New Purchase – Svenska Handelsbanken

Many banks have made it onto our screens in the past 18 months. However, that doesn't mean they are all suitable for our fund. We have concentrated on the businesses that have demonstrably enough capital, cheap valuations and frequently also a change of management that has driven a change in the business model, preferably focussing on managing costs, rather than growth. We want to invest in banks that offer growth and income going forward and avoid the value traps.

When we analyse a financial business, the 1st step is usually to digest the annual report as far back as 2007-8 as not only does this give some idea of peak margins, it also provides a valuable instruction on how the business survived the financial crisis, and the impact on profitability and damage to the Balance Sheet. This is very useful when estimating the 'worst case' scenario that forms part of our research process.

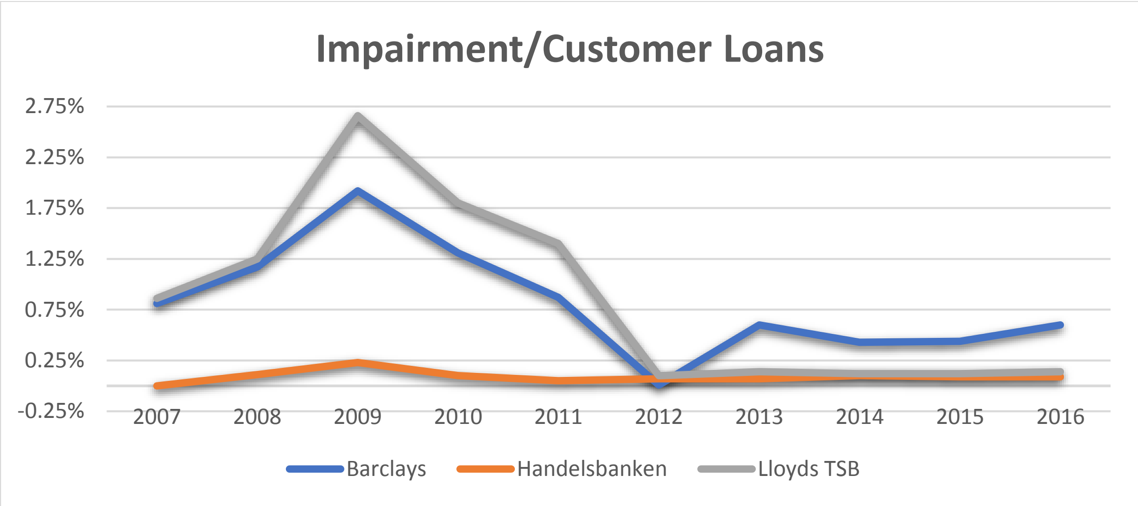
I have watched Handelsbanken for many years and after meeting with the 'new' Chief Executive last month decided it was worth a fresh look. It is not often that you meet a new CEO who has no plans to change or improve the business, but that is the objective of Anders Bouvin. He has been with the company for over 30 years and he wants to ensure that Handelsbanken continues with its devolved strategy. The previous CEO lasted 18 months and was dismissed for trying to manage more centrally and adding another management tier.

The business is concentrated in Sweden, UK, Denmark, Finland, Norway and the Netherlands. It tends not to be the cheapest on the high street, but as customers appreciate the service, the bank tends to attract a higher share of deposits. Lending has a high mortgage/property bias which accounts for around 80% of total loans. Trading income is volatile. NII accounts for 69% of total revenue.

Handelsbanken is not like other banks: there is no central (top-down) planning and each branch operates like a stand-alone business, responsible for its own P&L. Central services are shared at actual cost and each branch typically only lends in its own small geographic area! The company is opening branches, not closing them and customer satisfaction is high. To put this in context, for the eighth year in a row, an independent survey *(EPSI rating October 2016)* of British bank customers' satisfaction has found Handelsbanken to have the most satisfied customers in Britain, both for individual and corporate banking.

Handelsbanken appears to know its customers very well, which means it is easier to avoid high risk borrowers. As a result, loan impairment against customer advances look favourable versus Barclays and LloydsTSB:

SARACEN
share success

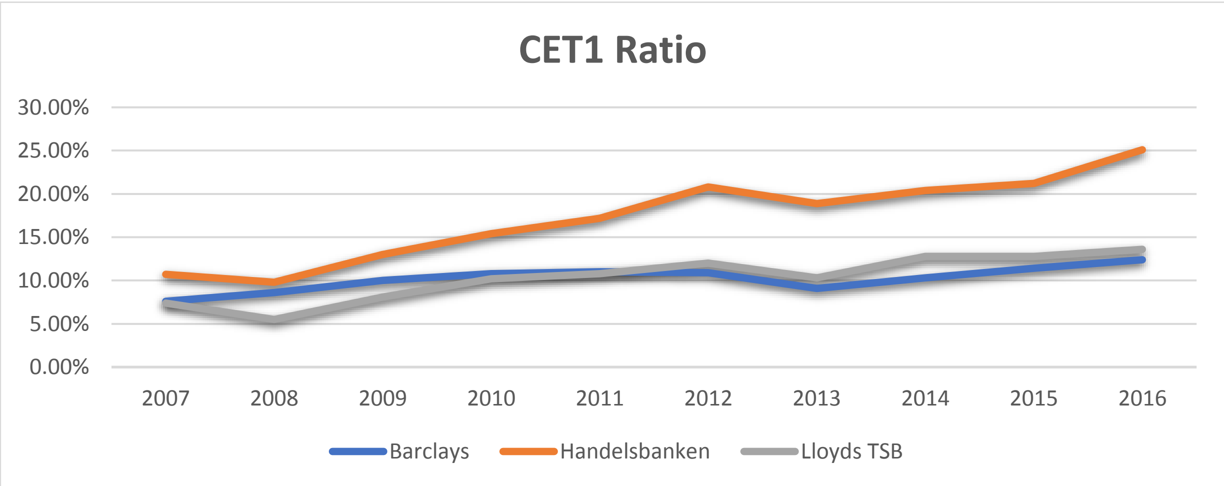


Source: Saracen

At the peak write-off in 2009, impaired loans were 0.23% of customer advances, which is around a 10th of impairments taken by many competitors.

We have only invested in banks with a clear gap in their reported capital above regulatory capital requirements. Not only does this provide a healthy buffer in times of stress, but it has also enables management to make choices with any surplus capital. E.g. in recent years our shareholdings in HSBC and JP Morgan have been boosted by share buy-backs.

The chart below highlights the Combined Equity Tier 1 Ratio to Risk Weighted Assets (CET1 /RWA's).



Source: Saracen

Svenska Handelsbanken is one of the strongest banks in the world with a CET1 ratio of currently over 23%. Although this must be compared to a robust minimum by the Swedish Regulator of 20%.

In good times, banks are often measured by their ability to grow lending. We must not forget that the business is also about controlling costs and avoiding losses on loans, by being able to accurately price the risks of default. In recent years, this disparity between competitors has narrowed and does not, in our opinion, reflect the inherent strength of Handelsbanken's business.

Our forecasts underpin a dividend yield of 4.3% and we anticipate further progress in earnings and special dividends in the years ahead.

Graham Campbell – CEO and Co-manager of the TB Saracen Global Income and Growth Fund