FITCH: SG'S 2Q14 RESULTS SOLID; LITIGATION RISK REMAINS

Fitch Ratings-London-01 August 2014: Fitch Ratings says that Societe Generale's (SG; A/Negative/a-) 2Q14 results were solid, as performance improved in most of its businesses. The results also underline that SG remains exposed to litigation and regulatory risk, as the bank continued to build reserves for litigation matters in 2Q14. The results have no immediate effect on SG's ratings.

SG reported a EUR1.3bn pre-tax profit in 2Q14, adjusted for fair value of own debt losses (EUR21m loss), debit and credit valuation adjustments (DVA/CVA; EUR42m gain) and the full acquisition of Newedge (EUR210m gain). This was down 1% yoy and 2% qoq. When further adjusting for provisions for litigation matters (EUR0.2bn in 2Q14, EUR0.1bn in 2Q13), the 2Q14 adjusted pre-tax profit would have been flat yoy and up 14% qoq. 2Q14 results particularly benefited from a decline in loan impairment charges (LICs) in all divisions. SG generated an 8.8% return on equity in 2Q14.

We expect SG's French retail banking business to continue to generate satisfactory pre-tax return on allocated equity (20% in 2Q14 on an annualised basis, stable qoq), although performance is likely to remain constrained by low client demand and persistently low interest rates. Loan exposure continued to decline in 2Q14 (-2.9% yoy), mainly in the corporate segment (-4.2% yoy). SG is working on cost reduction due to weak revenue generation prospects, and the bank maintained a satisfactory 62% cost to income ratio in 2Q14. LICs dropped 4bp yoy to 57bp of customer loans in 2Q14 on an annualised basis, although the bank could not repeat the lower levels achieved in 1Q14 (51bp), particularly in the corporate segment.

SG's global banking and investor solutions (GBIS) business includes its global markets, financing and advisory activities, securities services and asset and wealth management businesses. It generated a solid EUR0.8bn operating profit in 2Q14, up 43% yoy at constant exchange rates mainly due to strongly improving revenue in the financing and advisory business as well as lower LICs.

In global markets, the fixed income business performed well as revenue was up 1% yoy and 27% qoq (excluding CVA/DVA impact), better than at its US peers, which have generally seen yoy declines in fixed income trading. Revenue in the equities business was down 13% from a strong 2Q13 (excluding some non-recurring recoveries in 2Q13), as SG's leading franchise in equity derivatives helped the bank maintain a satisfactory performance despite low volatility and cash equity volumes in 2Q14. The global market business also benefited from provision write-backs in its legacy asset portfolio in 2Q14 (EUR6m against EUR133m impairment charges in 2Q13). We expect SG's legacy portfolio to be more or less at break-even in the coming quarters.

Operating profit in SG's financing and advisory business rose by EUR171m yoy to EUR249m in 2Q14. SG's solid European franchise benefited from sustained debt and equity underwriting volumes, particularly in euro corporate bonds and financial institutions' equity-related issuance. In addition, SG booked write-backs in 2Q14 (EUR24m against a EUR47m charge in 2Q13); LICs can be volatile in this business and depend on a small number of transactions.

We expect the asset and wealth management and securities services businesses to remain smaller contributors to GBIS's operating profit (7% for asset and wealth management, EUR25m operating loss for securities services in 2Q14).

Operating profit in the international retail banking and financial services to corporates (IRBFS) businesses increased 28% yoy at constant exchange rates. Both the financial services and insurance parts of IRBFS saw an increase in revenue in 2Q14 (+13% yoy and +6% yoy respectively), with particularly good momentum in fleet financing and non-life premiums. We consider both businesses continue to provide good earnings diversification, as they together generated around 15% of the bank's operating profit in 2Q14, and their earnings volatility remains moderate through the cycle.

IRBFS benefited from a decline in LICs, which came in further, largely in international banking, after an improvement in 1Q14. LICs represented 106bp of customer loans in 2Q14 on an annualised basis, against 138bp in 1Q14 (133bp in 2Q13). The yoy drop in LICs mainly came from Romania, other Europe and Africa and the Mediterranean basin. SG's international retail banking business has the largest presence in the Czech Republic, which continues to drive the division's operating profit (42% in 2Q14). SG's other two largest subsidiaries are in Russia and Romania, where LICs consumed almost all of their pre-impairment operating profit in 2Q14, although LICs declined 20% yoy in Romania.

In Russia, we believe the global economic and political uncertainty in the region will likely continue to weigh on LICs. Earnings generation might also become more constrained given political sanctions on certain Russian counterparties and consequent more caution extension of new business. SG's customer loan book in Russia was EUR13bn at end-2Q14.

We believe that SG is exposed to litigation and regulatory risk, as is the case for its peers. Its Viability Rating remains sensitive to further large litigation or regulatory expenses that would significantly alter its capital ratios or severely tarnish its franchise. Reserves for litigation matters were EUR0.9bn at end-2Q14.

Fitch views SG's capital ratios as sound. The bank's fully applied Basel III common equity Tier 1 ratio of 10.2% is within the peer group average and improved by 10bp in 2Q14 as the contribution from retained earnings (15bp after dividend provision) and other small adjustments (4bp) was partly offset by the acquisition of remaining shares of two subsidiaries (Newedge and Boursorama; -10bp). The bank's CRD IV leverage ratio (based on total CRD IV Tier 1 capital, but including additional Tier 1 instruments subject to phase-out) reached 3.6% on a fully applied basis at end-2Q14, which compares adequately with European peers.

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