Goodbody

Permanent TSB

Irish Banks

A transformed credit proposition

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Ulster Bank deal: a game-changer for PTSB and for credit investors

This note sets out a review of the key factors underpinning the PTSB credit investment case and outlines how the Ulster Bank (NWG) transaction will be transformative for the bank. The deal will significantly boost PTSB's market positioning, the size of its loan book and its income and profitability profile. Importantly, the bulk of the acquired assets have now migrated to PTSB, significantly reducing transaction execution risk.

PTSB now presents a sound credit investment proposition

In our view, the key points to consider for prospective PTSB credit investors are: i) the significant strengthening in the profitability of the bank due to both the Ulster Bank deal and the higher interest rate environment; ii) the consolidation of the Irish banking landscape, which will leave PTSB as the clear third player in the market; iii) the defensive nature of PTSB's balance sheet on account of a strong bias towards secured lending (i.e., mortgages), very low exposure to high indexed LTVs, and very high provision coverage ratios; iv) PTSB's strong capital position with high FLCET1 (14.9% at end-3Q22) and Total Capital (24.7% on a transitional basis at end-3Q22) ratios; v) an improving credit ratings profile; and vi) a resilient macro backdrop.

PTSB to become a regular issuer in the primary debt markets

A conservative analysis of PTSB's MREL requirements (assuming a 30% MREL requirement in 2024) indicates a relatively modest need for new MREL issuance (c.€1.0bn by FY24). However, a desire to maintain a buffer above regulatory minima and a wish to establish a consistent presence in primary markets will, in our view, see PTSB undertake new issuance above its minimum requirements in FY23/FY24.

Key Capital Metrics

	FY21A	1H22A	FY22F	FY23F	FY24F
RWAs (€bn)	8.60	8.24	10.58	11.53	11.80
CET1 capital (€bn)	1.27	1.21	1.63	1.68	1.84
CET1 capital ratio	14.7%	14.7%	15.4%	14.6%	15.6%
Total capital (€bn)	1.68	1.63	2.29	2.35	2.50
Total capital ratio	19.5%	19.7%	21.7%	20.3%	21.2%

Source: Company information, Goodbody

Key Credit Metrics

	FY18A	FY19A	FY20A	FY21A	1H22A
NPLs (€bn)	1.7	1.1	1.1	0.8	0.8
NPL ratio	10.0%	6.4%	7.6%	5.5%	5.2%
Provision coverage ratio	6.4%	5.0%	4.9%	4.1%	3.9%

Source: Company information

PTSB plc (OpCo)

	Long-term rating	Outlook
S&P	BBB	Positive
Moody's	A2	Stable
DBRS	BBBL	Stable

PTSB Group Holdings (HoldCo)

	Long-term rating	Outlook
S&P	BB-	Positive
Moody's	Baa2	Positive
DBRS	BBH	Stable

Source: Company information, Bloomberg

Key Liquidity Metrics

	FY21A	1H22A
LDR	75%	72%
LCR	274%	315%
NSFR	170%	183%

Source: Company information

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Permanent TSB

Value Drivers	Dec 20a	Dec 21a	Dec 22f	Dec 23f	Dec 24f
Per Share Data - c					
Adj EPS	-39.1	-6.6	45.0	5.7	24.2
DPS	-	-	-	-	-
NAV	375.2	366.4	371.7	381.7	410.7
T/NAV	375.2	366.4	371.7	381.7	410.7
Pre-Provision Profit	10.2	3.5	3.1	38.5	46.5
Operating Profit	-23.9	3.7	4.5	34.4	38.7
No of Shares (m)	454.7	454.7	468.1	545.6	545.6
Momentum					
Total Income	-9.1%	-3.8%	13.7%	63.0%	8.9%
Pre Provision Profit	-44.8%	-65.4%	5.2%	1,147.4%	20.9%
Loan impairment charge	1,437.7%	-100.6%	-691.4%	382.1%	90.6%
Operating Profit	-247.4%	115.6%	45.6%	658.3%	12.6%
Adj EPS	-687.8%	83.1%	781.7%	-87.3%	323.8%
DPS	n/a	n/a	n/a	n/a	n/a
PBT	-511.3%	87.8%	1,196.4%	-57.6%	106.1%
NAV	-11.3%	-2.3%	1.5%	2.7%	7.6%
Net Loans	-9.7%	0.1%	35.7%	11.0%	4.7%
Deposits	4.8%	5.8%	13.0%	10.0%	1.5%
RWA	-14.4%	1.6%	23.0%	9.0%	2.3%
Profitability Metrics					
Net Interest Margin	1.74%	1.51%	1.50%	2.35%	2.29%
Non int / Total Income	9.1%	13.3%	12.6%	9.4%	10.4%
Cost / Income Ratio	87.7%	95.6%	95.9%	68.6%	65.2%
Revenue / Average Assets	1.8%	1.7%	1.7%	2.4%	2.4%
Costs / Average Assets	1.6%	1.6%	1.6%	1.6%	1.6%
Net int inc / RWAs	3.7%	3.7%	3.7%	5.5%	5.6%
Total Revenue / RWAs	4.1%	4.2%	4.3%	6.1%	6.3%
RoE (adjusted)	-5.8%	0.5%	2.3%	7.0%	8.3%
RoTE (adjusted)	-5.8%	0.5%	2.3%	7.0%	8.3%
Return on Core Capital (adjusted)	-6.2%	0.5%	2.4%	7.4%	9.0%
Return on Assets (adjusted)	-0.8%	0.0%	0.1%	0.4%	0.5%
Return on RWAs (adjusted)	-1.9%	0.1%	0.3%	1.0%	1.2%
Dividend Cover	n/m	n/m	n/m	n/m	n/m
Per Share Data - c					
Adj EPS	-39.1	-6.6	45.0	5.7	24.2
DPS	-	-	-	-	-
NAV	375.2	366.4	371.7	381.7	410.7
T/NAV	375.2	366.4	371.7	381.7	410.7
Pre-Provision Profit	10.2	3.5	3.1	38.5	46.5
Operating Profit	-23.9	3.7	4.5	34.4	38.7
No of Shares (m)	454.7	454.7	468.1	545.6	545.6
Capital and Asset quality metrics					
FLCET1 Ratio	15.1%	14.7%	15.4%	14.6%	15.6%
Tier 1 Ratio (FLCETI + ATI)	17.5%	16.1%	18.9%	17.8%	18.8%
Tier 2 Ratio	0.7%	3.4%	2.7%	2.5%	2.5%
Total Capital Ratio	18.2%	19.5%	21.7%	20.3%	21.2%
Leverage Ratio	7.1%	6.3%	7.6%	7.0%	7.3%
Tangible Equity / Total Assets	8.1%	7.5%	7.7%	7.1%	7.4%
Tangible Equity / RWAs	20.1%	19.4%	19.2%	18.1%	19.0%
RWAs / Total Assets	40.4%	38.7%	40.2%	39.1%	39.1%
Impaired Loans / Gross Loans	7.9%	5.7%	4.2%	3.8%	3.6%
Provisions / Impaired Loans	64.5%	73.9%	73.0%	75.7%	80.9%
Cost of Risk	n/m	n/m	n/m	n/m	n/m
Valuation					
P/E (adjusted)	n/m	n/m	5.2x	41.2x	9.7x
Price / Pre Provision Profit	6.0x	36.9x	76.2x	6.1x	5.0x
Dividend Yield	-	-	-	-	-
Price / NAV (adjusted)	0.2x	0.4x	0.6x	0.6x	0.6x
Price / TNAV (adjusted)	0.2x	0.4x	0.6x	0.6x	0.6x

Financial Statements	Dec 20a	Dec 21a	Dec 22f	Dec 23f	Dec 24f
Profit & Loss (€m)					
Net Interest Income	341	313	359	606	653
Non-Interest Income	34	48	52	63	76
Total Income	375	361	411	669	729
Total Costs	-329	-345	-394	-459	-475
Pre-Prov-Profit	46	16	17	210	254
Loan Impairment Charge	-155	1	8	-22	-43
Operating Profit	-109	17	25	188	211
Other Items (incl. exceptionals)	-63	-38	206	-90	-10
PBT	**-172**	**-21**	**230**	**98**	**201**
Tax	4	1	-3	-23	-26
Minorities	-	-	-	-	-
Other After Tax Items (incl AT1 coupon)	-	-	-	-	-
Net Income	**-168**	**-20**	**227**	**74**	**175**
Net Attributable Income	**-178**	**-30**	**211**	**31**	**132**
Balance Sheet (€m)					
Net Loans to Customers	14,240	14,256	19,346	21,467	22,472
Loans To Banks	3,312	4,174	944	3,734	3,349
Financial Investments	2,583	2,494	3,000	3,000	3,000
Other Interest Bearing Assets	-	-	1,700	-	-
Interest Earning Assets	**20,135**	**20,924**	**24,990**	**28,201**	**28,821**
Other Assets	851	1,311	1,320	1,320	1,320
Total Assets	**20,986**	**22,235**	**26,310**	**29,521**	**30,141**
Customer Deposits	18,039	19,089	21,571	23,728	24,084
Deposits by Banks	-	347	822	822	822
Debt Securities in Issue	809	524	794	1,794	1,900
Other Interest Bearing Liabilities	187	234	467	467	467
Interest Earning Liabilities	**19,035**	**20,446**	**23,909**	**27,066**	**27,528**
Other Liabilities	-	252	255	255	255
Total Liabilities	19,035	20,446	23,909	27,066	27,528
Total Equity	1,951	1,789	2,401	2,456	2,614
Total Liabilities and Equity	**20,986**	**22,235**	**26,310**	**29,521**	**30,142**
Average interest earning assets	19,580	20,731	23,845	25,815	28,511

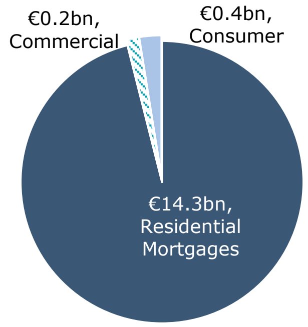
Share Price Performance	1mth	3mth	6mth	YTD	12mth
Share Price Movement	15.8%	36.6%	51.6%	29.8%	36.6%
vs Europe Regional Banks	11.0%	13.3%	19.1%	15.4%	50.8%

Key Dates			
Last Report	05/09/2022	Ex Final Div	n/a
Forecast Change	13/02/2023	Ex Interim Div	n/a
Next Update	n/a		

PTSB Business Overview – Ulster Bank deal is a game-changer for PTSB

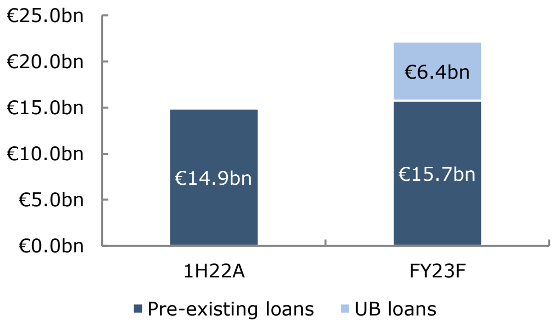
PTSB is a full-service Retail and SME bank with 1.1 million customers in Ireland. It delivers its services via a multi-channel distribution strategy, including the operation of 98 bank branches (including acquired Ulster Bank branches) across the country. The bank has a material share of the market in its key product lines, including a 16.9% share of new mortgage lending in 9M22 (lending volumes of €1.6bn in 9M22; +21% y/y), placing it as the clear third player in the domestic market. 96% of PTSB's gross loan book of €14.9bn at end-1H22 was comprised of residential mortgages, but it has ambitions to significantly expand its lending to the domestic SME sector – and, for example, it has earmarked a SME new lending fund of €1bn that it aims to deploy over the three years to FY24.

Gross loan book (1H22A)



Source: Company information

UB deal to add c.40% to loan book



Source: Goodbody, Company information

Ulster Bank deal – a transformative transaction

In December 2021, PTSB signed a binding agreement with NatWest Group (NWG) for the acquisition of €7.6bn of assets from Ulster Bank (UB), including €7.0bn of performing non-tracker mortgages, €0.2bn of SME loans, €0.4bn of asset finance facilities and 25 bank branches. On 7th November 2022, PTSB announced that it had migrated c.€5.2bn of mortgages and that it expected to migrate the remaining c.€1bn of mortgages in 2Q23, but no later than 4Q23 (the lower total is due to expected redemptions in the period since the deal was first announced). It also stated that it anticipated that the migration of the remaining UB assets would complete in 1Q23, but no later than end-2Q23. The transaction was funded from internal sources and from the issuance of 90.9 million new ordinary shares, equivalent to a 16.67% shareholding of the enlarged entity, to NatWest Group (NWG), Ulster Bank's parent.

We believe this acquisition will prove to be a game-changer for PTSB. It will significantly increase PTSB's market presence and positioning, its loan portfolio (PTSB's mortgage book will expand by c.40% in size terms) and its income and returns capabilities (we see underlying PBT increasing to €211m in FY24F from just €17m in FY21). The transaction is also one of the factors that will drive a reduction in PTSB's NPL ratio to less than 4%, with PTSB's 3Q22 trading update confirming that its NPL ratio had dropped to 4.8%, a notable milestone for the bank. Significantly, PTSB is acquiring the loans at a 2.6% discount to book value and the gain on the transaction will be recognised in FY22F.

Taking a broader view of the exits of Ulster Bank and KBC Bank Ireland from the Irish banking market, these market changes provide enormous one-off share capture opportunity for the remaining incumbents, with positive medium-term implications for loan growth and non-interest revenue streams. By acquiring books of active customer relationships (and associated staff), particularly through the SME and asset finance portfolios, as well as 25 branches, PTSB is well placed to capitalise on these opportunities.

State relationship – State shareholding has reduced to c.62% following NWG equity issuance

The Irish State has been the majority shareholder in PTSB since the bank required a capital injection from the public purse in the midst of the GFC in 2011 which resulted in the State taking a 99% shareholding in the bank. The State's shareholding reduced to 75% in April 2015 when PTSB raised €400m of fresh equity via a share placing, alongside a separate disposal of shares by the Minister for Finance. The State's shareholding reduced further to c.62% in November 2022 due to the dilutive effect of the share issuance to NWG as part of the aforementioned Ulster Bank loan portfolio acquisitions.

The Irish government made significant strides in reducing its shareholdings in Irish banks in 2022. Following the completion of a trading plan in Bank of Ireland Group (BIRG) shares that had commenced in June 2021 (at a point when the State's shareholding stood at c.14%) the Minister for Finance announced, in September 2022, that the State had fully exited its BIRG shareholding. A similar trading plan, alongside two successful share placings in June and November 2022, saw the State's shareholding in AIBG reduce from 71% at the start of 2022 to c.57% by year-end. Although we consider a sell-down of the State's shareholding in PTSB to be unlikely to be imminent (and we note a *Bloomberg* report on 9th January which cited internal briefing papers prepared by the Department of Finance that indicated that a share sale was not imminent), we have some optimism that, aided by sharply improving returns metrics, sufficient investor interest could be generated for possible government and NWG share sales in 2H23 or in 2024.

A further sign of the gradual normalisation of relations between the Irish banking sector and the State was the recent easing of remuneration restrictions in the sector, on foot of recommendations contained within the *Retail Banking Review Report*, which was commissioned by the Department of Finance and published in November 2022. The key changes implemented with immediate effect were: i) the lifting of pay caps at BIRG given that the State is no longer a shareholder in that institution; ii) allowing all three listed banks to pay bonuses of up to €20,000 p.a. to staff members; and iii) allowing the banks to procure fringe benefits to staff (e.g., health insurance, childcare cost contributions). These changes have been broadly welcomed by investors given that the restrictions have long put Irish banks at a disadvantage in the context of attracting, retaining and motivating talent in a competitive marketplace (and not just at top management level). While, from PTSB's standpoint, it is not ideal that the €500,000 executive pay cap has not yet been lifted, the *Retail Banking Review Report* recommended that this restriction be removed at AIBG and PTSB "*when the state's shareholding… is at an appropriate level*". Although the lack of specificity on what constitutes an "*appropriate level*" is unhelpful, it is perhaps instructive that documents released under FOI legislation (and reported on by *The Irish Times* in December 2022) show that previous drafts of the *Retail Banking Review Report* recommended that the pay caps at AIBG and PTSB be lifted once the State's shareholding dropped below 50% in those institutions. While we judge this to be the most likely outcome at this juncture, this will effectively be a political decision for the Minister for Finance at the relevant time.

Financial Forecasts – UB deal transforms outlook for PTSB's profitability

Following a prolonged period of challenged profitability, our updated forecasts show PTSB's u/l PBT rising materially in both FY23F and FY24F. Although the addition of the UB loan portfolios is clearly very beneficial for NII, the rising rate environment is also highly constructive for a highly rate-sensitive bank such as PTSB given that, at end-1H22, 33% of its mortgages were trackers that automatically reprice in line with the ECB Refi Rate (notwithstanding that this book is in run-off). As an aside, we do conservatively model materially higher tracker mortgage redemptions over the coming years as some of these customers refinance onto fixed (mostly) or variable rate products (but one point that will put some kind of brake on this switching activity is the seasoning of the tracker portfolio). It is worth noting that the interest rate assumptions underpinning our revenue forecasts are conservative – we assume that the ECB Deposit Facility Rate and Refi Rate remain at 2.5% and 3.0% respectively over our forecast horizon, despite firm market expectations for further rises in the coming months. Although the same inflationary forces that are pushing rates higher also exert cost pressures, these cost challenges are heavily outweighed by the upward revenue momentum – and we forecast a reduction in PTSB's Cost/Income ratio to 65% by FY24F (from 96% in FY22F). Although our forecasts assume a return to more normalised cost of risk (CoR) levels in the coming periods following net writebacks in FY21A and FY22F, we believe PTSB is very defensively provisioned in relation to any deterioration in credit quality metrics (see '*Asset Quality'* section below).

Permanent TSB Income Statement (key lines)	FY21A	FY22F	FY23F	FY24F
	€m	€m	€m	€m
Total income	**361**	**411**	**669**	**729**
Operating expenses (incl. bank levy)	-345	-394	-459	-475
Pre-impairment operating profit	**16**	**17**	**210**	**254**
Impairments	1	8	-22	-43
Underlying profit before tax	**17**	**25**	**188**	**211**
Exceptionals	-38	206	-90	-10
Reported Pretax Profits	**-21**	**230**	**98**	**201**
Taxation Credit & AT1 cost	-9	-20	-67	-70
Profit for the period	**-30**	**211**	**31**	**132**
Per Share				
Underlying eps (c)	1.8	1.1	22.2	26.0
dps (c)	0.0	0.0	0.0	0.0
Key Metrics				
Net interest margin	1.51%	1.50%	2.35%	2.29%
Cost/Income ratio	95.6%	95.9%	68.6%	65.2%

Returns Analysis	FY21A	FY22F	FY23F	FY24F
Estimated Underlying PAT	6	31	110	141
Average Tangible Equity (excl DTAs)	1,229	1,363	1,559	1,691
Headline RoTE	0.5%	2.3%	7.0%	8.3%
RoTE (assuming CET1 ratio of 14.0%)	0.5%	2.4%	7.4%	9.0%

Net loans forecasted to increase by c.50% between FY21A and FY23F

Permanent TSB Balance Sheet (key lines)	FY21A	FY22F	FY23F	FY24F
	€m	€m	€m	€m
Assets				
Net loans	14,256	19,346	21,467	22,472
Other assets	7,979	6,964	8,054	7,669
Total assets	**22,235**	**26,310**	**29,521**	**30,141**
Liabilities				
Customer deposits	19,089	21,571	23,728	24,084
Other liabilities	1,357	2,338	3,338	3,444
Total liabilities	**20,446**	**23,909**	**27,066**	**27,528**
Equity				
Shareholder Equity	1,666	2,028	2,083	2,241
Other Equity	123	373	373	373
Total equity	**1,789**	**2,401**	**2,456**	**2,614**
Total liabilities & equity	**22,235**	**26,310**	**29,521**	**30,142**
Per Share				
TNAV	1,544	1,894	1,949	2,107
No. of shares (m)	455	546	546	546
TNAV per share (c)	340	347	357	386
Key Metrics				
LDR	75%	90%	90%	93%

The impact of the Ulster Bank acquisition is clearly seen on PTSB's balance sheet and is the primary driver of projected net loan growth of 51% between FY21A and FY23F. That said, the exits of UB and KBC Bank Ireland from the market, PTSB's expanding branch network (on account of its acquisition of 25 UB branches) and the funding challenges being experienced by non-bank mortgage lenders in a rising rate environment, are all conducive to organic loan growth for PTSB. On the liability side of its balance sheet, PTSB reported a 9% rise in customer deposits in the nine months to end-3Q22 and we expect to see further substantial deposit build in 4Q22F and through FY23F due to PTSB's significant success to date in terms of new customer capture as accounts at UB and KBC are closed and as dormant accounts are reactivated (PTSB reported in November that it had opened more than 100,000 new current accounts and 35,000 new deposit accounts YTD, representing y/y increases of 250% and 80% respectively).

Capital Analysis – rising buffers already incorporated in PTSB's CET1 target

PTSB printed a fully loaded pro-forma CET1 capital ratio of 14.9% at end-3Q22 after accounting for the sale of a BTL loan portfolio with a net book value of c.€700m (announced on 21st September 2022) which boosted the FLCET1 capital ratio by 85bps. We estimate that the FLCET1 capital ratio rose to 15.4% at end-FY22F, following the issuance of new equity to NWG in November and the associated booking of the net gain on the UB transaction. We see the FLCET1 capital ratio remaining comfortably above PTSB's long-term target of 14% over our forecast horizon – rising to 15.6% by end-FY24F. It is worth noting that, although we don't currently model any dividends at PTSB by FY24F, we expect the bank to be in a strong position to recommence distributions shortly thereafter (based on financial performance, and subject to the removal of the dividend blocker) and we consider there to be a reasonable possibility of a FY24F dividend which, of course, would reduce PTSB's capital ratios commensurately.

Looking further down the capital stack, PTSB issued a €250m AT1 instrument in October last year, with the PerpNC5.5 security paying an attractive 13.25% coupon, while it also issued a separate €125m 7.875% AT1 instrument in November 2020. PTSB has €250m of Tier 2 notes outstanding (callable in May 2026 and maturing in 2031). These instruments will contribute a combined 6.3ppts to PTSB's end-FY22F total capital ratio of 21.7% on our forecasts.

The table below sets out our capital forecasts for PTSB:

Capital Analysis	FY21A	FY22F	FY23F	FY24F
CET1 capital	1,265	1,628	1,683	1,841
Tier 1 capital	1,388	2,001	2,056	2,214
Tier 2 capital	290	290	290	290
Total capital	1,678	2,291	2,346	2,504
Risk-weighted assets	8,603	10,581	11,531	11,799
RWAs/Total assets	39%	40%	39%	39%
RWAs/Net loans	60%	55%	54%	53%
CET1 capital ratio	**14.7%**	**15.4%**	**14.6%**	**15.6%**
Tier 1 capital ratio	16.1%	18.9%	17.8%	18.8%
Tier 2 capital ratio	3.4%	2.7%	2.5%	2.5%
Total capital ratio	19.5%	21.7%	20.3%	21.2%

Regulatory capital requirements

Looking firstly at PTSB's Pillar 1 and P2R CET1 capital requirements, these remained unchanged in 2022, at 4.5% and 1.94% respectively. Notably, PTSB's P2R (1.94%) is materially higher than the P2R's applicable to both AIBG (1.55%) and BIRG (1.27%) and, while it would not be unreasonable to expect PTSB's P2R to gradually migrate towards its domestic peer banks (particularly as its NPL ratio will fall to c.4% in the near-term – and recognising that the bank will also become a larger, more diverse operation following the Ulster Bank deal), our analysis conservatively assumes an unchanged P2R for PTSB.

The Central Bank of Ireland's (CBI) latest bi-annual *Financial Stability Review* (FSR) was published on 24th November last, within which the CBI announced a 50bps rise in the CCyB to 1.0% (effective from November 2023). This was in line with its previously announced intention to gradually rebuild the CCyB and it also reiterated its view that a CCyB of 1.5% is appropriate when "*cyclical risks are deemed to be neither elevated nor subdued*". As such, we expect to see a further 50bps increase in the CCyB announced in mid-2023 (effective from mid-2024), albeit the CBI acknowledges that this is "*dependent on the evolution of macro-financial conditions in the intervening period*". Notably, in its prior FSR in June 2022, the CBI set out its view that the CCyB is now considered to be to be its primary capital tool for safeguarding resilience in the system, rather than through a combination of the CCyB and the SyRB. This was a welcome development and reflected the CBI's efforts to reduce complexity in the capital framework.

Separately, it is worth noting that PTSB is not currently designated as an O-SII and is not required to hold an O-SII buffer. Importantly however, the relevant authority (in this case the CBI) retains the ability to use both quantitative and qualitative factors in its judgement regarding O-SII status and its comments in November regarding the consolidating banking landscape are worthy of attention: "*The announced withdrawal of two retail banks from the domestic market coupled with the publically announced transfer of loans and deposits will result in changes in the size and scale of some of the remaining institutions. These developments will result in changes in the Irish banking system. In turn, they will feed through to the O-SII assessments carried out by the Central Bank in the future*".

Given that, of the "*remaining institutions*", PTSB's scale will be most transformed by the banking sector consolidation, it seems reasonable to infer that the CBI had PTSB front of mind when it made these comments – which is relevant as it undertakes its next O-SII assessments in late-2023 (with any changes to take effect 12 months later). We therefore factor in a 1.0% O-SII buffer in our analysis of the expected evolution of capital requirements for PTSB – as illustrated in the table below. While we recognise that the evolution of capital buffers remains uncertain, and there is a risk that they move higher than we have assumed, PTSB's long-term target FLCET1 capital ratio of 14% appears to us to be very conservatively struck.

Components of PTSB's CET1 capital requirement

	FY21A	FY22F	FY23F	FY24F
Pillar 1	4.50%	4.50%	4.50%	4.50%
P2R	1.94%	1.94%	1.94%	1.94%
CCB	2.50%	2.50%	2.50%	2.50%
SRB	0.00%	0.00%	0.00%	0.00%
CCyB	0.00%	0.00%	**1.00%**	**1.50%**
O-SII	0.00%	0.00%	0.00%	**1.00%**
Minimum CET1 requirement (MDA)	**8.9%**	**8.9%**	**9.9%**	**11.4%**
CET1 capital ratio	14.7%	15.4%	14.6%	15.6%
Buffer to MDA	**5.8%**	**6.4%**	**4.7%**	**4.2%**
Assumed P2G				1.0%
Management buffer				1.6%
Target CET1				**14.0%**

Source: Goodbody, Company information, CBI

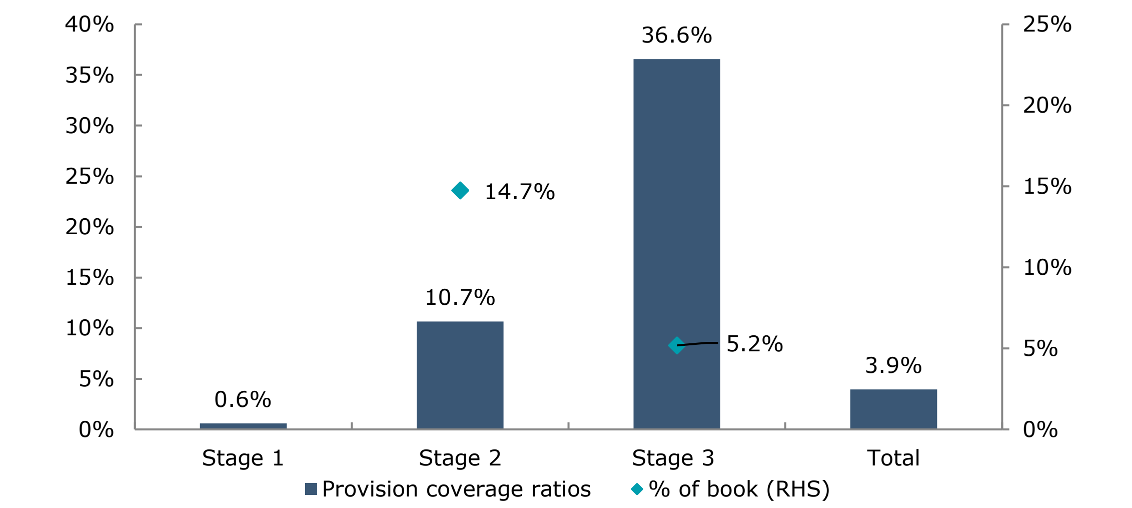
It is also worth noting that we expect PTSB to maintain a healthy buffer to MDA throughout our forecast period, including a strong buffer of 6.4% at end-FY22F, which should provide a significant degree of comfort to credit investors. Furthermore, PTSB's leverage ratio stood at a robust 5.6% on a fully loaded basis at end-1H22.

Asset Quality – lending composition and strong coverage provide comfort

Homing in on asset quality, we see PTSB as very defensively provisioned in the context of any possible deterioration in credit quality metrics on foot of heightened affordability challenges. This view is formed on the basis of: i) very strong coverage levels, including a high proportion of PMAs; ii) a strong bias towards secured lending; and iii) a resilient macro backdrop. Briefly, taking each of these factors in turn:

i) **Very strong coverage levels, including a high proportion of PMAs** – PTSB reports very high provision coverage ratios, relative both to peer Irish banks and European names (in a loan stage and loan segment context, taking into account NPL differences). It reported an overall provision coverage ratio of 3.9% at end-1H22, with coverage on Stage 2 and Stage 3 loans, at 10.7% and 36.6% respectively, looking particularly strong. Furthermore, PMAs accounted for a high share (17% / €101m) of PTSB's stock of provisions at end-1H22, which largely reflects the conservative approach to provisioning taken in FY20 at the height of the Covid crisis. PTSB incurred an impairment charge of €155m in FY20 (equivalent to a CoR of 104bps) and reported net writebacks of just €10m between FY21 and 1H22.

Provision coverage ratios and apportionment of gross loans (End-1H22)



Source: Company information

ii) **Strong bias towards secured lending** – 96% of PTSB's net loan book at end-1H22 was comprised of Irish residential mortgages. 74% of its residential mortgage exposures had an indexed LTV of <70% at the same point, while just 5% of exposures had indexed LTVs of above 90% (and latest data, covering the period up to November 2022, show that residential property prices in Ireland have continued to rise since June 2022). Furthermore, since their introduction in February 2015, the CBI's macroprudential mortgage lending rules have placed strict LTI and LTV limits on the bulk of new mortgage lending.

iii) **Resilient macro backdrop** – the Irish economy is one of the most open economies in the world and is inevitably vulnerable to slowing global growth and high inflation. However, a few unique features pertaining to the Irish economy are expected to help it offset these global headwinds and avoid a recession this year:

1) A strong fiscal position: A boom in tax revenues catapulted Ireland's public finances to the best position in Europe in 2022. Ireland finished the year with a budget surplus of 2% of GNI*, the largest budget surplus since 2006, which has provided the government with the fiscal space to introduce significant financial supports for households and businesses (more of which are expected to follow soon). The public finances have, once again, started the new year strongly and the government has articulated its willingness to roll over these fiscal supports should that be required later this year.

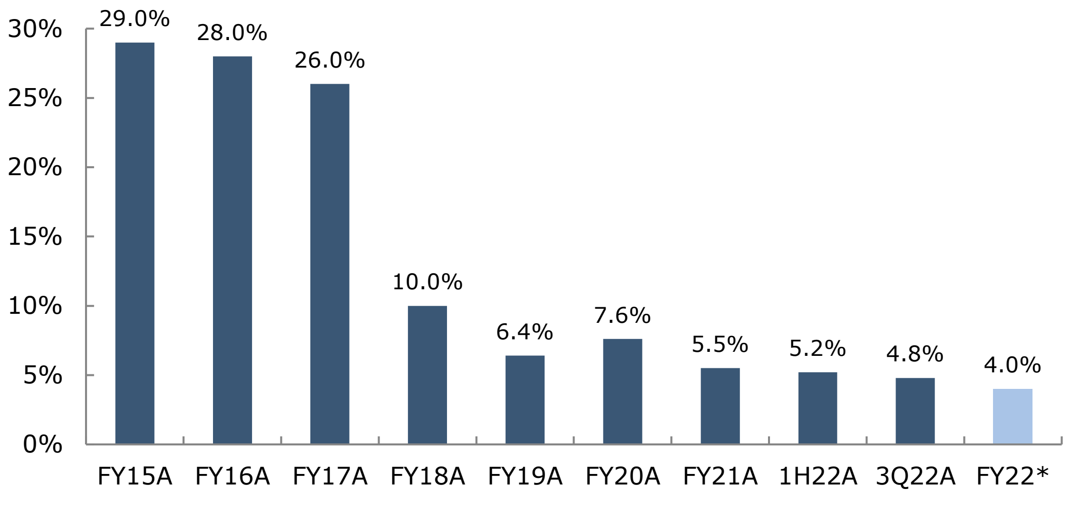
2) Healthy household balance sheets: Households entered the current period of high inflation with plenty of resources to combat the real earnings hit in 2023. Irish households had the highest savings ratio in the EU in 2022 and, as a result of the unprecedented level of savings built up over the pandemic period, *Goodbody Economics* estimates that Irish households have built up an 'excess' savings pool equal to c.19% of average disposable incomes. Furthermore, household debt has declined to all-time lows in the country.

For a detailed discussion on these topics, and other matters of importance to the Irish economy, please see Goodbody Economics' '*Q1 2023 Health Check: War Chests'* report, published on 23rd January and available at the following link: **Download War chests; Q1 2023 Health Check**

NPL ratio below 5% and set to decline to c.4% at in FY22F

PTSB has made significant progress over a prolonged period in reducing its NPLs, primarily through asset sales. From an exceptionally high 29% NPL ratio at end-FY15, PTSB's latest (end-3Q22) NPL ratio stood at 4.8% and management has guided to an expected ratio of c.4% at end-FY22F (broadly comparable to the other listed Irish banks), with the UB acquisition helping to reduce PTSB's NPL ratio owing to the higher denominator.

Several years of progress bring NPL ratio below 5%

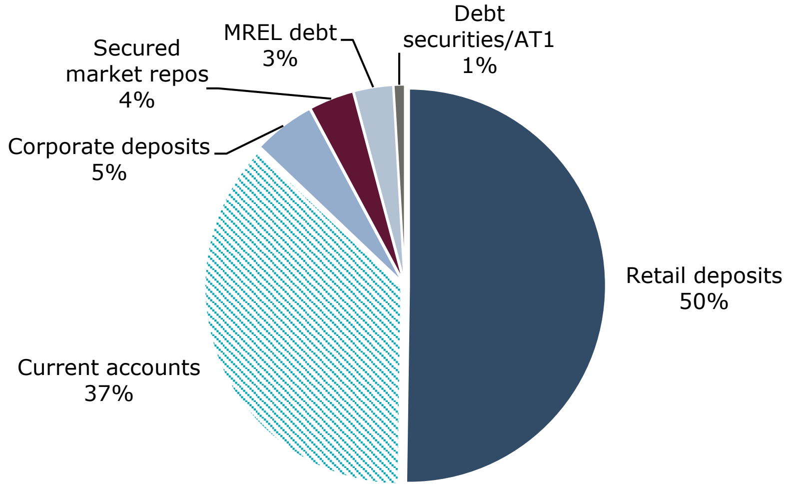


*Company guidance. Source: Company information

Funding Profile and Debt Issuance Requirements

PTSB is primarily funded by retail deposits and its balance sheet is well-positioned to absorb the transfer of Ulster Bank assets. In common with the other listed Irish banks, PTSB reported a low LDR (67%) at end-3Q22 as deposit balances rose in response to Ulster Bank and KBC Bank Ireland beginning to withdraw from the market. Total deposits increased by 9% in the nine months to 30th September to €20.8bn, and we forecast that deposit balances will rise to €23.7bn by end-FY23F. PTSB is well-placed to capture a greater share of deposits from the departing players than that implied by its current market share given that, as outlined above, it has acquired 25 Ulster Bank branches (the vast majority of which reopened as PTSB outlets in early February) and has had significant success in new account opening activity during 2022. Notwithstanding material deposit growth, we forecast PTSB's LDR ratio will increase to 90% at end-FY23F following the migration of all UB assets, which would utilise a significant amount of excess liquidity and drive a far more efficient Balance Sheet.

Funding profile (End-1H22)



Source: Company information

Key Funding Metrics	FY20A	FY21A	1H22A	FY22F	FY23F	FY24F
LDR	79%	75%	72%	90%	90%	93%
LCR	276%	293%	297%			
NSFR	160%	170%	183%			

Source: Goodbody, Company information

Debt issuance in FY23 and FY24 will likely be above PTSB's minimum MREL requirement

PTSB has been a relatively infrequent debt issuer in recent years given its limited funding requirements and contracting balance sheet. However, it successfully completed two transactions in FY22: a €300m 3-year non-call 2-year HoldCo senior debt issue in June and a €250m AT1 issuance in October. Although PTSB has not disclosed its expected MREL requirements, taking an illustrative (and conservative, in our view) example of a 30% requirement, and using our forecasts for RWA and total capital evolution, would see PTSB need to issue a relatively modest c.€1.0bn of new MREL debt by FY24. This appears to us to be eminently achievable based on its successful primary market activity in FY22, a rapidly rising profitability profile, an improving credit ratings profile (see below) and the expected completion of the UB deal in the coming months. That said, we also expect that management will seek to maintain a prudent buffer above regulatory minima and establish a consistent presence in primary markets in benchmark size, which, potentially combined with some pre-funding of growth opportunities, will likely see PTSB undertake new debt issuance above its minimum MREL requirement over the next two years.

Manageable minimum MREL issuance by FY24	€bn
RWAs FY24F	11.8
Target MREL ratio (illustrative)	30%
MREL requirement (illustrative)	**3.5**
Total capital (FL) FY24F	-2.5
MREL debt requirement	**1.0**
Current MREL debt	-0.7
MREL maturities/ineligibilities by FY24	0.7
Minimum new issuance by FY24	**1.0**

NB: on a fully-loaded basis. Source: company information, Bloomberg, Goodbody

Positive credit ratings migration already underway

PTSB has received upgrades from two credit ratings agencies in recent months, which will significantly support its future debt issuance plans. Most recently, in December 2022, S&P raised its ratings on the bank's OpCo (Permanent TSB plc) by one notch to BBB (while reaffirming its BB- rating on the HoldCo) and retained its Positive Outlook. It cited improving NPL ratios, increasing profitability, the resilient characteristics of Irish residential mortgage portfolios and sufficient buffers of '*bail-in-able*' debt.

Similarly, in September 2022, Moody's announced that it had upgraded PTSB's credit ratings to investment grade status. In its rationale, Moody's set out its view that the Ulster Bank transaction will give PTSB "*a more relevant share of the Irish mortgage market, a slightly more diversified business model, a broader foundation to support significantly improved profitability along with stable asset risk and a solid deposit-based funding profile*". It also noted the positive impact of the reduction in PTSB's NPL ratio (both as a consequence of the transaction and as a result of proactive internal management) and the improved outlook for profitability on account of the impact of ECB rate rises on PTSB's tracker mortgage portfolio and the acquired (and to-be-acquired) UB assets.

	PTSB plc (OpCo)		PTSB Group Holdings (HoldCo)	
	Long-term rating	Outlook	Long-term rating	Outlook
S&P	BBB	Positive	BB-	Positive
Moody's	A2	Stable	Baa2	Positive
DBRS	BBBL	Stable	BBH	Stable

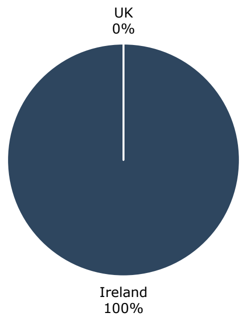
Source: Company information, Bloomberg

Permanent TSB

Operational Overview

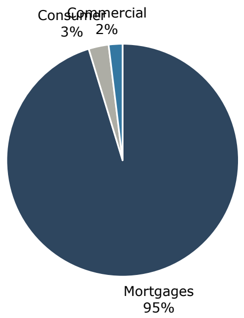
Permanent TSB delivers a full-service banking experience to all customers, framed within the boundaries of a low risk appetite. Its business model today is a full-service Retail and SME Bank. Its ambition is to be Ireland's best personal and small business bank.

Regional Mix Loans (FY21)



Source : Goodbody

Loan book breakdown (FY21)

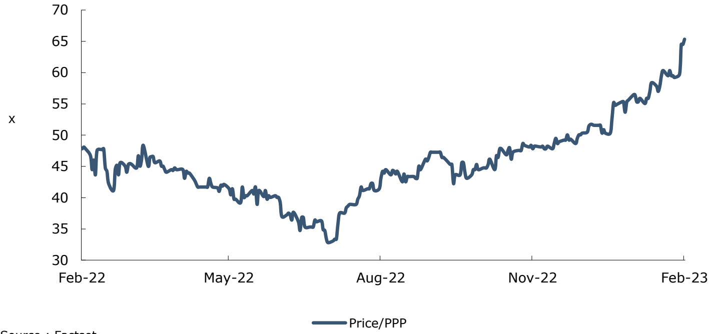


Source : Goodbody

Risks

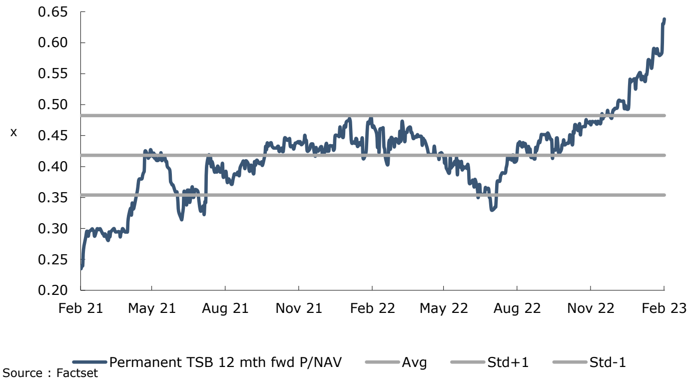
As a bank, PTSB is very sensitive to macroeconomic activity levels, interest rate levels, returns on investment assets and the credit cycle. It is also subject to capital assessments from European regulators. PTSB's loan book is largely Irish-focused and is predominantly mortgage-based, so it is particularly susceptible to the performance of the Irish economy and the consumer and housing market activity.

Price / Pre Provision Profit



Source : Factset

Permanent TSB 12 mth fwd P/NAV



Source : Factset

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