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ISSUER COMMENT
13 February 2020

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Hamburg Commercial Bank AG

Rigorous shrinkage keeps HCOB on track to sector transition

On 13 February, Hamburg Commercial Bank AG (HCOB, Baa2/Baa2 stable, ba2)[1] confirmed further progress towards achieving its medium-term financial targets, which are designed to ensure its admission as a full member of the German private banks sector (BdB), a credit positive.

2019 was a year of extensive change for HCOB, which included a simplification and strengthening of its capital base, the bank's key credit strength. By year-end 2019, HCOB's achieved a close to unchanged regulatory Common Equity Tier 1 ratio of 18.5% (December 2018: 18.4%), despite a marked increase in risk-weighted assets (RWA) as a result of internal model adjustments in anticipation of stricter regulatory requirements that had led to a temporary dip of the ratio to 17.0% as of June 2019. Following an additional decline in total assets to €47.7 billion as of year-end 2019, down from reported assets of €55.1 billion as of December 2018 and €50.2 billion as of 30 June 2019, the bank's regulatory Tier 1 leverage ratio improved to 8.2% from 7.3% as of year-end 2018, leaving HCOB well-positioned to absorb the remaining effects of tighter risk-weighted assets regulations within the context of Basel IV.

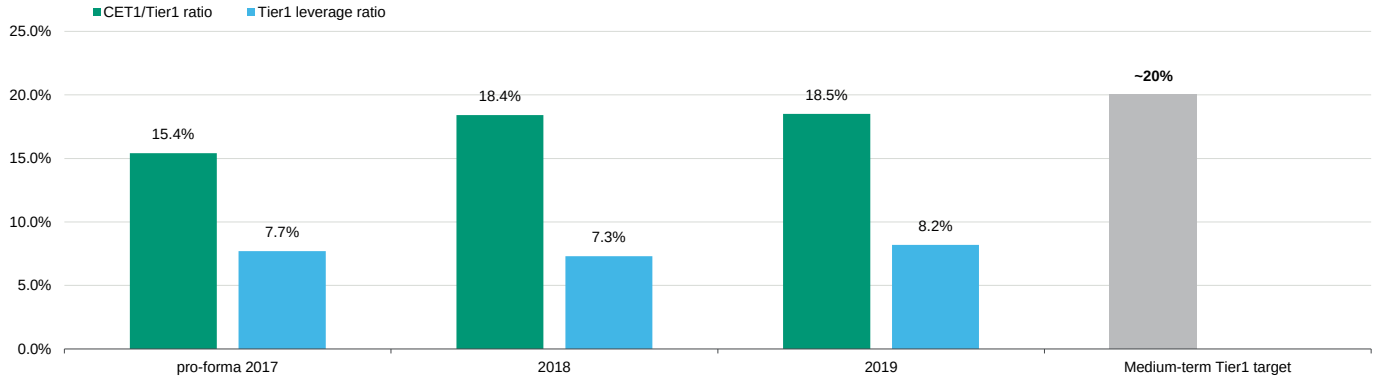
In parallel, HCOB further reduced within 2019 its workforce by more than 200 to less than 1,500 full time equivalent (FTE) employees and booked additional reserves for an even sharper staff reduction to about 700 FTE, about 250 less than initially planned. In spite of additional costs related to reserves and IT investments, the bank maintained its 2019 administrative expenses broadly stable at €413 million (2018: €402 million). Supported by a net reversal of loan loss provisions of €11 million (2018 HCOB had booked loan loss provisions of €316 million), the bank pre-announced a moderate pre-tax profit of €77 million (2018: €97 million).

The bank's loan loss provision reversal was supported by a further reduction in non-performing exposures to 1.8% of total credit exposures (from 2.0% as of year-end 2018), which bodes well for keeping it below its target of 2.0%. By 2022, HCOB aims for an ambitious cost-to-income ratio of around 45%, with no progress update provided as part of its preliminary results announcement. Based on the broadly unchanged administrative expenses, we would expect this ratio to have remained in the area of 70%, down somewhat from the 76% ratio in the first half of 2019.

With its 18.5% CET1 ratio, the bank's 20.0% medium term target looks achievable, which would constitute a significant step towards the admission into the BdB, given HCOB had originally targeted only a 16.0% CET1 ratio for the targeted admission date.

Exhibit 1

Hamburg Commerical Bank medium-term target is achievable



Note: 2017 pro-forma capital ratios are calculated excluding the regulatory RWA relief effect of the second loss guarantee; 2019 representive of preliminary results;
Source: Moody's Investors Service, company information

In a recently published peer comparison with Norddeutsche Landesbank GZ (A3/A3 stable, ba3) we provided an overview on the benefits of the progress made and the challenges ahead for HCOB on its way towards transitioning from the Sparkassen-Finanzgruppe (S-Finanzgruppe, Aa2 negative, a2)[2] sector into the BdB.

For 2020, the bank's main challenges will in our view consist of 1) maintaining a sound credit performance of its lending exposures to cyclical sectors, including commercial real estate and its remaining shipping loan book while global trade has weakened and faces additional headwinds from the yet uncertain consequences of the coronavirus, 2) carefully managing its expansion into new business areas, including the financing of factoring and leasing companies as well as diversified lending, including outside of Germany, for which the bank may benefit from its new owners' and board members' expertise, but has not itself established a track record and 3) maintaining course in reshaping and diversifying the bank's funding structure.

Endnotes

1 The bank ratings shown in this report are the banks' deposit ratings, their senior unsecured ratings and outlook and the banks' Baseline Credit Assessment.

2 The ratings shown are S-Finanzgruppe's Corporate Family Rating and outlook and its Baseline Credit Assessment.

REPORT NUMBER 1214540

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