# BNP Paribas Long-Term Earnings Evolution: Consumer Finance - A Jewel in the Crown

**In this report Scope considers how the earnings profile of BNP Paribas (BNPP, issuer rating: AA-, stable outlook) has changed since the years immediately prior to the financial crisis, under the umbrella of its diversified universal banking model. We examine in particular the contribution of the international consumer finance businesses under BNP Paribas Personal Finance, which we consider to be a stand-out in terms of its earnings profile within the Group. We also briefly comment on the earnings profiles of some of the Group's other businesses including and compare BNPP's Corporate and Investment Banking business, France's largest, to that of European rivals.**

One of the key drivers of BNPP's rating is its diversified universal banking business model which (albeit on a larger scale than rivals in some businesses such as investment banking and consumer finance) is also typical of the other large French banks. BNPP has provided a relatively high level of disclosure concerning the details of its earnings, and we have used this to review changes in the period since 2005, predating the financial crisis. While certain businesses have seen a decline in the importance of their profit contributions over time, others have helped to compensate by growing healthily.

BNPP Group presents its earnings using three main operating segments: Domestic Markets, International Financial Services (IFS) and the Corporate and Institutional Bank (CIB). We have chosen a somewhat different and more granular approach for this analysis. BNPP sub-divides each main business segment, either geographically or by product group, and provides a detailed income statement for each sub-division down to the pre-tax profit line. The regulatory capital allocated to each sub-division is published, along with assets and external liabilities.

While these internal income statement and balance sheet allocations are not perfect – the Group runs a good proportion of its exceptional/restructuring costs through its corporate centre – they reveal more about the Group's pre-tax profit evolution in recent years than would be the case looking only at the results of the main operating segments, particularly as some businesses have been moved between segments over time.

For example, the Domestic Markets segment encompasses not only the retail banking businesses in France, Italy, Belgium and Luxembourg, but also several businesses with very different dynamics: Arval (the international vehicle leasing business); Leasing Solutions (equipment leasing); Personal Investors (online savings and brokerage); and Compte-Nickel (which supplies internet bank account services without offering credit, acquired in July 2017).

The IFS segment comprises not only the retail banking businesses in the U.S. and Europe-Mediterranean (formerly known as Emerging Markets), but the consumer finance businesses within BNP Paribas Personal Finance, and the Group's insurance and wealth and asset management (WAM) businesses. In terms of return on allocated capital these two latter businesses are BNPP's most profitable (along with Securities Services. i.e. Global Custody), and therefore improve the results of IFS as a whole.

Finally, CIB includes not only the Global Markets and Corporate Banking businesses, but the Global Custody business (which had been included within IFS until 2014).

Based on allocated regulatory capital, we have calculated the pre-tax return on average equity (ROAE) for each of the sub-divisions over time, and also compared metrics including the scale of the pre-tax profit contribution, amount of capital allocated (the less the better), the cost/income ratio, the cost of risk and profit growth over time.

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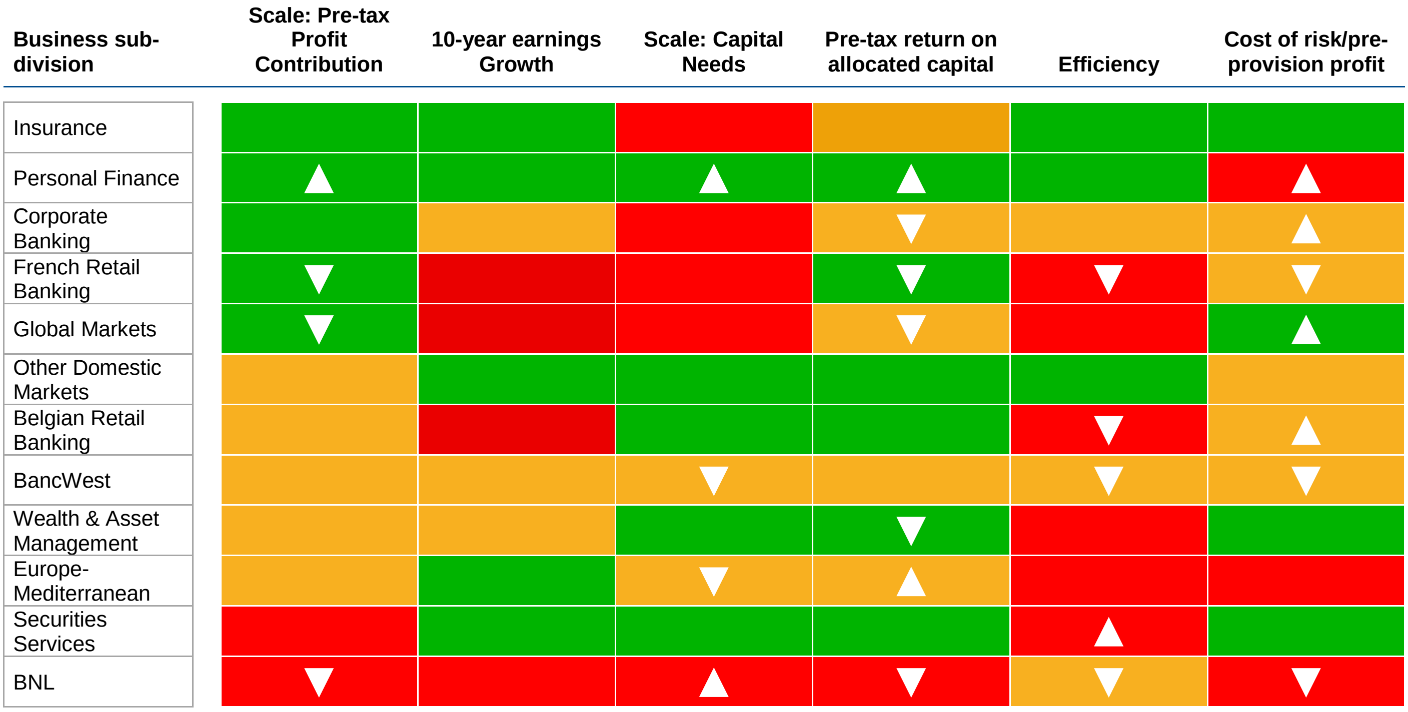
We summarise our findings below in a ‘traffic light’ heatmap (see Figure 1) and by the numbers (see Figure 2 and Figures 4 through 14).

**Figure 1: BNP Paribas’ business sub-divisions: heatmap**




Source: Scope Ratings

**Figure 2: BNP Paribas’ business sub-divisions: 2017 performance**

| BNP Paribas: Breakdown of sub-divisions' 2017 performance | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Business** | **Revenues (EUR m)** | **Operating expenses (EUR m)** | **Gross operating income (EUR m)** | **Pre-tax profit (EUR m)** | **Cost of Risk (EUR m)** | **Cost to income ratio** | **Pre-tax ROAE** | **Allocated equity (EUR bn)** |
| Insurance | 2,514 | 1,251 | 1,263 | 1,865 | 8 | 50% | 24% | 7.8 |
| Personal Finance | 4,923 | 2,427 | 2,496 | 1,606 | 1,009 | 49% | 30% | 5.8 |
| Corporate Banking | 4,165 | 2,430 | 1,735 | 1,424 | 348 | 59% | 11% | 12.4 |
| French Retail Banking | 6,352 | 4,658 | 1,694 | 1,365 | 331 | 73% | 15% | 9.4 |
| Global Markets | 5,585 | 4,254 | 1,331 | 1,234 | 105 | 76% | 15% | 7.8 |
| Other Domestic Markets | 2,782 | 1,607 | 1,175 | 1,129 | 89 | 58% | 29% | 4 |
| Belgian Retail Banking | 3,676 | 2,554 | 1,122 | 1,083 | 67 | 69% | 22% | 5.3 |
| BancWest | 2,995 | 2,034 | 961 | 855 | 112 | 68% | 13% | 6.4 |
| Wealth & Asset Management | 3,193 | 2,387 | 807 | 839 | 35 | 75% | 42% | 1.9 |
| Europe-Mediterranean | 2,336 | 1,661 | 675 | 618 | 259 | 71% | 12% | 4.9 |
| Securities Services | 1,955 | 1,587 | 368 | 369 | 3 | 81% | 43% | 0.9 |
| BNL | 2,907 | 1,801 | 1,106 | 191 | 871 | 62% | 4% | 5.8 |

Source: Company data, Scope Ratings

### Retail banking sub-divisions

Although naturally considered as one of the main pillars within the Group's infrastructure, the profitability of BNPP's retail banking business as a whole has declined in recent years. Profitability has been affected by the prevailing low interest-rate environment, and by negative operating jaws as expenses have grown faster than revenues even though some of the necessary upfront investment costs supporting the Group' digital transformation are fed through the Corporate Centre.

BNPP has five 'pure' retail banking sub-divisions: in France, Belgium, Italy, the U.S, (BancWest). and Europe-Mediterranean. The latter operates in 14 countries through 2,258 branches, and includes banks in Turkey, Poland, Ukraine, Morocco, Tunisia, Algeria, sub-Saharan Africa and a partnership with Bank of Nanjing in China.

The Group's digital bank, Hello bank!, is also accounted for within the retail banking results. Launched in 2013 and designed for use on smartphones and tablets, Hello bank! operates in France, Italy, Belgium, Germany and Austria. By year-end 2017 it had acquired 2.9 million customers (YE16: 2.5 million), accounting for 11% of revenues from individual clients.

In 2012 the retail sub-divisions accounted for 45%% of Group revenues and 42% of Group pre-tax profit. By 2017 the respective percentages were 42% and 34%, with pre-tax profit having fallen 12% over the five-year period. In the past few years the cost/income ratio has deteriorated across each of the five retail geographies, notably in the U.S. (see Figure 8). Minor improvements in cost-income ratios were seen in Belgium and the U.S. in 2017, but not enough to compensate for the longer-term trend.

**French retail business**: As a sub-division, this continues to be the Group's largest single top-line revenue generator accounting for 15% of total revenues in 2017, and 11% of pre-tax profit (compared to 25% and 18% respectively in 2005). However, even with restrained expense growth revenues have been falling since 2011, thus pre-tax profit has fallen in absolute terms.

Like other French banks BNPP has not found it easy to cut costs in the domestic network – in part because of the upfront investment necessary to achieve the bank's digital transformation but also because the numbers of branches and employee headcount have proved resistant. In 2006 BNPP had 2,200 branches in France, and 31,000 full-time employees (FTEs). By the end of 2016 the comparable numbers were 1,964 branches and 29,000 FTEs.

**Italian retail business:** BNPP acquired BNL Banca Commerciale (BNL) for EUR 9 bn in 2006, shortly before the financial crisis. Given BNL's subsequent performance and BNPP's more recent focus on digital as opposed to bricks-and-mortar expansion, the timing could hardly have been worse.

BNPP managed, entirely based on top-line growth, to lower BNL's cost-income ratio from above 70% to 55% in 2013 and 2014 (though it had worsened to 62% in 2017). This made BNL the Group's most efficient retail banking business. However, the scale of the initial revenue improvements has since been more than wiped out by BNL's elevated cost of risk. BNL has accounted for between a quarter and one third of BNPP's total loan loss provisions since 2012, as it works out a large problem loan portfolio (20% of total loans as of YE16). Therefore since 2013 BNL has been the worst performer amongst BNPP's business sub-divisions, with the lowest pre-tax ROAE, at just 4% in 2017.

**Belgian retail business**: BNPP's acquisition of Fortis Bank's operations in Belgium and Luxembourg) was completed in 2009, after Fortis was bailed out by the Benelux governments. In Belgium, restrained expense growth coupled with gradual revenue growth and a reduced cost of risk over the past few years has seen the pre-tax profit contribution grow from 4% in 2009 to 8% in 2017. To date the Fortis acquisition has proved far more successful than that of BNL, with pre-tax profit more than trebling between 2009 and 2017 and the cost of risk falling to minimal levels.

BNPP's retail bank in Luxembourg is that country's second largest, with 15% and 23% shares respectively of retail banking and SME markets. This is accounted for within the 'Other Domestic Markets' business sub-division. However, analysing this is tricky, as it subsumes the Luxembourg retail business with other businesses that are dissimilar to it. We estimate that at least 80% of the revenues and pre-tax profits of Other Domestic Markets are accounted for by these other businesses, predominantly Arval, the Group's corporate vehicle leasing business.

### Consumer Finance

In our view the consumer finance sub-division, known as BNP Paribas Personal Finance (PF), is a stand-out amongst the Group's businesses. Its contribution to pre-tax profit is substantial (13% in 2017), and thus has provided a very useful hedge against the weaker performance of the pure retail businesses in recent years.

Numbers tell a large part of the story: the scale of the sub-division's pre-tax profit contribution is growing (by an aggregate of 219% between 2006 and 2017), and efficiency is strong (with a cost/income ratio below 50% since 2009). Further, the capital needs of PF are lower than those of several worse-performing sub-divisions, including French retail banking, BancWest and the CIB businesses. In fact the amount of equity allocated to PF is the same (EUR 5.8 bn) as was allocated to BNL at the end of 2017. The pre-tax ROAE (30% in 2017) was only bettered by that of the Group's WAM and Global Custody businesses, which, like PF, are not as capital-intensive as the retail and CIB businesses.

Here we examine PF's business model, to draw out reasons for its relative success. The long-established consumer finance company Cetelem is the largest flagship brand within PF, and still accounts for the largest share of its earnings. Established in 1953 under Compagnie Bancaire, which eventually became part of BNPP, its success is rooted in its original business model.

Cetelem's business model largely defined market practice for offering consumer credit in France, first though its operations in retail outlets (instalment loans, often for cars, at point of sale), and second through more direct forms of credit. These included personal loans, often sold to former clients, but with a higher interest rate.

The strategy evolved as Cetelem expanded by using additional credit offerings to clients who had already accessed its products through retail outlets, and with an existing credit history with Cetelem. These customers were considered more likely to repay than unknowns selected by retailers, and the average amount borrowed was higher. Types of credit offered also included revolving loans through cards and other means.

In France, revolving credit turned out to be very profitable. It is geared towards lower-income customers who may have poor credit histories and thus fewer borrowing options. Amounts borrowed tend to be relatively small, with payments spread over flexible periods. Cetelem has paid attention both to keeping down costs and the rates it offers to such customers.

The business model has proved to be scalable both in France and internationally, and much of the growth in recent decades has been organic in nature. In 2007 the decision was taken to combine the Group's specialised mortgage lender UCB with Cetelem under the PF umbrella. PF includes brands such as Cofinoga, Findomestic (Italy) and AlphaCredit (Belgium and Luxembourg). In addition BNPP also acquired the 50% it did not already own of revolving credit specialist LaSer Cofinoga from the retailer Galeries Lafayette in 2014, enhancing its market position. BNPP continues to merge the company into PF's existing business.

PF now has about 17,500 employees in 30 countries (i.e. about 40% fewer than in the French retail bank network alone). The product range encompasses a full range of consumer loans made at point of sale (retail stores and car dealerships), or through PF's customer relations centres or online. Locally-tailored insurance products (drawn from the BNP Paribas Cardif business and some local partners) are also part of the customer offering along with savings and retirement funding. PF also has a mortgage business in a few countries.

Only in terms of cost of risk does PF appear worse than most other Group businesses (with the exception of BNL). However, this is factored into its business model, as the expectation of higher credit losses in some customer segments is dealt with through appropriate risk pricing. Further, PF has managed down its cost of risk in the past five years, in part because low interest rates have increased affordability of loan payments for its customers, and also through repositioning its asset mix towards lower-risk products such as car loans.

The consumer credit business also operates within the Group's Retail Banking network in some countries, through 'PF Inside', which applies in Germany, Bulgaria, France, Hungary and Italy. Further, BNPP announced an initiative in the Czech Republic in November 2017, Hello bank! by Cetelem. The internet-only bank here aims to piggyback off Cetelem's existing local presence (400,000 active clients and 2,000 retail partners), and to draw upon BNP Paribas Cardif for insurance products.

### Other non-retail sub-divisions

While it is beyond the scope of this report to provide a detailed view of all the other non-retail sub-divisions, we comment on several of these below.

**Equipment Financing:** Based on pre-tax ROAE, this is one of the Group's strongest business lines in terms of growth and profitability. It includes Arval's international corporate vehicle leasing business. Arval has its roots in a transatlantic joint venture with the car rental company Avis, and reinforced its already strong market position in Europe when it took over GE Capital's European fleet management services in 2015. Arval now leases and manages fleets consisting of over one million cars and light trucks. Activities include fuel purchasing, accident management services and car rentals for both small and large companies. In some cases services are provided on a 'white label' basis for Arval's car manufacturing partners.

Although the scale of its profit contribution is lower than that of the retail banks in France and Belgium, we estimate that it has grown far more rapidly since 2005. As these businesses are folded into 'Other Domestic Markets', as noted above, there is no exact breakdown available. We believe the inclusion of this sub-division within the Domestic Markets segment flatters the performance of the segment as a whole, which is mostly made up of pure retail banking businesses.

**Insurance:** The global insurance business centred on BNP Paribas Cardif has been in existence for over 40 years and has also provided a solid hedge against the pressures experienced in most of the Group's retail banking businesses. Between 2006 and 2017 pre-tax profit grew faster than that of any sub-division, by 267%. In 2016 the insurance sub-division's pre-tax profit for the first time exceeded that of the French retail banking business. In 2017 it accounted for 15% of the Group's pre-tax profit. Pre-tax ROAE was 24%.

The two main business lines within the insurance sub-division are Savings and Protection. The latter covers property and casualty, health, travel, budget and income protection and creditor protection (autos, mortgages, consumer loans). Cardif ranks third in the French life insurance market and is the top credit protection insurer worldwide. Just over half of its business is written in France, but it also operates in Italy, the rest of Europe, Latin America and Asia.

While the insurer acts through BNPP's own international network it also maintains partnerships with international banks including BBVA and UniCredit, and with retailers and the finance arms of auto manufacturers such as Volkswagen, Renault and Peugeot.

**Global Custody:** The top four global custody banks (defined by assets under custody) are all U.S.-based, and in two cases (State Street and Bank of New York Mellon Corp) custody is a very dominant business for the bank. BNPP (along with French peer Sociéte Générale) is within the world's top 10 global custody banks. However, although the business is BNPP's most profitable measured by pre-tax ROAE (43% in 2017), it only accounted for 3% of 2017 pre-tax profit.

**Commercial and Investment Banking (CIB):** The CIB business (which in our analysis includes both the Global Markets and Corporate Banking sub-divisions but – unlike BNPP's approach – excludes the Global Custody business) contributed 24% of pre-tax profit in 2017. The contribution of Global Markets and the Corporate Banking business taken as a whole has fallen from over one third of pre-tax profit before the financial crisis. The main decline has come in the Global Markets segment, in which 2017 revenues were not much higher than in 2006, but expenses had climbed by 28%.

We also note that although other European names with CIB businesses have a higher investment banking profile in league table terms, BNPP's CIB compares very well to most competitors in terms of scale (if we define this as the revenue base) and also the pre-tax return on revenues.

**Figure 3: 2017 Pre-tax return on revenues: BNPP's CIB business versus comparable business segments of selected European peers**

| Bank | Net revenues (EUR m) | Pre-tax profit (EUR m) | Pre-tax return on revenues % |
|---|---|---|---|
| BNP Paribas | 9,749 | 3,024 | 31% |
| UBS | 6,616 | 1,068 | 16% |
| Credit Suisse | 9,601 | 1,686 | 18% |
| Barclays | 11,118 | 2,314 | 21% |
| Deutsche Bank | 14,226 | 877 | 6% |
| HSBC | 22,772 | 9,508 | 42% |

Note: YE17 figures converted to EUR from reporting currencies using exchange rates as at 29th Dec 2017
Source: Company reports, Scope Ratings.

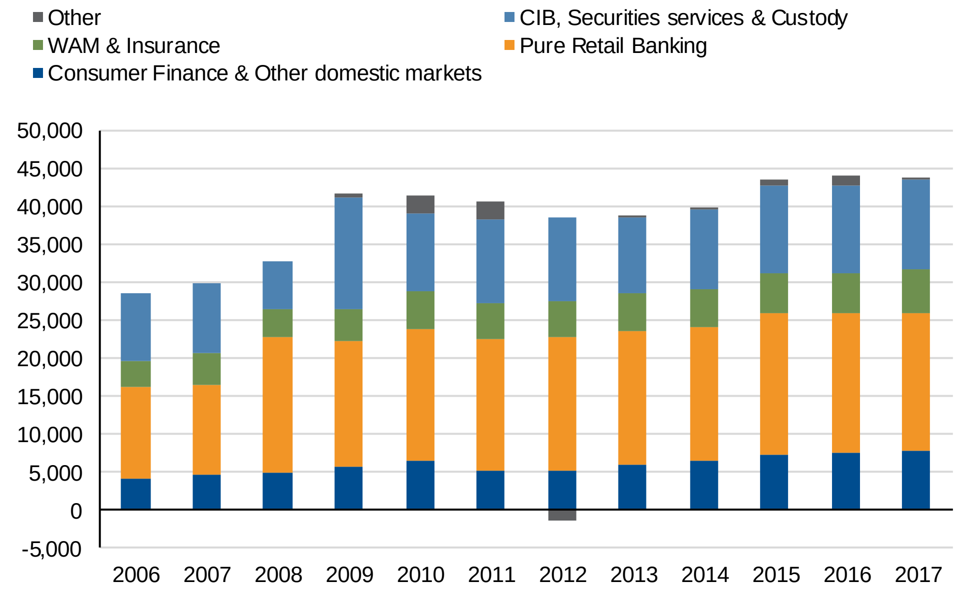
The snapshot comparison in Figure 3 is imperfect given that each bank classifies its businesses differently in terms of divisional booking of corporate banking business, but compared to UBS, Credit Suisse, Barclays and Deutsche Bank (each of which is undergoing some form of restructuring) BNPP benefits from better cost/income ratios – 76% in Global Markets and 58% in the Corporate Bank for FY17. As demonstrated in

Figure 9, both ratios have deteriorated noticeably since 2006 as expense growth has outpaced revenue growth over time.

Perhaps the best European comparison for BNPP (given the depth and reach of its corporate banking relationships) is HSBC, which delivered more than twice the revenue base and three times the pre-tax profit compared to BNPP in 2017, and was also more efficient.

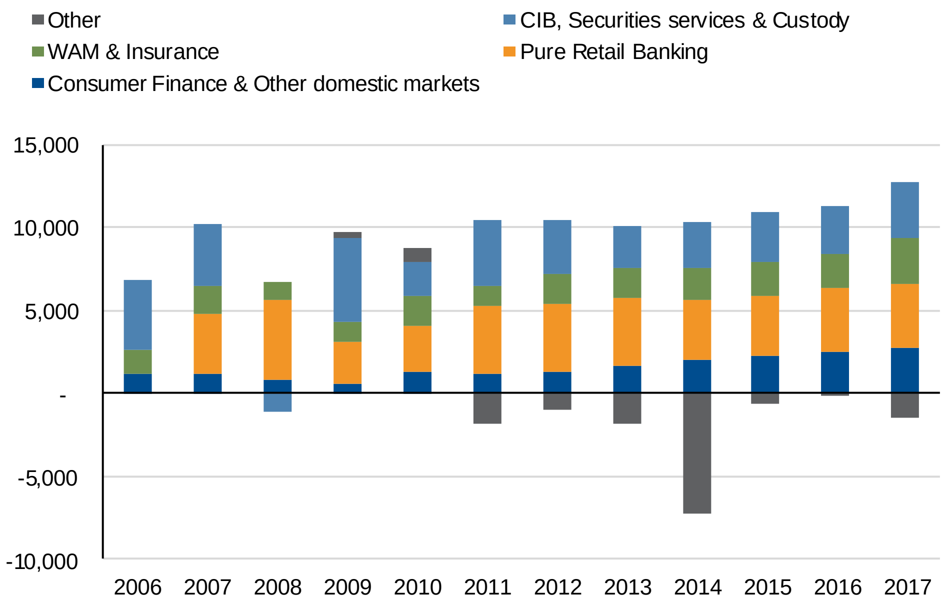
The scale of the CIB taken as whole undoubtedly keeps it as the second key pillar within BNPP's strategy. Equity analysts focus on fluctuations in results due to market conditions but from a credit perspective we consider that the Corporate Bank has been performing sufficiently steadily on a pre-tax profit basis throughout the crisis period to-date. Global Markets has also turned in a sound enough performance since 2011. BNPP has reduced its risk-taking in certain areas, and as a result we don't see the reduction in the importance of the CIB business within the bank's earnings as a credit negative.

**Figure 4: BNP Paribas revenue evolution 2006-2017 (EUR m)**



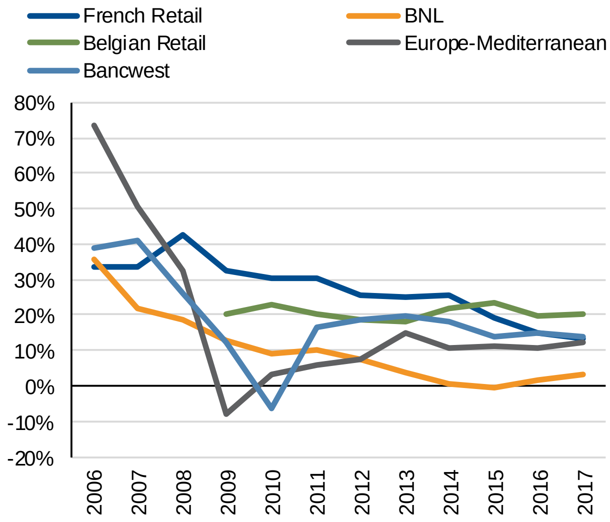

Source: Company data, Scope Ratings

**Figure 5: BNP Paribas' pre-tax profit evolution, 2006-2017 (EUR m)**



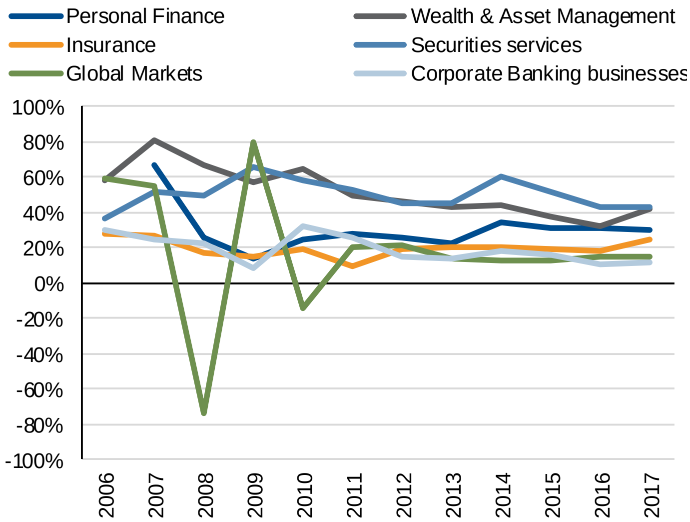

Source: Company data, Scope Ratings

**Figure 6: Pre-tax ROAE evolution: retail sub-divisions**



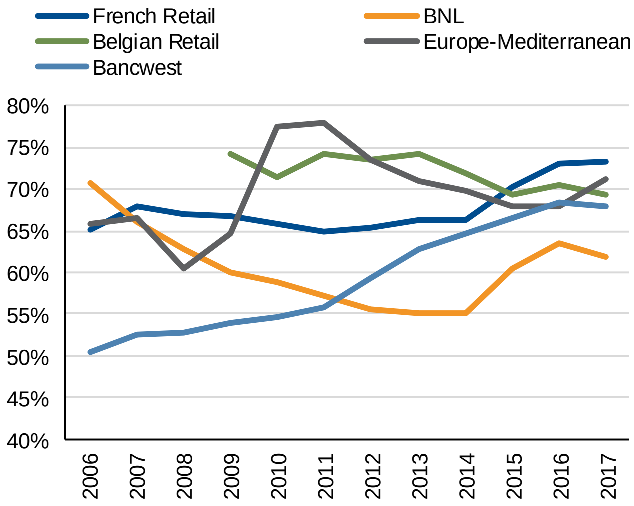

Source: Company data, Scope Ratings

**Figure 7: Pre-tax ROAE evolution: other sub-divisions**



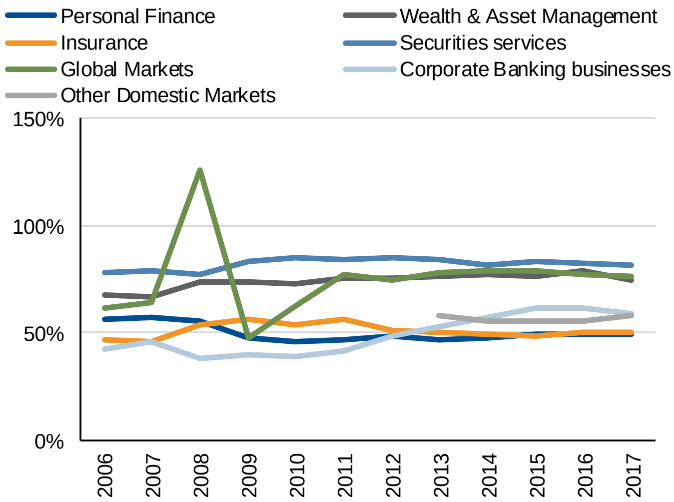

Source: Company data, Scope Ratings

**Figure 8: Cost income evolution: retail sub-divisions**



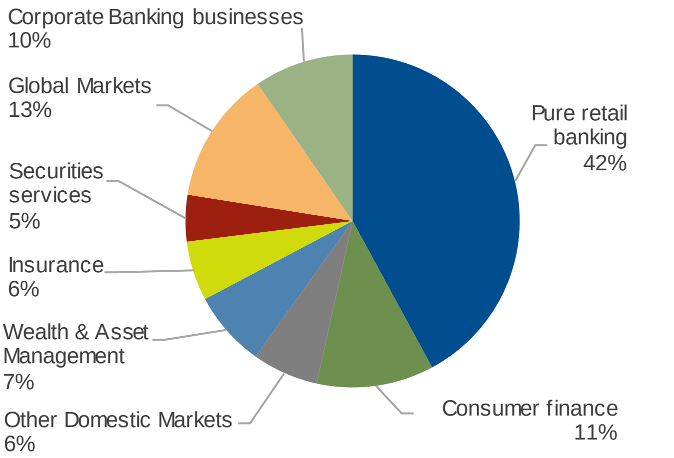

Source: Company data, Scope Ratings

**Figure 9: Cost income evolution: other sub-divisions**



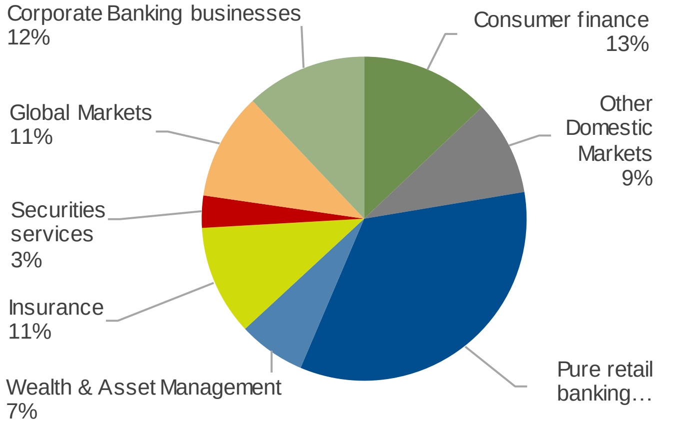

Source: Company data, Scope Ratings

**Figure 10: Allocation of 2017 revenues by business area**



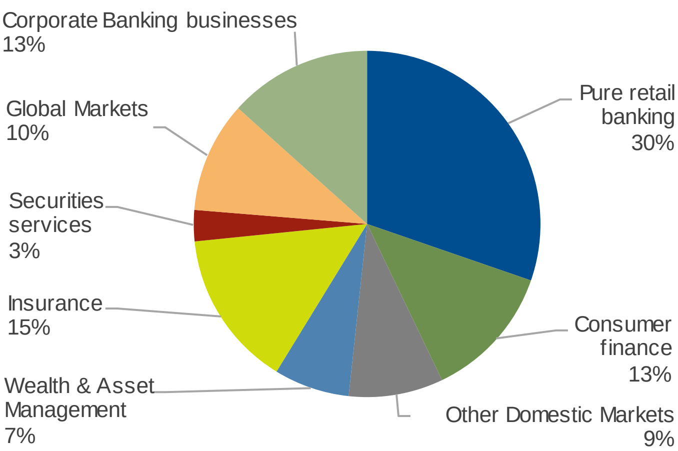

Source: Company data, Scope Ratings

**Figure 11: Allocation of 2017 operating income by business area**



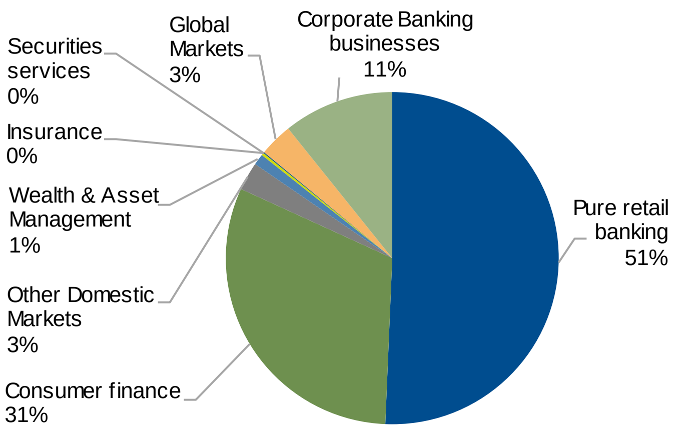

Source: Company data, Scope Ratings

**Figure 12: Allocation of 2017 pre-tax profit by business area**



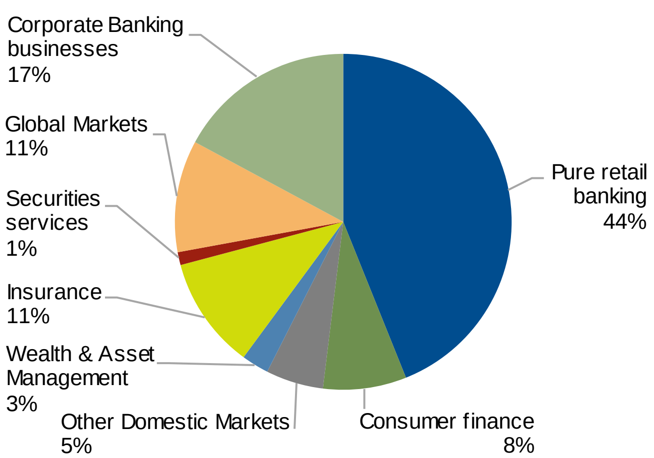

Source: Company data, Scope Ratings

**Figure 13: 2017 Allocation of cost of risk by business area**




Source: Company data, Scope Ratings

**Figure 14: Allocation of 2017 regulatory capital by business area**




Source: Company data, Scope Ratings

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