**COMPANY NOTE**

Target | Estimate Change

Netherlands | Financials | Banks

5 February 2018

Jefferies

# ING Groep N.V. (INGA NA)

## Pump Up Dividend

**Key Takeaway**

**ING is one of our favorite names in the European banking sector as it offers good earnings growth and visibility, a solid solvency base with some good options for capital use and trades with a 13% to 20% discount to Eurozone banks. We upgrade our PT from €18.8 to €19.9 post adjusting our earnings forecast after Q4 results.**

**We expect 11.7% EPS CAGR in the next 3 years, which is mainly driven by retail activities.** We forecast that 61% of ING's growth will come from retail activities, of which 43% from Growth and Challengers markets. Based on new estimates, we are 2% ahead consensus for 2018, 11% for 2019 and 14.5% for 2020. We remain convinced that ING is one of the best ways to play the "digital revolution" in the banking sector and offers a good option to play the macro-economic rebound of the Eurozone.

Post management first guidance on Basel IV impacts, ING still retains a robust solvency base, which could open the door to further optimization. **Management is due to update the market by Q1-2018 results, 9th May, on its 2020 RoTE target and we expect a new target in the range of 12% on the back of group's earnings capability and some higher capital redistribution.** Despite the most likely increase of group's RWA density, due to the implementation of Basel IV, we believe management should be able to stabilize its CET 1 ratio at 14%, implying c. 150bps management buffer, allowing them to increase the pay-out ratio. We have assumed a payout increase from 54% in 2017 to 60% over the next 3 years.

**Valuation/Risks**

ING trades on a 13.5% discount on its 2017 P/TNAV and 20% on 2018E earnings vs the Eurozone average. It trades on 1.3x 2017 TNAV with a 12% 2020 RoTE and 10.4x of 2018 earnings. We believe that the discount isn't justifiable due to the group's sound earnings base and its options for capital optimization. Today, ING offers a 4.3% dividend yield in 2017, slightly below the average of its French and Benelux peers; however, with our forecasted pay-out increase by 2020, it will bring ING's yield above the French and Benelux average. PT of €19.9 is on a blended basis of Bull 40%, Bear 10% and Base 50% scenarios.

**Risks**: 1) Delays in the implementation of group digital strategy; €800m of investments for €900m of synergies by 2021, 2) A cyber-attack blocking ING's systems would challenge group's digital skills 3) ING wholesale bank is largely exposed to the energy sector and any corrections will penalize group's equity story despite its good track record in risk management.

| EUR | *Prev.* | 2017E | *Prev.* | 2018E | *Prev.* | 2019E | *Prev.* | 2020E |
|---|---|---|---|---|---|---|---|---|
| Rev. (MM) | *17,611.0* | 17,706.0 | *18,716.0* | 18,633.0 | *19,797.0* | 19,952.0 | *221,123.0* | 21,620.0 |
| **EPS** | | | | | | | | |
| FY Dec | *1.24* | 1.23 | *1.34* | 1.31 | *1.50* | 1.53 | *1.64* | 1.70 |
| FY P/E | | 12.7x | | 12.0x | | 10.2x | | 9.2x |

Rev: Bank only

**BUY**
Price target €19.90
(from €18.80)
Price €15.66^

| **Financial Summary** | |
|---|---|
| Net Debt (MM): | €0.0 |

| **Market Data** | |
|---|---|
| 52 Week Range: | €16.69 - €12.81 |
| Total Entprs. Value (MM): | €60,839.1 |
| Market Cap. (MM): | €60,839.1 |
| Shares Out. (MM): | 3,885.0 |
| Float (MM): | 3,885.4 |
| Avg. Daily Vol.: | 14,571,030 |


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**Price Performance**


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

EQUITY RESEARCH EUROPE

ING Group

# BUY: €19.9p Price Target in 12 months



## Scenarios

**Base Case**

- 2020E adj EPS €1.75 with 5.6% CAGR 2017E/2020E
- Growth breakdown: Retail 10%, Wholesale 9%, CC-15.1%, Group 11%
- 2020E C/I ratio 48%
- 2020E Dividend €1.02 assuming a 60% payout ratio
- 2020E group RoTE 12%,
- 2020E Retail RoE 19.6%, Wholesale 11.4%
- 2020E CET1 ratio = 14%
- 2020E RWA €379bn
- Price target = €17.9 by 2019, 13% upside

**Valuation methodology:**

- **Weighted PT in 12 months: €19.9, 27% upside** (10% Bear case, 50% Base case, 40% Bull case)

**Bull Case**

- 2020E adj EPS €2.67 with 22% CAGR,
- Growth breakdown: Retail 24.8%, Wholesale 27.2%, CC-22.4%, Group 28%
- 2020E C/I ratio 42%
- 2020E Dividend €1.58 assuming a 60% payout ratio
- 2020E group RoTE 17.7%,
- 2020E Retail RoE 27.7%, Wholesale 15.4%
- 2020E CET1 ratio = 13.6%
- 2020E RWA €417bn

Price target = €24.7 by 2019, 58% upside

**Bear Case**

- 2020E adj EPS €1.29 with -4.7% CAGR,
- 2020E C/I ratio 51.4%
- 2020E Dividend €0.74 assuming a 60% payout ratio
- 2020E group RoTE 9.1%,
- 2020E Retail RoE 21.6%, Wholesale 9.1%
- 2020E CET1 ratio = 13%,
- 2020E RWA €391bn
- Price target = €10.7 by 2019, 32% 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 11.2% and 14.5% 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 divided hike and some external growth. With a pro-forma CET1 of 12.5% in Q4-17 and an optimal cap of 14% by 2020, we increase the pay-out to 60% by 2020

## Catalysts

- 9th May – Q1 2018 results
- Update on profitability targets, expected with Q1 results
- Litigation update

## Long Term Analysis

**Long Term Financial Model Drivers**

| | |
|---|---|
| **B3 CET1 Ratio (2020e)** | **14%** |
| Adjusted Revenue Growth (2017E-2020e) | **7.1%** |
| Adjusted Cost Income Ratio (2020e) | **46.6%** |
| Loan Growth (2017E-2020e) | **3.8%** |



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# Capital – current status quo

ING's CET1 ratio came to 14.7% in Q4-17, against the fully loaded requirements of 11.8% (ex P2G), with a dividend of €0.67 per share setting the 2017 dividend yield at 4.3% with a pay-out ratio of 54%. The 2017 dividend reflects, according to management, the 'considerations on regulatory developments and growth opportunities' with updated profitability targets to be delivered in H1-2018.

Basel IV impact 15%-18% of 2027 RWAs, means a pro-forma CET1 of 12.5%

So first of all, ING quantified the impact of Basel IV in the range of 15%-18% of RWAs by 2027 on the current balance sheet without any mitigation actions. So if we assume some inflation of current RWAs, we estimate the impact at c. 190-225bps. This implies the worst case pro-forma CET1 at 12.5% against the requirement of 11.8%, leaving ING just enough space to meet the Pillar 2 guidance (not disclosed but we assume c. 0.75bps). The Basel IV impact should come 1/3 from the retail portfolios (NL and Belgium mortgages) and 2/3 from the wholesale activities (lending to corporates and financial institutions mainly and to some extend structured finance).

Basel IV front loading ahead of Basel timelines

Upside to this 190-225bps hit is that 1) we expect ING to take actions to mitigate the impact, and 2) as we wrote in our recent ABN AMRO initiation report (What's Next? Initiate at Hold), we believe there will be further watering down of the standards during the EC transposition period. However, in the absence of being able to quantify the impact of both actions, since our ING initiation in April 2017 (Digital Option, Initiating with a Buy), we have gradually been increasing the RWAs in anticipation of Basel IV and other regulatory actions, such as TRIM. The loan density sees increase from 54% in 2017 to 59% by 2020 and in the same period we predict organic loan growth of 3.8%, whilst c. 3% growth in RWAs comes from the front-running of Basel IV.

**Table 1: RWAs development 2017-2020**

| GROUP | 2017 | 2018E | 2019E | 2020E | CAGR 17-20 |
|---|---|---|---|---|---|
| Group Loans | 574.2 | 593.7 | 617.3 | 641.4 | **3.8%** |
| Loan growth | 2.4% | 3.4% | 4.0% | 3.9% | |
| Group RWAs | 309.9 | 335.7 | 356.6 | 378.6 | **6.9%** |
| RWA growth | -0.7% | 8.3% | 6.2% | 6.2% | |
| Loan density | 54.0% | 56.5% | 57.8% | 59.0% | |
| | | | | | |
| **NL retail** | | | | | |
| Loans | 150.0 | 148.0 | 148.7 | 150.6 | **-0.8%** |
| RWAS | 48.2 | 47.4 | 48.3 | 48.9 | **-0.1%** |
| Density | 32.2% | 32.0% | 32.5% | 32.5% | |
| | | | | | |
| **Belgium retail** | | | | | |
| Loans | 81.5 | 84.2 | 86.3 | 88.1 | **3.5%** |
| RWAS | 35.1 | 37.4 | 38.5 | 39.5 | **3.7%** |
| Density | 43.1% | 44.4% | 44.6% | 44.9% | |
| | | | | | |
| **C&G retail** | | | | | |
| Loans | 167.7 | 176.3 | 184.9 | 193.6 | **5.3%** |
| RWAS | 74.3 | 88.9 | 95.3 | 102.3 | **8.9%** |
| Density | 44.3% | 50.4% | 51.5% | 52.8% | |
| | | | | | |
| **Industry lending** | | | | | |
| loans | 113.2 | 117.7 | 124.2 | 130.4 | **3.3%** |
| RWAS | 69.3 | 72.2 | 77.0 | 81.5 | **3.9%** |
| Density | 61.2% | 61.3% | 62.0% | 62.5% | |
| | | | | | |
| **General lending** | | | | | |
| loans | 53.1 | 59.5 | 65.4 | 71.3 | **11.0%** |
| RWAS | 48.0 | 53.5 | 60.2 | 67.7 | **10.4%** |
| Density | 90.4% | 90.0% | 92.0% | 95.0% | |

Source: Jefferies estimates, company data

Aside from Basel IV, ING will also need to meet TLAC and MREL requirements, which will impact the future capital and debt structure of ING. Back in December, ING already disclosed the impact of the EBA interpretation on the eligibility of instruments issued from subsidiaries counting towards the consolidated capital for resolution purposes. The



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impact on total capital comes to c. 90bps; however, this will mainly disappear as ING will issue new capital instruments from the holding company. This actually present ING the opportunity to optimise its capital structure considering ING's T2 stack is at 2.8% well-above the requirement of 2%, plus other sub debt which is not CRR compliant. In 2018, €4.9bn (63% of which is CRR compliant) of subordinate debt issued by the bank can be re-issued by the holding company, either via capital compliant T2 debt or senior debt, which will be structurally subordinated. There are also some saving opportunities when it comes to maturing of c. €10bn senior debt, which ING will need to replace. In total, we expect potential savings of around €150-€160m on the NII line, which is c. 1.1% of the 2017 NII.

# Capital – Next Steps

Post the Basel IV clarification, we expect management to update the targets with Q1-18 results, 9th May, where we should have new RoTE targets for the next 3 years. In our view, management should aim for a 12% RoTE by 2021. To get there, management will have to optimize its capital base looking at it via multiple lenses. First, organic growth, then RWAs inflation caused by Basel IV and other regulatory actions, third a revision of capital distributing, and lastly but not least some potential external growth.

First, on organic growth, we expect a 3.8% CAGR loan growth over the next 3 years, with retail loan book up by 2.7% and wholesale book up by 6%. The higher growth from corporate activities is expected from the rebound of the European activities, whilst on the retail side most of markets have had seen strong origination volumes driven by low rates in the past 3 years, except for Netherlands. Indeed, in its domestic market, management aims for a further reduction of its mortgage exposure in favour of SME and consumer credit activities; both these activities have  better margins, better balance sheet rotation and hence the ability to benefit from earlier interest rates increases.

Second, we have assumed a 6.9% CAGR RWAs inflation compared to a 3.8% CAGR loans, as we believe management will be gradually implementing Basel IV and other regulatory actions (TRIM). Consequently, we forecast that loan density against RWAs will move from 54% in 2017 to 59% in 2020.

Third, ING's solvency base is rich enough to support a higher distribution policy. Despite our generous growth assumptions on loans and RWA, we believe management can raise it pay-out guidance to 60%. In our view, management will like to keep c. a 150bp capital buffer, which means a 14% maximum CET 1 ratio. Based on this assumption and without some large external growth, ING should be able to increase its pay-out ratio to 60% over the next 3 years. Such move would re-enforce group's equity story, supported by a mix of good earnings growth and a high dividend yield. Based on our 2020 forecast with a 60% pay-out ratio, ING could pay a €1 dividend, i.e. a 6.4% dividend yield, which will position ING in the first quartile of the European banks.

Lastly, in terms of external growth, the group should focus on investing in some "fintechs" in addition to their organic investments. Nevertheless, with Q4-17, management highlighted some potential interests to re-enforce their skills in some financing activities such as consumer credit or SME lending to reduce their exposure to mortgages.


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# Recap of Q4 results

Q4 results dragged downy by higher opex, which in our view should have been anticipated, solid underlying results otherwise.

In our view, ING delivered solid underlying results although the opex was higher than expected by consensus, which meant net income was 14% below the street expectations. The high level of opex came as no surprise to us as the group cautioned about the higher regulatory cost in Q4-17 as Q4-16 saw refunds from its German operations and as such Q4-17 was a mere normalisation, and the catch up in the investment cost, which was somewhat delayed, including other year end cost. A total of €206m of investment cost was booked in 2016 with another €450m to be booked by 2021. We expect a heavy part of the investment to come in 2018, but we also expect to see the benefits of savings to be visible in late 2018, before benefits fully crystallise in 2019 and 2020.

Loan growth was strong across all divisions except for NL where mortgages continued to decline and growth for other lending was just a seasonal effect on a YoY basis. Loan growth in Belgium has been strong for the past two years and has helped to offset some of the NIM pressure, whilst in Growth and Challengers (C&G) retail we saw the impact of fast growing strategy with improving margins. Overall, NII was up by 5.1% YoY and although it was supported by hedging effects, the NIM ended at 158 vs 152 in Q4-16. Management mentioned on the call that this positive hedging impact should minimise going forward. Fee Income was up by 10% YoY, in line with ING's plan to diversify its revenues stream; fee growth comes from all division with wholesale contribution being particularly strong. The fee strategy in retail is supported by progressing the investment product range, with ING now offering investment products in all 13 ING retail countries and the online offering plays a major role with this product line.

Most of the divisions beat consensus except for Other retail in Growth and Challengers and Financial markets. The weakness in Other retail comes from aforementioned higher cost (staff, marketing and investment cots); but in our view this is to be expected considering that the total lending was up by 8.5% in 2017 vs 2016, which is reflected in revenue growth of 10% YoY in 2017. Overall, C&G markets is where the primary customers grow the most, in Q4 they attracted 281k new customers (94% of all new primary customers in Q4). Financial markets were impacted by lower market volatility and delivered a negative PBT of €99m, but this division only accounts for 1.1% of the group PBT in 2017.

All in all, probably the most exciting part of the Q4 results was an update on the impact of Basel IV and promise of an update on profitability targets by H1-2018.



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# Where is growth coming from?

**So factoring what we learned in Q4, where are we going to move by 2020 from 2017?** We forecast revenue CAGR of 6.9% whilst opex growth to be at 1.9% only, delivering a C/I ratio of 48% by 2020 from 55.5% in 2017. Cost of risk will normalise at CAGR rate of 41%, delivering PBT growth of 9%. The group tax rate should go down from current 30% to 26.5% by 2020, which helps to deliver net income CAGR of 11% between 2017 – 2020. The growth is fairly balanced between divisions with 10% CAGR in retail activities and 9% in wholesale. The corporate line CAGR is negative by 15%. In terms of contribution to the growth, retail brings 61% and wholesale 31.4%, whilst the CC contributed with 7.6%. In terms of net income breakdown in 2020, retail brings 66% of the net income and 37% comes from wholesale. Looking at the picture per divisions we expect the following:

## Retail banking

In our initiation report we called for CAGR 2016-2020 of 4.2% with 1.5% coming from Orange bank and 7.6% from Growth and Challengers. Just short of a year, we have moved to retail banking CAGR 2017 -2020 of 10% with 4.5% from Orange bank and 18.8% from C&G.

**Orange bank** – we expect the NIM to continue to be under pressure in 2018 before picking up again in 2019 and 2020. Especially in Belgium, where 2017 was hard as there was nowhere to hide from the low interest environment after hitting the deposit rate floor, although on the positive side the low rates have supported strong loan growth, which somewhat helped to offset the pressure. However, income should be supported by stronger fee income, which is up by 5.8%. Progressing with the digitalisation plan means that opex is actually down by 0.6%, mainly driven by Belgium post the restructuring, delivering a C/I ratio of 48% by 2020. After normalisation of cost of risk, we still expect CAGR of 2.7% for the Orange bank and a RoE of 23.3% in 2020.

**Growth & challengers** – Revenue CAGR is at 12% with core strength in both NII and fee lines, supported not only by rate improvements but also good lending volumes. Opex is up by 5.7% as synergies are partially offset by strong growth translating into cost expansion (marketing, staff and application replications across different markets). With strong loan volume growth (4.9%) we expect CoR to increase to 35bps in 2020 from 17bps in 2017. Pre-tax CAGR is 17.7% and a 2020 RoE is 16.3%.

## Wholesale banking

We forecast net income CAGR of 9%, with 65% of net income to come from Industry lending and 32% from General lending. Aggregating these two divisions, we expect good revenue growth of 8% coming from both NII and Fees. With opex growing at 4.5%, the operating income growth comes to 9.9% and with CoR coming to 30bps, the PBT growth between 2017 and 2020 is 6%. 2020 ROE comes to13.6%.

## Corporate Centre

By 2020, the PBT comes to negative €134m compared to negative €369m in 2017 as we expect improvements on the funding side following debt restructuring.



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### Table 2: ING P&L CAGR 2017-2020

| 2017 | Total retail | Orange bank | *Netherlands* | *Belgium* | Growth&Challengers | *Germany Welcome* | *Model-bank* | Wholesale Markets | Industry & General | *Industry* | *General* | Financial Markets | Treasury | Operating divisions | corporate line | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Total income** | **11,862** | **6,942** | ***4,469*** | ***2,474*** | **4,919** | ***1,892*** | ***3,027*** | **5,923** | **4,419** | ***2,836*** | ***1,583*** | **1,086** | **418** | **17,785** | **- 78** | **17,706** |
| Operating expenses | - 6,747 | - 3,795 | *- 2,212* | *- 1,584* | - 2,951 | *- 1,032* | *- 1,919* | - 2,792 | - 1,543 | *- 728* | *- 815* | - 1,003 | - 246 | - 9,539 | - 290 | - 9,829 |
| **Gross operating income** | **5,115** | **3,147** | ***2,257*** | ***890*** | **1,968** | ***860*** | ***1,108*** | **3,131** | **2,877** | ***2,108*** | ***768*** | **82** | **172** | **8,246** | **- 368** | **7,877** |
| Cost of risk | - 391 | - 117 | *- 13* | *- 104* | - 274 | *10* | *- 284* | - 287 | - 160 | *- 143* | *- 17* | - 2 | - 125 | - 678 | - 1 | - 678 |
| **Operating income** | **4,724** | **3,030** | ***2,244*** | ***786*** | **1,694** | ***870*** | ***824*** | **2,844** | **2,717** | ***1,966*** | ***751*** | **80** | **47** | **7,568** | **- 369** | **7,199** |
| Taxation | - 1,292 | - 861 | *- 566* | *- 296* | - 430 | *- 241* | *- 189* | - 880 | - 740 | *- 537* | *- 202* | - 18 | - 122 | - 2,172 | 13 | - 2,159 |
| Minority interests | - 68 | 2 | *-* | *2* | - 70 | *- 3* | *- 67* | - 15 | - 12 | *- 6* | *- 7* | - 4 | 2 | - 83 | - | - 83 |
| **Net results** | **3,364** | **2,170** | ***1,678*** | ***491*** | **1,194** | ***626*** | ***568*** | **1,949** | **1,965** | ***1,422*** | ***543*** | **58** | **- 73** | **5,313** | **- 356** | **4,957** |
| | | | | | | | | | | | | | | 0 | | |
| **2020** | **Total retail** | **Orange bank** | *Netherlands* | *Belgium* | **Growth&Challengers** | *Germany Welcome* | *Model-bank* | **Wholesale Markets** | **Industry & General** | *Industry* | *General* | **Financial Markets** | **Treasury** | **Operating divisions** | **corporate line** | **Total** |
| **Total income** | **14,556** | **7,645** | ***4,772*** | ***2,872*** | **6,912** | ***2,415*** | ***4,496*** | **6,886** | **5,574** | ***3,439*** | ***2,135*** | **1,041** | **271** | **21,443** | **177** | **21,620** |
| Operating expenses | - 7,216 | - 3,727 | *- 2,229* | *- 1,499* | - 3,488 | *- 1,241* | *- 2,247* | - 2,870 | - 1,758 | *- 780* | *- 978* | - 938 | - 175 | - 10,086 | - 311 | - 10,397 |
| **Gross operating income** | **7,341** | **3,917** | ***2,544*** | ***1,374*** | **3,423** | ***1,174*** | ***2,249*** | **4,016** | **3,816** | ***2,658*** | ***1,158*** | **104** | **96** | **11,357** | **- 134** | **11,223** |
| Cost of risk | - 1,296 | - 636 | *- 374* | *- 262* | - 660 | *- 106* | *- 554* | - 613 | - 578 | *- 509* | *- 68* | - 3 | - 33 | - 1,909 | - | - 1,909 |
| **Operating income** | **6,045** | **3,282** | ***2,170*** | ***1,112*** | **2,763** | ***1,068*** | ***1,695*** | **3,403** | **3,238** | ***2,149*** | ***1,089*** | **100** | **64** | **9,447** | **- 134** | **9,313** |
| Taxation | - 1,462 | - 810 | *- 532* | *- 278* | - 652 | *- 296* | *- 356* | - 876 | - 798 | *- 505* | *- 293* | - 27 | - 51 | - 2,338 | - 84 | - 2,422 |
| Minority interests | - 108 | 3 | *-* | *3* | - 111 | *- 3* | *- 107* | - 6 | - 4 | *- 4* | *-* | - 2 | - | - 114 | - | - 114 |
| **Net results** | **4,475** | **2,475** | ***1,638*** | ***837*** | **2,000** | ***768*** | ***1,232*** | **2,521** | **2,437** | ***1,640*** | ***796*** | **72** | **13** | **6,996** | **- 218** | **6,778** |

Source: Jefferies estimates, company data



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**Table 3: ING P&L CAGR 201-2020**

| Growth | Total retail | Orange bank | Netherlands | Belgium | Growth&Challengers | Germany Welcome | Model-bank | Wholesale Markets | Industry & General | Industry | General | Financial Markets | Treasury | Operating divisions | Corporate line | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Total income** | **7.1%** | **3.3%** | ***2.2%*** | ***5.1%*** | **12.0%** | ***8.5%*** | ***14.1%*** | **5.2%** | **8.0%** | ***6.6%*** | ***10.5%*** | **-1.4%** | **-13.4%** | **6.4%** | **-231.3%** | **6.9%** |
| Operating expenses | 2.3% | -0.6% | *0.3%* | *-1.8%* | 5.7% | *6.3%* | *5.4%* | 0.9% | 4.5% | *2.4%* | *6.3%* | -2.2% | -10.8% | 1.9% | 2.3% | 1.9% |
| **Gross operating income** | **12.8%** | **7.6%** | ***4.1%*** | ***15.6%*** | **20.3%** | ***10.9%*** | ***26.6%*** | **8.7%** | **9.9%** | ***8.0%*** | ***14.6%*** | **8.0%** | **-17.6%** | **11.3%** | **-28.6%** | **12.5%** |
| Cost of risk | 49.1% | 75.8% | *208.6%* | *35.8%* | 34.1% | *-321.4%* | *25.0%* | 28.9% | 53.4% | *52.8%* | *58.5%* | 18.6% | -36.1% | 41.2% | -100.0% | 41.2% |
| **Operating income** | **8.6%** | **2.7%** | ***-1.1%*** | ***12.3%*** | **17.7%** | ***7.1%*** | ***27.2%*** | **6.2%** | **6.0%** | ***3.0%*** | ***13.2%*** | **7.7%** | **10.5%** | **7.7%** | **-28.7%** | **9.0%** |
| Taxation | 4.2% | -2.0% | *-2.1%* | *-2.0%* | 14.9% | *7.1%* | *23.5%* | -0.2% | 2.6% | *-2.1%* | *13.2%* | 13.4% | -25.3% | 2.5% | -285.3% | 3.9% |
| Minority interests | 16.5% | 19.4% | *NA* | *19.4%* | 16.5% | *7.1%* | *16.9%* | -28.0% | -33.1% | *-13.1%* | *-100.0%* | -24.7% | -100.0% | 10.9% | NA | 10.9% |
| **Net results** | **10.0%** | **4.5%** | ***-0.8%*** | ***19.4%*** | **18.8%** | ***7.1%*** | ***29.4%*** | **9.0%** | **7.4%** | ***4.9%*** | ***13.6%*** | **7.6%** | **-155.8%** | **9.6%** | **-15.1%** | **11.0%** |

| Contribution to growth by division (%) | Total retail | Orange bank | Netherlands | Belgium | Growth&Challengers | Germany Welcome | Model-bank | Wholesale Markets | Industry & General | Industry | General | Financial Markets | Treasury | Operating divisions | Corporate ine | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Total income** | **68.9%** | **17.9%** | ***7.8%*** | ***10.2%*** | **50.9%** | ***13.4%*** | ***37.5%*** | **24.6%** | **29.5%** | ***15.4%*** | ***14.1%*** | **-1.1%** | **-3.7%** | **93.5%** | **6.5%** | **100.0%** |
| Operating expenses | 82.5% | -12.0% | *3.0%* | *-15.0%* | 94.5% | *36.8%* | *57.7%* | 13.8% | 37.9% | *9.3%* | *28.6%* | -11.6% | -12.5% | 96.3% | 3.7% | 100.0% |
| **Gross operating income** | **66.5%** | **23.0%** | ***8.6%*** | ***14.5%*** | **43.5%** | ***9.4%*** | ***34.1%*** | **26.5%** | **28.1%** | ***16.4%*** | ***11.6%*** | **0.6%** | **-2.3%** | **93.0%** | **7.0%** | **100.0%** |
| Cost of risk | 73.5% | 42.1% | *29.4%* | *12.8%* | 31.4% | *9.4%* | *22.0%* | 26.5% | 33.9% | *29.8%* | *4.2%* | 0.1% | -7.5% | 100.1% | -0.1% | 100.0% |
| **Operating income** | **62.5%** | **11.9%** | ***-3.5%*** | ***15.4%*** | **50.6%** | ***9.4%*** | ***41.2%*** | **26.4%** | **24.7%** | ***8.7%*** | ***16.0%*** | **0.9%** | **0.8%** | **88.9%** | **11.1%** | **100.0%** |
| Taxation | 64.8% | -19.8% | *-13.0%* | *-6.8%* | 84.6% | *20.9%* | *63.6%* | -1.7% | 22.3% | *-12.3%* | *34.6%* | 3.2% | -27.2% | 63.1% | 36.9% | 100.0% |
| Minority interests | 130.7% | -3.5% | *0.0%* | *-3.5%* | 134.3% | *2.1%* | *132.2%* | -30.7% | -28.0% | *-6.3%* | *-21.7%* | -8.4% | 5.7% | 100.0% | 0.0% | 100.0% |
| **Net results** | **61.0%** | **16.7%** | ***-2.2%*** | ***19.0%*** | **44.3%** | ***7.8%*** | ***36.4%*** | **31.4%** | **25.9%** | ***12.0%*** | ***13.9%*** | **0.8%** | **4.7%** | **92.4%** | **7.6%** | **100.0%** |

Source: Jefferies estimates, company data



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# Valuation

On today's valuation, ING appears to be one of the most interesting stories combining earnings growth, a dividend yield and a valuation discount vs the French and Benelux peers and the Eurozone average. Indeed, ING trades with a 13.5% discount on a P/TNAV basis vs the Eurozone, offers one of the highest EPS growth vs the French and Benelux peers and lastly, offers a dividend yield slightly below France and Benelux in 2017. However, we expect the yield to move above the peers' average by 2019 should management increase the pay-out ratio as assumed in our forecasts where we factor in a move from 53% in 2017 to 60% by 2020.

Our target price is upgraded from €18.8 to €19.9 on the base of our earnings changes as we keep our valuation matrix unchanged. ING valuation case offers 27% upside in our base case scenario, 58% upside in our Bull case with a €24.7 target price and 32% downside in the case of our bear case with a €10.7 target price. Based on our base case scenario, ING would trade on 13.3x 2018 earnings which means a 1.5% premium vs Eurozone.

**Chart 1: ING – share price performance, price target and various scenarios**


**Source: Jefferies estimates, company data**

**Table 4: ING valuation matrix**

| | Price | P/E 2018E | P/TBV 2018E | Adj RoTE 2020E | EPS 2018 | TBVps 2018 |
|---|---|---|---|---|---|---|
| Target price | 19.9 | 13.2x | 1.51x | 12.4% | 1.50 | 13.15 |
| Bull | 24.7 | 11.9x | 1.84x | 17.9% | 2.08 | 13.42 |
| Base | 17.9 | 11.9x | 1.36x | 12.4% | 1.50 | 13.15 |
| Bear | 10.7 | 9.7x | 0.83x | 9.4% | 1.10 | 12.97 |

**Source: Jefferies estimates, company data**

ING trades on a 1.2x 2017 TNAV for 12% underlying RoTE by 2019 which means a 13.5% discount vs Eurozone average, or on 10.4x 2018 earnings, i.e. a 21% discount vs the Eurozone average with a 9.2% EPS CAGR over 2016/19E or 11.4% between 2017/20E.



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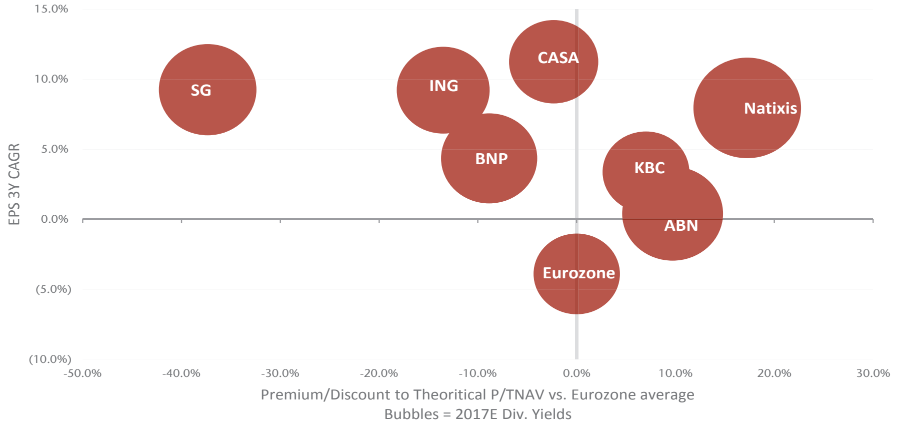
**Chart 2: Valuation matrix**




Source: Jefferies estimates, company data

**Table 5: Valuation matrix for ING and its peers**

| | 2017 | 2019 | | 2016/19E | 2017E |
|---|---|---|---|---|---|
| | P/TNAV | RoTE | Prem/Disct | EPS CAGR | Div. yields |
| KBC | 2.1x | 16.0% | 7.0% | 3.4% | 3.7% |
| ABN | 1.3x | 10.2% | 9.7% | 0.4% | 5.0% |
| ING | 1.2x | 12.0% | -13.5% | 9.2% | 4.3% |
| | | | | | |
| BNPP | 1.00x | 9.1% | -8.9% | 4.4% | 4.6% |
| CASA | 1.3x | 10.7% | -2.3% | 11.3% | 3.9% |
| Natixis | 1.6x | 11.7% | 17.3% | 8.0% | 5.7% |
| SG | 0.8x | 11.1% | -37.4% | 9.3% | 4.7% |
| | | | | | |
| **Eurozone** | **1.3x** | **10.9%** | **0.0%** | **-4%** | **3.70%** |

Source: Jefferies estimates, company data

### Changes in Earnings estimates 2017-2020

We have increased our PT by 5.9% to €19.9 by changing our net income estimates by -1.5% for 2018, +1.7% in 2019 and +3.4% in 2020. In 2018, we reflect the guidance of a nearly flat C/I ratio vs 2017 and as such, we assume a catch-up of the investment cost in 2018 and we charge €250m of cost vs the €180 initially planned. The same assumptions are also taken on the savings as we expect a delayed effect in 2018, with accumulated savings of €240m by 2018 vs €300m planned, and then catching up in 2019 and 2020.

Against pre-Q4 consensus, we are 2.3% ahead for 2018, 11.2% for 2019 and 14.5% in 2020. We are higher in 2019 and 2020 on our expectations of the digital options crystalizing via higher sales driving stronger NII and fee income. We expect the rates increase only in late 2018 or early 2019, and considering ING's low sensitivity to rate moves, we only expect a meaningful impact in 2020. We assume a delivery of the saving cost plus some stabilisation of the cost post the investment phase, and as such our C/I ratio in 2020 is 48% vs the consensus of 51%. The loan CAGR is 3.8%, which is just within the company's targets. Our stronger growth of RWAs (+6.9%), combined with increasing pay-out ratio, delivers a CET1 ratio of 14% in 2020, against consensus of 15.2%.

**Table 6: Earnings changes 2018 -2020**

| | 2018 | % change | 2019 | % change | 2020 | % change | 2017-2020 CAGR |
|---|---|---|---|---|---|---|---|
| Total income | 18,633 | *-0.4%* | 19,952 | *0.8%* | 21,620 | *2.4%* | 6.9% |
| Operating expenses | - 10,110 | *3.4%* | - 10,003 | *0.9%* | - 10,397 | *2.1%* | 1.9% |
| **Gross operating income** | **8,522** | *-4.6%* | **9,948** | *0.7%* | **11,223** | *2.6%* | **12.5%** |
| Cost of risk | - 1,085 | *-26.4%* | - 1,424 | *-6.6%* | - 1,909 | *3.7%* | 41.2% |
| **Operating income** | **7,438** | *-0.3%* | **8,524** | *2.0%* | **9,313** | *2.3%* | **9.0%** |
| Taxation | - 2,083 | *4.2%* | - 2,302 | *3.5%* | - 2,422 | *0.4%* | 3.9% |
| Minority interests | - 71 | *-25.4%* | - 97 | *-13.8%* | - 114 | *-13.8%* | 10.9% |
| **Net result** | **5,284** | *-1.5%* | **6,126** | *1.7%* | **6,778** | *3.4%* | **11.0%** |

Source: Jefferies estimates, company data



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## Appendix 1 – ING Financial Summary

### Table 7: ING Financial Summary – P&L, data per share and key financial ratios

| | 2015 | 2016 | 2017 | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Condensed P&L (€m) | | | | | | |
| **Total income** | **16,552** | **17,458** | **17,706** | **18,633** | **19,952** | **21,620** |
| ow Domestic retail activities | 6,949 | 7,010 | 6,942 | 6,939 | 7,132 | 7,645 |
| ow Others retail activities | 4,318 | 4,782 | 4,919 | 5,593 | 6,298 | 6,912 |
| ow Wholesale activities | 5,570 | 5,608 | 5,923 | 5,985 | 6,374 | 6,886 |
| ow Corporate Line | -285 | 59 | -78 | 116 | 147 | 177 |
| ***- Clean Revenues*** | ***16,401*** | ***17,345*** | ***17,622*** | ***18,633*** | ***19,952*** | ***21,620*** |
| Operating expenses | -9,246 | -9,456 | -9,829 | -10,110 | -10,003 | -10,397 |
| **Gross operating income** | **7,306** | **8,002** | **7,877** | **8,522** | **9,948** | **11,223** |
| Cost of risk | -1,347 | -974 | -678 | -1,085 | -1,424 | -1,909 |
| **Operating income** | **5,959** | **7,029** | **7,199** | **7,438** | **8,524** | **9,313** |
| Others non-operating items | 0 | 0 | 0 | 0 | 0 | 0 |
| **Pre-tax income** | **5,959** | **7,029** | **7,199** | **7,438** | **8,524** | **9,313** |
| ***- Clean pre-tax income*** | ***6,428*** | ***7,859*** | ***8,107*** | ***8,353*** | ***8,975*** | ***9,638*** |
| **BANK NET INCOME** | **4,529** | **4,177** | **4,957** | **5,284** | **6,126** | **6,778** |
| Hybrid costs | -90 | -135 | -133 | -185 | -185 | -185 |
| Non-Bank contribution | -520 | 475 | -52 | - | - | - |
| **ING GROUP NET INCOME** | **3,919** | **4,517** | **4,772** | **5,099** | **5,940** | **6,593** |
| ***- ING Group Net income Clean*** | ***4,904*** | ***4,806*** | ***5,768*** | ***5,830*** | ***6,269*** | ***6,785*** |
| **GROUP Data per share** | | | | | | |
| Stated EPS (EUR) | 1.01 | 1.17 | 1.23 | 1.31 | 1.53 | 1.70 |
| Clean EPS (EUR) | 1.27 | 1.24 | 1.49 | 1.50 | 1.62 | 1.75 |
| Net DPS (EUR) | 0.65 | 0.66 | 0.67 | 0.72 | 0.89 | 1.02 |
| Pay-out ratio | 64% | 57% | 54% | 55% | 58% | 60% |
| Dividend Yield | 6.4% | 4.9% | 4.2% | 4.6% | 5.6% | 6.4% |
| BVPS (EUR) | 12.4 | 12.9 | 13.0 | 13.6 | 14.2 | 14.9 |
| TBVPS (EUR) | 12.0 | 12.5 | 12.6 | 13.2 | 13.8 | 14.5 |
| NOSH (avg diluted) (m) | 3,862 | 3,873 | 3,878 | 3,878 | 3,878 | 3,878 |
| **GROUP Equity** | | | | | | |
| Stated RoE | 8.0% | 9.3% | 9.5% | 9.9% | 11.0% | 11.7% |
| Clean RoE | 10.0% | 9.8% | 11.5% | 11.3% | 11.6% | 12.0% |
| Stated RoTE | 8.4% | 9.6% | 9.8% | 10.2% | 11.4% | 12.0% |
| Clean RoTE | 10.6% | 10.2% | 11.9% | 11.7% | 12.0% | 12.4% |
| **GROUP Capital & Solvency (€ bn)** | | | | | | |
| CET1 capital FL B3 | 40.8 | 44.6 | 45.6 | 47.8 | 50.3 | 53.0 |
| CET1 ratio FL B3 | 12.7% | 14.2% | 14.7% | 14.3% | 14.1% | 14.0% |
| FL B3 RWAs | 321.2 | 314.3 | 309.9 | 335.7 | 356.6 | 378.6 |
| Tier 1 FL B3 Capital | 47.4 | 52.3 | 50.7 | 53.0 | 55.5 | 58.2 |
| Tier 1 FL B3 ratio | 14.7% | 16.6% | 16.4% | 15.8% | 15.6% | 15.4% |
| Capital Rotation (Rev./CET 1 Cap) | 40.6% | 39.2% | 38.9% | 38.9% | 39.6% | 40.8% |
| **Group Key financial ratios** | | | | | | |
| Stated Revenues/average assets | 1.83% | 1.92% | 2.05% | 2.12% | 2.05% | 2.16% |
| Clean Revenues/average Assets | 1.81% | 1.90% | 2.04% | 2.12% | 2.05% | 2.16% |
| Stated Revenues/average RWA | 5.28% | 5.52% | 5.71% | 5.77% | 5.76% | 5.88% |
| Clean Revenues/average RWA | 5.23% | 5.49% | 5.68% | 5.77% | 5.76% | 5.88% |
| Stated Cost/Income | 55.9% | 54.2% | 55.5% | 54.3% | 50.1% | 48.1% |
| Clean Cost/Income | 52.6% | 49.1% | 50.1% | 49.4% | 47.9% | 46.6% |
| Stated LLP/avg loans | 0.25% | 0.18% | 0.12% | 0.19% | 0.24% | 0.30% |
| Stated LLP/avg RWA | 0.43% | 0.31% | 0.22% | 0.34% | 0.41% | 0.52% |
| Loss absorption ratio vs Avg loans | 1.73% | 1.72% | 1.73% | 1.73% | 1.65% | 1.65% |
| NII/average assets | 1.34% | 1.46% | 1.54% | 1.63% | 1.65% | 1.69% |
| **Group Key balance sheet items (€bn)** | | | | | | |
| Loans and receivables due from customers | 537 | 564 | 575 | 632 | 746 | 671 |
| Intangibles | 1.6 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| TOTAL ASSETS | 842 | 1,042 | 846 | 911 | 1,034 | 967 |
| Due to customers | 509 | 523 | 540 | 553 | 570 | 584 |
| Total minority interests | 0.6 | 0.6 | 0.7 | 0.7 | 0.7 | 0.7 |



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**Table 7: ING Financial Summary – P&L, data per share and key financial ratios**

| | 2015 | 2016 | 2017 | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Ordinary shareholders' equity | 47.8 | 49.8 | 50.4 | 52.7 | 55.2 | 57.8 |
| | | | | | | |
| **Asset Quality** | | | | | | |
| NPL's / gross total loans (ex repos) | 3% | 2% | 2% | 2% | 2% | 2% |
| Coverage Ratio | 38% | 40% | 40% | 40% | 40% | 40% |
| | | | | | | |
| **GROUP Free cash flow (€bn)** | | | | | | |
| Gross free cash flow | 1.4 | 5.4 | 5.3 | 2.1 | 3.5 | 4.0 |
| Gross free cash flow / RWAs | 0.4% | 1.7% | 1.7% | 0.6% | 1.0% | 1.1% |
| Net free cash flow | - 1.2 | 2.8 | 2.7 | - 0.7 | 0.0 | 0.1 |
| Net free cash flow / RWAs | -0.4% | 0.9% | 0.9% | -0.2% | 0.0% | 0.0% |
| | | | | | | |
| **Growth YoY (%)** | | | | | | |
| **Revenues** | **8%** | **5%** | **1%** | **5%** | **7%** | **8%** |
| Costs | 3% | 2% | 4% | 3% | -1% | 4% |
| **Gross Operating profit** | **16%** | **10%** | **-2%** | **8%** | **17%** | **13%** |
| Provisions | -15% | -28% | -30% | 60% | 31% | 34% |
| **Operating profit** | **26%** | **18%** | **2%** | **3%** | **15%** | **9%** |
| Pre-tax profit | 26% | 18% | 2% | 3% | 15% | 9% |
| **Bank Net Income** | **74%** | **-8%** | **19%** | **7%** | **16%** | **11%** |
| **Group Net income** | **213%** | **15%** | **6%** | **7%** | **17%** | **11%** |
| | | | | | | |
| **Customer loans** | | | | | | |
| Total Assets | -15.2% | 23.7% | -18.8% | 7.7% | 13.5% | -6.4% |
| Due to customers | 4.0% | 2.8% | 3.2% | 2.5% | 3.0% | 2.5% |
| | | | | | | |
| CET1 capital FL B3 | 27.5% | 9.3% | 2.2% | 5.0% | 5.2% | 5.2% |
| FL B3 RWAs | 6.8% | -2.1% | -1.4% | 8.3% | 6.2% | 6.2% |
| EPS | 211.7% | 14.9% | 5.5% | 6.8% | 16.5% | 11.0% |
| DPS | 441.7% | 1.5% | 1.5% | 7.9% | 22.9% | 14.8% |
| TNAV per share | -1.1% | 4.0% | 0.8% | 4.7% | 4.9% | 4.9% |

Source: Jefferies estimates, company data



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Jefferies

## Company Description

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.

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## Investment Recommendation Record

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

| | |
|---|---|
| Recommendation Published | , 13:54 ET. February 4, 2018 |
| Recommendation Distributed | , 00:00 ET. February 5, 2018 |

## Explanation of Jefferies Ratings

Buy - Describes securities that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.



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Hold - Describes securities that we expect to provide a total return (price appreciation plus yield) of plus 15% or minus 10% within a 12-month period.

Underperform - Describes securities that we expect to provide a total return (price appreciation plus yield) of minus 10% or less within a 12-month period.

The expected total return (price appreciation plus yield) for Buy rated securities with an average security price consistently below $10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated securities with an average security price consistently below $10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated securities with an average security price consistently below $10, the expected total return (price appreciation plus yield) is minus 20% or less within a 12-month period.

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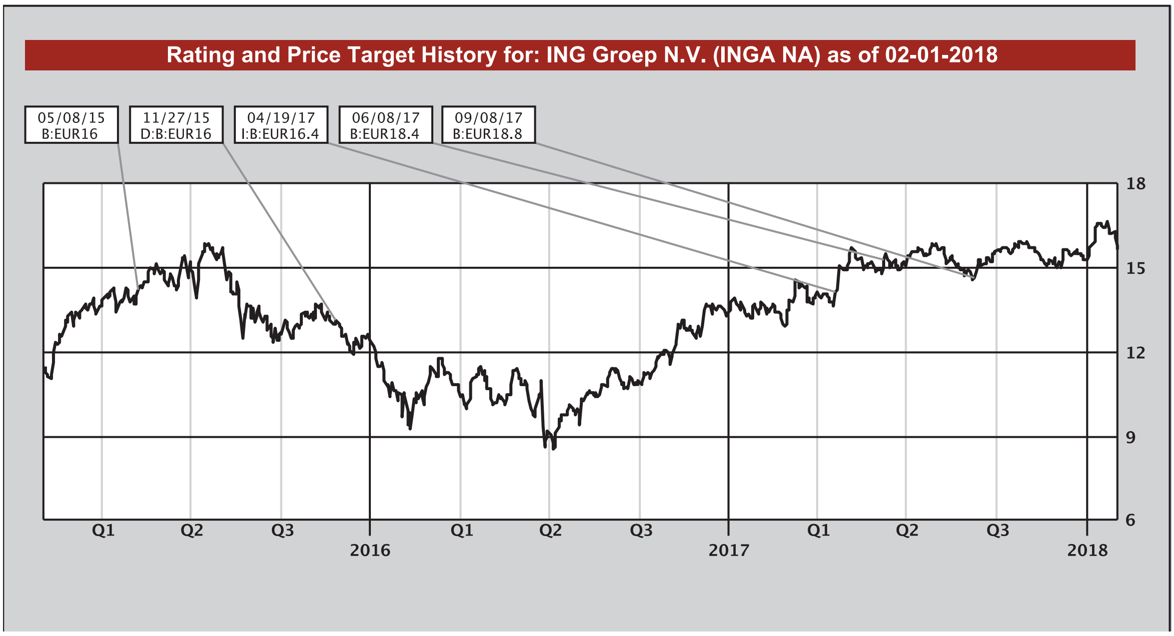



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**Notes:** Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

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## Distribution of Ratings

| | | | IB Serv./Past 12 Mos. | | JIL Mkt Serv./Past 12 Mos. | |
|---|---|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent | Count | Percent |
| BUY | 1101 | 53.14% | 339 | 30.79% | 67 | 6.09% |
| HOLD | 827 | 39.91% | 164 | 19.83% | 23 | 2.78% |
| UNDERPERFORM | 144 | 6.95% | 19 | 13.19% | 3 | 2.08% |


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