assets	1.47%	1.53%	1.58%	1.61%	1.68%	1.75%
Group Key balance sheet items (€bn)						
Loans and receivables due from customers	537	564	575	594	621	645
Intangibles	1.6	1.5	1.5	1.8	1.8	1.8
TOTAL ASSETS	842	1,042	846	864	898	930
Due to customers	509	523	540	556	556	556
Total minority interests	0.6	0.6	0.7	0.7	0.7	0.7

Table 1: ING – P&L, data per share and key financial ratios

ING Summary	2015	2016	2017	2018E	2019E	2020E
Ordinary shareholders' equity	47.8	49.8	50.4	50.7	53.6	56.7
Asset Quality						
NPL's / gross total loans (ex repos)	3%	2%	2%	2%	2%	2%
Coverage Ratio	38%	40%	40%	39%	39%	39%
GROUP Free cash flow (€bn)						
Gross free cash flow	2.3	4.4	5.3	2.7	3.4	4.0
Gross free cash flow / RWAs	0.7%	1.4%	1.7%	0.8%	1.0%	1.1%
Net free cash flow	- 0.2	1.9	2.7	0.1	0.1	0.2
Net free cash flow / RWAs	-0.1%	0.6%	0.9%	0.0%	0.0%	0.1%
Growth YoY (%)						
Revenues	8%	5%	1%	1%	7%	8%
Costs	3%	2%	4%	1%	-3%	3%
Gross Operating profit	16%	10%	-2%	0%	18%	13%
Provisions	-15%	-28%	-30%	-1%	51%	40%
Operating profit	26%	18%	2%	0%	15%	10%
Pre-tax profit	26%	18%	2%	0%	15%	10%
Bank Net Income	74%	-8%	19%	-12%	37%	12%
Group Net income	213%	15%	5%	-11%	37%	12%
Customer loans						
Total Assets	-15.2%	23.7%	-18.8%	2.1%	3.9%	3.6%
Due to customers	4.0%	2.8%	3.2%	3.0%	0.0%	0.0%
CET1 capital FL B3	27.5%	9.3%	2.2%	0.0%	5.6%	5.7%
FL B3 RWAs	4.3%	0.2%	-1.4%	4.0%	6.4%	6.2%
EPS	211.7%	14.9%	4.7%	-11.1%	37.2%	12.2%
DPS	441.7%	1.5%	1.5%	0.4%	24.0%	16.2%
TNAV per share	-1.1%	4.0%	0.8%	0.5%	5.9%	5.9%

Source: Jefferies estimates, company data

ING P&L Changes

Table 2: ING forecast changes

	Current JEF forecast (€m)			Changes from previous forecast (%)			JEF vs consensus (%)		
	2018	2019	2020	2018	2019	2020	2018	2019	2020
Total income	17,877	19,047	20,550	0.3%	1.7%	0.5%	-0.3%	3.0%	7.4%
Operating expenses	- 9,969	- 9,705	- 9,967	-0.7%	0.0%	1.3%	0.3%	-2.9%	-0.9%
Gross operating income	7,907	9,341	10,583	1.5%	3.4%	-0.3%	-1.0%	11.2%	16.4%
Cost of risk	- 674	- 1,021	- 1,425	-7.6%	13.5%	1.6%	4.4%	-2.4%	10.4%
Profit before tax	7,233	8,320	9,158	2.4%	2.3%	-0.6%	-9.4%	-1.0%	0.7%
Taxation	- 2,008	- 2,255	- 2,374	2.0%	2.3%	-0.6%	1.5%	17.4%	18.5%
Minority interests	- 86	- 94	- 109	10.3%	-2.5%	-11.7%	-10.4%	-1.4%	8.7%
Net result	4,397	5,971	6,675	-12.3%	2.4%	-0.4%	-1.4%	12.8%	20.5%

Source: Jefferies estimates

Company Description

ING Groep N.V.

ING Bank N.V. provides various banking services in the Netherlands, Belgium, Rest of Europe, North America, Latin America, Asia, and Australia. The company operates through Retail Netherlands, Retail Belgium, Retail Germany, Retail Other, and Wholesale Banking segments. It accepts current and savings accounts; and offers business lending, mortgage, and other consumer lending products. The company also provides payments and cash management, corporate finance, real estate, leasing, factoring, and treasury services, as well as equity and debt capital market solutions. It serves individuals, small and medium-sized enterprises, mid-corporates, financial institutions, governments, and supranational bodies. The company was incorporated in 1927 and is headquartered in Amsterdam, the Netherlands. ING Bank N.V. is a subsidiary of ING Groep N.V.

Company Valuation/Risks

ING Groep N.V.

We applied several valuation methodologies - P/E, P/TBV (Gordons Growth), P/PPP and sum of the parts. The valuation blend is based on a mix of Bull (40%), Bear (10%) & Base (50%) scenarios. No structural discount or premium applied. Risks: a slower implementation of the plan than expected, which would delay the cost synergies, litigation risks and slower European macro.

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Investment Recommendation Record

(Article 3(1)e and Article 7 of MAR)

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Recommendation Published
Recommendation Distributed

September 4, 2018 , 07:49 ET.
September 4, 2018 , 07:49 ET.

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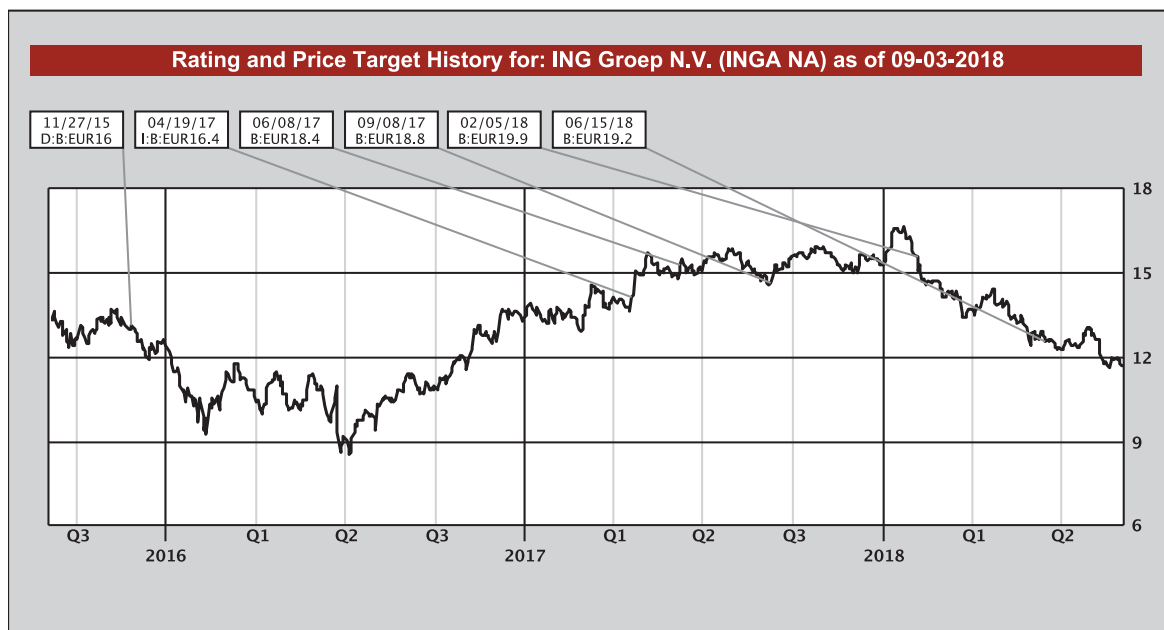
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Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

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			Count	Percent	Count	Percent
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