

Country: Switzerland  
 Industry: Banking  
 June 1998

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## Credit Profile

# Zuger Kantonalbank

**One of Switzerland's many cantonal banks**

Zuger Kantonalbank (Zuger KB) is one of 24 members of the Swiss Cantonal Bank group which had combined balance sheet assets of CHF 269 billion at year end 1997. This corresponds to 15% of domestic assets of all Swiss banks. As major providers of banking services in Switzerland, state-owned cantonal banks are firmly anchored in their respective areas of operation and tend to be the regional leaders in retail banking and mortgage lending.

**Mid-sized retail bank, ...**

Zuger KB is one of the mid-sized cantonal banks in the central Swiss Canton of Zug. It operates with a network of 19 branch offices throughout the canton. By year end 1997, it reported total assets of CHF 7.6 bn, 71% of which were classified as mortgage loans. With the emphasis placed on residential and corporate lending, balance-sheet business contributed 69% to total gross operating revenue. Nevertheless, Zuger KB's operating profile is considerably more balanced than that of most other cantonal or regional Swiss banks as it earns substantial income from investment and asset management services, and proprietary trading.

**... balanced business profile**

**Majority owned by the cantonal government and municipalities**

Zuger KB is incorporated as a limited company under public law (Aktiengesellschaft nach öffentlichem Recht) and is majority-owned by the cantonal government (see shareholder structure below). Its shares trade on the Swiss exchange with a current total market capitalization of CHF 545 million.

Shareholders	%
Canton of Zug (Swiss Federal State of Zug)	50%
Private investors and institutions	50%

Source: Company data

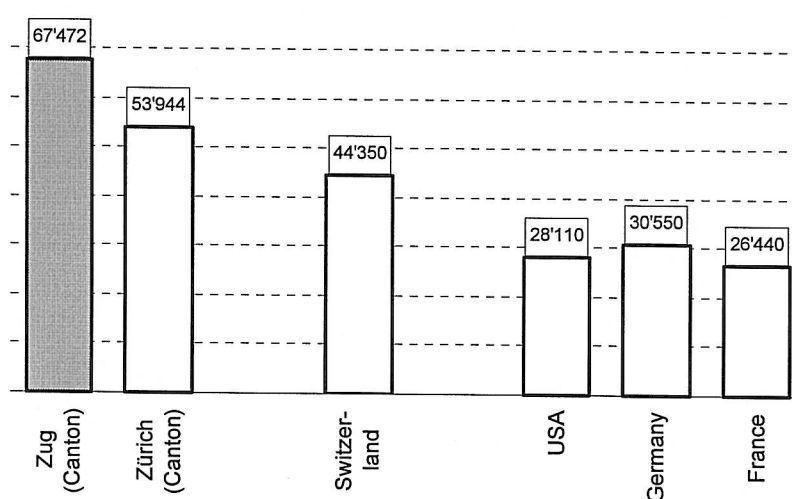
**Strong track record**

In contrast to many other cantonal banks, KB Zug's record of strong operational performance and low loan losses remained unblemished throughout the recessionary phase in the early nineties. For the last 10 years operating profits have been climbing each year with only one small decline in 1990. Zuger KB's operating efficiency is highlighted by its 1997 cost/income ratio of 46% which was the lowest of all cantonal banks.

### Healthy economy provides sound operating base

Zuger KB has certainly been helped by a comparatively strong local economy in which growth rates have continually exceeded national averages. In 1997, for example, the Canton of Zug's GNP grew by 2%, while the Swiss economy expanded by a mere 0.4%. Zug's income per capita is the highest of all Swiss cantons (see the comparison of per capita incomes below). Zug's economic success is partially rooted in its status as a tax haven within Switzerland. This attracts both national and international companies, mainly from the service sector, to establish their domicile in one of Zug's communities. The proximity to the greater Zurich area, the economic hub of Switzerland, has also drawn a host of export-oriented mid-sized companies to Zug. As a matter of fact, these companies served as the engine for Zug's 1997 economic growth when exports advanced by a spectacular 22%.

### Comparison of per capita incomes (in CHF)



Source: Swiss Federal Office of Statistics, 1996 figures; international data from NZZ issue 17.4.98

### State guarantee for senior liabilities, ..

As is generally the case, the cantons guarantee senior liabilities of their respective cantonal banks<sup>1</sup>. This is why the Swiss investor community considers saving with cantonal banks a safe investment option. By law, bonds from cantonal banks are mandated «mündelsicher», which means that estate trustees may include them as eligible financial instruments into portfolios of orphans and widows.

### .. unlikely to be removed soon

There have been discussions in various cantons about removing such explicit guarantees or at least charging a fair, market-based price for them because private banks claim that such preferential treatment distorts competition in the banking market. Although a proposed amendment to Swiss banking law no longer makes state guarantees a prerequisite for the status of cantonal bank, all cantons which have recently revised their cantonal bank law<sup>2</sup> have decided to maintain them (e.g. Bern, Zurich, Wallis, St. Gallen).

<sup>1</sup> The only exceptions are the Geneva Cantonal Bank (no guarantee) and Vaud Cantonal Bank (guarantee for savings accounts only)

<sup>2</sup> The revisions mentioned were generally targeted at providing more entrepreneurial freedom for cantonal banks and opening them to outside shareholders. Zuger KB, as mentioned, has had a diversified shareholder base for a long time.

**Strong implicit support for subordinated debt:****Double-A quality**

Subordinated debt is excluded from this state guarantee. There is, however, a strong implicit support for such junior debt instruments. In our view, subordinated creditors are not likely to suffer any credit losses unless a major systemic crisis forces an institution into liquidation<sup>3</sup>. As shown by the recent restructuring experience of cantonal banks, cantons have resolved financial problems by either providing fresh equity (Jura, Valais, Bern) or spinning-off banks to one of the large Swiss banks (Solothurner KB to SBC and Appenzell-Ausserrodner KB to UBS)

In line with the practice of official rating agencies, we believe that the ratings of Zuger KB's junior debt securities are one or two notches below the senior level. Given that the Canton of Zug can be considered as one of the most creditworthy states in Switzerland (implicit Triple-A rating), we view subordinated bonds of Zuger KB as double-A quality paper.

**Selected senior bond issues of Zuger KB**

Coupon	Maturity / Call	Amount
7%	91 - 15.02.2001/ 1999	CHF 100 m
4 ½%	93 - 01.10.2001	CHF 50 m
6%	93 - 25.01.2003 / 2001	CHF 80 m
6 ¾%	92 - 16.11.2004 / 2002	CHF 80 m
5%	93 - 31.03.2005 / 2003	CHF 60 m
4 ¾%	96 - 26.04.2006	CHF 60 m

Source: Bloomberg

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Published in German and English

<sup>3</sup> For perspective, senior creditors would, assuming such a worst case scenario, probably receive cantonal bonds to compensate their claim. Given the economic turmoil associated with a crisis of this magnitude, it would be questionable how much value could still be attached to such a security.