Jefferies

EQUITY RESEARCH
KBC Group (KBC BB)

KBC
Margin Strength Will Provide Support at Q4

17 January 2020

Key Takeaway

Since our upgrade in October KBC has delivered everything we asked for with good volumes and improved margins at Q3. Our updated review of the two main divisions, Belgium and CZ, supports our confidence that the robust trends will continue in Q4 and beyond. We reiterate Buy.

In this note we revisit KBC's two largest entities: their underlying trends give us conviction in KBC's ability to deliver at Q4:

- **Belgium** — improved margins are driven by actual repricing rather than just a lower funding cost. The changes in tax benefit led to a surge in volumes over Q4, which, combined with mortgage repricing, should have a positive impact on margins. Although volumes are expected to normalise post 2019, growth should be supported by the Flemish government's 2050 energy targets leading to customers taking out loans for renovation work.
- **Czech Republic** — mixed messages between lower industrial production and high inflation data lead us to believe the CNB will keep rates stable rather than raising them. Mortgage volumes remain robust, c. 6%, despite the front loading in 2018. In line with trends in Belgium, the mortgage market is undergoing repricing and with some recovery in market rates since the lows of summer 2019, we remain confident margins will remain stable.

Post CEO's comment at Q3: '*we are going to distribute surplus capital...that can have different forms, including share buybacks*', consensus '19 pay-out ratio moved from 68% to 73%. While we see this pay-out as manageable, **we are keeping our pay-out at 65% in 2019 with a gradual increase to 70% by 2021**. This reflects our view that the company will continue to be conservative this quarter as the medium-term distribution of capital will likely be discussed at the Investor day on 17 June. **Our 2019 DPS of €3.75 is up 7% YoY and offers a yield of 5.7%.**

Our forecasts are mostly unchanged with average changes of 1% between '18 - '21. We are ahead of consensus by 1% and 2.9% for '20 - '21 as we expect the cost of risk to normalise more slowly. Our price target increases by 11.4% to €78.2 reflecting the improvement in the market's implied cost of equity since summer 2019.

Valuation: KBC trades on 11.6x its 2019e P/TNAV and offers 2021e adj RoTE of 13.8%.

Target | Estimate Change

Belgium | Banks

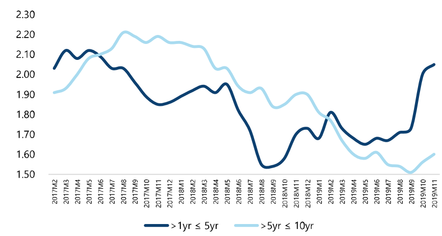
RATING	BUY
PRICE	€67.38^
MARKET CAP	€28.2B / $31.4B
PRICE TARGET (PT)	€78.20 (FROM €70.00)
UPSIDE SCENARIO PT	€86.00
DOWNSIDE SCENARIO PT	€48.70

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

FY Dec

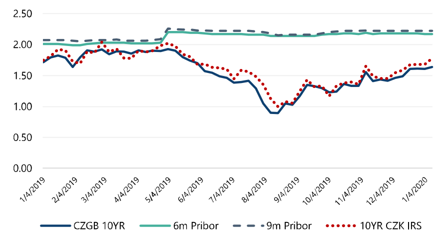
EUR	2018A	2019E	2020E	2021E
EPS	6.03	5.77	5.81	5.98
Prev.		*5.73*	*5.73*	*5.89*

Exhibit 1 - Belgium: mortgage repricing continues



Source: NBB

Exhibit 2 - Czech Republic - market rates recovery



Source: Factset

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KBC (KBC BB)

Estimates				
€	2018A	2019E	2020E	2021E
Rev. (MM)	7,513.0	7,522.0	7,743.0	7,952.0
Previous		7,491.0	7,800.0	7,969.0
Dividend	3.50	3.75	3.95	4.18
Previous	3.92	3.72	3.72	3.83
EPS	6.03	5.77	5.81	5.98
Previous		5.73	5.73	5.89

Valuation				
	2018A	2019E	2020E	2021E
P/Rev	3.7x	3.7x	3.6x	3.5x

Market Data	
52-Week Range:	€68.70 - €48.65
Total Entprs. Value	€28.2B
Avg. Daily Value MM (USD)	41.67
Float (%)	66.9%

The Long View

Scenarios

Base Case

- 2021E EPS €5.98 -0.3% CAGR '18-'21E
- Growth net income breakdown: -2.65% in Belgium, CZ +9.6%, international markets -9.7%, which makes -0.4% for the group
- 2021E C/I ratio 54.7%
- 2021E Dividend €4.18 assuming a 70% payout ratio
- 2021E group RoTE 13.8%
- 2021E Belgium RoE 19.1%, CZ 39%, International 15.2%
- 2021E CET1 ratio = 17%
- 2021E RWA €104bn
- Price target = €78.2 by 2020, 16% upside

Upside Scenario

- 2021E EPS €6.22 with 1% CAGR
- 2021E C/I ratio 56%
- 2021E Dividend €4.4 assuming a 70% payout ratio
- 2021E group RoTE 14.3%
- 2021E Belgium RoE 21%, CZ 39%, International 16%
- 2021E CET1 ratio = 17%
- 2021E RWA €105bn

Price target = €86 by 2019, 27.6% upside

Downside Scenario

- 2021E EPS €4.1 with -12% underlying CAGR
- 2021E C/I ratio 61%
- 2021E Dividend €2.87 assuming a 70% payout ratio
- 2021E group RoTE 9.7%
- 2021E Belgium RoE 13%, CZ 34%, IR 7.9%
- 2021E CET1 ratio = 17%
- 2021E RWA €101bn

Price target = €48.7, 27.8% downside

Investment Thesis / Where We Differ

- Material increase in capital distribution on hold ahead of the investor day on 17 June
- Risks: Brexit impact and European economy weakens faster than expected, including Czech Republic macro
- Earnings: we expect 1.9% revenue growth between 2018-2021E, but costs go up by 0.7% only; and a normalization of the group's cost of risk from 0bp in 2018 to 23bp in 2021E

Catalysts

- Q4 results - 13 Feb
- Potential M&A in core markets

We upgraded KBC in October (link) as we believed in the stability of the Czech business, rates would remain stable vs the market's expectations of a rate cut and that the market was overlooking the positive drivers on the asset side in the Belgium division such as volumes and improved mortgage margins. KBC has delivered all we expected, but we believe the stock has more to give with good Q4 results ahead.

This notes covers three topics: revisiting our thesis for Belgium and the Czech Republic, and then capital distribution as KBC reached its CET1 threshold of 15.7% by Q2-19 and management made it clear that anything above that will be available for distribution.

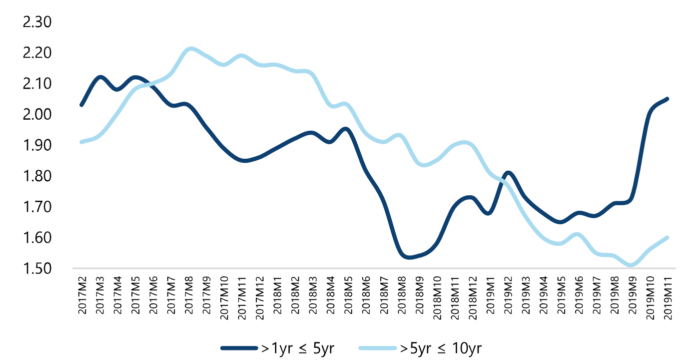
1. Belgium

The volume story is positioned well for Q4 — The Flemish government canceled the tax benefits of the housing bonus effectively from 1 January. It can only be claimed if the deed of sale was signed by a notary before the end of 2019. This led to a surge in applications with KBC reporting that the number of approved files was twice as high in October and November compared to an average month (Standaard). Volumes for new applications normalised in December as it was too late to get the files ready for the notary sign-off; however, as the tax benefit covered existing loans, a record number of people drew down existing loans in December as these didn't require a notary's approval.

Sustainable growth? Going forward, we expect the number of new mortgages to stabilize compared to 2019 volumes. However, we still expect positive growth, albeit at a reduced level, as it will continue to be driven by homeowners taking loans either to improve current dwellings or keep up with the energy efficient mortgage initiatives that have strong support in Belgium. Just meeting the home quality and energy efficiency standards set in the 2050 energy targets by the Flemish government would imply that 57% of all homes, 1.5 million, need renovating; this would be at a cost of €34bn between now and 2050 (source: VUB research). Meeting all the 2050 energy targets for homes would mean that 2.5 million homes (95% of all homes) would need renovation work at a cost of c. €4.6bn to €4.8bn per year. In comparison, currently about €6bn is already spent annually for renovations in Flanders.

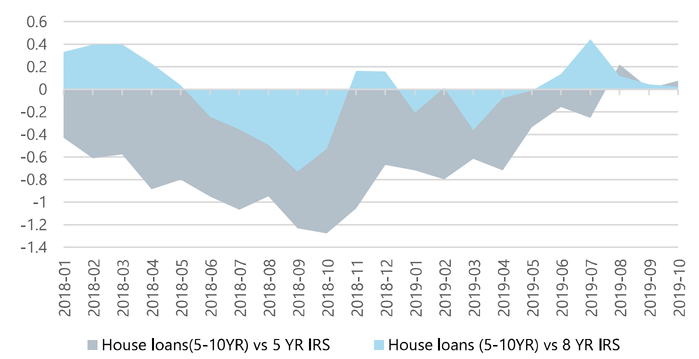
Improved margins - As discussed in our October report, measures imposed by the NBB on the mortgage market were expected to have a positive repricing impact. This was confirmed by the CEO at Q3 who stated that '*the net margins on new mortgage production were up by 30bps*', a trend noticeable in the system data from the NBB as 1-5 YR mortgage rates went up by c. 38bps and 5-10 YR mortgage rates improved by c. 5bps in the last three months (exhibit 3). The repricing combined with lower funding cost (exhibit 4) should have a positive impact at Q4.

Exhibit 3 - Mortgage rates on new production



Source: NBB

Exhibit 4 - Spreads between mortgage and IRS rates



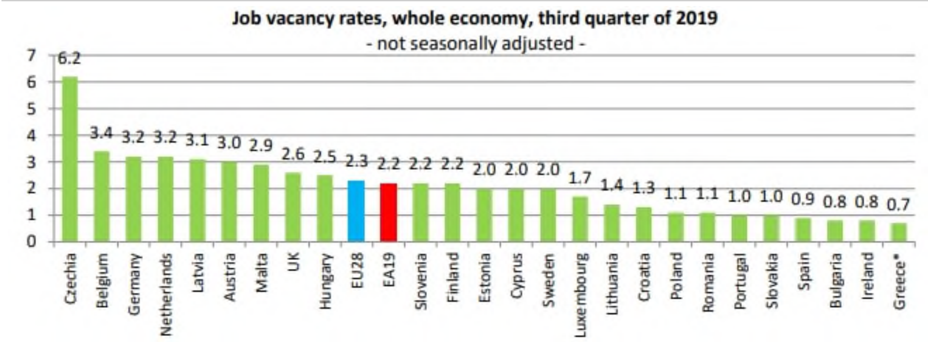
Source: NBB, Bloomberg

2. Czech Republic

In the past six months the market has gone from worrying about a rate cut to expecting a rate hike as December inflation of 3.2% touched the upper range of the CNB's tolerance band. **However, we believe rates will remain unchanged** as the CNB is taking into careful consideration the lower industrial production data and a slowdown in the Czech economy - see our Komercni banka initiation note for detail (link). The weaker industrial production is in line with expectations, and we expect the impact on banks in the Czech Republic will be manageable in 2020 mainly due to:

- With record low unemployment levels, the labor market remains tight. The number of vacant positions in the Czech Republic continues to be the highest compared to the EU average (exhibit 5), thus any workforce at risk should be absorbed by the market.
- The workforce shortage has led to the largest increase in non-EU agency workers in the past 10 years. The agency workers will be the first in line for any large lay-offs limiting the negative impact on consumption of Czech households.
- A change in demand led to a number of German companies re-allocating some production lines to the Czech Republic to save costs.

Exhibit 5 - Euro area job vacancy rate at 2.2%

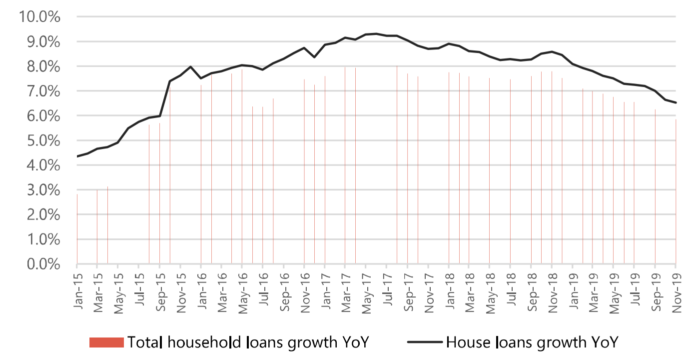


Source: Eurostat

Volumes are normalizing:

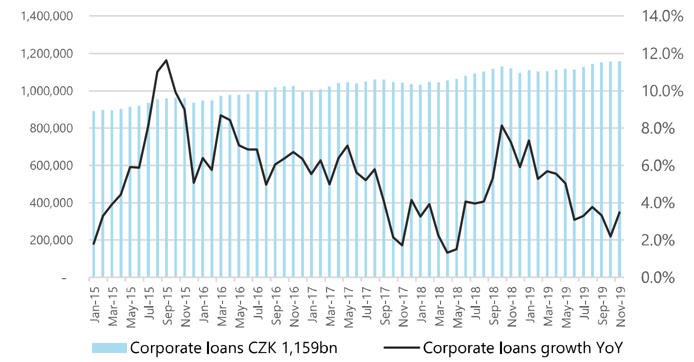
- **Total retail lending was stable at c. 6% in October and November**.
  - Consumer lending growth continued at c. 7%, while mortgage growth at an average 6.5% held up better than expected considering the strong front-loading in 2018 (exhibit 6).
  - We expect mortgage volumes to normalize at around 4% — 5% post 2019.
- **Corporate lending in 2019 was generally sluggish** as many companies turned to bond issuance for long-term funding combined with lower investments on the back of the expected economic slowdown. Despite a pick-up in November, we expect overall corporate demand to be in line with GDP growth post 2019. Upside could be delivered from the government's planned spending on infrastructure projects and a change in trends leading companies to invest more in automating production lines.

Exhibit 6 - Household lending growth YoY



Source: Jefferies, CNB

Exhibit 7 - Corporate lending growth YoY %



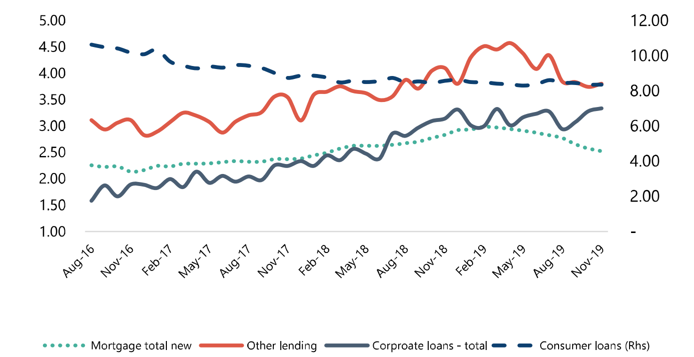
Source: Jefferies, CNB

'*Net mortgage margins were up by 10bps in the Czech Republic*', CEO at Q3 call. The sector data shows most lending rates were stable in October and November, except for mortgages, which recorded a small dip in November (exhibit 8).

However, many large mortgage players were active with repricing in December, including CSOB (KBC), which increased mortgage rates by 20bps on average, and other banks continued in January with Ceska sporitelna (Erste N/C) increasing rates by 20-30bps.

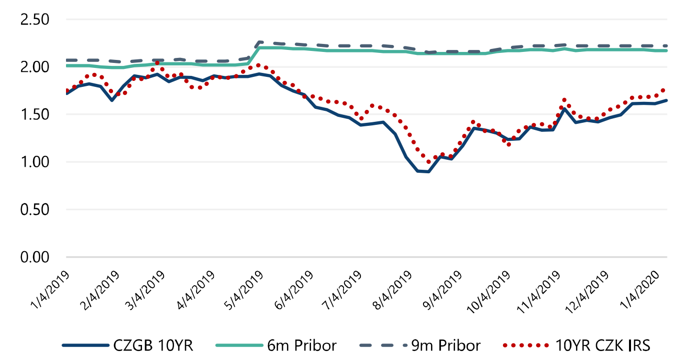
The market rates have continued to improve since the lows of summer 2019, which will help banks to maintain stable returns on their replicating portfolios.

Exhibit 8 - Lending rates



Source: Jefferies, CNB

Exhibit 9 - Market rates recovery



Source: Factset

3. Capital distribution

'*Everything above 15.7% is surplus capital... the way we are going to distribute surplus capital can have different forms including buy-backs*' CEO, Q3 call. Post Q3, consensus moved the pay-out from 68% to 73% in 2019, with YE 2019 CET1 at 15.9%.

Even though we agree that management have significant scope to increase the distribution this year, we believe they will remain conservative as at the same time the CEO guided that the capital deployment plan will be explained at the Investor day (17 June).

We keep our 2019 dividend pay-out unchanged at 65%, compared to 59% in 2018, and **gradually increase it to 70% by 2021** as post the investor day there should be better clarity on the distribution plans. **This delivers a progressive dividend with an '18-'21e CAGR of 6% despite flat EPS.**

Jefferies estimate changes and consensus

We made small changes to our forecasts as most of the trends observed at Q3 were already integrated in them. The small changes reflect the below:

- The impact of SEPA regulation on fees in 2020 (company guidance for €18m), mostly in the Czech business division.
- Lower cost of risk to reflect slower normalization.
- Phase out increase of the pay-out ratio from 65% to 70% by 2021.

This means we are 0.8%, 1% and 2.9% ahead of the post Q3 consensus (exhibit 11). This is mainly due to us forecasting a lower cost of risk.

Exhibit 10 - Changes in estimates

	Actual			JEF forecast €m			'18-'21	Previous Jeff forecast €m			Change in Jeff forecast (%)		
KBC Group P&L	2016	2017	2018	2019	2020	2021	CAGR	2019	2020	2021	2019	2020	2021
Net interest income	3,722	4,425	4,543	4,620	4,676	4,749	*1.5%*	4,566	4,685	4,726	1.2%	-0.2%	0.5%
Non-life insurance before reinsurance	628	705	760	729	764	834	*3.2%*	696	755	828	4.7%	1.1%	0.7%
Life insurance before reinsurance	(151)	(58)	(19)	(5)	(2)	(7)	*-29.5%*	10	9	14	-152.3%	-122.8%	-147.1%
Ceded reinsurance result	(35)	(7)	(41)	(16)	(13)	(13)	*-32.1%*	(9)	(11)	(11)	71.8%	18.2%	18.2%
Dividend income	75	63	83	81	86	86	*1.3%*	81	106	106	1.1%	-18.9%	-18.9%
Net result from FI at FVTPL	540	587	231	108	266	264	*4.5%*	146	281	269	-25.7%	-5.3%	-1.9%
Net realised result via FV at OCI	-	-	9	-	-	-	*-100.0%*	-	-	-	-	-	-
Net fee and commission income	1,448	1,704	1,720	1,714	1,741	1,804	*1.6%*	1,707	1,755	1,806	0.4%	-0.8%	-0.2%
Other net income	257	117	236	291	225	235	*-0.1%*	293	220	230	-0.7%	2.3%	2.2%
Total income	**6,670**	**7,736**	**7,513**	**7,522**	**7,743**	**7,952**	*1.9%*	**7,491**	**7,800**	**7,969**	**0.4%**	**-0.7%**	**-0.2%**
Operating expenses	(3,943)	(4,072)	(4,233)	(4,259)	(4,321)	(4,349)	*0.9%*	(4,264)	(4,373)	(4,383)	-0.1%	-1.2%	-0.8%
Gross operating income	**2,727**	**3,664**	**3,279**	**3,263**	**3,422**	**3,602**	*3.2%*	**3,225**	**3,427**	**3,586**	**1.2%**	**-0.2%**	**0.5%**
Cost of risk	(201)	28	17	(180)	(272)	(364)	*-379.2%*	(216)	(323)	(396)	-16.6%	-15.5%	-8.1%
Operating income	**2,526**	**3,692**	**3,296**	**3,083**	**3,149**	**3,238**	*-0.6%*	**3,009**	**3,104**	**3,189**	**2.4%**	**1.4%**	**1.5%**
Equity affiliates	29	9	17	9	26	26	*15.5%*	18	26	26	-52.6%	0.0%	0.0%
Other	-	-	-	-	-	-	*NA*	-	-	-	-	-	-
Pre-tax income	**2,555**	**3,700**	**3,313**	**3,092**	**3,175**	**3,264**	*-0.5%*	**3,029**	**3,130**	**3,215**	**2.1%**	**1.4%**	**1.5%**
Tax	(663)	(1,009)	(739)	(632)	(699)	(718)	*-1.0%*	(586)	(689)	(707)	7.9%	1.4%	1.5%
Net income	**1,893**	**2,692**	**2,574**	**2,460**	**2,477**	**2,546**	*-0.4%*	**2,443**	**2,442**	**2,508**	**0.7%**	**1.4%**	**1.5%**
Non-controlling interests	0	0	0	0	0	0	*64.5%*	0	0	0	1.7%	4.4%	4.6%
Group net income	**1,893**	**2,692**	**2,574**	**2,460**	**2,477**	**2,546**	*-0.4%*	**2,443**	**2,442**	**2,508**	**0.7%**	**1.4%**	**1.5%**
Divisions													
- Belgium	897	1,693	1,450	1,308	1,330	1,343	*-2.5%*	1,327	1,322	1,332	-1.4%	0.6%	0.8%
- Czech Republic	596	702	654	794	835	860	*9.6%*	808	828	860	-1.8%	0.9%	0.1%
- International Markets	428	444	537	347	367	392	*-10.0%*	361	378	387	-3.8%	-2.8%	1.3%
o/w Slovakia	*93*	*80*	*84*	*55*	*51*	*67*	*-7.3%*	*64*	*64*	*61*	-13.8%	-20.1%	9.9%
o/w Hungary	*130*	*146*	*197*	*172*	*186*	*194*	*-0.4%*	*172*	*182*	*191*	0.0%	2.3%	1.8%
o/w Bulgaria	*20*	*50*	*96*	*89*	*93*	*100*	*1.3%*	*91*	*85*	*91*	-2.3%	8.5%	9.5%
o/w Ireland	*185*	*168*	*155*	*32*	*37*	*31*	*-41.6%*	*34*	*46*	*44*	-8.3%	-19.3%	-29.8%
- Group Center	-28	-147	-67	13	-56	-48	*-10.2%*	-53	-86	-71	-123.6%	-34.8%	-31.5%
Total	**1,893**	**2,692**	**2,574**	**2,460**	**2,477**	**2,546**	*-0.4%*	**2,443**	**2,442**	**2,508**	**0.7%**	**1.4%**	**1.5%**
EPS	4.41	6.31	6.03	5.77	5.81	5.98	*-0.3%*	5.73	5.73	5.89	0.8%	1.5%	1.6%
DPS	2.80	3.00	3.50	3.75	3.95	4.18	*6.1%*	3.72	3.72	3.83	0.8%	6.2%	9.4%
Pay-out	50%	49%	59%	65%	68%	70%		65%	65%	65%	0.0%	4.6%	7.7%
CET1	15.8%	16.3%	16.0%	16.0%	16.6%	17.0%		16.1%	16.5%	16.9%	-0.5%	0.2%	0.3%
RWAs 'bn	88	92	95	100	102	104	*3.2%*	100	102	106	0.5%	-0.5%	-1.3%
Cost/Income	59.1%	52.6%	56.3%	56.6%	55.8%	54.7%		56.9%	56.1%	55.0%	-0.6%	-0.5%	-0.6%
Tax rate	26%	27%	22%	20%	22%	22%		19%	22%	22%	5.7%	0.0%	0.0%

Source: Jefferies estimates, company data

Exhibit 11 - Jefferies vs Consensus

KBC Group P&L	Actual 2016	Actual 2017	Actual 2018	JEF forecast €m 2019	JEF forecast €m 2020	JEF forecast €m 2021	'18-'21 CAGR	JEF vs consensus (%) 2019	JEF vs consensus (%) 2020	JEF vs consensus (%) 2021	Current Consensus €m 2019	Current Consensus €m 2020	Current Consensus €m 2021	'18-'21 CAGR
Net interest income	3,722	4,425	4,543	4,620	4,676	4,749	*1.5%*	0.3%	0.8%	1.2%	4,605	4,640	4,694	*1.1%*
Non-life insurance before reinsurance	628	705	760	729	764	834	*3.2%*	0.6%	-3.1%	2.1%	724	788	817	*2.5%*
Life insurance before reinsurance	(151)	(58)	(19)	(5)	(2)	(7)	*-29.5%*	-40.1%	-59.9%	567.5%	(9)	(5)	(1)	*-62.6%*
Ceded reinsurance result	(35)	(7)	(41)	(16)	(13)	(13)	*-32.1%*	-27.2%	-45.8%	-43.5%	(22)	(24)	(23)	*-17.8%*
Dividend income	75	63	83	81	86	86	*1.3%*	1.8%	3.6%	1.2%	80	83	85	*0.9%*
Net result from FI at FVTPL	540	587	231	108	266	264	*4.5%*	-12.7%	-7.0%	-9.6%	124	286	292	*8.1%*
Net realised result via FV at OCI	-	-	9	-	-	-	*-100.0%*	na	na	na	9	8	8	*-4.3%*
Net fee and commission income	1,448	1,704	1,720	1,714	1,741	1,804	*1.6%*	-0.8%	-2.2%	-1.5%	1,728	1,780	1,831	*2.1%*
Other net income	257	117	236	291	225	235	*-0.1%*	3.3%	-0.4%	2.6%	282	226	229	*-1.0%*
Total income	**6,670**	**7,736**	**7,513**	**7,522**	**7,743**	**7,952**	*1.9%*	**0.1%**	**-0.4%**	**0.4%**	**7,517**	**7,770**	**7,921**	*1.8%*
Operating expenses	(3,943)	(4,072)	(4,233)	(4,259)	(4,321)	(4,349)	*0.9%*	-0.3%	0.2%	-0.3%	(4,270)	(4,312)	(4,361)	*1.0%*
Gross operating income	**2,727**	**3,664**	**3,279**	**3,263**	**3,422**	**3,602**	*3.2%*	**0.5%**	**-1.1%**	**1.2%**	**3,247**	**3,458**	**3,560**	*2.8%*
Cost of risk	(201)	28	17	(180)	(272)	(364)	*-379.2%*	-6.2%	-21.9%	-14.8%	(192)	(349)	(427)	*-394.4%*
Operating income	**2,526**	**3,692**	**3,296**	**3,083**	**3,149**	**3,238**	*-0.6%*	**0.9%**	**1.3%**	**3.4%**	**3,055**	**3,109**	**3,133**	*-1.7%*
Equity affiliates	29	9	17	9	26	26	*15.5%*	-4.2%	160.0%	136.4%	9	10	11	*-13.3%*
Other	-	-	-	-	-	-	*NA*	-	-	-	-	-	-	*NA*
Pre-tax income	**2,555**	**3,700**	**3,313**	**3,092**	**3,175**	**3,264**	*-0.5%*	**0.9%**	**1.8%**	**3.8%**	**3,065**	**3,119**	**3,144**	*-1.7%*
Tax	(663)	(1,009)	(739)	(632)	(699)	(718)	*-1.0%*	1.6%	4.7%	7.3%	(622)	(667)	(669)	*-3.3%*
Net income	**1,893**	**2,692**	**2,574**	**2,460**	**2,477**	**2,546**	*-0.4%*	**0.7%**	**1.0%**	**2.9%**	**2,443**	**2,452**	**2,475**	*-1.3%*
Non-controlling interests	0	0	0	0	0	0	*64.5%*	-	-	-	-	-	-	*-100.0%*
Group net income	**1,893**	**2,692**	**2,574**	**2,460**	**2,477**	**2,546**	*-0.4%*	**0.7%**	**1.0%**	**2.9%**	**2,443**	**2,452**	**2,475**	*-1.3%*
Divisions														
- Belgium	897	1,693	1,450	1,308	1,330	1,343	*-2.5%*	-1.4%	-3.9%	-1.1%	1,327	1,385	1,357	*-2.2%*
- Czech Republic	596	702	654	794	835	860	*9.6%*	1.6%	2.9%	4.4%	781	811	824	*8.0%*
- International Markets	428	444	537	347	367	392	*-10.0%*	-0.5%	4.1%	8.5%	349	353	361	*-12.4%*
o/w Slovakia	*93*	*80*	*84*	*55*	*51*	*67*	*-7.3%*	-0.5%	-14.7%	9.3%	*55*	*60*	*61*	*-10.0%*
o/w Hungary	*130*	*146*	*197*	*172*	*186*	*194*	*-0.4%*	0.2%	5.8%	6.1%	*172*	*176*	*183*	*-2.4%*
o/w Bulgaria	*20*	*50*	*96*	*89*	*93*	*100*	*1.3%*	0.7%	17.3%	20.4%	*88*	*79*	*83*	*-4.7%*
o/w Ireland	*185*	*168*	*155*	*32*	*37*	*31*	*-41.6%*	-12.2%	0.9%	-11.9%	*36*	*37*	*35*	*-39.1%*
- Group Center	-28	-147	-67	13	-56	-48	*-10.2%*	-189.9%	-18.9%	-27.8%	*-14*	*-69*	*-67*	*0.2%*
Total	**1,893**	**2,692**	**2,574**	**2,462**	**2,477**	**2,546**	*-0.4%*	**0.8%**	**1.0%**	**2.9%**	**2,443**	**2,452**	**2,475**	*-1.3%*
EPS	4.41	6.31	6.03	5.77	5.81	5.98	*-0.3%*	1.0%	0.7%	2.7%	5.72	5.77	5.82	*-1.2%*
DPS	2.80	3.00	3.50	3.75	3.95	4.18	*6.1%*	-4.3%	-1.0%	1.8%	3.92	3.99	4.11	*5.5%*
Pay-out	50%	49%	59%	65%	68%	70%		-11.3%	-7.1%	-7.5%	73%	73%	76%	
CET1	15.8%	16.3%	16.0%	16.0%	16.6%	17.0%		0.8%	3.0%	5.3%	15.9%	16.1%	16.1%	
RWAs 'bn	88	92	95	100	102	104	*3.2%*	na	na	na	99	102	105	*3.5%*
Cost/Income	59.1%	52.6%	56.3%	56.6%	55.8%	54.7%		-0.3%	0.6%	-0.7%	56.8%	55.5%	55.1%	
Tax rate	26%	27%	22%	20%	22%	22%		na	na	na	20%	21%	21%	

Source: Jefferies estimates, company data

Exhibit 12 - Q4 2019 expectations

KBC Group €m	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q319	Jefferies Q4 19E	JEFe YoY	JEFe QoQ
Net interest income (NII)	1,125	1,117	1,136	1,166	1,130	1,132	1,174	1,183	1.5%	0.8%
Non-life insurance	162	202	197	198	161	174	192	201	1.6%	4.8%
Life insurance	(7)	2	(9)	(2)	(3)	1	(5)	2	-195.0%	-134.1%
Ceded reinsurance result	(9)	(14)	(6)	(12)	(7)	1	(9)	(2)	-83.4%	-77.0%
Dividend income	21	34	12	15	12	39	14	15	-1.8%	1.0%
Net results from FVTPL	96	55	79	2	99	(2)	(46)	58	3039.8%	-225.4%
Net realised from FVTOCI	1	8	(0)	0	1	-	-	-	nm	nm
Net fee income	450	439	424	407	410	435	444	424	4.3%	-4.5%
Other income	71	23	56	76	59	133	43	60	-21.2%	39.7%
Total income	**1,912**	**1,864**	**1,888**	**1,849**	**1,862**	**1,913**	**1,813**	**1,941**	**4.9%**	**7.0%**
Operating expenses	(1,291)	(966)	(981)	(996)	(1,296)	(988)	(975)	(1,000)	0.5%	2.6%
Gross operating income	**621**	**897**	**906**	**854**	**567**	**925**	**838**	**940**	**10.2%**	**12.2%**
Cost of risk	56	1	2	(43)	(68)	(40)	(26)	(48)	12.9%	86.1%
Equity affiliates	6	3	2	3	3	4	-	4	15.1%	-
Profit before tax	**683**	**902**	**911**	**814**	**502**	**889**	**812**	**896**	**10.0%**	**10.3%**
Tax	(127)	(210)	(211)	(192)	(73)	(144)	(200)	(215)	11.7%	7.5%
Net income	**556**	**692**	**701**	**622**	**429**	**745**	**612**	**681**	**9.5%**	**11.3%**
Divisions										
- Belgium	243	437	409	361	176	388	368	379	5%	3%
- Czech Republic	171	145	168	170	177	248	159	210	23%	32%
- International Markets	137	163	141	93	70	104	85	90	-4%	6%
o/w Slovakia	*34*	*19*	*27*	*13*	*18*	*11*	*12*	14	*5%*	*17%*
o/w Hungary	*35*	*62*	*51*	*49*	*25*	*55*	*45*	48	*-2%*	*7%*
o/w Bulgaria	*21*	*26*	*31*	*19*	*13*	*29*	*23*	23	*23%*	*-2%*
o/w Ireland	*57*	*55*	*32*	*11*	*14*	*9*	*4*	5	*-54%*	*10%*
- Group Center	5	-53	-17	-3	7	4	0	3	-188%	-2053%
Total	**556**	**692**	**701**	**622**	**429**	**745**	**612**	**681**	**9%**	**11%**
C/I %	**67.5%**	**51.9%**	**52.0%**	**53.8%**	**69.6%**	**51.6%**	**53.9%**	**51.5%**		
CET1	15.9%	15.8%	16.0%	16.0%	15.8%	15.6%	15.4%	16.0%		
RWAs	93,172	92,930	93,979	94,875	96,526	96,526	97,367	100,175		

Source: Jefferies estimates, company data

Valuation

KBC's PT is revised to €78.2 from €70 (+11.4%) and offers 16% potential upside. We use a Gordon growth framework using RoTE and cost of equity on a 2021 basis as well as a discounted value of dividend payments and excess capital. We have upgraded our earnings by an average 1% for the next few years and increased the pay-out ratio from 65% to 70% by 2021. However, the main driver of our PT increase is the change in the market's implied cost of equity. In our previous valuation we used a CoE of 10% as the market was reflecting a higher geopolitical risk in our view, and over time the CoE has reached c. 8.5%. In our current valuation we applied a CoE of 9.5%, 100bps ahead of the market's implied CoE.

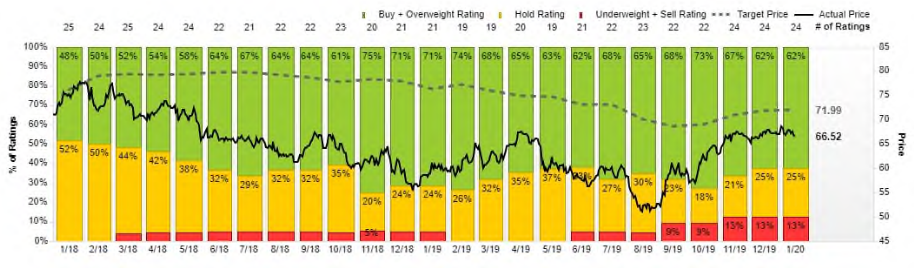
Exhibit 13 - KBC valuation

	Bear	Base	Bull
RoTE	9.8%	13.8%	14.3%
Growth	0.8%	1.5%	1.6%
CoE	11.0%	9.5%	9.0%
(+) Dividends to be paid	6.4	7.3	7.6
(+) Excess Capital per share	9.8	9.5	9.3
(+) P/TNAV valuation	37.6	68.4	76.5
Value per share	**53.8**	**85.2**	**93.4**
Discounted valuation	**48.7**	**78.2**	**86.0**
Upside/downside	-27.8%	16.0%	27.7%

Source: Jefferies estimates

Analysts' PT is €71.99, +10% since October, and it is a Buy rating for 62% of analysts compared to 73% in October.

Exhibit 14 - Analysts recommendations in the past 2 years



Source: Factset

Exhibit 15 - KBC Financial forecast 2019 - 2021

KBC Summary	2017	2018	2019E	2020E	2021E	2016	2017	2018	2019E	2020E	2021E
Condensed P&L (€m)						% YoY					
Total Income	7,736	7,513	7,522	7,743	7,952	-6.7%	16.0%	-2.9%	0.1%	2.9%	2.7%
ow Belgium	4,989	4,549	4,430	4,475	4,529	-15.1%	20.4%	-8.8%	-2.6%	1.0%	1.2%
ow Czech Republic	1,490	1,539	1,714	1,812	1,897	4.2%	11.9%	3.3%	11.3%	5.7%	4.7%
ow Hungary	514	565	554	579	600	-4.9%	0.0%	10.0%	-1.9%	4.4%	3.6%
ow Slovakia	320	317	308	319	334	3.6%	-2.5%	-0.9%	-2.8%	3.5%	4.6%
ow Bulgaria	173	248	251	255	276	2.0%	106.4%	43.4%	1.5%	1.6%	8.1%
ow Ireland	244	168	284	235	262	44.2%	22.6%	-31.2%	69.1%	-17.3%	11.8%
- Clean Revenues	7,852	7,502	7,474	7,743	7,952	-6.7%	17.7%	-4.5%	-0.4%	3.6%	2.7%
Operating Expense	-4,072	-4,233	-4,259	-4,321	-4,349	1.4%	3.3%	4.0%	0.6%	1.5%	0.7%
Gross Operating Income	3,664	3,279	3,263	3,422	3,602	-16.4%	34.4%	-10.5%	-0.5%	4.9%	5.3%
Cost of risk	28	17	-180	-272	-364	-73.3%	-113.8%	-39.8%	-1176.5%	51.3%	33.6%
Operating Income	3,692	3,296	3,085	3,149	3,238	0.6%	46.1%	-10.7%	-6.4%	2.1%	2.8%
Others non-operating items	9	17	9	26	26	61.2%	-70.5%	97.2%	-48.9%	201.6%	0.0%
Pre-tax income	3,700	3,313	3,094	3,175	3,264	1.0%	44.8%	-10.5%	-6.6%	2.6%	2.8%
- Clean pre-tax income	3,718	3,186	3,061	3,175	3,264	0.6%	46.2%	-14.3%	-3.9%	3.7%	2.8%
Net Income	2,692	2,574	2,460	2,477	2,546	-28.2%	42.2%	-4.4%	-4.4%	0.7%	2.8%
AT1 cost	-52	-59	-59	-59	-59	0.0%	0.0%	13.5%	0.0%	0.0%	0.0%
Group Net Income	2,640	2,515	2,403	2,418	2,487	-28.7%	43.4%	-4.7%	-4.4%	0.6%	2.9%
- Clean Group Net Income	2,699	2,416	2,377	2,418	2,487	0.6%	47.5%	-10.5%	-1.6%	1.7%	2.9%
Group Data per share	2017	2018	2019E	2020E	2021E	2016	2017	2018	2019E	2020E	2021E
Stated EPS (€)	6.31	6.03	5.77	5.81	5.98	-28.7%	43.2%	-4.5%	-4.2%	0.6%	2.9%
Clean EPS (€)	6.45	5.79	5.71	5.81	5.98	0.5%	47.3%	-10.3%	-1.3%	1.7%	2.9%
NET DPS (€)	3.00	3.50	3.75	3.95	4.18	40.0%	7.1%	16.7%	7.2%	5.3%	5.9%
Pay-out ratio	49%	59%	65%	68%	70%						
Dividend yield	4.2%	6.2%	5.7%	6.0%	6.3%						
BVPS (€)	39.40	41.37	43.99	45.99	47.92	4.7%	9.1%	5.0%	6.3%	4.5%	4.2%
TBVPS (€)	36.52	38.18	40.22	42.22	44.15	4.7%	8.2%	4.5%	5.3%	5.0%	4.6%
Nosh (avr diluted) (m)	418	417	416	416	416						
Capital & Solvency											
CET1 capital (€mn)	15,106	15,151	16,051	16,883	17,688	4.8%	8.8%	0.3%	5.9%	5.2%	4.8%
RWAS	92,409	94,875	100,175	101,831	104,335	-1.4%	5.3%	2.7%	5.6%	1.7%	2.5%
CET1 ratio (%)	16.3%	16.0%	16.0%	16.6%	17.0%						
Tier 1 capital	16,506	16,151	17,551	18,383	19,188						
Tier 1 ratio	17.9%	17.0%	17.5%	18.1%	18.4%						
Capital rotation (Rev./CET1 cap)	0.51	0.50	0.47	0.46	0.45						
EQUITY RATIOS											
Stated RoTE	18.0%	16.1%	14.7%	14.1%	13.8%						
Stated RoE	16.7%	14.9%	13.5%	12.9%	12.7%						
Clean RoTE	18.4%	15.5%	14.6%	14.1%	13.8%						
Clean RoE	17.1%	14.3%	13.4%	12.9%	12.7%						
Group Key financial ratios											
Stated Revenues/average assets	2.0%	1.7%	1.6%	1.5%	1.6%						
Clean Revenues/average Assets	5.7%	5.2%	4.9%	4.9%	5.0%						
Stated Revenues/average RWA	9.6%	8.9%	8.5%	8.5%	8.5%						
Clean Revenues/average RWA	9.7%	8.9%	8.5%	8.5%	8.5%						
Stated Cost/Income	52.6%	56.3%	56.6%	55.8%	54.7%						
Clean Cost/Income	50.4%	56.3%	56.8%	55.8%	54.7%						
Stated LLP/avg loans	-0.02%	-0.01%	0.12%	0.17%	0.23%						
Stated LLP/avg RWA	-0.03%	-0.02%	0.20%	0.30%	0.39%						
Loss absorption ratio vs Avg loans	2.7%	2.3%	2.2%	2.2%	2.2%						
NII/average assets	3.23%	3.15%	3.05%	2.97%	2.96%						
Key balance sheet items (€m)	2017	2018	2019E	2020E	2021E	2016	2017	2018	2019E	2020E	2021E
Customer loans	140,999	147,052	156,101	158,942	161,717	4.1%	5.9%	4.3%	6.2%	1.8%	1.7%
TOTAL ASSETS	292,342	283,809	281,732	285,812	276,187	9.1%	6.2%	-2.9%	-0.7%	1.4%	-3.4%
Due to customers	194,460	194,291	212,649	224,073	235,783	10.0%	9.6%	-0.1%	9.4%	5.4%	5.2%
Total minority interests	0	0	0	0	0	-	-	-	-	-	-
Ordinary shareholders' equity	16,478	17,260	18,305	19,137	19,942	4.7%	9.2%	4.7%	6.1%	4.5%	4.2%
Asset Quality											
NPL's / gross total loans (ex repos)	6.0%	4.3%	4.1%	4.2%	4.3%						
Coverage Ratio	44%	45%	44%	45%	45%						
GROUP Free cash flow (€bn)											
Gross free cash flow	2,164	2,288	1,847	2,285	2,256						
Gross free cash flow / RWAs	2.3%	2.4%	1.8%	2.2%	2.2%						
Net free cash flow	909	827	285	640	515						
Net free cash flow / RWAs	1.0%	0.9%	0.3%	0.6%	0.5%						

Source: Jefferies estimates, company data

Company Description

KBC

KBC Bank N.V. is a Belgian universal multi-channel bank, focusing on private clients and small and medium-sized enterprises. Besides retail banking, insurance, and asset management activities (in collaboration with sister companies KBC Insurance NV and KBC Asset Management NV), KBC is active in European debt capital markets, domestic cash equity markets and in the field of corporate banking, leasing, factoring, reinsurance, private equity and project and trade finance in Belgium, Central and Eastern Europe and elsewhere (mainly in Europe).

Company Valuation/Risks

KBC

We apply several valuation methodologies - P/E, P/TBV (Gordons Growth), P/PPP and sum of the parts. Our valuation blend is based on a mix of Bull, Bear & Base scenarios. Risks: macro deterioration in the CEE region and ongoing market turbulence impacting fee income.

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Investment Recommendation Record

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

Recommendation Published	January 17, 2020 , 09:44 ET.
Recommendation Distributed	January 17, 2020 , 09:44 ET.

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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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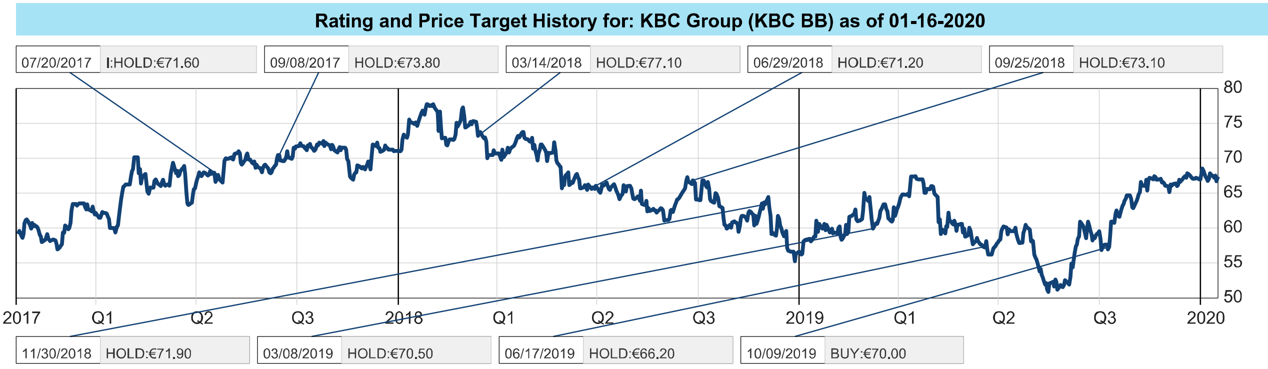

Notes: Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

Distribution of Ratings

Distribution of Ratings						
			IB Serv./Past12 Mos.		JIL Mkt Serv./Past12 Mos.	
	Count	Percent	Count	Percent	Count	Percent
BUY	1218	52.64%	109	8.95%	15	1.23%
HOLD	937	40.49%	30	3.20%	4	0.43%
UNDERPERFORM	159	6.87%	1	0.63%	0	0.00%

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