German and Swiss wealth management

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German and Swiss wealth management

German wealth managers should enjoy slightly better domestic structural growth than their Swiss counterparts, but some of the Swiss managers more than compensate for this with their emerging markets exposure, which offers fantastic long-term potential. Both should benefit from better markets and investor sentiment and most of the stocks in this report do not have PIIGS exposures or regulatory issues.

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German wealth managers

Germany is ageing faster than Switzerland and the UK, and its population has more to do to change from state provision for retirement to personal provision. This should produce excellent long-term growth potential for wealth managers and repatriated money from Switzerland can only add to the potential.

Swiss wealth managers

Switzerland already has more millionaire households than any other European country and with Pillar 3 self-provision for retirement well established it can be expected that domestic growth in wealth management will be steady rather than spectacular. Offsetting this are the tremendous growth opportunities from emerging markets.

Sensitivities

The main sensitivity is financial confidence, which can hinder client activity and the movement of money from one firm to another. More confidence not only improves these two factors but can also give a boost through rising equity markets and assets under management. These are beta stocks but, unlike the larger banks, they do not have residual issues over their balance sheets.

Valuation

At this stage of the economic cycle P/E ratios are of limited use, but DCF analysis shows that most are reasonably valued using a relatively high cost of equity of 10%. But these stocks are positively geared to the economic cycle and equity markets and would look increasingly attractive should markets recover. Our preferred investment would be Hypoport where there is a margin recovery story in addition to the economic rebound and good favourable valuation. If financial confidence does not rebound then all the companies in this report will suffer, though Julius Baer would probably be more resilient than the others.

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Investment summary: Structural growth and positively geared to recovering markets

Structural growth markets

Both Germany and Switzerland are wealthy developed nations and have come through the recent financial crises better than most in North America and Western Europe. This, combined with increasing wealth from economic growth, should be enough to fuel a decent 5% to 10% growth in their wealth management business. The German wealth managers have considerable opportunity from the need for Germans to increase their own provision for retirement, the so-called Pillar 3 resources, rather rely on the state (Pillar 1) (see page 10) which has provided the bulk of their provision so far. The German companies should also enjoy some repatriation of German money from Switzerland as a result of the new double tax agreement, but the Swiss stocks covered in this report should be able to compensate for this by the tremendous opportunities from the emerging markets to focus on, either cross-border into Switzerland or increasingly onshore in the emerging markets themselves. The German wealth managers we include in this report focus more on Germany or Eastern Europe, and while the latter can arguably be called an emerging market as far as wealth management goes, it is not as significant as Asia, Latin America or the Middle East.

Sensitivities

The most important sensitivity for these wealth managers is client and financial confidence, and over the last five years both have taken a battering. Not only is less wealth created in such an environment, but clients are less inclined to move their money to a new manager from the safe havens of their mattress or incumbent bank or wealth manager, which reduces net new money accumulation for the fast growing institutions in this study, but has a negative affect on client transaction activity as well. Moreover, this has been combined with extremely low interest rates, which make if difficult to make a spread on deposit business in the banks or for life insurers to make profits on their investment portfolios. Other sensitivities have included a strong Swiss franc, which has hurt the Swiss private banks that earn most of their revenues in non-Swiss francs but for whom most of their costs are in Swiss francs. Other sensitivities include tax regulation, pension regulation and the regulations concerning how retail products can be sold.

Financials

The nine companies in this study include private banks, brokers and financial conglomerates, which include a mixture of banks and insurers. All have their financial strength measured in different ways, but only EFG International and W&W AG have to build up their capital resources in our view, and both of these plan to do this through internal capital generations. PIIGS (Portugal, Ireland, Italy, Greece and Spain) exposure amongst the companies in this study is also generally low, even for those with exposure like EFG International and W&W, and Greece has been provided for to the required amount. Only Vontobel has a significant investment banking operation.

Valuation

Exhibit 1: Valuation statistics

Note: Priced at 26 April 2012.

	Price	Mkt cap	P/E (x) 2012	P/E (x) 2013	Div yield 2012	P/tNAV (x) 2012	P/E (x) Average	Upside to sector average
German	€	€m						
Hypoport	10.81	67.0	12.5	10.3	0.0%	21.1	23.5	(12%)
MLP	6.46	697.0	13.4	11.9	4.6%	2.7	27.0	(18%)
OVB	18.98	270.5	57.8	49.1	1.8%	3.9	39.9	N/A
W&W	15.49	1,425.1	5.9	5.7	3.2%	0.5	13.2	84%
German average (ex OVB)			10.9	9.3	2.0%	7.0		0%
Swiss	CHF	CHF						
EFG Int	8.65	1,269	15.3	12.7	1.2%	5.6	26.7	(12%)
Julius Baer	34.74	7,094	13.9	11.9	1.7%	2.7	22.1	(3%)
Sarasin	27.95	1,752	14.1	11.6	3.6%	1.6	28.2	(4%)
Vontobel	22.15	1,418	10.2	8.8	5.4%	1.0	14.7	32%
VZ Holding	97.00	765	13.9	12.6	2.7%	3.9	17.2	(3%)
Swiss average			13.5	11.5	2.9%	3.0		0%

Source: Edison Investment Research

Prospective 2012 and 2012 P/E ratios are well below the historic average over the last five years, which normally would indicate good value. However, the last five years has seen two serious financial crises and earnings in that period were at a cyclical low, making P/Es of limited use. In order to show the relative valuation we have shown the upside and downside for each stock compared with its country average in 2012, though in the case of Germany we have omitted OVB as an obvious outlier.

In a financial crisis the equity market falls and with it AuM on which fees are earned, and clients are too uncertain to undertake transaction or long-term commitments, lowering margins and further reducing profits. Moreover, interest rates are also at all-time lows, lowering earnings on interest and most of the Swiss companies had added problems caused by a strong Swiss franc, given that most of the revenues were not earned in Swiss francs but typically 80% of the costs were in Swiss francs.

A better method of valuation in this situation is to do multi-year discounted cash flow analysis, though this also is highly subjective, especially as regards the cost of equity to use. Using a 10% cost of equity and adjusting for our estimates of over- or under-capitalisation of the companies, we produce the following estimates of the values of these companies.

Exhibit 2: DCF valuations

Note: Priced at 26 April 2012.

	DCF value	Deficit/ surplus	Net value	No. of shares	DCF value per share	Share price	Upside
German	€m	€m	€m	m	€	€	
Hypoport	92.4	-5.0	87.4	6.2	14.09	10.81	30%
MLP	714.8		714.8	107.9	6.62	6.46	3%
OVB	74.5	20.0	94.5	6.2	15.24	18.98	-20%
W&W	2,189	-500	1,689	92	18.36	15.49	19%
Swiss	CHFm	CHFm	CHFm	m	CHF	CHF	
EFG Int	1,361		1,361	146.7	9.3	8.65	7%
Julius Baer	5,955	800	6,755	196.4	34.4	34.74	-1%
Sarasin	1,510	200	1,710	62.7	27.3	27.95	-2%
Vontobel	1,613		1,613	64.0	25.2	22.15	14%
VZ Holding	827		827	7.9	104.9	97.00	8%

Source: Edison Investment Research

Whilst our basic approach has been to use a 20-year DCF for each of these companies, the models vary slightly in appearance as a result of the different nature of the companies and the operating metrics that they use to measure their performance. The following table summarises the main features and assumptions of the models used.

Exhibit 3: DCF models and valuation

	DCF based on	Gross margin	Cost/inc ratio	EBIT margin	Growth	Cost of equity	NB: EBIT margin 2010	2011
German								
Hypoport	EBIT			10%	8%	10%	9.6%	7.0%
MLP	EBIT			14%	6%	10%	9.0%	3.5%
OVB	EBIT			4%	5%	10%	2.6%	2.9%
				ROE			ROE	ROE
W&W	ROE			8%	5%	10%	6.5%	6.3%
Swiss								
EFG Int	AuM	0.95%	80%	20%	7%	10%	15%	12%
Julius Baer	AuM	1.05%	67%	33%	7%	10%	35%	32%
Sarasin	AuM	0.70%	75%	25%	7%	10%	27%	25%
Vontobel	PB AuM	0.80%	80%	20%	7%	10%	23%	16%
Vontobel	AM AuM	0.45%	75%	25%	9%	10%	23%	19%
VZ Holding	AuM	1.75%	55%	45%	9%	10%	48%	46%

Source: Edison Investment Research

This method is broadly supportive of the stocks at the current share price. However, in a more upbeat market environment an 8% cost of equity might be more appropriate and in that case the DCF valuations and upside potential would rise on average by around 20%.

German and Swiss wealth management markets

Germany and Switzerland are both wealthy countries whose economies have come out well from the financial crisis and whose citizens want to – and can afford to – save for their retirement and pass on sums to future generations. As with other developed nations, they face an ageing population and the likelihood that individuals will have to increasingly provide for their future rather than rely on the state. In addition, for historical reasons, Switzerland is a significant offshore banking sector and continues to attract money from abroad, though perhaps at a lower rate than formerly. These factors mean that the German and Swiss wealth management markets are inherently high growth markets, though with different structural drivers; however, periods of financial turmoil hide this occasionally.

Size of the markets

Wealth markets are traditionally divided between the private banking sector – essentially those households with net wealth over US$1m – and the affluent/retail segment, which is essentially everything less than this amount. Both segments can be attractive for wealth management companies if a nation's households have sufficient wealth to be managed by wealth management companies. Household property is not normally managed by wealth managers so we just define the market as that for financial wealth, and here the Germans have €4.7trn and the Swiss €1.6trn. By comparison, UK households have financial asset wealth of €3.8trn. Financial wealth per household in Switzerland is €480,000, compared with €145,000 in the UK and €117,000 in Germany. It should be noted though that Germans and the British are likely to have additional wealth overseas which may not be included in these figures.

Exhibit 4: Household wealth in Germany and Switzerland

Note: German and UK data is for end 2009, Swiss for 2010.

€bn	Germany	Switzerland	UK
Property	5,600	1,174	4,393
Mortgage loans	1,538	525	1,445
Net housing	4,062	649	2,948
Financial assets	4,663	1,625	4,024
Consumer credit		41	227
Net financial wealth	4,663	1,584	3,797
Net household wealth	8,725	2,234	6,745
Households (m)	39.7	3.3	26.1
Net wealth per household €'000s	220	677	258
Financial wealth per household €'000s	117	480	145

Source: Bundesbank, Deutsche Bank,SNB and Halifax

The astonishingly high wealth of Swiss households is a reflection of the number of millionaire households in the country. According to a study by the Economist Intelligence Unit undertaken for Barclays Wealth there were 2.4m households in Germany and 0.7m in Switzerland with net worth over US$1m in 2007. This is equivalent to 6% of German households but a massive 22.3% of

Swiss ones. Switzerland is in fact third in the world for density of households with net wealth in excess of US$1m, and is only beaten by Singapore with 23.3% and Hong Kong with 26.4%. Even the UK beats Germany with 15.6% of households with US$1m of net wealth. We believe this reflects the comparatively egalitarian society in Germany compared with other countries, but also perhaps the tendency of some wealthy Germans to escape the high tax rates in Germany and move their money out of the country, normally to Switzerland or Luxembourg.

The main drivers behind the continued growth of domestic wealth in Germany and Switzerland are:

- Continued economic growth – and it should be noted both have come through the financial crisis in a comparatively good shape for further economic growth.
- Demographic change – both Germany and Switzerland have ageing populations that will want to save for retirement. It is estimated that by 2030, 28% of German's will be over 65, compared with the current 21%, and in Switzerland it is estimated some 23% will be, compared with 17% today (see exhibit below). This saving will increasingly be done by individual households rather than the State, as the economic burden for the state will be too high.
- In the case of Germany, there is a good chance that new tax legislation should, over time, increasingly lead to more German money being repatriated from tax havens abroad.

Exhibit 5: Population over 65 in the next 20 years (%)

	2010	2020	2030
Germany	20.7	23.0	28.1
Switzerland	16.8	19.4	23.6
UK	16.4	18.7	21.2
Europe average	16.0	19.1	22.6

Source: Eurostat

The Economist Intelligence Unit study also forecast the number of millionaire households in 10 years' time, in 2017, and the number of such households was expected to rise 73% in Germany and just 30% in Switzerland, as we show in the following exhibit. This is an annual compound growth rate of 2.7% in Switzerland and 5.6% in Germany. Fund performance of, say, around 3% per year on average would mean that these markets for domestic wealth of over US$1m per household are growing, at just under 6% per year in Switzerland and over 8.5% per year in Germany. The higher German figure is the result of more households crossing that threshold than in Switzerland where households had already crossed that threshold some time ago. But domestic growth is not the only source of growth, as the Swiss also attract money from emerging markets – which the Germans do not.

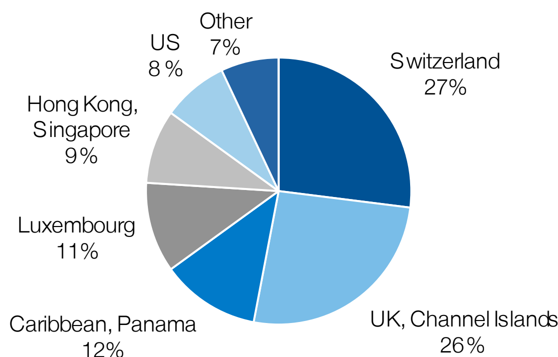
Exhibit 6: Number of households with net worth greater than US$1m in 2007 ('000s)

		2007	2017	% change
1	US	16,658	29,744	79%
2	UK	4,068	5,280	30%
3	Japan	3,596	10,677	197%
4	France	3,004	3,767	25%
5	Italy	2,768	3,232	17%
6	Germany	2,381	4,117	73%
7	Canada	1,086	1,979	82%
8	Spain	977	1,501	54%
9	Australia	929	1,187	28%
10	Switzerland	744	967	30%

Source: Barclays Wealth and Economist Intelligence Unit

In addition to domestic wealth, the Swiss banks are also fortunate that they attract money from other countries because of its political and economic stability and, especially in the past but less so in the future, the Swiss bank secrecy rules that facilitated tax avoidance. SNB data indicate that around half of the money in Swiss bank custody accounts actually belongs to non-residents. This has not been the case in Germany for largely historic reasons and means that the Swiss wealth management industry is not limited to just domestic wealth but international wealth as well. This is the so-called offshore banking market. The Boston Consulting Group estimates that the size of the cross-border market in 2009 was around US$7.4trn and that Switzerland had the largest market share of this with 27%, or US$2trn, as we show in the following exhibit.

Exhibit 7: Market shares in cross-border private banking



Source: Boston Consulting Group

Although Switzerland may lose money from EU countries such as Germany as bank secrecy and the tax breaks they allow are removed, it is expected that Switzerland will benefit from emerging market wealth creation. EU-sourced money probably accounts for around a third of the total in Switzerland, so growth from other areas should be able to compensate for a decline in EU money. The newly wealthy in those countries will want some of their wealth to be managed in a safe haven like Switzerland, not so much for tax avoidance purposes, but mainly because of security, to avoid the risk of it being taken by criminal gangs or their governments.

Regulation

German wealth managers are likely to benefit from regulatory changes requiring more funding for retirement to be undertaken by individuals rather than the state. In addition, they could also reap the benefits from repatriated money from Switzerland, as Germans lose the tax breaks for placing their money in Switzerland.

Pension regulations

Exactly how a country chooses to fund, or not to fund, its old age pensions can have a significant effect on household accumulation of wealth. Rights to such funds are typically included in estimates of a household wealth when they are rights on a pension fund or assets under management, but not if they are rights on a government old age pension scheme.

A country's pension system is normally described as comprising three pillars. These are:

1) state pay-as-you-go pensions;
2) funded occupational schemes; and
3) individual savings.

There are currently large differences between the sources of retirement income between Switzerland and Germany, as we show in the following exhibit.

Exhibit 8: Distribution of pension income between pillars (%)

	Netherlands	Switzerland	UK	US	Germany	France
First Pillar	50	42	65	45	85	79
Second Pillar	40	32	25	13	5	6
Third Pillar	10	26	10	42	10	15
	100	100	100	100	100	100

Source: Aegon, September 2010

Most of the retirement income that Germans currently receive is from the state scheme (Pillar 1), with very little from occupational schemes (Pillar 2) or individual savings (Pillar 3). In contrast, Switzerland was one of the first countries in the world to shift the retirement burden from the State to occupational schemes and individual savings. This is one of the reasons why the financial wealth of households in Switzerland is so high compared with Germany.

Over the last 10 years there have been some large changes in German retirement provision which should see the proportion of reliance from the state diminishing in the future. This will inevitably mean that more and more funds will find their way into occupational schemes and individual savings. These changes include the following:

Pillar 1

- From 2011 to 2023 the retirement age will be increased by one month per year, reaching 66 in 2023.
- From 2023 it will be increased by two months per year, to reach 67 in 2029.

Pillar 2 and Pillar 3

- Tax breaks for employers and employees, to encourage the accumulation of pension rights under these two pillars.

The Germans are now moving in the direction of more Pillar 2 and Pillar 3 provision and so are following a path that other countries, notably the Swiss, have already gone down. This should lead to additional growth in the German wealth management industry.

German and Swiss double tax treaty

Another regulatory change that should benefit German wealth managers is the German/Swiss double tax treaty. A large amount of German money is believed to be in Switzerland – we estimate some €222bn in the next chapter – and that money has long been a target for German politicians incensed that some of their citizens are not doing their national and social duty to pay tax on their earnings. An EU savings tax arrangement with Switzerland partly addressed this issue by levying a withholding tax on income, but it was only levied on interest income and there were numerous loopholes to avoid the tax.

In 2011, Germany and Switzerland signed a new double tax agreement, to be effective from 2013. Its main components were:

- Legacy assets, already in Switzerland to be 'regularised' by a one-off flat rate tax of 19-34%, or alternatively the owners could declare their assets in Switzerland to the German authorities and be subject to taxation by them.
- Withholding tax for all future revenue from German assets in Switzerland equal to 26.375% (the German flat rate of 25% plus the solidarity surcharge).

The Swiss believe that these arrangements maintain Swiss banking secrecy as only tax payments will be handed over to the tax authorities, not the names of the account holders. It should be noted that similar arrangements to those with Germany were also made with the UK and are expected to be a model for the rest of the EU.

There is currently some debate in Germany over whether they will ratify the latest German-Swiss tax agreement. The problem is that the Social Democrats and Green Party leaders believe that the proposed rules are too lenient to 'tax cheats' and should be considerably strengthened. The whole debate has been complicated by Switzerland issuing arrest warrants for some German tax inspectors who it believes were responsible for buying stolen tax lists of German clients from Swiss bank employees. On the 5 April 2012, in response to this opposition, the German and Swiss governments announced that the rates on legacy assets would rise from 19% to 34% to 21% to 41%, in an attempt to win support in the Bundesrat, Germany's upper chamber where the government does not have a majority.

The new rules do considerably reduce the tax advantages for Germans to have money in Switzerland and over time it is to be expected that more and more of this money returns to Germany. The Swiss banks will try and keep the money of course and will open operations in Germany to do so, but they face increased competition from the German financial sector on its home turf.

German money in Switzerland

There is a large amount of German money invested in Swiss banks in absolute terms – we estimate around €220bn. A lot of it has already been declared to the German tax authorities and we estimate this amount has been increasing over time, although some €130bn has not been declared. We expect more and more German money will be repatriated to Germany. But these amounts need to be put in context; German money represents just 12% of total non-resident money in Switzerland and 5% of total German financial wealth.

Estimates of German money in Switzerland

The Swiss National Bank (SNB) publishes data on the amount of money held in custody accounts by non-residents. At the end of 2010 this amounted to some CHF2,389bn and was larger than money from Swiss residents which amounted to just CHF2,063bn. A large part of the CHF2,389bn non-resident money was in euros, some CHF662bn in fact, and we believe that this figure is approximately equal to total EU money in Switzerland. Of course, EU citizens may have money in Swiss banks in different currencies, but the tendency for private banking clients is to invest in their home currency and not engage in currency speculation. Conversely, some non-EU citizens may also deposit money in Swiss banks in Euros. We believe that the two more or less cancel out and have justified this assumption using data on EU savings tax collections which we discuss in the next paragraph. It should be noted that most Swiss bank clients are mostly interested in capital preservation in their domestic currency and do not want to engage in currency speculation, with 70% of non-resident money actually not invested in Swiss francs.

We have verified this figure by a completely different route, using Swiss Finance Ministry data on tax it has collected for EU member states as part of the EU savings tax agreement. EU citizens have the option of either suffering a withholding tax on their interest income, or alternatively declaring their interest income to their tax authorities but leaving the money in Switzerland. By making some assumptions about the level of interest rates and the proportion of interest paying assets in the portfolio it is possible to estimate the size of EU assets in Switzerland. We have done this for a number of years and in each year reasonable assumptions more of less equal the total of non-resident money denominated in euros, according to SNB statistics.

However, the Swiss Finance Ministry gives the amount of withholding tax collected and interest income declared by country and this makes it possible to drill down and estimate the amount of declared and undeclared money by country. In the exhibit below we have shown the results for Germany from 2007 to 2010. At the end of 2010 German money, both declared and undeclared, amounted to just over 40% of total EU money in Switzerland, with total EU money in Switzerland amounting to just under 30% of the total of non-resident money in Switzerland. The 2011 data will not be available until June 2012.

Exhibit 9: German money in Switzerland

€bn	2007	2008	2009	2010
Undeclared	129	96	113	131
Declared	58	47	67	91
Total	187	143	180	222
% declared	31%	33%	37%	41%

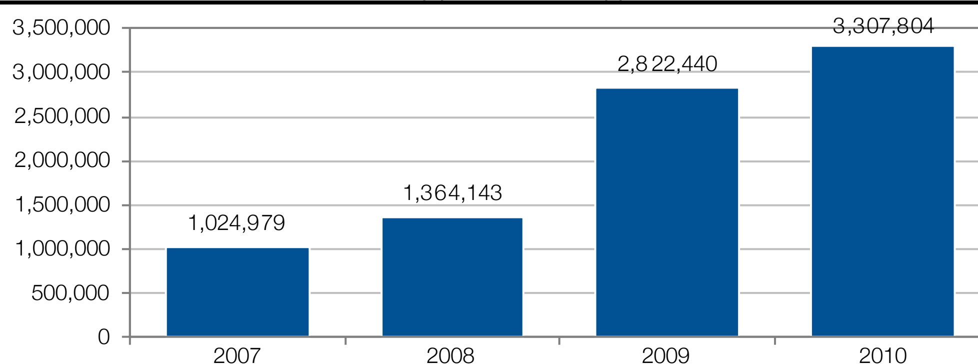
Source: Swiss Ministry of Finance, Edison estimates

We estimate that at the end of 2010 declared money was around 41% of the total in Switzerland, a figure supported by comments from some of the banks. For instance, Julius Baer has indicated that around a half of its German money has been declared to the German authorities already.

The increasing proportion of money that has been declared reflects the efforts by the German tax authorities to bring non-taxpayers to account. One method of doing this has been for German tax authorities to buy lists of Germans with bank accounts in Switzerland from Swiss bank employees for actually quite small amounts of money. The revelation of these purchases has actually frightened many Germans into declaring their untaxed money, with some even bringing the money home. The sale of these lists is against the law in Switzerland and the Swiss authorities have actually issued arrest warrants for three German tax inspectors.

Another interesting fact revealed by this data is that the number of German individuals choosing to declare their earnings was 56,566 in 2007, but by 2010 this had fallen to just 27,496. We believe this reflects the repatriation of money to Germany rather than the decision by Germans not to declare their earnings. The amount of declared money per individual has actually risen though, suggesting that is has been Germans will small amounts of money in Switzerland who have repatriated their money, presumably because they do not believe that the penalties in Germany are worth the amount of tax that they could save.

Exhibit 10: German Swiss declared money per declaration (€)



Source: Swiss Ministry of Finance, Edison estimates

The amount of German money in Switzerland needs to be put into context however. At €222bn at the end of 2010 it represents just 5% of German financial wealth and 12% of non-resident money in Switzerland so it is manageable for the Swiss industry as a whole, but some of the very small private banks and independent asset managers, which are not included in this study, would probably have problems.

Swiss banks in Germany

Swiss banks have been following their clients back to Germany and building an onshore business, but they face stiff competition from the German banks with their vast branch networks and facilities.

Swiss banks' onshore presence in Germany: Attempting to retain the money

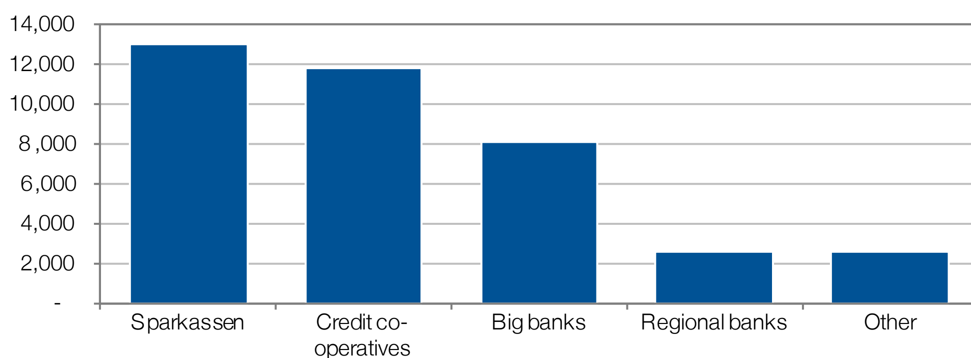
Exhibit 11: Swiss bank activities in Germany

Bank	Presence
Credit Suisse	12 major German cities
UBS	14 locations and 1,000 employees
EFG International	Frankfurt
Julius Baer	Kiel, Hamburg, Dusseldorf, Frankfurt, Wurzburg, Stuttgart, Munich
Sarasin	Frankfurt, Hamburg, Hannover, Cologne, Munich, Nuremberg
Vontobel	Cologne, Frankfurt, Hamburg, Munich
VZ Holding	Dusseldorf, Frankfurt, Nuremberg, Munich

Source: Banks

While the Swiss have increased their onshore presence in Germany considerably over the last few years, they are really minor players compared with the German banks and wealth managers. Consider the following chart showing the branch networks of the German banking sector, and this excludes the Postbank branch network. There are over 38,000 bank branches in Germany which compares with the near 50 branches for the Swiss banks in the above table. In addition of course, there are also the German wealth managers who are going after the same money. The Swiss banks will have to work very hard to stop the money moving back, let along capture new money.

Exhibit 12: German bank branch network



Source: Bundesbank

Without the tax breaks that have been available from having money in Switzerland, the Swiss banks have little to offer German clients that the German banks cannot give them. One of their sources of competitive advantage has been lost, though the Swiss do argue that their levels of service are superior to those of the German banks. This does not necessarily mean that the German clients will immediately take out their money from the Swiss banks, just that over time we expect that the money will tend to drift to the German banks as various lifetime events occur, such as the passing of wealth to the next generation.

Emerging markets

Switzerland is a destination for emerging market money, which is not the case for the German banks. Moreover, the Swiss are actively setting up operations to capture growth in emerging markets, in a way that German banks, with the exception of Deutsche Bank, are not. This should give them an additional growth driver compared with their German peers.

Emerging market growth

The number of household dollar millionaires may grow by 63% in Germany and Switzerland between 2007 and 2017, according to the Economist Intelligence Unit estimations, but the growth in the emerging markets will be truly stellar in comparison. Among the BRIC countries the growth rate in that period will be 5036%, as we show in the following exhibit.

Exhibit 13: Number of millionaires and growth rates: Germany and Switzerland vs BRICS

'000s	2007	2017	% change
Germany	2381	4117	73%
Switzerland	744	967	30%
Total	3,125	5,084	63%
BRICSs			
Brazil	Negligible	675	
Russia	17	508	
India	Negligible	411	
China	22	409	
	39	2003	5,036%

Source: Economist Intelligence unit

Swiss banks in the emerging markets

The Swiss banks have made a concerted attempt over the last 10 years to win business in the emerging markets in a way that the German banks have not, Deutsche Bank excepted. The following exhibit summarizes their emerging market presence as best as we can estimate. It should also be noted that a lot of emerging market money will actually be managed offshore in Switzerland. This is not for tax reasons, but because Switzerland gives greater security than many emerging market customers feel they could achieve in their domestic markets – where the prospect of their wealth being taken by criminal gangs or even their governments is a true possibility. Furthermore, while currency portability is relatively widespread today, that has not always been the case, and wealth emerging market families like to have some money in a Swiss bolt hole just in case.

Exhibit 14: Swiss bank presence in emerging markets

	Asia	Other	Total
EFG International	18%	15%	33%
Julius Baer	15%	20%	35%
Sarasin			16%
Vontobel			12%
VZ Holding			0%

Source: Banks, Edison Investment Research estimates

Emerging market money may be expensive to acquire initially and bring with it a sort of new business strain, but the growth potential is so vast that they could truly transform the business of banks such as Julius Baer and EFG International.

Business models and profit drivers

There are a large number of companies looking to benefit from the growth of wealth management in Germany and Switzerland, from the very large such as Deutsche Bank, UBS or Allianz, to small unquoted individuals. For the mega caps, the wealth management business tends not to be the central focus of market attention, with investors more worried about investment banking or the P&C cycle. The micro caps are unquoted so investors do not have access to them. Among those that remain, the main business models are brokers and private banks, so their financial statements look very different but their sensitivity to market conditions is similar and is overwhelmingly dominated by market confidence and emerging market growth.

The wealth management industry in Germany and Switzerland has many participants. At one end of the scale there are the giant banks and insurance companies such as Deutsche Bank and Allianz in Germany and Credit Suisse, UBS and ZFS in Switzerland. At the other end of the scale are the numerous independent financial advisers who thrive in both countries. Both the large companies and the small players will benefit from the long-term structural features we have described that will support growth in German and Swiss wealth management, neither is an ideal vehicle to invest in to gain exposure to this as an investment theme. For the big companies wealth management tends to be only part of their business and the equity market is more concerned with other themes which swamp the wealth management business. For the large banks such as Deutsche Bank, Credit Suisse and UBS it is the future of investment banking and Basel III capital standards. For the insurers like Allianz and ZFS it is the underwriting cycle, reserve adequacy and Solvency 3. The small independent financial advisers are simply not quoted so investment in them is impossible.

The companies we have identified to enable investors to gain exposure to wealth management in Germany and Switzerland are a mixture of brokers and private banks. In Germany, the private banks are not quoted on the market, but there are brokers who do have quotes, though some are quite small. In Switzerland, there are some well-known private banks that are quoted and there is a new entity, VZ Holding. Brokers tend to sell other companies' products for a fee and to be transaction based, though there is some recurring commission. Private banks also sell other companies' products – they virtually all claim to be open architecture – but they have ongoing relationships with their clients and the amount of fees that are recurring tends to be higher than for the brokers. Both business models are viable but we have a slight preference in favour of private banks, which tend to create more customer loyalty than the brokers and, in periods of weak financial markets, can at least earn fees on their AuM and are not entirely dependent on transactions.

The following two exhibits summarise the companies in this report as regards business model, EBIT margin and ownership. As can be seen, the German companies are mostly brokers and they have tiny EBIT margins while the Swiss are private banks with much larger EBIT margins. The private banks earn part of their margin from using their own balance sheet and making margins on deposits and loans – which the brokers do not do – and the brokers compete largely on price, whereas the private banks use their brand to generate customer loyalty.

Exhibit 15: German companies

	Germany			
	Hypoport	MLP	OVB	W&W
Business	Broker	Broker	Broker	Bank and insurance conglomerate
Gross margins	N/A	N/A	N/A	N/A
EBIT Margin	7%	3%	3%	4%
Revenue by geography				
Germany	100%	100%	33%	100%
Switzerland				
Emerging markets			57%	
Other			10%	
	100%	100%	100%	100%

Source: Company reports, Edison Investment Research

Exhibit 16: Swiss companies

	Switzerland				
	EFG Int	Julius Baer	Sarasin	Vontobel	VZ Holding
Business	Private Bank	Private Bank	Private Bank	Private Bank & Inv Bank	Private Bank
Gross margins	0.94%	1.04%	0.68%	N/A	1.70%
EBIT Margin	12%	34%	26%	20%	44%
Revenue by geography					
Germany	2%	10%	8%	10%	100%
Switzerland	8%	20%	40%	25%	
Emerging markets	45%	40%	25%	10%	
Other	45%	30%	27%	55%	
	100%	100%	100%	100%	100%

Source: Company reports, Edison Investment Research

The main macro profit drivers are economic and financial confidence on the one hand and emerging market exposure on the other. The following table summarizes these exposures for the companies in this report. Both brokers and private banks are highly sensitive to the economic environment for investing, with low economic confidence tending to considerably reduce transaction activity and the creation of long-term savings commitments. Emerging markets exposure simply gives far greater profit and growth prospects in the long term. In addition to the macro drivers there are also more stock specific drivers. We summarise these in the table below.

Exhibit 17: Macro and stock specific profit drivers

Note: XXX indicates highly exposed.

	Financial confidence	Emerging markets	Gain in market share	Gross margin	Cost control	FX risks
Hypoport	XXX		XXX		XXX	
MLP	XXX		X		XX	
OVB	XXX	XXX		XX	X	
W&W	XXX				XXX	
EFG Int	XXX	XXX		XX	XXX	XXX
Julius Baer	XXX	XXX		XX	XXX	XXX
Sarasin	XXX	XX	XX		XXX	XX
Vontobel	XXX		X	XX		XX
VZ Holding	XXX				X	

Source: Edison Investment Research

Valuation

Most of the stocks in this study are trading at P/Es below their recent average, but arguably that average has been heavily distorted by the exceptional five years that we have recently undergone in the financial markets. We do find that the current valuations are broadly supported by our discounted cash flow analysis at a cost of equity of 10%, arguably quite a conservative figure.

The 2012 P/Es for the German and Swiss companies are well below their recent five-year historic averages, as we show in the exhibit below.

Exhibit 18: Valuation statistics

Note: Priced at 26 April 2012.

	Price	Mkt cap	P/E (x) 2012	P/E (x) 2013	Div yield 2012	P/tNAV (x) 2012	P/E (x) average	Upside to historic average
German	€	€m						
Hypoport	10.81	67.0	12.5	10.3	0.0%	21.1	23.5	88%
MLP	6.46	697.0	13.4	11.9	4.6%	2.7	27.0	102%
OVB	18.98	270.5	57.8	49.1	1.8%	3.9	39.9	(31%)
W&W	15.49	1,425.1	5.9	5.7	3.2%	0.5	13.2	122%
German average (ex OVB)			10.9	9.3	2.0%	7.0		0%
Swiss	CHF	CHF						
EFG Int	8.65	1,269	15.3	12.7	1.2%	5.6	26.7	74%
Julius Baer	34.74	7,094	13.9	11.9	1.7%	2.7	22.1	59%
Sarasin	27.95	1,752	14.1	11.6	3.6%	1.6	28.2	100%
Vontobel	22.15	1,418	10.2	8.8	5.4%	1.0	14.7	44%
VZ Holding	97.00	765	13.9	12.6	2.7%	3.9	17.2	24%
Swiss average			13.5	11.5	2.9%	3.0		

Source: Edison Investment Research

However, we believe that P/E ratios are a dangerous valuation guide when looking at the last five-year record, as that period was one of financial crisis and earnings for these companies were depressed, and therefore did not reflect the true earnings power of many of these companies. The market was well aware of that and so looked through the temporary depressed earnings to consider something more normal in establishing market valuations for these companies. The upside to the five-year historic P/E ratio does indicate the potential for these companies in a 'blue sky' scenario though.

A more satisfactory way of valuing these companies is probably some sort of discounted cash flow analysis, as this takes many years of profits into account and so is not distorted by one particularly good or bad year. In doing such an analysis though we believe that it is important to estimate the current capital strength of the companies, as some clearly have surplus capital and others a deficit. In the following table we have summarised the capital strength of the companies in this study.

Exhibit 19: Balance sheet strength of German and Swiss wealth managers

Balance sheet ratios 2011				
German	Tier 1 ratio	Equity ratio	Tangible equity ratio	Financial conglomerate
Hypoport		43%	8%	
MLP		27%	19%	
OVB		54%	46%	
W&W				140%
Swiss	Tier 1 ratio	Equity ratio	Tangible equity ratio	Financial conglomerate
EFG Int	12.8%			
Julius Baer	21.8%			
Sarasin	15.6%			
Vontobel	23.3%			
VZ Holding		19%	19%	

Source: Companies

The four Swiss banks for whom we have shown the tier 1 ratios in the above exhibit have comfortable tier 1 ratios, (the current minimum is 4% and most banks would consider a figure over 10% to be good) and these banks are almost completely unaffected by the move to Basel III rules. The exception is EFG International, whose current tier 1 capital is made up of a significant amount of bons de participation, which are set to be retired under Basel III rules. If they were excluded, the tier 1 ratio would be an unsatisfactory 4%. The company has said that it will reach a total capital ratio of 14% through balance sheet management and capital retention. Julius Baer has excess capital, and we have allowed for this in our valuation. Perhaps the same could also be said for Vontobel, but this company does use its balance sheet in its core Swiss equity warrants business and we do not believe that in reality it could run its business at a lower capital ratio than the current published one.

As for the German companies, we believe the way to analyse capital strength for them is to use equity ratios, or more precisely tangible equity ratios, as most have significant levels of goodwill and intangibles on their balance sheets. Here the standout ratio on the positive side is OVB, which indicates a degree of overcapitalisation. The laggard is Hypoport, which has suffered poor profitability from its policy of aggressive expansion. It hopes to boost its capital position when its profits improve. And finally, the financial conglomerate W&W, where we have published their 'financial conglomerate ratio'. Our high level analysis of their balance sheet – when allowing for the separate banking and insurance business – suggests the need to increase their equity capital base by around €500m over the next few years until 2019 when Basel III becomes effective and we have allowed for this in our valuation.

In summary, the allowances we have made in considering the valuations of these companies are shown below. Our approach is to calculate the DCF value of the company, assuming it is properly capitalised, and then make a deduction from that value if it needs more capital or add to that valuation if it needs additional capital. The figures in brackets show the impact on our valuations.

Exhibit 20: Excess/deficit capital estimates

German	
Hypoport	Deficit €5m (-5%)
OVB	Surplus €20m (+27%)
W&W	Deficit €500m (-23%)
Swiss	
Julius Baer	Surplus CHF800m (+12%)
Sarasin	Surplus CHF200m (+13%)

Source: Edison Investment Research

Using 20-year DCF valuation models with a 10% cost of equity we arrive at the following valuations.

Exhibit 21: Valuation statistics

Note: Priced at 26 April 2012.

	DCF value	Deficit/ surplus	Net value	No. of shares	DCF value per share	Share price	Upside
German	€m	€m	€m	m	€	€	
Hypoport	92.4	(5.0)	87.4	6.2	14.09	10.81	30%
MLP	714.8		714.8	107.9	6.62	6.46	3%
OVB	74.5	20.0	94.5	6.2	15.24	18.98	(20%)
W&W	2,185	(500)	1,685	92	18.32	15.49	18%
Swiss	CHFm	CHFm	CHFm	m	CHF	CHF	
EFG Int	1,361		1,361	146.7	9.3	8.65	7%
Julius Baer	5,955	800	6,755	196.4	34.4	34.74	(1%)
Sarasin	1,510	200	1,710	62.7	27.3	27.95	(2%)
Vontobel	1,613		1,613	64.0	25.2	22.15	14%
VZ Holding	827		827	7.9	104.9	97.00	8%

Source: Edison Investment Research

This more conservative approach is supportive of the current share prices, and indeed, Hypoport looks extremely good value on this measure. Of course, if a bull market were to return and investors took a far more positive view of the future then it would be appropriate to use a lower cost of equity. Lowering the figure to 8%, for instance, would add around 20% to most of our valuations. If financial market confidence does not return however, we expect that all of these stocks would fall in value, but in such a circumstance Julius Baer would be our preferred holding given its liquidity, balance sheet strength and comparatively flexible cost base.

The key statistics we have used in our valuations are shown in the following exhibit.

Exhibit 22: Key DCF assumptions

	DCF based on	Gross margin	Cost/inc ratio	EBIT margin	Growth	Cost of equity	NB: EBIT margin 2010	2011
German								
Hypoport	EBIT			10%	8%	10%	9.6%	7.0%
MLP	EBIT			14%	6%	10%	9.0%	3.5%
OVB	EBIT			4%	5%	10%	2.6%	2.9%
				ROE			ROE	ROE
W&W	ROE			8%	5%	10%	6.5%	6.3%
Swiss								
EFG Int	AuM	0.95%	80%	20%	7%	10%	15%	12%
Julius Baer	AuM	1.05%	67%	33%	7%	10%	35%	32%
Sarasin	AuM	0.70%	75%	25%	7%	10%	27%	25%
Vontobel	PB AuM	0.80%	80%	20%	7%	10%	23%	16%
Vontobel	AM AuM	0.45%	75%	25%	9%	10%	23%	19%
VZ Holding	AuM	1.75%	55%	45%	9%	10%	48%	46%

Source: Edison Investment Research

Company profiles

Edison investment research

Hypoport

Year end	Revenue (€m)	Net income* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/10	66.9	3.3	0.53	0.00	20.4	N/A
12/11	84.4	3.7	0.60	0.00	18.0	N/A
12/12e	96.2	5.4	0.86	0.00	12.5	N/A
12/13e	107.6	6.5	1.05	0.00	10.3	N/A

Note: *Normalised. Edison estimates.

Investment summary: Consistent revenue growth

Hypoport offers financial products directly to customers via the internet, backed up by a branch network and sales agents, and an internet-based platform for financial intermediaries (B2B). Despite two financial crises in the last five years, it has been able to show consistent revenue growth with a CAGR of 26% from 2006 to 2011. EBIT growth has been less than half this level as it has invested on product diversification and developed a branch network to support its online presence, but these should lead to more profit and revenue growth in the future and a return to 20% EBIT margins.

Consistent growth

Hypoport has been able to produce consistent growth and it plans to continue this and has made the necessary investments. Management is convinced that a combination of business volume growth and a slowdown in investment in its branch network should allow its EBIT margins to double. It believes that hot online leads backed up by face-to-face meetings in the branches is a winning combination in the private client business. In the B2B unit, investments to renew the platform have been made, leading to better performance and lower costs of tying in new partners. Management is convinced that the scalable business model will heavily contribute to growth from market and the ”market place effect” as product providers join others already on the platform.

Sensitivities

Sensitivities include: (1) financial confidence, which is vital for the sale of mortgage (40% of EBIT) and investment and savings products. Hypoport has been able to grow its way out of the last two financial crises, but its increased size may not allow it to do this next time. (2) Competition from the many other product providers in Germany.

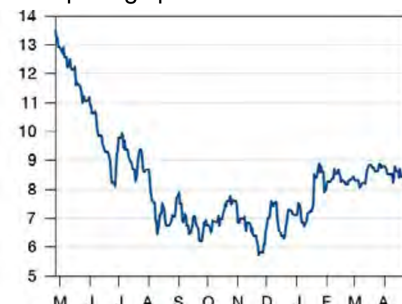
Valuation

At a P/E of 12.5x 2012 earnings Hypoport is trading well below its five-year average of 23.5x, but that figure is artificially high as earnings have been depressed by the financial crises. Our 20-year DCF, using a 10% cost of equity, suggests a value of €14.09, even allowing for additional equity to reinforce its balance sheet and this is well above the current share price. We estimate the company needs around €5m more equity and that it should be able to acquire this through retained earnings.

Price*	€10.81
Market cap	€67m

*As at 26 April 2012

Share price graph



Share details

Code	HYQ GY
Listing	Frankfurt
Sector	Finance - Other Services
Shares in issue	6.2m

Price

52 week	High	Low
	€13.55	€5.90

Balance sheet as at 31 December 2011

tNAV per share (€)	0.51
Equity ratio (%)	43
Tangible equity ratio (%)	5

Business

Hypoport AG is an internet-based financial services provider acting as a broker for the retail market and institutional clients. It is developing a branch business to capitalise on the leads from its online presence. Further, Hypoport is providing an internet-based marketplace that integrates product providers with financial intermediaries.

Revenue by segment

Financial products	B2B	Other
71%	28%	1%

Analyst

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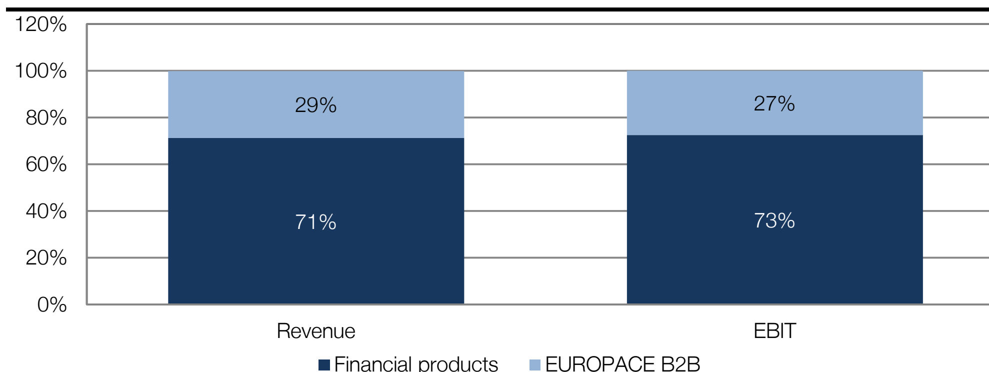
Company description: Internet-based financial services

Hypoport has two main areas of operation: the selling of retail financial products via the internet, mostly through its Dr. Klein & Co subsidiary, and an online B2B financial marketplace for brokering financial products known as EUROPACE.

As we show in the following exhibit, the financial products business is the most important, contributing over 70% of revenue and EBIT (before group eliminations) in 2011.

Exhibit 1: Hypoport revenue and EBIT by segment

Note: EBIT share calculated before inter-company elimination.



Source: Company

The financial products segment comprises two elements, one dealing with real estate professionals and the other with private clients. The former are mostly offered mortgage loans and insurances and the latter mortgage loans, personal finance, current accounts, deposit accounts and insurance products. Around 86% of this segment's revenue is from the private client sub unit. The private clients can buy products over the internet, via a branch or through sales agents. There are now some 190 branches throughout Germany, with 680 advisors operating in them. It claims to have a strong leading generating capacity through its strong online presence. Originally mortgage loans were the dominant product, but this has been surpassed by other products in recent years.

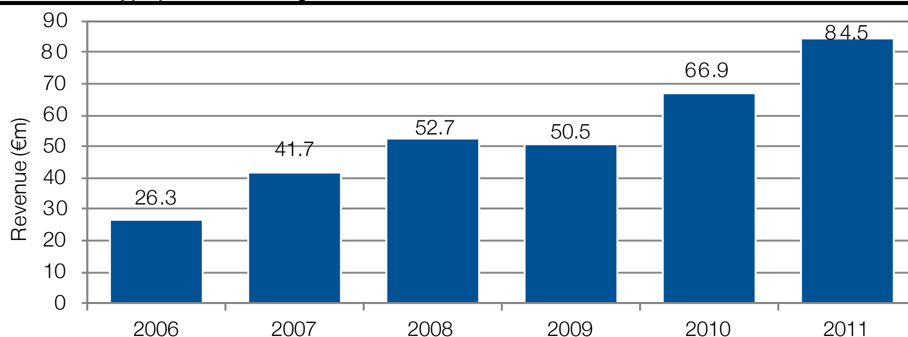
EUROPACE allows independent distributors to process their financial transactions with the product suppliers that they represent. It was started in 1999 and there are some 190 partners leading to several thousand financial advisors who use it to process their transactions. It is heavily dependent on state of the art technology and has some 100 IT staff employed. In this respect, Hypoport acts as an IT company.

Consistent growth

The last five years have been somewhat exceptional for the financial world with two major financial crises in 2008/09 and 2011, but even over that period Hypoport was able to produce steady growth, which actually resulted in a compound annual growth rate of some 26%.

Unfortunately, profit growth has not kept pace with this revenue growth and over this period has grown at a compound annual growth rate of just 11%. Management attributes this to increasing investment in product diversification and more product distribution channels, including the branches, which should lay the grounds for further revenue and profit growth in the future.

Exhibit 2: Hypoport revenue growth

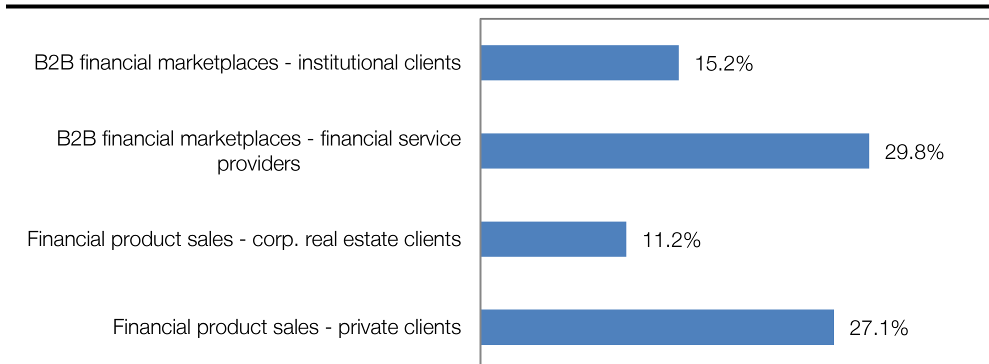


Source: Company reports

In terms of the growth in its two main business segments, those dealing with end customers – either directly in the financial product sales or through intermediaries in the B2B financial marketplace – have shown the best growth, as we show in the following exhibit.

Exhibit 3: Hypoport five-year CAGR revenue growth by business segment

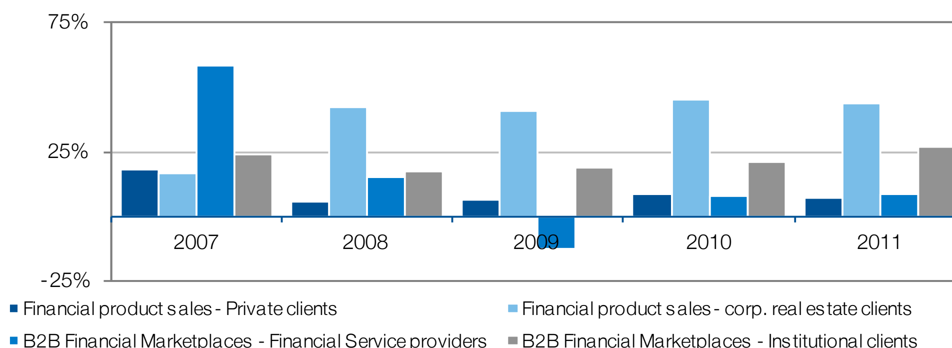
Note: B2B financial marketplace growth for institutional clients for four years only.



Source: Company reports

The sale of financial products to private clients accounts for over 60% of group revenue and has seen a marked fall in EBIT margins as the company spends on developing its branch network, as we show in the chart below.

Exhibit 4: Hypoport EBIT margins by segment



Source: Company reports

Management has a large stake in Hypoport with the CEO, Ronald Slabke, through Revenia Gmbh owning 34.8%. Other management members or their foundations own 21.4%, Deutsche Postbank 9.7% leaving a free float (excluding board members) of 34.1%. No dividend is paid and earnings are retained in the business to strengthen the balance sheet.

Sensitivities

The group's main sensitivities are to:

- **Market confidence:** Client demand for financial products, be it mortgage loans or investment products, depends on confidence and although Hypoport has managed to grow through the last two financial crises, it may not be so successful next time.
- **Competition.** Competition from the many banks and other product distributors in Germany is likely to intensify as the market grows, but Hypoport expects that its ability to offer a wide range of products through an efficient platform should give it the edge over the integrated providers.

Financials

We have factored in mid-teen revenue growth over the next two years and a gradual increase in EBIT margins. This may be too conservative. If revenue growth was in line with the historic average of 26% per year and EBIT margins rebounded to 25% as they were in 2006 and 2007, then net profits in 2012 would be just over €20m, compared with our forecast of €6.5m. This shows the sensitivity of the company's profits.

Exhibit 5: Profit and loss

€'000s					Change		
	2010	2011	2012e	2013e	11/10	12/11	13/12
Financial product sales - corp. real estate clients	8,506	8,505	9,000	9,500	(%)	6%	6%
Financial product sales - private clients	40,264	51,686	59,439	65,383	28%	15%	10%
B2B financial marketplaces - financial service providers	14,804	20,395	23,454	28,145	38%	15%	20%
B2B financial marketplaces - institutional clients	3,271	3,733	4,200	4,500	14%	13%	7%
Other	67	67	67	67			
Revenue	**66,912**	**84,386**	**96,160**	**107,595**	**26%**	**14%**	**12%**
Selling expenses	(26,634)	(39,903)	(44,234)	(49,494)	50%	11%	12%
Gross profit	40,278	44,483	51,926	58,101	10%	17%	12%
Own work capitalised	5,742	4,021	4,000	4,000	(30%)	(1%)	N/A
Other operating income	1,363	1,845	1,800	1,800	35%	(2%)	N/A
Personnel	(24,603)	(26,690)	(30,771)	(34,430)	8%	15%	12%
Other operating expenses	(11,633)	(12,564)	(13,250)	(14,000)	8%	5%	6%
Depreciation and amortisation	(4,721)	(5,180)	(5,200)	(5,350)	10%	%	3%
EBIT	**6,426**	**5,915**	**8,505**	**10,121**	**(8%)**	**44%**	**19%**
Financial result	(1,603)	(808)	(800)	(800)	(50%)	(1%)	N/A
Earnings before tax	4,823	5,107	7,705	9,321	6%	51%	21%
Tax	(1,561)	(1,358)	(2,312)	(2,796)	(13%)	70%	21%
Net profit	**3,262**	**3,749**	**5,394**	**6,525**	**15%**	**44%**	**21%**
Minority interests	12	(32)	(35)	(40)			
Net profit after minority interests	**3,274**	**3,717**	**5,359**	**6,485**	**14%**	**44%**	**21%**
Weighted average number of shares (m)	6.2	6.2	6.2	6.2			
EPS	**0.53**	**0.60**	**0.86**	**1.05**	**13%**	**44%**	**21%**
DPS	N/A	N/A	N/A	N/A			
Payout ratio	N/A	N/A	N/A	N/A			
EBIT margin	9.6%	7.0%	8.8%	9.4%			
Cost/income ratio	91.3%	93.4%	91.7%	91.1%			
Selling expenses/revenue	40%	47%	46%	46%			
Personnel expenses/revenue	37%	32%	32%	32%			
Tax rate	32%	27%	30%	30%			

Source: Hypoport, Edison Investment Research estimates

Exhibit 6: Balance sheet

€'000s

Balance Sheet	2010	2011	2012e	2013e	11/10	12/11	13/12
Goodwill & intangibles	27,809	27,867	28,000	28,000	0%	0%	
Other	39,369	44,269	47,000	50,000	12%	6%	6%
Total assets	67,178	72,136	75,000	78,000	7%	4%	4%
Other liabilities	39,788	40,867	38,342	34,843	3%	(6%)	(9%)
Minority interests	188	220	250	265			
Shareholders' equity	27,202	31,049	36,408	42,892	14%	17%	18%
Total liabilities	67,178	72,136	75,000	78,000	7%	4%	4%
Number of shares at year end m	6.2	6.2	6.2	6.2			
BV per share	4.39	5.01	5.87	6.92			
BV per share (ex intangibles)	-0.10	0.51	1.36	2.40			
Equity ratio	41%	43%	49%	55%			
Tangible equity ratio	(1%)	8%	18%	30%			
Return on equity (ex intangibles)	(539%)	289%	92%	56%			

Source: Hypoport, Edison Investment Research estimates

MLP

Edison investment research

Year end	Revenue (€m)	Net income* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/10	523	34.0	0.32	0.30	20.5	4.6
12/11	546	12.5	0.12	0.60	56.0	9.3
12/12e	578	52.1	0.48	0.30	13.4	4.6
12/13e	611	58.7	0.54	0.35	11.9	5.4

Note: *Normalised. Edison estimates.

Investment summary: Profit recovery

MLP should see a profit revival in 2012 with an absence of restructuring one-offs that hurt 2011 profits (€33.4m), plus the benefits of that restructuring and hopefully better market conditions, but uncertainties remain. Its solid business model of providing holistic financial services to well educated professional Germans from university to retirement should produce steady growth. Growth has moderated over the last few years on the back of the financial crises and ensuing uncertainty. However, its policy of paying out high dividends of around 60% to 70% of earnings means it offers a good yield and is probably sustainable, given that it is essentially an agency broker and does not need capital for expansion.

Solid business model, but competition

MLP's business model of serving upmarket, well-educated Germans from university to retirement with all their financial services needs has proved so successful that it has been copied by others, who have consequently attempted to poach MLP's consultants. This has put pressure on growth and margins. The company has responded with an efficiency programme and has increased its consultant remuneration and should be able to resume growth, but at a slower pace than the bulls of the stock anticipated in the past. Management expects a slight increase on old-age and health insurance in 2012 and stronger growth in wealth management in 2012.

Sensitivities

Sensitivities include: (1) equity market strength and client confidence; (2) pension and tax regulation in Germany; and (3) competition for clients and especially for consultants.

Valuation

At a P/E of 13.4x 2012 earnings MLP is trading below its 27x average over the last five years. But that average was based on expected high growth rates that have not materialised and earnings depressed by the financial crises. Our 20-year DCF gives a fair value of €6.62 at a cost of equity of 10% in line with the current share price. This model assumes growth of 6% per year. If that was increased to 8%, our valuation would increase to €7.9.

Price*	€6.46
Market cap	€697m

*As at 26 April 2012

Share price graph

Share details

Code	MLP GY
Listing	Frankfurt
Sector	Financial Services
Shares in issue	107.9m

Price

	High	Low
52 week	€7.34	€4.11

Balance sheet as at 31 December 2011

tNAV per share (€)	2.4
Loans/deposits (%)	44
Equity ratio (%)	26.8

Business

MLP is a financial services consulting company that seeks to provide lifetime financial advice to high earners, such as doctors and lawyers, from the time they leave university to their retirement.

Commissions and fees by product

Old age provision	Wealth mgmt	Health ins	Other
59%	16%	15%	10%

Analyst

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Company description: Holistic financial advice

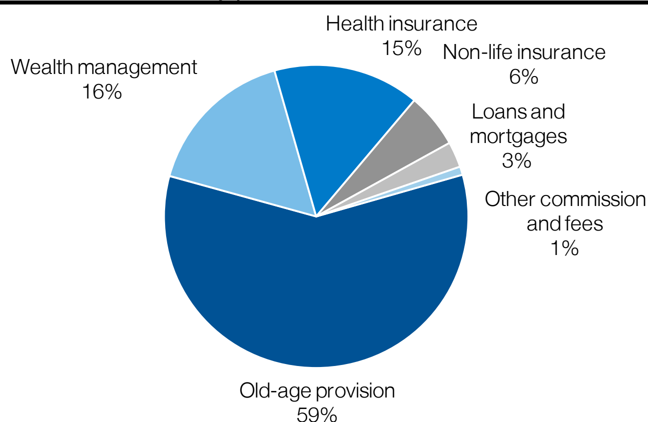
MLP AG is a leading independent financial consulting company in Germany. It was founded in 1971 by Eicke Marschollek and Manfred Lautenschlager and floated in 1988. Its business model is based on providing holistic financial planning advice to well educated Germans from university to retirement. It started with lawyers, medical professionals and dentists as it believed that in the long run they would earn good salaries and have a need for financial service provision, but it has since broadened its customer base to include engineers and economists. MLP has attempted to expand outside Germany into places such as Switzerland and the Netherlands, and even the UK, but it was not able to repeat the success abroad that it had in Germany – due to the strength of incumbent distributors – and those initiatives have now ceased. MLP has always focused on providing independent research, which was slightly at odds with its ownership of a life insurance company, but in 2005 that business was sold to HBOS to underline that independence was its core offering to its client base.

It has diversified its product offering and now provides consultancy services to companies on products such as occupational pension schemes. At a group level, such consultancy services now account for 20% of revenue.

In recent years the company has made some acquisitions, the most notable being in Feri AG, which offers financial advice, asset management, economic research and a rating agency. It bought a 43% stake in 2006 and increased that to 100% in 2011, though there has been some dispute with Feri AG shareholders about the €115m price paid. Other acquisitions include ZSH (2009), which focuses on consultation for dentists and TPC (2008), which specialists in pension consultation. ZSH cost €11.3m, but no price was disclosed for the TPC purchase.

Around 95% of MLP's revenues are earned from commissions and fees and over these old-age provisions, wealth management and health insurance make up around 90% of the total, as we show in the exhibit below.

Exhibit 1: MLP Commissions and fees by product



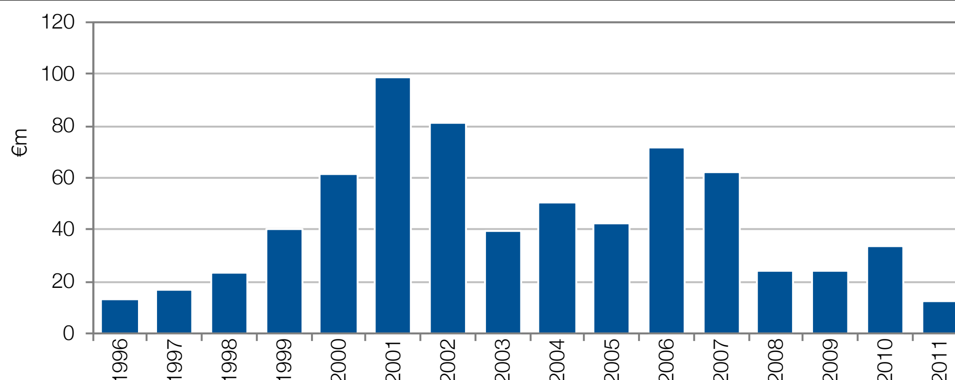
Source: MLP

Growth potential unrealised

When MLP AG was floated on the market it quickly became a market darling and offered high growth potential with its distinctive business model. Unfortunately, the growth that was hoped for MLP did not materialise, as we show in the exhibit below.

Exhibit 2: MLP net profit progression

Note: Excluding profit from the sale of the life company in 2005.



Source: Company reports

The financial crises of 2008/09 and 2011 had a damaging effect on the demand for long-term financial commitments from clients and this has hurt earnings progression. There has also been intensified competition in its core market for quality consultants as well as clients. Combined with some expensive and ultimately unsuccessful entries into other markets, which were also a drain on profits, the end result was most disappointing. In 2011 MLP undertook some efficiency initiatives and increased the commission paid to its consultants in an attempt to keep them and it hopes this will lead to resumed profit growth. We have assumed some growth in 2012 and 2013 in our forecasts. But given the company's previous problems on delivery we have taken a cautious approach.

Sensitivities

The group's main sensitivities are to:

- **Equity markets.** MLP customers seem, like most, to be very sensitive to tying up their money in long-term products such as old age provision when the economic and financial climate are uncertain.
- **Competition.** MLP is not alone in noticing that its target market is one of the most attractive and has lost both customers and consultants to the competition.
- **Regulation:** Increased incentives for old age provision in Germany.

Financials

We anticipate that in 2012 MLP AG will not have a repeat of the €33.4m of restructuring costs that hurt profits in 2011, and that customers will slightly increase their propensity to undertake more financial activity. The company actually targets an EBIT margin of 15% in 2012, which is quite possible in good market conditions, but we have been more conservative and forecast just under 13%. If it did achieve 15% though, it should boost net profits by 25% more than our forecast.

Exhibit 3: Profit and loss

€m					change		
	2010	2011	2012e	2013e	11/10	12/11	13/12
Old-age provision	288	293	308	323	2%	5%	5%
Wealth management	79	81	88	95	3%	8%	8%
Health insurance	61	78	85	94	27%	10%	10%
Non-life insurance	28	29	30	32	4%	5%	5%
Loans and mortgages	12	14	14	15	12%	5%	5%
Other commission and fees	4	4	5	5	10%	5%	5%
Commission and fees	472	499	530	563	6%	6%	6%
Interest income	25	28	28	28	12%	0%	
Revenue	497	527	558	591	6%	6%	6%
Other revenue	25	19	20	20	-26%	6%	
Total revenue	523	546	578	611	4%	6%	6%
Commission expenses	(189)	(213)	(228)	(242)	13%	7%	6%
Interest expenses	(9)	(8)	(8)	(8)	-9%	-4%	N/A
Personnel expenses	(106)	(117)	(116)	(122)	10%	-1%	6%
Depreciation and amortisation	(16)	(18)	(18)	(18)	16%	-2%	N/A
Other operating expenses	(157)	(171)	(135)	(138)	9%	-21%	2%
Associates	1.3	1.1	1.0	1.0	-15%	-9%	N/A
EBIT	47.1	18.9	74.4	83.8	-60%	294%	13%
Other interest and similar income	6	3	3	3	-48%	-9%	N/A
Other interest and similar expenses	(6)	(4)	(3)	(3)	-44%	-14%	N/A
Finance cost	0.0	(0.2)					
Earnings before tax	47.1	18.7	74.4	83.8	-60%	298%	13%
Taxation	(13.0)	(6.5)	(22.3)	(25.1)	-50%	241%	13%
Earnings from continuing operations	34.1	12.2	52.1	58.7	-64%	329%	13%
Earnings from discontinued operations	(0.1)	0.3					
Net profit	34.0	12.5	52.1	58.7	-63%	318%	13%
Weighted average number of shares	107.9	107.9	107.9	107.9			
EPS	0.32	0.12	0.48	0.54	-63%	318%	13%
DPS	0.30	0.60	0.30	0.35	100%	-50%	17%
Payout ratio	95%	520%	62%	64%			
Consultants	2,273	2,132	2,140	2,145	-6%	0%	0%
New clients	34,000	34,600					
AuM bn	19.8	20.2	21.2	22.3	2%	5%	5%
EBIT Margin	9.0%	3.5%	12.9%	13.7%			
Commision expenses/Commissions and fees	40%	43%	43%	43%			
Personnel expenses/Total revenue	20%	21%	20%	20%			
Tax rate	28%	35%	30%	30%			
Cost/income ratio	91%	97%	87%	86%			

Source: MLP and Edison Investment Research estimates

Exhibit 4: Balance sheet

€m					change		
Balance Sheet	2010	2011	2012e	2013e	11/10	12/11	13/12
Loans	343	360	378	397	5%	5%	5%
Investment portfolio	253	232	250	250	-8%	8%	N/A
Goodwill & intangibles	148	140	140	140	-5%	N/A	N/A
Other	779	756	780	823	-3%	3%	6%
Total assets	1,523	1,488	1,548	1,609	-2%	4%	4%
Deposits	819	827	868	912	1%	5%	5%
Other liabilities	284	262	260	258	-8%	-1%	-1%
Shareholders' equity	420	399	419	440	-5%	5%	5%
Total Liabilities	1,523	1,488	1,548	1,609	-2%	4%	4%
Number of shares at year end	107.9	107.9	107.9	107.9			
BV per share	3.89	3.70	3.88	4.07			
BV per share (ex intangibles)	2.52	2.40	2.58	2.78			
Loans/deposits	42%	44%	44%	44%			
Equity ratio	27.6%	26.8%	27.1%	27.3%			
Tangible equity ratio	19.8%	19.2%	19.8%	20.4%			
Return on Equity (ex intangibles)	12.7%	4.7%	19.4%	20.3%			

Source: MLP and Edison Investment Research estimates

Edison investment research

OVB Holding

Year end	Revenue (€m)	Net income* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/10	186.3	4.0	0.28	0.50	67.6	2.6
12/11	209.1	4.2	0.29	0.35	64.4	1.8
12/12e	218.6	4.7	0.33	0.35	57.8	1.8
12/13e	228.6	5.5	0.39	0.35	49.1	1.8

Note: *Normalised. Edison estimates.

Investment summary: Emerging market growth

OVB Holding is a pan-European broker of financial products, mostly pensions, with significant operations in Central and Eastern Europe, a region of vast potential due to the structural change in the pensions/long-term savings markets in these countries and the GDP growth potential. Its recent results have been negatively affected by poor client confidence as a result of the European sovereign debt crisis, but the long-term potential of the stock is considerable. The shares are trading at a very high P/E, but this reflects to a large extent the surplus capital in the business. We are not aware that the company has plans to distribute this capital back to shareholders in the near future.

Differential growth

OVB's business in Germany is comparatively slow growing and its business in Southern and Western Europe has fallen as a result of the problems brought about by the sovereign debt crisis and the poor economic outlook in most of that region. OVB mostly distributes long-term pension products and these are very sensitive to client confidence, given that the customers need to consider whether they can make such a long-term financial commitment. However, business in Central and Eastern Europe has picked up strongly and is the driving force of the business, and makes up just under 60% of commission revenue.

Sensitivities

Sensitivities include: (1) financial confidence, which is the most important factor for long-term pension provision and any setback would harm OVB's business considerably; and (2) competition from the many other product providers in Europe, which will only intensify as the market expands.

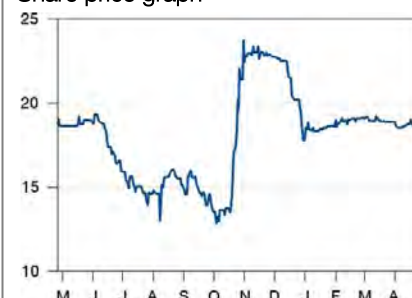
Valuation

A P/E of 58x 2012 earnings is demanding and indeed is above its five-year average of 39.9x, which itself is high. We believe this high valuation reflects the small free float and the high amount of capital in the business. OVB is majority owned by insurance companies, which also provide the main products that are broked and we do not believe there is any intention in the short term to return this capital to shareholders. Allowing for surplus capital, our 20-year DCF at a cost of equity of 10% suggests a value of around €15.24, which is actually relatively close to the current share price of €18.98.

Price*	€18.98
Market cap	€271m

*As at 26 April 2012

Share price graph



Share details

Code	O4B GR
Listing	Frankfurt
Sector	Financials
Shares in issue	14.25m

Price

52 week	High	Low
	€23.70	€12.85

Balance sheet as at 31 December 2011

tNAV per share (€)	4.8
Equity ratio (%)	64
Tangible Equity ratio (%)	46

Business

OVB Holding is a European broker of financial services with a significant business in Central and Eastern Europe.

Commission income by geography

Germany	Central and Eastern Europe	Southern and Western Europe
33%	57%	10%

Analyst

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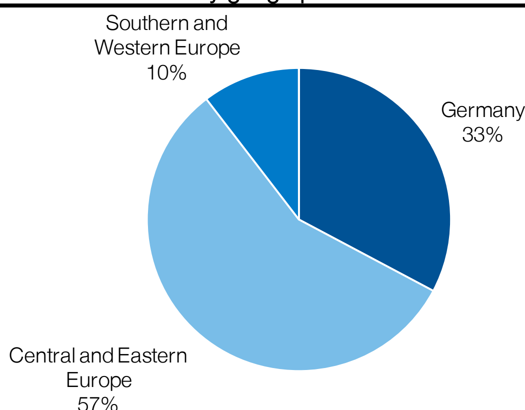
Company description: A European company

OVB is a 41-year old company that was listed in Germany in 2006. It is a broker of financial products in 14 European countries, with a focus on private households in the middle to upper income range and companies with turnover of up to €10m. It has 4,900 full-time financial advisors and some 2.9m customers of whom 60% live in Central and Eastern Europe. It sources its products from 100 banks and insurance and investment companies. It estimates that in its geographic area of operation there are some 447m people. As essentially a broker of financial products, its margins are lower than those of a traditional private bank, which also captures some of the product producer margin.

The extensive development of OVB outside Germany can be seen in the following pie chart, with Germany accounting for just one-third of commission revenue in 2011.

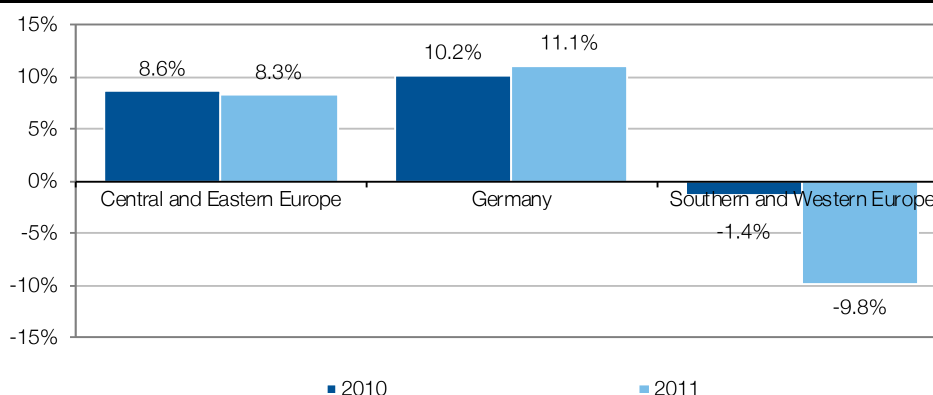
Exhibit 1: OVB 2011 sales commission by geographic area



Source: Company

The business in Germany though has the highest EBIT margin in the group, as it enjoys economies of scale in that market. Central and Eastern Europe is close behind, but Southern and Western Europe is currently unprofitable.

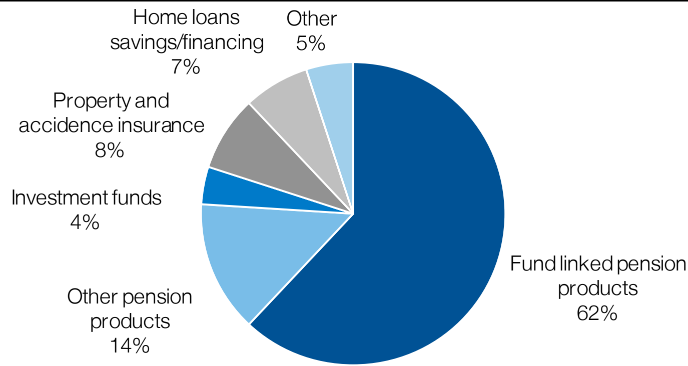
Exhibit 2: OVB EBIT margins in 2010 and 2011 by geographic market



Source: Company

As regards products, mostly OVB earns commissions from selling pension-based products, as we show in the following pie chart. Its growth should therefore be driven not just by more consultants and more market share, but by the expansion in the market as these markets expand with increasing wealth.

Exhibit 3: OVB 2011 new business by products

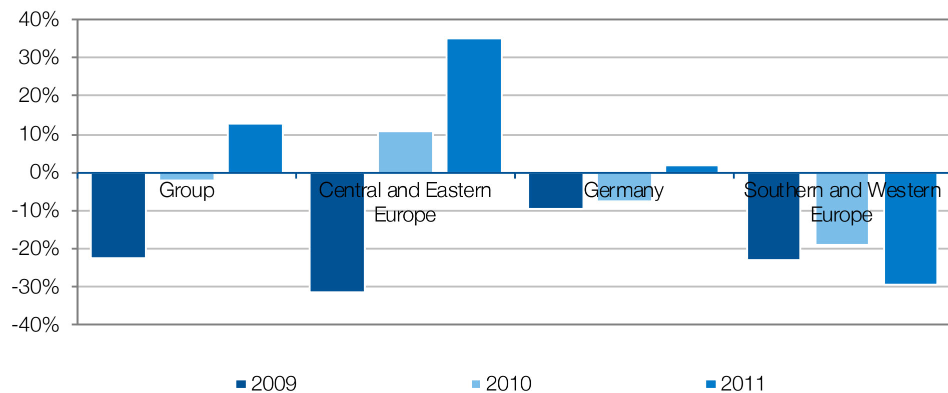


Source: Company

Growth affected by the economic climate

Given the long-term nature of OVB's product range, it is not surprising that the company has produced negative growth in some years and in some regions. Individuals just do not like to make long term commitments when the economic outlook is uncertain. The following chart shows the experience of the company over the last three years, with the 2008/09 European sovereign debt crisis and the ensuing uncertainty clearly visible in the results. In Central and Eastern Europe the long-term savings and pension market has only really started to develop since the countries ceased to be communist, and being relatively wealthy – by emerging market standards – we believe the long-term potential is considerable. Although the company does have profit and loss exposure to the problems of Southern and Western Europe, it does not have meaningful balance sheet exposure as it is essentially an agency broker without balance sheet loans or investments.

Exhibit 4: OVB annual commission growth rates by geographic area



Source: Company reports

There is a very small free float of just 3.19% in OVB, with most of the shares owned by insurance companies, notably Deutscher Ring Beteiligungsholding with 32.57% and IDUNA Vereinigte Lebensversicherung with 31.48%.

Sensitivities

The group's main sensitivities are to:

- **Market confidence:** Client demand for long-term financial products is highly sensitive to client confidence, with stable economic growth being the best environment to produce client confidence and with it product sales.
- **Competition.** Competition from the many banks and other product distributors in Central and Eastern Europe is likely to intensify as the market grows.
- **FX risk.** Given most of its sales commissions are outside Germany, the company is exposed to foreign exchange risk as its results are reported in euros. For the most part though, FX income is matched with FX expenses.

Financials

OVB expects sales growth of 5% in 2012 with earnings up 10% and more progress the following year. This crucially depends on the economic climate of slowly improving confidence. Our forecasts are broadly in line with company guidance. EBIT margins are lower in this broker business than they are in traditional private banks, which capture some of the margin from being a product provider and ongoing fees for advice.

Exhibit 5: Profit and loss

€m					change		
	2010	2011	2012e	2013e	11/10	12/11	13/12
Brokerage income	175.0	199.5	209.1	219.1	14%	5%	5%
Other operating income	11.3	9.6	9.5	9.5	(15%)	(1%)	N/A
Total income	186.3	209.1	218.6	228.6	12%	5%	5%
Brokerage expenses	(112.5)	(134.2)	(139.5)	(146.8)	19%	4%	5%
Personnel expenses	(24.8)	(24.8)	(26.0)	(27.0)	N/A	5%	4%
Depreciation and amortization	(3.1)	(4.0)	(4.0)	(4.5)	29%	N/A	13%
Other operating expenses	(41.1)	(40.0)	(42.0)	(42.0)	(3%)	5%	N/A
EBIT	4.8	6.1	7.1	8.3	27%	16%	17%
Financial result	1.6	1.2	1.2	1.2			
Taxation	(2.4)	(3.1)	(3.6)	(4.0)			
Net profit	4.0	4.2	4.7	5.5	5%	11%	18%
Wtd av no of shares	14.3	14.3	14.3	14.3			
EPS	0.28	0.29	0.33	0.39	5%	11%	18%
DPS	0.50	0.35	0.35	0.35			
Payout ratio	178%	119%	107%	90%			
Tax rate	37%	42%	43%	42%			
Brokerage expense/income	64.3%	67.3%	66.7%	67.0%			
Personnel expenses/brokerage income	14.2%	12.4%	12.4%	12.3%			
Other operating expenes/brokerage income	22.1%	19.1%	19.2%	18.4%			
EBIT/Total income	2.6%	2.9%	3.2%	3.6%			

Source: OVB and Edison Investment Research estimates

Exhibit 6: Balance sheet

€m						change	
Balance Sheet	2010	2011	2012e	2013e	11/10	12/11	13/12
Cash	30.9	40.0	40.0	40.0			
Receivables	46.0	45.2	46.0	46.0			
Investment portfolio	41.2	38.3	40.0	40.0			
Goodwill & intangibles	12.8	11.6	11.6	11.6			
Other	14.0	13.7	11.4	11.4			
Total assets	144.9	148.8	149.0	149.0	3%	N/A	N/A
Other liabilities	61.4	68.7	69.2	68.7	12%	1%	(1%)
Shareholders' equity	83.5	80.1	79.8	80.3	(4%)	N/A	N/A
Total Liabilities	144.9	148.8	149.0	149.0	3%	N/A	N/A
Number of shares at year end	14.25	14.25	14.25	14.25			
BV per share	5.9	5.6	5.6	5.6			
BV per share (ex intangibles)	5.0	4.8	4.8	4.8			
Return on Equity (ex intangibles)	5%	5%	6%	7%			
Equity/Assets	58%	54%	54%	54%			
Tangible Equity/Assets	49%	46%	46%	46%			

Source: OVB and Edison Investment Research estimates

Edison investment research

W&W

Year end	Revenue (€m)	Net income* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/10	5,453	180	1.79	0.50	8.6	3.2
12/11	5,141	192	1.94	0.50	8.0	3.2
12/12e	5,620	255	2.61	0.50	5.9	3.2
12/13e	5,720	266	2.73	0.50	5.7	3.2

Note: *Normalised. Edison estimates.

Investment summary: Profit target in sight

W&W has undergone something of a transformation in recent years with a focus on efficiency and meeting its profit target of €250m in 2012. We expect it will reach the milestone, giving the company an 8% return on equity. For a company controlled by a charitable foundation, working in the competitive German financial services mass market, an 8% return on equity would be a good achievement and should be sustainable if W&W continues to focus on profitability. The group does have some PIIGS exposure of around €0.6bn and its capital strength is complicated by the complexity of the combination of its banking and insurance operations. Consequently, the P/E rating is low, like many large European financials.

Focus on profitability

In 2006 W&W decided to improve its profitability and revitalise the business, under pressure from its main shareholder, which is a charity and dependent on W&W for its income. It has done this through a focus on costs and should make its target €250m net profit in 2012. It has a large 6m client base, with the potential to reach 40m, so future growth beyond this is possible and not just limited to the rising wealth of its existing client base.

Sensitivities

Sensitivities include: (1) economic confidence; (2) interest rates; (3) competition; and (4) regulation of both its banking and insurance operations as regards solvency and the sale of products.

Valuation

At a P/E ratio of 6x 2012 earnings W&W is trading below its five-year average of 13.x. Valuation of the company is complicated by its conglomerate structure of bank banking and insurance activities, and in the market's eyes its €0.6bn of PIIGS exposure. In our 20-year DCF valuation we have deducted €500m to allow for the capital and PIIGS uncertainty, and with a cost of equity of 10% we arrive at a value of €18.3 per share, above the current share price of €15.5.

Price*	€15.49
Market cap	€1.4bn

*As at 26 April 2012

Share price graph

Share details

Code	WUW GF
Listing	Frankfurt
Sector	Financials
Shares in issue	92m

Price

	High	Low
52 week	€19.40	€13.18

Balance sheet as at 31 December 2011

tNAV per share (€)	29.8
Loans/Deposits (%)	130
Financial conglomerate (%)	129

Business

Wustenrot & Wurttembergische (W&W) is a financial conglomerate offering banking and insurance products throughout Germany through a multi-channel distribution arrangement.

Net profits by segment

Banking	Life/health	P&C
60%	15%	25%

Analyst

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Company description: Bank and insurance provider

W&W (Wustenrot & Wurttembergische) is the product of the 1999 merger of the Wurttembergische insurance business and the Wustenrot home loans and savings bank. There have been several acquisitions over the past 10 years of small home loans and savings banks and an insurance company, Karlsruher Versicherungsgruppe. In 2006 the company initiated a fundamental restructuring of the group, with the "W&W 2009" modernisation programme followed by "W&W 2012" efficiency programme, which aimed for a net profit of €250m in 2012. The company is both a product producer and product provider, and operates a multichannel distribution model with its own mobile sales force of 6,000 tied agents, direct channels, 8,000 brokers, banks and other partners. It estimates it has potential sales access to 40m customers, but its current customer base is just 6m. It is focused on retail clients and small/medium size commercial customers, mainly in Germany but also some in the Czech Republic.

The main products offered are:

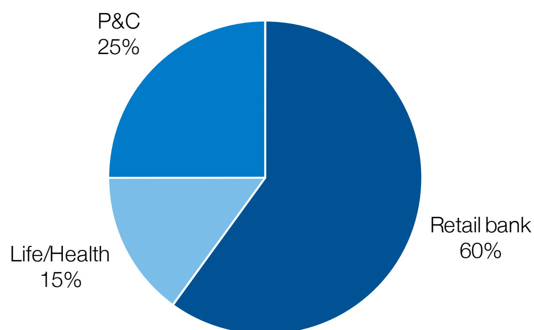
- retail banking, especially mortgage lending (€17.8bn of building society deposits at the end of 2010 and mortgage disbursements in the year of €4.9bn);
- life and health insurance (2010 gross premiums of €2.6bn); and
- property and casualty insurance (2010 gross premiums of €1.3bn).

It has a good market position in Germany and is number two in home loan savings, but just number nine in property and casualty insurance and number 10 in life insurance. Its assets under management at the end of 2010 were €27.7bn and its total assets were €76bn. A major part of its target to make €250m net profit in 2012 is to increase the proportion of cross-selling of products. At the end of 2010 just 10% of customers had both a bank and insurance product from W&W and the ambition is to increase this to 20% by 2012. There are always risks of mis-selling in such a sales environment but it should be noted that the company does pride itself on the quality of its management and the high standards of its corporate culture.

The free float of W&W shares is only some 8%. The majority of the company (66.1%) is owned by a charitable foundation called Wustenrot Stiftung through Wustenrot Holding, LBBW (Landesbank Baden-Wurttemberg) owns nearly 9%, Unicredito 7.5%, L Bank (Statebank for Baden-Wurttemberg) nearly 5% and Swiss Re 4.7%. The charitable foundation derives all its income from its W&W holding so it is important that the company produces good profits and dividends and we believe that this is the motivating factor in the profit improvement plans. We understand that LBBW and Unicredit are interested in placing their shares in the near future.

As regards the relative importance of its three main business lines, Exhibit 1 shows the average profit contribution over the past three years. The banking business accounted for around 60% of group profit and insurance 40%, with P&C business being more important that life/health in today's business, but arguably in the long term the life/health business should have much greater potential to grow.

Exhibit 1: Average net profit contribution by business line at W&W AG



Source: Edison Investment Research estimates

Capital strength

W&W is unquestionably a financial conglomerate and as such its capital requirements are more complicated than they would be for a bank or an insurance company. W&W, and its regulator, takes the approach of ensuring that each bank and insurance business is adequately capitalised on a standalone basis. Overall the company says that it has 129% of the capital its operating entities require under their own regulatory guidelines, down from 133% in 2010. However, there are new capital rules for banks, Basel III, and the Solvency II rules for insurance companies, and the company admits it will be some time before it meets these levels.

Sensitivities

The group's main sensitivities are to:

- **Economic confidence.** Client activity levels in both banking and insurance are impacted by economic confidence, with clients less keen to enter long-term commitments in uncertain times. Conversely, steady economic growth and rising real incomes are good for business.
- **Interest rates.** Low interest rates may be good for encouraging mortgage lending, but they do not help savers and can be a problem in the insurance business where returns do depend on the expected investment return. If interest rates stay below long-term expected levels this tends to be bad for long-term life insurance profits.
- **Competition:** W&W faces still competition for the many banks, insurers and independent providers in Germany. However, its high ownership by a charitable foundation and emphasis on customer care do differentiate it in the market.
- **Regulation:** Stiffer capital rules, especially for a financial conglomerate such as W&W, can damage profitability. The company also faces increasing regulatory pressures when doing business in insurance and mortgage banking, along with the rest of the market of course.

Financials

Our forecasts are shown in the following table. After its efficiency drive in recent years and the successful 2011 it does seem that the company is set to meet its €250m net profit target for 2012.

Exhibit 2: Profit and loss

€m	2010	2011	2012e	2013e	change 11/10	12/11	13/12
Net financial result	1,671	1,391	1,760	1,820	(17%)	27%	3%
Net fee and commission result	(355)	(400)	(360)	(365)	13%	(10%)	1%
Net premiums earned	3,782	3,750	3,860	3,900	(1%)	3%	1%
Insurance benefit to customers	(3,942)	(3,462)	(3,950)	(4,000)	(12%)	14%	1%
General expenses	(1,137)	(1,162)	(1,170)	(1,200)	2%	1%	3%
Other	196	75	200	200	(62%)	167%	N/A
Earnings before tax	215	192	340	355	(11%)	77%	4%
Taxation	(35)		(85)	(89)			
Net profit	180	192	255	266	7%	33%	4%
Minority interests	(15)	(15)	(15)	(15)			
Net profit after minority interests	165	177	240	251			
Wtd av no of shares	92.0	91.2	92.0	92.0	(1%)	1%	N/A
EPS	1.79	1.94	2.61	2.73	8%	34%	5%
DPS	0.50	0.50	0.50	0.50			
Payout ratio	28%	26%	19%	18%			
Tax rate	16%		25%	25%			
Profits by division							
Banking products/mortgages	110	21					
Life and Health Insurance	41	40					
Property/Casualty insurance	26	107					
Other segments	113	97					
Adjustments	(110)	(73)					
Total	*180*	*192*					

Source: W&W and Edison Investment Research estimates

Exhibit 3: Balance sheet

€m Balance Sheet	2010	2011	2012e	2013e	change 11/10	12/11	13/12
Loans	49,305	49,422	52,882	56,583	N/A	7%	7%
Trading portfolio	2,148	2,367	2,100	2,100	10%	(11%)	N/A
Investment portfolio	19,489	18,733	19,670	20,653	(4%)	5%	5%
Goodwill & intangibles	215	215	215	215	N/A	N/A	N/A
Other	4,831	4,622	5,014	5,122	(4%)	8%	2%
Total assets	75,988	75,359	79,881	84,673	(1%)	6%	6%
Deposits	39,127	37,881	36,000	38,000	(3%)	(5%)	6%
Other liabilities	34,109	34,589	40,798	43,385	1%	18%	6%
Shareholders' equity	2,752	2,889	3,083	3,288	5%	7%	7%
Total Liabilities	75,988	75,359	79,881	84,673	(1%)	6%	6%
Number of shares at year end	92.0	92.0	92.0	92.0			
BV per share	29.8	32.2	33.5	35.7			
BV per share (ex intangibles)	27.6	29.1	31.2	33.4			
Loans/deposits	126%	130%	147%	149%			
Return on Equity (ex intangibles)	6%	6%	8%	8%			
W&W financial conglomerate	133%	129%					

Source: W&W and Edison Investment Research estimates

Edison investment research

EFG International

Year end	Revenue (CHFm)	Net income* (CHFm)	EPS* (CHF)	DPS (CHF)	P/E (x)	Yield (%)
12/10	808	114.6	0.65	0.10	13.4	1.2
12/11	789	83.5	0.45	0.10	19.0	1.2
12/12e	761	93.8	0.56	0.10	15.3	1.2
12/13e	803	111.0	0.68	0.10	12.7	1.2

Note: *Normalised. Edison estimates.

Investment summary: Geared to better markets

EFG International has a distinctive business model for a private bank, which has proved very attractive for recruiting private bankers. Over the last 15 years the bank's AuM have grown from virtually nothing to over CHF80bn from organic growth and acquisition. That growth has been checked in the last few years, however, as a result of the need to cut back from overexpansion and the write-down of just under CHF1bn of what in hindsight proved to be ill-considered acquisitions, especially that of the hedge fund Marble Bar. Further concerns have been raised by the purchase of life insurance contracts, which amount to a large proportion of its capital base. The bank is now under new management, with a new CEO and CFO, and is promising to get back to what it does best, private banking, but this time in a more disciplined way.

Delivery is key

The previous management made some serious strategic mistakes and the current one has set out to correct them and get the bank back on a disciplined and sustainable growth path. It is cleaning up the balance sheet and eradicating loss-making operations. It targets some CHF200m of net profit within three years, CHF1.2 per share, but investor confidence that this will be achieved is low. Delivery is vital.

Sensitivities

Sensitivities include: (1) equity market strength and client activity; (2) the strength of the Swiss franc; (3) the level of interest rates; (4) banking and tax regulation; (5) competition for clients and private bankers; and (6) longevity risk and US life company solvency risks in its portfolio of life settlement contracts.

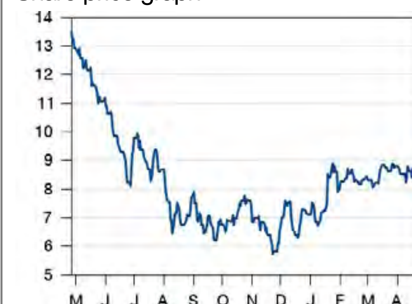
Valuation

At a P/E of 15.3x 2012 earnings, EFG International is trading below its five-year average of 26.7x, but that average was heavily distorted by its many problems over the last few years, as well as the financial crises. Our 20-year DCF using a cost of equity of 10% gives a valuation of CHF9.3, just ahead of the current share price. After the disappointments of the last few years, investors are likely to want to see some proof that the bank can actually deliver on its potential before there is a re-rating.

Price*	CHF8.65
Market cap	CHF1.3bn

**As at 26 April 2012*

Share price graph



Share details

Code	EFGN SW
Listing	SWX
Sector	Banks
Shares in issue	146.7m

Price

52 week	High	Low
	CHF13.30	CHF5.67

Balance sheet as at 31 December 2011

tNAV per share (CHF)	1.5
Loans/deposits (%)	66
Tier 1 ratio (%)	12.8

Business

EFG International is a private bank with AuM of around CHF80bn and has enjoyed spectacular growth over the last 15 years. Unlike most other private banks, it guarantees that its private bankers earn a share of the profits they produce.

AuM by geography

Europe	UK	Asia	Other
42%	19%	18%	21%

Analyst

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Company description: A victim of ambition

EFG International was founded in 1995 by Lonnie Howell and Jean Pierre Cuoni, formerly disaffected senior private bankers from Coutts and Citibank. They wanted to place the private banker, or client relationship officer (CRO) as they called them, at the heart of their private bank and empower them to effectively run their own business. The CROs would be contractually entitled to a certain percentage, normally around 20%, of the net contribution that they produced for the group. In contrast, most other private banks paid discretionary bonuses that required the CROs to be forever ensuring that they remained politically in favour in their organisations. This proved to be a very successful strategy for organic growth and for making acquisitions, and in a period of 15 years the bank increased its AuM from zero to almost CHF80bn. The business acquired seed capital from the Latsis family, who also own the Greek Bank Eurobank EFG, and that is the origin of their 49% holding in the company. There is no indication that they are under any financial pressure to sell their stake in EFG International.

In 2005, EFG International undertook an IPO on the Swiss market and raised around CHF1.4bn. The issue price was CHF38 per share. The bank made some aggressive comments about organic growth and growth via acquisitions and for a while managed to achieve them. However, it became difficult to maintain that pace with private banking assets and, in accordance with the fashion at the time, it started to acquire hedge funds. These included the fund business of CMA and the long/short European equity business of Marble Bar, the latter costing 18.5% to 30% of AuM. A large part all of the money raised at the IPO was spent on these two. This disappointed many investors who believed they were investing into a product distributor rather than a product creator, but those concerns were put aside at first because the hedge fund business did well. But in the financial crash of 2007 and 2008, despite performing better than their peers, CMA and Marble Bar lost significant amounts of their assets as clients took money out and their profits evaporated. Eventually EFG International had to write-off virtually all their investment.

Another problem that EFG International bought on itself was a reckless rate of expansion of offices and CROs, even after the financial crisis, which it believes presented a unique “once in a lifetime” opportunity to grow its business. Many of these new initiatives were not profitable, especially after the financial crisis.

However, this was not EFG International’s only problem. Just before the financial crisis it acquired some life settlement contracts it intended to on-sell to clients, but clients steered away from what they perceived as structured products. In these contracts EFG International buys the rights to receive the sums assured when someone dies but also promises to pay the remaining premiums. Their attraction is their comparatively high yield – 8% currently – and the non-correlation with other asset classes. They are dependent on longevity risk and the solvency of US life companies. At the end of 2011 they amounted to CHF0.7bn, equivalent to 100% of their tier 1 capital. Again, this was an investment that most investors did not want to see on their balance sheet. The next most significant problem was that a large part of their tier 1 capital was actually composed of ‘bons de participation’, which pay interest and are non-voting share capital but were counted as tier 1 capital on the old Basel II rules because they could absorb losses. In future, under Basel III they will not qualify, though they will be phased out over the next 10 years. At the end of 2011 the tier 1 ratio of EFG International was just 4.2% if these were excluded; if they were included it was a far more healthy 12.8%. EFG International actually bought some of

these back at the beginning of 2012, which should raise the ratio to 6.1% from 4.2%, and it seeks to get its total capital ratio to around 14% to 16% over time through retained profits.

Finally, EFG International has had to contend with its Greek ownership and accusations that it has significant Greek government bonds on its books. In fact its PIIGS exposure is comparatively modest, with Greek exposure – for instance – of just CHF95m before its write-down by 76%.

EFG International has potential

Given the plethora of problems that EFG International has faced over the last few years it is too easy to forget the tremendous growth it has achieved and the remarkable 'stickiness' of its clients and senior CROs. It has only lost eight of its top 300 CROs in the last five years for instance. We believe that this is testament to the strength of its business model.

Under the new CEO, John Williamson, for the successful UK operation, EFG International has embarked on a radical restructuring programme to cut out unprofitable units and focus on its core operations. It believes that these could generate some CHF200m of net profit by 2014. Most view this target as ambitious. Our forecast for 2013 for instance is for a profit of just CHF111m. There is also a new CFO and the company promises to be less more conservative in its investment decisions in the future than it has been in the past.

Sensitivities

The group's main sensitivities are to:

- **Equity markets.** Falling equity markets lower assets under management with typically around a third of client money invested in them; they also discourage clients to move their money.
- **Interest rates.** A third of client money is typically invested in cash instruments, much placed on its own balance sheet, and lower interest rates reduce the deposit margin it earns on this money.
- **Strength of the Swiss franc.** With just 5% of revenue earned in Swiss francs but some 40% of the cost based in the currency, a strengthening Swiss franc lowers revenue more than costs and squeezes profits.
- **Life settlement contracts.** Through its CHF0.7bn investment in these contracts it is exposed to longevity risk and solvency risk of US life insurers.
- **Competition:** International private banking is seen by many banks as a high growth and low capital consumptive business and therefore a very attractive one to develop. This makes it harder to win clients and recruit and keep top private bankers.

Financials

Our forecasts assume fund performance of 3% per year, NNM growth of 1% in 2012 rising to 4% in 2013, constant margins and a slow but steady decline in the cost income ratio as its cost saving initiatives have an effect. The results for 2010 and 2011 shown in the table below are on an underlying basis and exclude the many exceptional factors that affected published results in those years.

Exhibit 1: Profit and loss

CHFm					Change		
	2010	2011	2012e	2013e	11/10	12/11	13/12
Net interest income	251	212	213	215	(15)%	1%	1%
Net commissions	496	454	418	453	(9)%	(8)%	8%
Other income	108	123	130	135	14%	6%	4%
Total income	**855**	**789**	**761**	**803**	**(8)%**	**(4)%**	**5%**
Personnel expenses	(474)	(429)	(403)	(425)			
Other operating expenses	(215)	(225)	(212)	(212)			
Depreciation	(22)	(27)	(26)	(26)			
Amortisation of acquired intangibles	(15)	(14)	(12)	(12)			
Total expenses	(726)	(694)	(653)	(675)	(4)%	(6)%	3%
Pre-tax profit	**129**	**94**	**108**	**127**			
Income tax	(13)	(8)	(11)	(13)			
Minority interests	(2)	(3)	(3)	(4)			
Net income	**115**	**84**	**94**	**111**			
Bons de participation dividend	(20)	(17)	(11)	(11)			
Net inccome attributable to ordinary shareholders	**95**	**67**	**83**	**100**			
AuM	84.8	78.4	81.8	87.2	(8)%	4%	7%
Average AuM	85.9	80.9	80.1	84.5	(6)%	(1)%	5%
NNM	9.7	(1.2)	1.0	3.0			
NNM growth	11%	-1%	1%	4%			
Performance	-13%	-6%	3%	3%			
Wtd av no of shares	146.7	146.7	146.7	146.7			
EPS	**0.65**	**0.45**	**0.56**	**0.68**			
DPS	0.10	0.10	0.10	0.10			
Payout ratio	15%	22%	18%	15%			
Tax rate	10%	8%	10%	10%			
Employees	N/A	2,547	2,500	2,490			
CROs	675	567	500	520			
Gross margin bps	94.0	94.0	95.0	95.0			
Cost/income ratio	85%	88%	86%	84%			
Comp ratio	55%	54%	53%	53%			
Costs/average AuM bps	82.7	84.1	80.1	78.5			
Pre-tax margin bps	15.0	11.6	13.4	15.1			
EBIT margin	15%	12%	14%	16%			

Source: EFG International, Edison Investment Research estimates

Exhibit 2: Balance sheet

CHFm							
Balance Sheet	**2010**	**2011**	**2012e**	**2013e**	**11/10**	**12/11**	**13/12**
Loans	8,958	9,548	10,025	10,527	7%	5%	5%
Trading assets	625	814	800	800			
Investments	5,639	5,450	5,500	5,500	(3)%	1%	%
Goodwill & intangibles	579	301	290	280	(48)%	(4)%	(3)%
Other	5,717	5,742	5,700	5,700	%	(1)%	%
Total assets	**20,893**	**21,041**	**22,315**	**22,807**	**1%**	**6%**	**2%**
Deposits	14,904	14,398	14,830	15,275	(3)%	3%	3%
Other liabilities	4,690	5,631	6,395	6,182	20%	14%	(3)%
Bons de participation	500	484	321	321	(3)%	(34)%	%
Core equity	799	528	770	1,029	(34)%	46%	34%
Shareholders' funds	**1,299**	**1,012**	**1,091**	**1,350**	(22)%	8%	24%
Total Liabilities	**20,893**	**21,041**	**22,315**	**22,807**	**1%**	**6%**	**2%**
Risk weighted assets	5,499.0	5,614.0	5,614.0	5,614.0	2%	%	%
Number of shares at year end	146.7	146.7	146.7	146.7	%	%	%
BV per share	5.45	3.60	5.25	7.02	(34)%	46%	34%
BV per share (ex intangibles)	**1.50**	**1.55**	**3.27**	**5.11**			
Loans/deposits	60%	66%	68%	69%			
Tier 1 ratio	14%	13%	14%	19%			
Core tier 1 ratio	5%	4%	9%	13%			
Return on equity (ex intangibles)	43%	30%	23%	16%			
Shareholders' funds	1,299.0	1,012.0	1,090.8	1,350.1			
Goodwill and intangibles	(579.0)	(301.0)	(290.0)	(280.0)			
Adj to goodwill and intangibles	80.0	46.0	46.0	46.0			
Net goodwill and intangibles	(499.0)	(255.0)	(244.0)	(234.0)			
Other items	(35.0)	(38.0)	(38.0)	(38.0)			
Tier 1 capital	**765.0**	**719.0**	**808.8**	**1,078.1**			
Tier 1 ratio	14%	13%	14%	19%			

Source: EFG International, Edison Investment Research estimates

Edison investment research

Julius Baer Group

Year end	Revenue (CHFm)	Net income* (CHFm)	EPS* (CHF)	DPS (CHF)	P/E (x)	Yield (%)
12/10	1,794	504	2.45	0.60	14.2	1.7
12/11	1,753	452	2.23	1.00	17.5	2.9
12/12e	1,853	499	2.50	0.60	13.9	1.7
12/13e	2,001	561	2.92	0.60	11.9	1.7

Note: *Normalised. Edison estimates.

Investment summary: Geared to better markets

Julius Baer as a pure independent wealth manager is positively geared to improving equity markets and investor sentiment. It does not have the capital or balance sheet worries of many larger European banks yet its business is of sufficient scale at home and in emerging markets to take advantage of the tremendous growth opportunities available. Despite the adverse markets and repatriation of German money, it has managed to grow its NNM (net new money) in its 4% to 6% target range. It has also been proactive in addressing problems such as the strength of the Swiss franc and challenges in Germany. It still needs to resolve its dispute with the US authorities, but the bank is sufficiently confident of the outcome that it has announced a special dividend and reinstated its share buy-back programme.

Cost control and net new money growth

With revenue subdued by muted client activity and just some 25% of its revenue being earned in Swiss francs compared with 75% of its costs, Julius Baer's profits have been squeezed by the strengthening of the Swiss franc. It has proactively cut costs under the leadership of its CEO Boris Collardi, yet at the same time has had to raise its medium-term target cost/income ratio to 62-66% from 60-64% because of the strong Swiss franc. It has continued to grow its franchise with NNM growth in its target range, opening more offices and employing more front line private banking employees.

Sensitivities

Sensitivities include: (1) equity market strength and client activity; (2) the strength of the Swiss franc; (3) the level of interest rates; (4) banking and tax regulation; (5) litigation over past banking activities; and (6) competition for clients and private bankers.

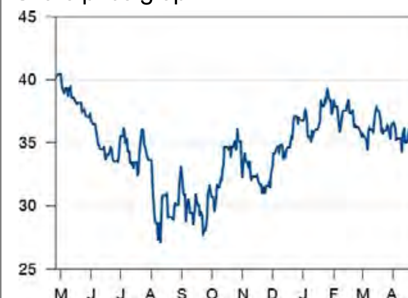
Valuation

At a P/E of 14x 2012 earnings, Julius Baer is trading below its 22.1x five-year average and towards the bottom of its 13x to 20x 10-year range. The bank has some CHF0.8bn of surplus capital and using a 20-year DCF at a 10% cost of equity gives a valuation of CHF34.4, in line with the current price. This is based on a growth rate of just 7% (performance of 3% and NNM growth of 4%), but raising growth to 9% would increase the value to CHF38 per share. A strong equity market and high inflows have been strong catalysts for the shares in the past and could well be again in the future.

Price*	CHF34.74
Market cap	CHF7.1bn

*As at 26 April 2012

Share price graph



Share details

Code	BAER VX
Listing	SWX
Sector	Banks
Shares in issue	196.4m

Price

	High	Low
52 week	CHF40	CHF27

Balance sheet as at 31 December 2011

tNAV per share (CHF)	12.7
Loans/Deposits (%)	47
Tier 1 ratio (%)	21.8

Business

Julius Baer is the leading Swiss independent private bank with some CHF170bn of assets under management. It focuses on private banking and does not have either investment banking or asset management activities.

AuM by geography

Switzerland	Europe	Asia	Other
25%	40%	15%	20%

Analyst

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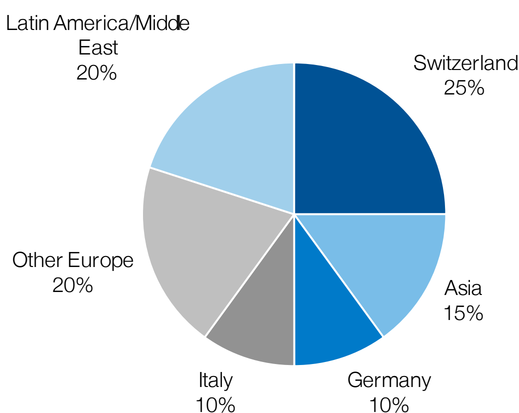
Company description: Largest independent Swiss private bank

Julius Baer Group's fortunes were transformed in 2005 when it merged with three small Swiss private banks being sold by UBS along with the alternative asset manager GAM. Not only did this merger double the AuM of the bank, but it brought in a whole new and ambitious management under the experienced financier Hans de Gier. Immediately they reinstated growth ambitions in Asia and the emerging markets and had plans that fund of hedge funds from GAM would enable it to boost gross margins in the private bank. Unfortunately, the cross-selling of GAM products to the traditional Julius Baer private banking client base was below company expectations, and, indeed, GAM hedge fund products fell dramatically out of favour with the financial crash of 2008. Consequently, Julius Baer split its operations with GAM and the asset management business of Julius Baer, now called Swiss & Global, being separately quoted as GAM Holding. This left Julius Baer Group as a pure private bank and the largest independent one in Switzerland. Hans de Gier left to go to GAM Holding and Julius Baer Group's is now managed by Boris Collardi, a private banking executive formerly with Credit Suisse, who joined in 2005. There is no cross shareholding between Julius Baer and GAM Holding, but GAM does brand some of its products with the Julius Baer name under a brand licence agreement.

A feature of Julius Baer is the large amount of AuM that it sources from western Europe and manages in Switzerland – this is the traditional 'offshore' business model. The old Julius Baer had a large German business and the three acquisitions from UBS added more western European business in France (Ferrier Lullin), Italy (Banca di Lugano) and Germany (Bank von Ernst). In addition, in 2009 Julius Baer bought ING Switzerland, which added business from the Benelux as well as Russia and Eastern Europe. Using company comments about the source of its AuM and our own estimates we believe around 40% of group AuMs are derived from western Europe, as we show in the following chart.

Exhibit 1: Julius Baer Group: Estimated source of assets under management



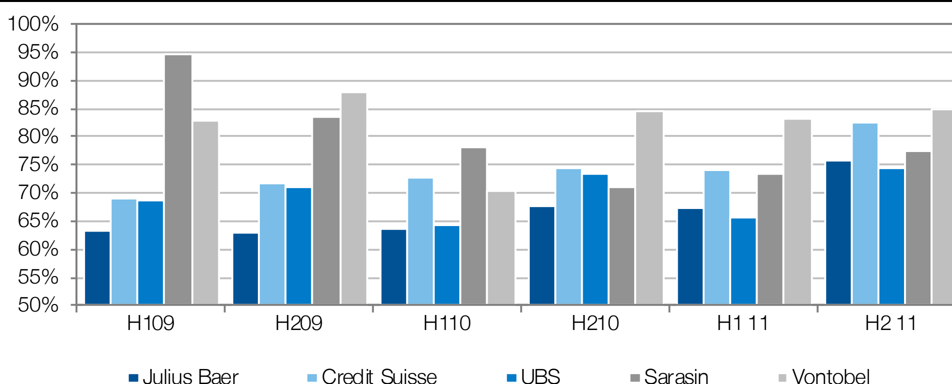
Source: Edison Investment Research estimates and company comments

Cost control and net new money growth

Western European sourced AuM are under pressure as a result of tax amnesties, such as in Italy, and new double tax agreements signed with Germany, Austria and the UK. Western European countries are more and more desperate to raise tax revenue on money that has been deposited in Switzerland and on which tax is not paid. German clients have increasing declared their money to the German tax authorities as they fear being caught and most of this has remained with Baer in Switzerland. Julius Baer and other banks have been establishing an onshore presence in Germany and Italy, in particular, to capture new and repatriated money. Given this pressure, the ability of Julius Baer to continue to show positive NNM is quite remarkable and in only one of the last six half-year reporting periods was net new money less than its 4% to 6% target. That was in H209 when it lost money in the Italian tax amnesty and the closure of its small offshore US operations.

Another achievement of Julius Baer has been to keep its cost/income ratio under control despite the recent adverse economic environment of, namely, low interest rates, a strong Swiss franc and low levels of client activity. Although its cost/income ratio has breached its 60-64% target and, indeed, it has raised that target to 62-66%, it has done much better than many other Swiss banks, as we show in Exhibit 3.

Exhibit 2: Julius Baer Group: Cost/income ratio compared with Swiss peers



Source: Company reports

Sensitivities

The group's main sensitivities are to:

- **Equity markets.** Falling equity markets lower assets under management with typically around a third of client money invested in them; they also discourage clients to move their money.
- **Interest rates.** A quarter of client money is typically invested in cash instruments, much placed on Julius Baer's own balance sheet and lower interest rates reduce the deposit margin they earn on this money.
- **Strength of the Swiss franc.** With just 25% of revenue earned in Swiss francs but some 75% of the cost based in the currency, a strengthening Swiss franc lowers revenue more than costs and squeezes profits.
- **Cross-border tax arrangements.** Julius Baer is having to face the fact that new European tax rules reduce the advantage for Europeans to place their money in Switzerland. To counter this development the bank is investing in its onshore network

in Europe. The bank has also had to deal with legacy tax disputes in Germany and the US.

- **Competition:** International private banking is seen by many banks as a high growth and low capital consumptive business and therefore a very attractive one to develop. This makes it harder to win clients and recruit and keep top private bankers.

Financials

Our forecasts assume fund performance of 3% per year, NNM growth of 5% to 6%, unchanged gross margins and good cost control so the cost/income ratio is within the company target by 2013. We assume the bank completes its CHF500m buy back over the next two years. In 2011 there was a special CHF0.4 dividend, which we do not expect to be repeated. Profits in 2011 were hurt by the strength of the Swiss franc, which pushed the cost income ratio up to 68% from 65%.

Exhibit 3: Profit and loss

CHFm					change		
	2010	2011	2012e	2013e	11/10	12/11	13/12
Net interest income	455.0	533.0	530.0	530.0	17%	(1%)	
Net fee and commission income	980.0	942.0	1,038.2	1,180.7	(4%)	10%	14%
Net trading income	332.0	269.0	275.0	280.0	(19%)	2%	2%
Other	27.0	9.0	10.0	10.0			
Operating income	1,794.0	1,753.0	1,853.2	2,000.7	(2%)	6%	8%
Personal expenses	(791.0)	(787.0)	(833.9)	(900.3)			
General expenses	(345.0)	(425.0)	(360.0)	(365.0)			
Depreciation and amortisation	(55.0)	(67.0)	(65.0)	(68.0)			
Operating expenses	(1,191.0)	(1,279.0)	(1,258.9)	(1,333.3)	7%	(2%)	6%
Operating profit	603.0	474.0	594.3	667.4	(21%)	25%	12%
Taxation	(99.0)	(73.0)	(95.1)	(106.8)			
Net profit	504.0	401.0	499.2	560.6	(20%)	24%	12%
Wtd av no of shares	205.7	202.2	200.0	191.7	(2%)	(1%)	(4%)
EPS	2.45	1.98	2.50	2.92	(19%)	26%	17%
DPS	0.60	1.00	0.60	0.60	67%	(40%)	
Payout ratio	24%	50%	24%	21%			
Tax rate	16%	15%	16%	16%			
Valuation adjustments etc	17.5	24.1	15.0	15.0			
Employees	3,578.0	3,643.0	3,750.0	3,800.0			
CROs	752.0	795.0	810.0	830.0			
AuM bn	169.7	169.7	183.3	197.8	N/A	8%	8%
Average AuM bn	170.4	167.6	176.5	190.5	(2%)	5%	8%
NNM bn	8.8	10.4	8.5	9.0			
NNM %	6%	6%	5%	5%			
Performance	-4%	-6%	3%	3%			
Gross margin bps	105.1	104.6	105.0	105.0	(%)	N/A	N/A
Cost/income ratio	65%	72%	67%	66%	9%	(6%)	(2%)
Comp ratio	44%	45%	45%	45%			
Costs/average AuM bps	69.9	76.3	71.3	70.0			
Pre-tax margin bps	35.4	28.3	33.7	35.0			
EBIT Margin	34%	27%	32%	33%			

Source: Julius Baer and Edison Investment Research estimates

Exhibit 4: Balance sheet

CHFm					change		
Balance sheet	**2010**	**2011**	**2012e**	**2013e**	**11/10**	**12/11**	**13/12**
Loans	14,570	16,408	17,000	18,000	13%	4%	6%
Trading portfolio	3,752	4,920	5,000	5,000	31%	2%	N/A
Investment portfolio	13,885	12,168	12,500	12,500	(12%)	3%	N/A
Goodwill & intangibles	1,798	1,707	1,617	1,527	(5%)	(5%)	(6%)
Other	12,282	17,725	17,605	17,501	44%	(1%)	(1%)
Total assets	**46,287**	**52,928**	**53,722**	**54,528**	**14%**	**1%**	**1%**
Deposits	28,847	34,841	36,000	38,000	21%	3%	6%
Other liabilities	12,956	13,777	13,280	11,888	6%	(4%)	(10%)
Shareholders' equity	**4,484**	**4,310**	**4,442**	**4,640**	**(4%)**	**3%**	**4%**
Total liabilities	**46,287**	**52,928**	**53,722**	**54,528**	**14%**	**1%**	**1%**
Risk weighted assets	12,735	12,811	13,452	14,124	1%	5%	5%
Number of shares at year end	207	204	196	188			
BV per share	21.7	21.1	22.7	24.7			
BV per share (ex intangibles)	**13.0**	**12.7**	**14.4**	**16.6**			
Loans/deposits	51%	47%	47%	47%			
Tier 1 ratio	22.6%	21.8%	22.4%	23.4%			
Return on equity (ex intangibles)	**19%**	**15%**	**18%**	**19%**			

Source: Julius Baer and Edison Investment Research estimates

Edison investment research

Sarasin

Year end	Revenue (CHFm)	Net income* (CHFm)	EPS* (CHF)	DPS (CHF)	P/E (x)	Yield (%)
12/10	691	108	1.74	0.90	16.1	3.2
12/11	686	99	1.60	0.00	17.5	N/A
12/12e	703	123	1.98	1.00	14.1	3.6
12/13e	775	150	2.42	1.00	11.6	3.6

Note: *Normalised. Edison estimates.

Investment summary: Ownership stability

Sarasin has at last found a long-term shareholder in the Safra Group, which, like Sarasin, is focused on private banking. This stability should be a comfort to Sarasin's clients and staff and allow the bank to continue its impressive growth strategy, but, as with other banks, it will increasingly have to balance growth with profitability. Sarasin also distinguishes itself from other Swiss private banks in that its asset management operations have a useful niche in the management of environmental 'sustainability funds' and in private banking it has been the leader in weeding out black untaxed money from its business.

Safra Group

Safra Group, a Brazilian private bank with AuM of US$109bn and equity of US$12.2bn, is set to acquire Rabobank's 46% equity interest in Sarasin (68.6% share of voting rights). The transaction should be completed by H212. Safra Group is focused on private banking and therefore should be a more supportive and knowledgeable shareholder than Rabobank. At the moment it says it wants to keep the separate Sarasin quote, but in the longer term this may not be the case. Speculation that Rabobank would sell its Sarasin stake to Julius Baer and the two would merge their operations had negatively affected business in H211.

Sensitivities

Sensitivities include: (1) equity market strength and client activity; (2) the strength of the Swiss franc; (3) the level of interest rates; (4) banking and tax regulation; (5) litigation over past banking activities; and (6) competition for clients and private bankers.

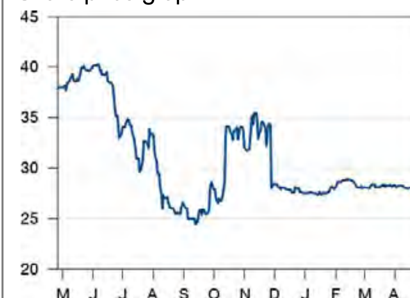
Valuation

At a P/E of 14.1x 2012 earnings Sarasin is trading below its 28x five-year historic average. Our 20-year DCF, after allowing for CHF200m of surplus capital, suggests the bank is worth CHF27.3 per share using a conservative 10% cost of equity, which is broadly in line with the current share price. This is also based on a growth rate of 7% (NNM of 3% and performance of 4%). Raising the growth rate to 9% would boost the value to CHF29 per share.

Price*	CHF27.95
Market cap	CHF1.8m

As at 26 April 2012

Share price graph



Share details

Code	BSAN SW
Listing	SWX
Sector	Banks
Shares in issue	62.7m

Price

	High	Low
52 week	CHF40.3	CHF24.4

Balance Sheet as at 31 December 2011

tNAV per share (CHF)	17.5
Loans/Deposits (%)	79
Tier 1 ratio (%)	15.6

Business

Sarasin undertakes private banking and asset management activities with an increasing focus on the emerging markets, especially Asia.

AuM by geography

Switzerland	Europe	Asia	Other
40%	37%	18%	5%

Analyst

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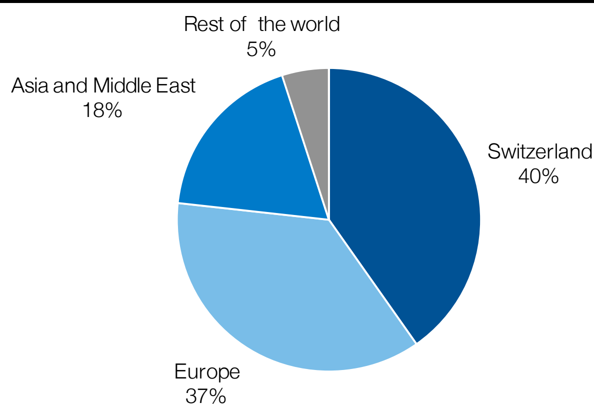
Company description: Shareholder stability now

In 2002 Rabobank took a 28% stake in Sarasin, with the option of acquiring a majority in the following seven years, in return for injecting its international private banking assets into the business. Rabobank at the time was seeking to become more international, and Sarasin had over expanded its business during the internet boom years and needed financial support. In 2006, with the prompting of its new CEO Joachim Strahle, Rabobank exercised its option and took its equity stake to 46.06% and 68% of the voting rights. Between 2002 and 2006 Rabobank had changed its senior management and strategy, and was less keen on international expansion and diversification, so this investment in Sarasin was something of a surprise. Nevertheless, under the leadership of Joachim Strahle the bank embarked on an expansionist strategy, especially in Asia. This proved to be successful and NNM flowed into the bank, but the costs of acquiring it kept the cost/income ratio elevated.

However, over the years there have been frequent rumours that Rabobank was going to sell its stake, and these reached a crescendo in H211 when Julius Baer let it be known that it was actively looking for an in-market merger. The resulting uncertainty negatively affected Sarasin clients and staff, and there were net outflows in H211 of CHF2.5bn, equal to 4.9% of AuM on an annualised basis. But once again Sarasin was rescued, as Safra Group, a large Brazil-based private bank of Lebanese origin with $160bn of assets under management, announced it had bought Rabobank's stake. This bank is a far more natural owner of Sarasin and for the first time in 10 years the ownership situation of the bank appears fully settled. Safra Group has indicated it wishes to keep the listing of Sarasin in Switzerland "for the time being", which implies that for now it will be comparatively hands off, but of course in the longer term there could be more collaboration.

Exhibit 1: Sarasin's assets under management by client domicile



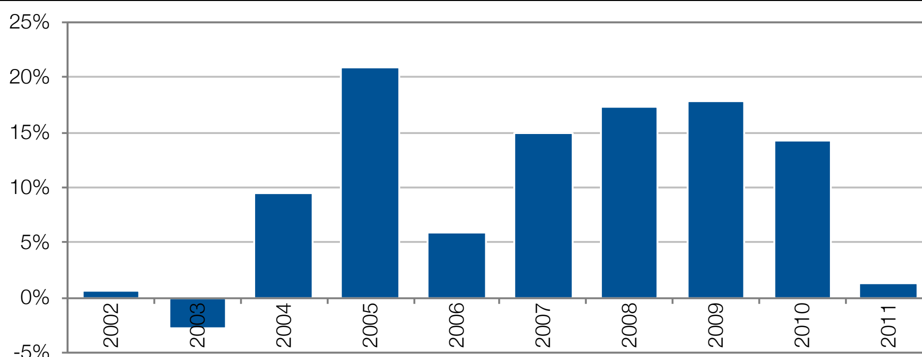
Source: Company

While Europe is seen to provide some 37% of group assets under management, it should be noted that a large proportion of these are derived from its London-based asset management business. Excluding these we estimate that Europe accounts for some 25% of the total. Sarasin claims that a comparatively low amount of its group assets under management, around 5%, are not tax compliant and it seeks to weed these out as soon as possible. This is a very low figure by Swiss private bank standards.

Net new money growth

Sarasin's major achievement since Joachim Strahle took over in 2005 has been to grow its assets under management with net new money and not just rely on performance, as we show in the chart below.

Exhibit 2: Net new money growth at Sarasin



Source: Company reports

Sarasin claims not to have the burden of large amounts of returning untaxed money that other banks have but, even so, the positive performance has been remarkable. 2011 was clearly an exception to this trend and was due to uncertainty over the ownership of the bank, Sarasin's aggressive attempts to weed out untaxed money, poor market conditions brought about by the European sovereign debt crisis and speculation over inheritance tax being introduced in Switzerland.

In fact, H111 at Sarasin was quite respectable with annualised inflows of 7.6%. The outflows were largely in the second half and presumably in particular reflect the negative combination of ownership uncertainty and poor equity markets.

Sensitivities

The group's main sensitivities are to:

- **Equity markets.** Falling equity markets lower assets under management with typically around a third of client money invested in them; they also discourage clients to move their money
- **Interest rates.** A third of client money is typically invested in cash instruments, much placed on Sarasin's own balance sheet and lower interest rates reduce the deposit margin they earn on this money
- **The strength of the Swiss franc.** With just under 30% of revenue earned in Swiss francs, but some 80% of the cost based in the currency, a strengthening Swiss franc lowers revenue more than costs and squeezes profits.
- **Ownership.** Sarasin has faced constant questions about its ownership structure and, indeed, continuing independence over the last few years, which has negatively affected client and staff confidence in the bank. That should come to an end with Safra Group replacing Rabobank as the main shareholder.
- **Competition.** International private banking is seen by many banks as a high growth and low capital consumptive business, and therefore a very attractive one to develop. This makes is harder to win clients and recruit and keep top private bankers.

Financials

Our forecasts assume fund performance of 3% per year, NNM growth of 5% to 6%, slightly rising gross margins and a modest decline in the cost income ratio. 2011 results were hurt by the strong Swiss franc pushing up the cost income ratio. The bank has announced no dividend for 2011 until the change of ownership to the Safra Group has been completed.

Exhibit 3: Profit and loss

CHFm					change		
	2010	2011	2012e	2013e	11/10	12/11	13/12
Net interest income	147	149	150	155	1%	1%	3%
Net commission income	457	441	460	500	(4%)	4%	9%
Trading income	60	94	90	95	57%	(4%)	6%
Other ordinary income	26	3	3	25	(89%)	(0%)	793%
Total operating income	691	686	703	775	(1%)	2%	10%
Personnel expenses	(368)	(382)	(394)	(434)	4%	3%	10%
General and admin expenses	(137)	(134)	(119)	(120)	(2%)	(11%)	1%
Total expenses	(505)	(516)	(513)	(554)	2%	(1%)	8%
Operating profit	185	170	190	221	(8%)	11%	16%
Depreciation and amortisation	(31)	(33)	(31)	(31)			
Valued adjustments, provisions and losses	(11)	(11)	(1)	(1)			
Profit before tax	143	126	158	189	(12%)	25%	19%
Taxes	(19)	(14)	(23)	(26)			
Minority interests	(17)	(12)	(12)	(12)			
Net Income	108	99	123	150	(8%)	24%	22%
Weighted average number of shares m	62	62	62	62			
EPS	1.74	1.60	1.98	2.42	(8%)	24%	22%
DPS	0.90	0.00	1.00	1.00			
Payout	52%	0%	50%	41%			
Tax rate	13%	11%	14%	14%			
Operating profit by division							
Private banking	108	100	105	125	(7%)	5%	19%
Trading & Family Office	29	23	27	29	(21%)	17%	9%
Asset Management, Products & Sales	63	61	68	75	(2%)	10%	11%
Bank zweiplus	12	6	6	6	(53%)	0%	11%
Corporate center	(26)	(19)	(15)	(15)	(27%)	(22%)	0%
Total	*185*	*170*	*190*	*221*	*(8%)*	*11%*	*16%*
Employees	1,642	1,715	1,720	1,740	4%	0%	1%
AuM bn	103.4	96.4	104.9	113.6	(7%)	9%	8%
Average AuM bn	94.9	99.7	101.3	109.0	5%	2%	8%
NNM bn	13.4	1.5	5.6	5.6			
NNM %	14.3%	1.4%	5.8%	5.3%			
Performance	-4.0%	-8.1%	3.0%	3.0%			
Gross margin bps	70.0	68.0	69.4	71.1	-3%	2%	2%
Cost/income ratio	77.6%	80.0%	77.4%	75.5%			
Comp ratio	53.3%	55.7%	56.0%	56.0%			
Costs/average AuM bps	56.5	55.1	53.7	53.7			
Pre-tax margin bps	15.1	12.6	15.6	17.3			
EBIT Margin	27%	25%	27%	28%			

Source: Sarasin, Edison Investment Research estimates

Exhibit 4: Balance sheet

CHFm						change	
Balance Sheet	2010	2011	2012e	2013e	11/10	12/11	13/12
Loans	9,457	9,932	10,429	10,950	5%	5%	5%
Trading portfolio	496	694	700	700	40%	1%	0%
Investment portfolio	3,210	2,609	2,500	2,500	(19%)	(4%)	0%
Goodwill & intangibles	148	131	120	110	(11%)	(8%)	(8%)
Other	4,194	4,129	4,271	4,300	(2%)	3%	1%
Total assets	17,505	17,495	18,020	18,560	(0%)	3%	3%
Deposits	11,850	12,618	13,249	13,911	6%	5%	5%
Other liabilities	4,426	3,647	3,481	3,271	(18%)	(5%)	(6%)
Shareholders' equity	1,229	1,230	1,290	1,378	0%	5%	7%
Total Liabilities	17,505	17,495	18,020	18,560	(0%)	3%	3%
Risk weighted assets	6,603	7,264	7,627	8,009	10%	5%	5%
Number of shares at year end	62.7	62.7	62.7	62.7	0%	0%	0%
BV per share	19.6	19.6	20.6	22.0	0%	5%	7%
BV per share (ex intangibles)	17.2	17.5	18.7	20.2	2%	6%	8%
Loans/deposits	80%	79%	79%	79%			
Tier 1 ratio	15.3%	15.6%	15.7%	16.0%			
Return on Equity	15.3%	15.6%	15.7%	16.0%			

Source: Sarasin, Edison Investment Research estimates

Edison investment research

Vontobel

Year end	Revenue (CHFm)	Net income* (CHFm)	EPS* (CHF)	DPS (CHF)	P/E (x)	Yield (%)
12/10	830	148	2.31	1.40	9.6	6.3
12/11	766	114	1.78	1.10	12.4	5.0
12/12e	834	138	2.17	1.20	10.2	5.4
12/13e	911	161	2.52	1.40	8.8	6.3

Note: *Normalised, Edison estimates.

Investment summary: Still an investment bank

Private banking accounts and asset management make up around half of Vontobel's operating profit. It has a successful structured products business in its investment bank that produces the bulk of the remaining profits. It is sensitive to conditions in the equity market with falling and volatile markets producing a slowdown in client activity, which negatively affects revenues and profits. The bank is attempting to grow its private banking and asset management operations to diversify its business, though the activities are also affected by market conditions.

Investment banking is still key

Despites its ongoing attempts to grow its private banking and asset management activities, Vontobel's investment banking operations still produce around one-half of group profit. It is attempting to grow its investment banking activities in Germany, Dubai and even Singapore for the Asian market, to diversify and grow. Vontobel is therefore trying to diversify away from its dependence on its Swiss investment banking business not just by expanding its private banking and asset management businesses, but also by diversifying its investment banking operations.

Sensitivities

Sensitivities include: (1) equity market strength and client activity; (2) the strength of the Swiss franc; (3) the level of interest rates; (4) banking and tax regulation; (5) litigation over past banking activities; (6) competition for clients and private bankers; and (7) the intentions of the large banks to enter the Swiss equity warrants business.

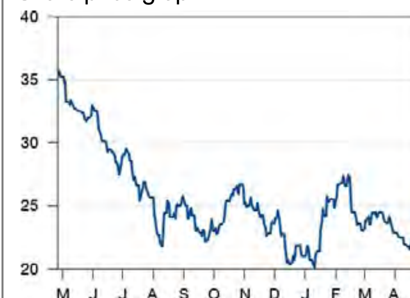
Valuation

At a P/E ratio of c 10x 2012 earnings Vontobel is trading below its 14.7x five-year average, but that average is distorted by the financial crises lowering earnings. Our 20-year DCF suggests a fair valuation of CHF25.2 with a 10% cost of equity, in line with the current share price. This assumes a growth rate in private banking and asset management of 7% per year. Raising this to 9% increases the value to CHF26 per share. This is a small increase because around 40% of the value of the company is derived from its investment bank, which we have valued at 80% of our estimate of the capital invested in this business.

Price*	CHF22.15
Market cap	CHF1.4bn

*As at 26 April 2012

Share price graph



Share details

Code	Vonn SW
Listing	SWX
Sector	Banks
Shares in issue	204.2m

Price

52 week	High	Low
	CHF35.7	CHF20.1

Balance Sheet as at 31 December 2011

tNAV per share (CHF)	21.2
Loans/deposits (%)	18
Tier 1 ratio (%)	23.3

Business

Vontobel has a leading position in the Swiss equity warrant business as well as private banking and asset management operations.

Profits/loss by division

Investment banking	Private banking	Asset Mgmt	Other
65%	22%	25%	-12%

Analyst

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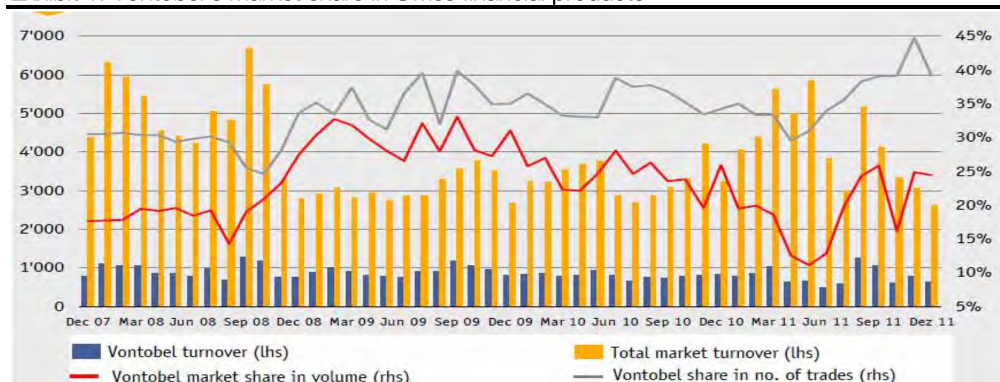
Company description: Leading position in Swiss structured products

In 2011 around half of Vontobel's profits were derived from its investment banking division. The sale of financial products, that is structured products, provided some 74% of this division's revenue, brokerage 11% and business with external asset managers 9%. The continued success of Vontobel in this business is remarkable considering the potential huge competition from Credit Suisse and UBS, not to mention other large investment banks from around the world. Vontobel puts its success down to its focus and dedication to its clients plus a flexible approach to bring new products to the market quickly as soon as demand emerges. The following exhibit shows its resilient market share over the past four years. In 2011 its market share in Swiss-listed structured products was 18%, a number three position.

Exhibit 1: Vontobel's market share in Swiss financial products



Source: Technolab, Vontobel

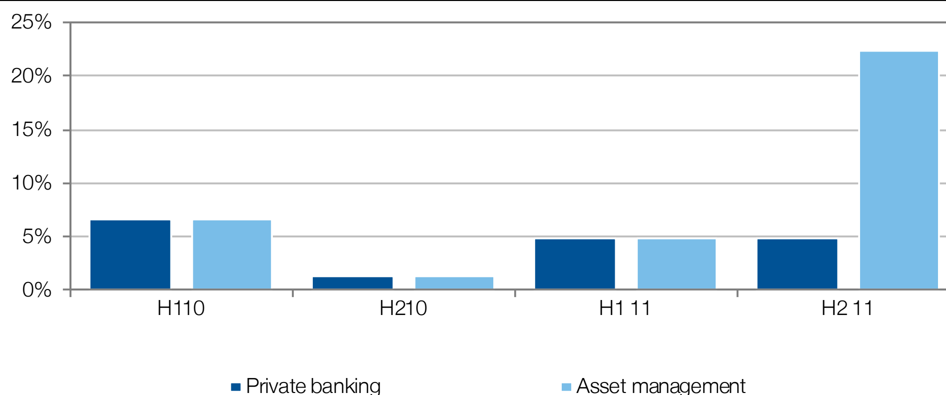
Vontobel has attempted to broaden its business in financial products and has entered the German market and claims to be within the top 10. It plans to further broaden its potential revenue base with operations in Dubai and Singapore.

A differentiated strategy in private banking and asset management

Vontobel's private banking unit has just CHF28.5bn of assets under management and so ranks as a mid-sized player at best in the industry. It is seeking to grow this business organically and through acquisition. It bought Commerzbank's Swiss business in July 2009 for an undisclosed sum and is seeking to expand its onshore presence in Germany and Italy in particular. While it is interested in emerging markets, its focus seems to be more on eastern Europe and the Middle East than many other banks, which seem to be more focused on Latin American and Asia, especially the latter.

Vontobel has some CHF45.8bn of assets under management in its asset management business, which caters for the institutional and wholesale markets. This again makes it more of a niche player than an industry leader. It has though enjoyed some good levels of inflows, especially into contemporary value products in the US, which had US$20bn of AuM at the end of 2011 following on from some good performance. This is a potentially lucrative source of profit growth for Vontobel if the unit can maintain its good investment performance.

Exhibit 2: Vontobel net new money inflows into private banking and asset management



Source: Vontobel

Sensitivities

The group's main sensitivities are to:

- **Equity markets.** Falling equity markets lower assets under management, with typically around a third of client money invested in them; they also discourage clients to move their money. Falling or very volatile markets reduce client activity, which negatively affects the sale of financial products in its investment banking operations.
- **Interest rates.** A third of client money is typically invested in cash instruments, much placed on Vontobel's own balance sheet and lower interest rates reduce the deposit margin they earn on this money.
- **Strength of the Swiss franc.** Thanks to its Swiss equity warrant business the mismatch between Swiss franc revenue and costs is less for Vontobel than it is for other Swiss banks. It has some 80% of its cost in Swiss francs but just under 60% of its revenues. A strengthening Swiss franc would lower revenue more than costs and squeezes profits.
- **Competition:** Vontobel faces a continued battle to maintain its position in the Swiss equity warrant business against large banks with far bigger balances sheets and resources. So far it has managed to win that battle, and, indeed, some like Deutsche Bank have retreated from the market in the past having made a concerted effort beforehand.

Financials

The key factor in forecasting Vontobel's profits is the investment banking unit and activity in Swiss equity warrants. In 2011 this business collapsed in H2, with the uncertainty over the European debt crisis and financial sector. In 2012 we currently forecast a muted recovery in this business, steady progress in private banking, but excellent progress in asset management on the back of its recent wins in net new money and expansion of its assets under management. We expect investment banking revenues and profits to be flat, but should equity markets be particularly strong this may prove too conservative, giving some upside potential to our profit forecasts.

Exhibit 3: Profit and loss summary (CHFm)

CHFm					change		
	2010	2011	2012e	2013e	11/10	12/11	13/12
Net interest income	53	60	61	61	13%	1%	1%
Net fee and commission income	478	452	509	564	(5%)	12%	11%
Net trading income	274	225	240	260	(18%)	7%	8%
Other	25	28	25	25	12%	(11%)	0%
Operating income	830	766	834	911	(8%)	9%	9%
Personal expenses	(392)	(373)	(407)	(448)	(5%)	9%	10%
General expenses	(196)	(179)	(187)	(194)	(9%)	5%	4%
Depreciation and amortisation	(62)	(60)	(62)	(62)	(3%)	3%	0%
Valuation adjustment, provisions and losses	(7)	(7)	(6)	(6)	(3%)	(17%)	0%
Operating expenses	(657)	(619)	(661)	(710)	(6%)	7%	7%
Operating profit	173	147	173	201	(15%)	18%	16%
Taxation	(26)	(33)	(35)	(40)	0%	0%	0%
Net profit	147	114	138	161	(23%)	22%	16%
Minority interests	(1)	0	0	0	0%	0%	0%
Net profit after minority interests	147.8	113.7	138.4	160.8	(23%)	22%	16%
Wtd av no of shares	63.9	63.8	63.8	63.8	(0%)	0%	0%
EPS	2.31	1.78	2.17	2.52	(23%)	22%	16%
DPS	1.4	1.1	1.2	1.4	(21%)	9%	17%
Payout ratio	61%	62%	55%	56%			
Tax rate	15%	23%	20%	20%			
Operating profit by division							
Private Banking	49	33	34	40	(32%)	3%	17%
Investment Banking	116	95	106	116	(18%)	12%	10%
Asset Management	51	37	52	66	(27%)	41%	28%
Corporate Centre	(42)	(18)	(19)	(21)	(57%)	4%	13%
Total	*173*	*147*	*173*	*201*	*(15%)*	*18%*	*16%*
AuM bn	78.6	82.2	91.1	100.8	5%	11%	11%
NNM bn	5.5	8.2	8.5	9.0			
NNM %	7.3%	10.4%	10.3%	9.9%	0%	0%	0%
Cost/income ratio	65.4%	67.9%	67.1%	65.9%	2%	-2%	-2%
Comp ratio	44.1%	44.9%	45.0%	45.0%	0%	0%	0%
EBIT Margin	21%	19%	21%	22%			

Source: Vontobel, Edison Investment Research estimates

Exhibit 4: Balance sheet

CHFm					change		
Balance Sheet	2010	2011	2012e	2013e	11/10	12/11	13/12
Loans	1,427	1,370	1,400	1,400	(4%)	2%	0%
Trading portfolio	2,017	1,442	1,450	1,450	(29%)	1%	0%
Investment portfolio	1,045	1,040	1,050	1,050	(0%)	1%	0%
Goodwill & intangibles	151	141	131	121	(7%)	(7%)	(8%)
Other	13,662	14,699	14,941	15,236	8%	2%	2%
Total assets	18,302	18,692	18,972	19,257	2%	1%	1%
Deposits	4,926	7,539	8,000	8,250	53%	6%	3%
Other liabilities	11,872	9,656	9,414	9,377	(19%)	(3%)	(0%)
Shareholders' equity	1,504	1,497	1,559	1,630	(0%)	4%	5%
Total Liabilities	18,302	18,692	18,972	19,257	2%	1%	1%
Risk weighted assets	5,690	4,969	5,218	5,479	(13%)	5%	5%
Number of shares at year end	64	64	64	64	0%	0%	0%
BV per share	23.5	23.4	24.4	25.5	(0%)	4%	5%
BV per share (ex intangibles	21.1	21.2	22.3	23.6	0%	5%	6%

Source: Vontobel, Edison Investment Research estimates

Edison investment research

VZ Holding

Year end	Revenue (CHFm)	Net income* (CHFm)	EPS* (CHF)	DPS (CHF)	P/E (x)	Yield (%)
12/10	133	49.4	6.27	2.30	15.5	2.4
12/11	144	51.1	6.48	2.40	15.0	2.5
12/12e	157	55.2	6.99	2.60	13.9	2.7
12/13e	171	60.9	7.71	2.90	12.6	3.0

Note: *Normalised. Edison estimates.

Investment summary: High expectations

VZ Holding has been a market darling since it first floated in 2007, and in a period when other financial stocks were running into severe difficulties that was justified as the company was producing 14% EPS growth from 2007 to 2011 on a compound basis per year. In addition, it did not have concerns about its balance sheet nor even the source of its money, as it is almost entirely a Swiss-focused business. However, earnings growth slowed in 2011 with the adverse market conditions and the company is now trying to grow in Germany, which may dampen earnings growth.

Solid business model, but competition

VZ's strategy is to focus on the over 50s, who have saved a large part of their old-age nest egg, or if they have not, need to save a lot quickly. It estimates its target market as around 0.5m, less than 10% of the Swiss population. It gives advice mainly about the best way to use that money in retirement, but of course it offers advice on other financial services provision as well. The company has enjoyed spectacular growth in its home Swiss market, but the low hanging fruit has been picked and competitors have stepped up their responses. Consequently, VZ Holding is now trying to expand in the German market.

Sensitivities

Sensitivities include: (1) equity market strength and client confidence; (2) pension and tax regulation in Switzerland and Germany; and (3) competition for clients and especially for consultants.

Valuation

On a P/E ratio of 14x 2012 earnings, VZ Holding is trading below its 17.2x five-year average. Using a 20-year DCF at a cost of equity gives a fair value of CHF104.9, which is in line with the current share price.

Price*	CHF97.0
Market cap	CHF765m

As at 26 April 2012

Share price graph

Share details

Code	VZN SW
Listing	SWX
Sector	Financial Services
Shares in issue	7.9m

Price

	High	Low
52 week	CHF141.9	CHF88.9

Balance Sheet as at 31 December 2011

tNAV per share (CHF)	25.1
Loans/Deposits (%)	52
Equity ratio (%)	28.1

Business

VZ Holding provides wealth management services with a focus on managing the money of those close to or over the retirement age.

AuM by geography

Switzerland

100%

Analyst

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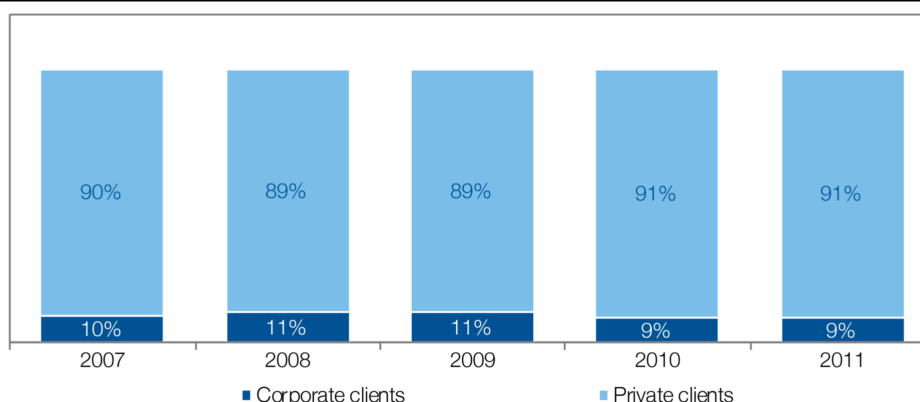
Company description: Transparency in pricing

VZ Holding was founded by Matthias Reinhardt and Max Bolanz in 1993 with the underlying ethos of bringing transparency to Swiss insurance and banking. Prior to that the pricing of products was opaque to say the least, but from the outset they set out to charge clients fees for the services they provide them and give the clients any sales commissions they received from the product provider. VZ Holding was adamant that it offered independent advice that it considered was best for the customer and not the product that gave it the best commission.

There are two segments to the business, the private client segment and the corporate client segment. The private client segment is by far the most important, at around 90% of group revenue. Revenues in this segment are earned as fees for consultancy on a time basis and as a management fee calculated as a percentage of volume of securities or mortgages when a client has signed up. In 2011 over 70% of the segment's revenues were management fees. The corporate client segment gives advice on pensions, insurance and risk management and 90% of its revenue is in the form of management fees.

Exhibit 1: VZ Holding revenue sources

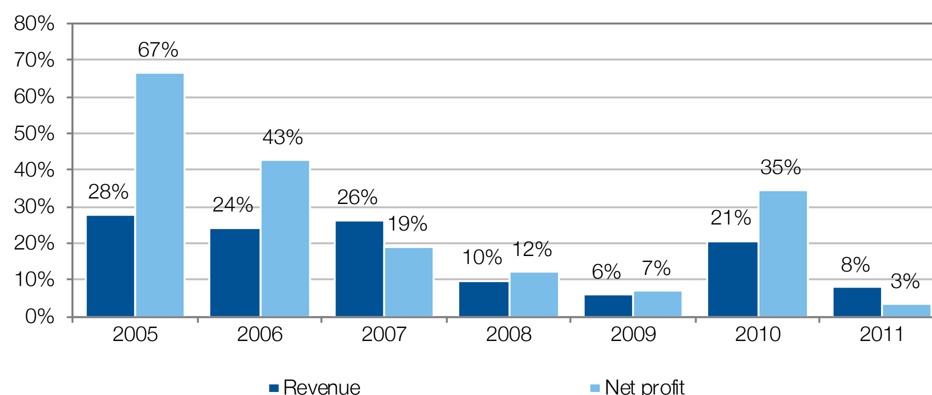


Source: VZ Holding

Growth still dependent on confidence in financial markets

Although VZ Holding has produced very strong growth since flotation in 2007, as with many other financial stocks, that growth is still heavily dependent on confidence in financial markets. In the financial crisis of 2008/09 its revenue and profit growth stalled and the same happened in the crisis of 2011, as we show in the following exhibit.

Exhibit 2: VZ Holding revenue and net profit growth



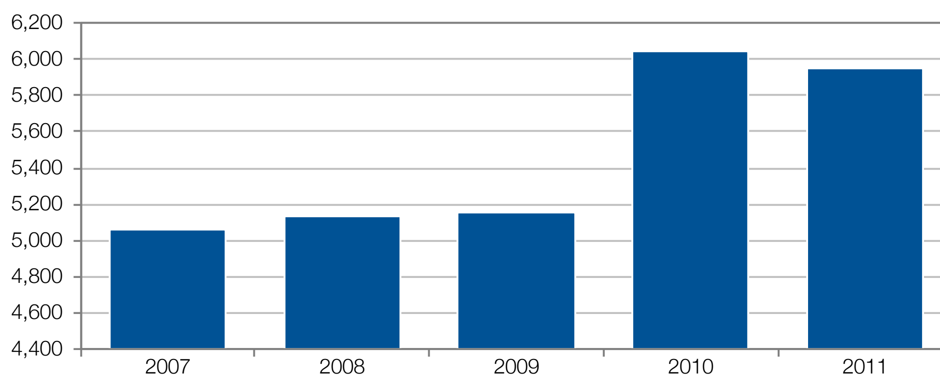
Source: Company reports

The company actually warns that revenue growth in 2012 will suffer, especially in H112, because of the lower assets under management brought forward from the weak equity markets at the end of 2011 as these are the driving force behind future fee generation. We estimate a 10% fall in AuM would lower operating profits by a similar amount.

In terms of generating future AuM the company believes that it is well placed in the longer run, given the ageing of the Swiss population and the fact that at the end of 2011 it only had some 14,785 clients and it estimates its target market at 500,000.

VZ Holding finds that consultant meetings are a useful indicator of future business and, as we show in the exhibit below, even though 2011 saw considerable financial turmoil there was still a high level of consultants meetings that year.

Exhibit 3: VZ Holding's consultants meetings



Source: Company reports

Sensitivities

The group's main sensitivities are to:

- **Equity markets.** Weak equity markets and financial uncertainty make people lose their confidence and as a consequence they tend to keep their money where it is and not move it to VZ Holding, or if they did, they are less reluctant to switch products.
- **Competition.** VZ Holding has shown how successful its strategy of targeting wealth individuals coming up to retirement and offering them transparent pricing can be, and this has inevitably attracted increased competition to this segment of the market.
- **Regulation:** Switzerland already has advanced Pillar 3 provision for old age, so beneficial changes are not expected for VZ Holding, which provides advice for this segment. We believe that adverse changes to regulations are unlikely, but clearly they are always possible.

Financials

In 2012 VZ Holding's profits will face a headwind from lower AuM at the start of the year as a result of weak equity markets at the end of 2001. This will hurt revenue growth, but it still expects expense growth in 2012 to be around 10% as a result of organic growth in Switzerland and the German initiative. The result will a somewhat lower than normal rate of profit growth in 2012, but 2013 should see a return to higher growth.

Exhibit 4: Profit and loss

CHFm					change		
	2010	2011	2012e	2013e	11/10	12/11	13/12
Consulting fees	15	15	16	17	(1%)	5%	5%
Banking revenues	19	21	23	24	12%	8%	8%
Management fees	99	107	118	130	9%	10%	10%
Revenue	133	144	157	171	8%	9%	9%
Personnel expenses	(52)	(58)	(63)	(68)	12%	8%	9%
Other operating expenses	(18)	(20)	(22)	(24)	11%	13%	7%
Total operating expenses	(69)	(77)	(85)	(92)	12%	9%	9%
EBITDA	64	66	72	79	4%	9%	10%
Depreciation and amortisation	(2)	(3)	(3)	(3)	21%	3%	0%
EBIT	61	63	69	76	3%	9%	10%
Interest expense	(1)	(0)	0	0	0%	0%	0%
Interest income	0	0	0	0	0%	0%	0%
Net finance income	(0)	0	0	0	0%	0%	0%
Profit before tax	61	63	69	76	3%	9%	10%
Taxation	(12)	(12)	(14)	(15)	3%	14%	10%
Net profit	49	51	55	61	3%	8%	10%
Weighted average number of shares	8	8	8	8	0%	0%	0%
EPS	6.27	6.48	6.99	7.71	3%	8%	10%
DPS	2.30	2.40	2.60	2.90	4%	8%	12%
Payout ratio	37%	37%	37%	38%	0	0	0
AuM bn	7.8	8.4	9.0	10.0	8%	5%	5%
Gross margin	170.4	177.2	180.1	180.1			
EBIT Margin	46.2%	44.0%	44.0%	44.5%			
Personnel expenses/Total revenue	39%	40%	40%	40%			
Tax rate	19%	19%	20%	20%			
Cost/income ratio	52%	54%	54%	54%			
	0	0	0	0			

Source: Edison Investment Research, VZ Holding

Exhibit 5: Balance sheet

CHFm					change		
Balance Sheet	2010	2011	2012e	2013e	11/10	12/11	13/12
Loans	418	437	459	482	5%	5%	5%
Trading portfolio	0	0	0	0	0%	0%	0%
Investment portfolio	124	219	220	225	77%	0%	2%
Goodwill & intangibles	2	2	2	2	0%	0%	0%
Other	296	400	462	525	35%	15%	14%
Total assets	840	1,058	1,143	1,234	26%	8%	8%
Deposits	654	834	876	919	28%	5%	5%
Other liabilities	18	24	32	42	33%	34%	30%
Shareholders' equity	168	200	235	273	19%	17%	16%
Total Liabilities	840	1,058	1,143	1,234	26%	8%	8%
	0	0	0	0	0%	0%	0%
Number of shares at year end	7.9	7.9	7.9	7.9	0%	0%	0%
BV per share	21.3	25.4	29.7	34.5	19%	17%	16%
BV per share (ex intangibles)	21.1	25.1	29.5	34.3	19%	17%	16%
Loans/deposits	63.9%	52.4%	52.4%	52.4%			
Equity ratio	20.0%	18.9%	20.5%	22.1%			
Tangible equity ratio	19.8%	18.8%	20.4%	22.0%			
Return on Equity (ex intangibles)	33.2%	28.1%	25.6%	24.2%			

Source: Edison Investment Research, VZ Holding

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