

European Banks & the ECB

Alert: Lower Rates Positive for Peripheral Bank Shares

ECB Eases Into Negative Territory – Today, the ECB announced three easing measures aimed at supporting the Eurozone economies: (1) refinancing rate lowered by 10 bps to 0.15%; (2) bank deposit rate lowered by 10 bps to a negative -0.10%; and (3) marginal lending rate lowered by 35 bps to 0.40%. Reasons cited by the Governing Council included the latest drop in headline inflation, the strong euro, significant amount of slack in the economy and persistently negative credit growth threatening the outlook for price stability over the medium to longer term.

Focus on Conference Call at 13.30 (BST) – Look out for the introductory statement during today's conference call which could provide further information on future liquidity, funding and QE actions as well as guidance on future policy rate developments.

Positive for Peripheral Banks – The announced ECB actions should positively impact the peripheral banks via three main routes: (1) lower sovereign yields should feed into lower funding costs and gains on the holdings of sovereign bonds; (2) lower rates should drive a reduction in the cost of equity; and (3) potentially provide incentives for the banks to increase credit to the real economy. Possible headwinds include lower carry trade profitability and subdued lending ahead of the AQR.

Buy BES, Bankia, Caixa, Unicredit in Periphery – Most periphery banks should benefit from the ECB actions. We have Buy ratings on BES, Bankia, Caixa and Unicredit. Among the small caps we also like UBI (Neutral rated).

(BES.LS; €1.06; 1H)(CABK.MC; €4.56; 1)(BKIA.MC; €1.49; 1)(CRDI.MI; €6.60; 1)(UBI.MI; €7.01; 2H)

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Banco Espirito Santo

(BES.LS; €1.06; 1H)

Valuation

To value BES, we use an 5-year dividend discount model (DDM). On this basis, we calculate BES's fair value is €1.75/share, which we set as our target price. To derive this figure we employ a cost of equity 11% and a growth rate of 2%.

Risks

We rate BES as High Risk, based on our assessment of industry- and company-specific risk factors. Our risk rating principally reflects the uncertainties surrounding the current sovereign debt crisis in Europe. We see the following as risks that could impede the share price from reaching our target price:

The key risk to our investment case for the Portuguese banks is that Portugal does not converge with core Europe and the conclusion to the current debt crisis is disorderly.

In our opinion, a disorderly conclusion to the current debt crisis in Portugal or any of the periphery countries would put significant negative pressure on BES shares.

Additionally, with c70% of its stock of loans in corporates, a new economic downturn could impair capital. Outside the Euro Area, the key risks to our investment cases are: (i) a sharp correction in global commodity prices; and (ii) limited improvements in the democratisation and transparency of Angola's government.

Bankia SA

(BKIA.MC; €1.49; 1)

Valuation

We value Bankia on a Dividend Discount Model (DDM) methodology. Our €1.70 target price is adjusted for any capital and provisions surplus (shortfall). The DDM assumes a sustainable ROE of c10.0% (18.0% on a base of 10% of RWA) with a cost of equity of 11.0% and 1.0% growth rate.

Risks

With regards to Bankia, we would highlight the following specific risks which could cause the stock to deviate from our target price. (1) Macro-economic environment: a weak recovery in real GDP growth and employment in Spain could mean the shares undershoot our forecasts. Conversely, a better than expected recovery could make the share price outperform our target. (2) Asset quality: we have assumed normalisation of credit costs in 2015-16. If non-performing loans and provisions increase more than expected, the shares may not reach our TP. Conversely, if non-performing loans and provisions normalise, the shares may rise beyond our TP.

CaixaBank SA

(CABK.MC; €4.56; 1)

Valuation

We value CaixaBank on a Dividend Discount Model (DDM) methodology. Our €5.10 target price is adjusted for any capital and provisions surplus (shortfall). The DDM assumes a sustainable ROE of 8.2% (18.0% on a base of 10% of RWA) with a cost of equity of 10.5%. We cross check our main valuation against the results of two other methods, Sum of the Parts and Discount to NAV, which explicitly value CaixaBank's segments and stakes.

Risks

With regards to CaixaBank, we would highlight the following specific risks which could cause the stock to deviate from our target price (TP): (1) Macro-economic environment: a weak recovery in real GDP growth and employment in Spain could mean the shares undershoot our TP. Conversely, a better than expected recovery could make the share price outperform our TP. (2) Asset quality: we have assumed normalization of credit costs in 2015-16. If non-performing loans and provisions increase more than expected, the shares may not reach our TP. Conversely, if non-performing loans and provisions normalise, the shares may rise beyond our TP.

UniCredit Group

(CRDI.MI; €6.60; 1)

Valuation

We have a €7.30 target price for UCI. In valuing UCI, we focus primarily on a DDM valuation, using a c10.5% cost of equity and a c11% sustainable tangible ROE, we also take into account the group's capital position and business mix. We cross-check this with a price-to-book methodology. At our target price, the stock would trade at c1.0x price to tangible book valuation.

Risks

We identify a number of industry- and company-specific risks that may prevent the shares achieving our target price, although after the large clean-up in 4Q13 the market's perception of implied risk in the group's balance sheet has decreased. While AQR remains a headwind for the banking sector, we expect UCI to be in a more comfortable position now. Other key risks that need to be considered include potential deterioration of macroeconomic conditions and sovereign volatility, credit rating agency action, political developments in Italy, liquidity and execution risk in the restructuring plan all could weigh on group profitability (lower revenue growth and higher cost of risk) and share price performance. UCI has a large exposure to CEE, which still leaves a risk of incurring sizeable credit or other losses if there is concern over EM profitability or in case of currency volatility. The group also has significant capital market activities (more than other Italian banks), which have caused sizeable losses in the past. The group is exposed to credit risk (provisions are higher than peers) as well as market rate risk.

Unione Banche Italiane

(UBI.MI; €7.01; 2H)

Valuation

We have a €5.80 target price for UBI. In valuing UBI, we focus primarily on a DDM valuation using a c10% cost of equity and a c7% sustainable tangible ROE, also taking into account the group capital position. We cross-check this with a price-to-book methodology. At our target price, the stock would trade at c0.7x price to tangible book, reflecting UBI's defensive business mix and balance sheet characteristics, but accounting also for the low level of profitability.

Risks

We have a High Risk Rating on UBI. Any revenue slippage would affect UBI's profits. Net interest income is the major revenue generator; NII margin and profitability are at risk in the event of movement of the ECB rate and market rates, or of more pricing pressure in Italy both on the asset and liability side. Among the potential risks for the stock, we would highlight: a weaker-than-expected Italian economy, regulatory pressure on capital, slowdown in dividend payments or payment in script, deterioration in asset quality, rising provisions, any worries on Italian sovereign risk, rating agency downgrade and any speculation indicating UBI as a possible partner in case of a rescue merger of any of its peers. Also, any development on the group outstanding convertible bond, represent an additional area of uncertainty for the market. If the impact of these risk factors is more or less negative than we currently anticipate, then the share price could deviate significantly from our target price.

Appendix A-1

Analyst Certification

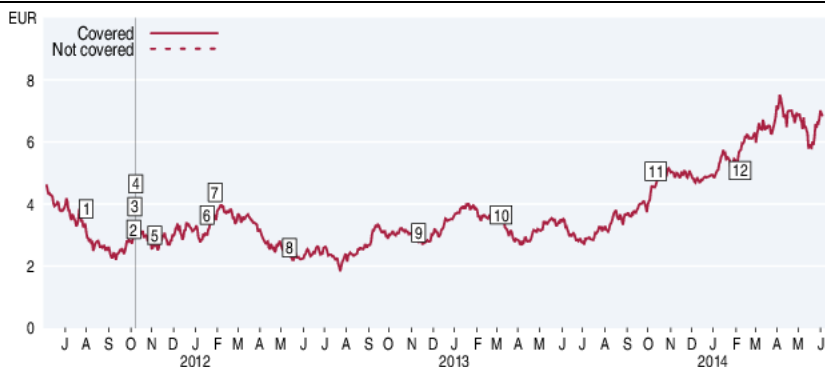
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IMPORTANT DISCLOSURES

Unione Banche Italiane (UBI.MI)

Ratings and Target Price History Fundamental Research

Analyst: Azzurra Guelfi



	Date	Rating	Target Price	Closing Price
1	1-Aug-11	*2S	*3.80	3.09
2	6-Oct-11	2S	*3.00	2.99
3	7-Oct-11	Stock rating system changed		
4	8-Oct-11	*2H	3.00	2.96

* Indicates change

	Date	Rating	Target Price	Closing Price
5	4-Nov-11	2H	*2.85	2.66
6	18-Jan-12	2H	*3.20	2.99
7	30-Jan-12	2H	*3.70	3.51
8	13-May-12	*2	-	2.50

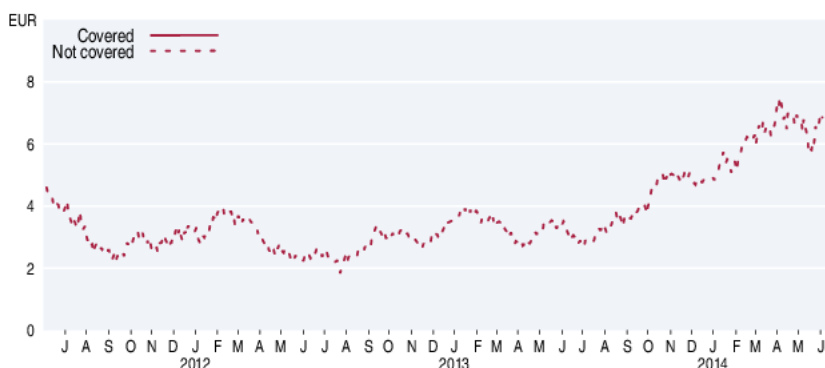
	Date	Rating	Target Price	Closing Price
9	12-Nov-12	*2H	*2.85	2.78
10	7-Mar-13	2H	*3.50	3.47
11	11-Oct-13	2H	*4.70	4.60
12	7-Feb-14	2H	*5.80	5.72

Rating/target price changes above reflect Eastern Standard Time

Unione Banche Italiane (UBI.MI)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Azzurra Guelfi



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

CaixaBank SA (CABK.MC)

Ratings and Target Price History

Fundamental Research

Analyst: Stefan Nedialkov
Covered since March 11 2013



Date	Rating	Target Price	Closing Price
1 8-Sep-11	Coverage terminated		
2 14-Sep-11	*3H	*2.70	3.08
3 5-Oct-11	*3S	*2.75	3.14
4 7-Oct-11	Stock rating system changed		
5 8-Oct-11	*3H	2.75	3.28
6 20-Jan-12	3H	*2.65	3.83
7 27-Feb-12	3H	*2.55	3.54

* Indicates change

Date	Rating	Target Price	Closing Price
8 24-Apr-12	3H	*2.25	2.47
9 8-Jun-12	3H	*0.98	2.30
10 18-Jul-12	3H	*1.08	2.25
11 23-Oct-12	3H	*1.76	2.88
12 21-Jan-13	3H	*2.30	3.09
13 25-Jun-13	*2H	*2.35	2.38
14 23-Jul-13	2H	*2.60	2.63

Date	Rating	Target Price	Closing Price
15 3-Sep-13	2H	*2.90	2.86
16 23-Oct-13	2H	*4.20	3.75
17 14-Nov-13	*1	4.20	3.41
18 21-Jan-14	*2	*4.60	4.31
19 16-Apr-14	*1	*5.10	4.56

Rating/target price changes above reflect Eastern Standard Time

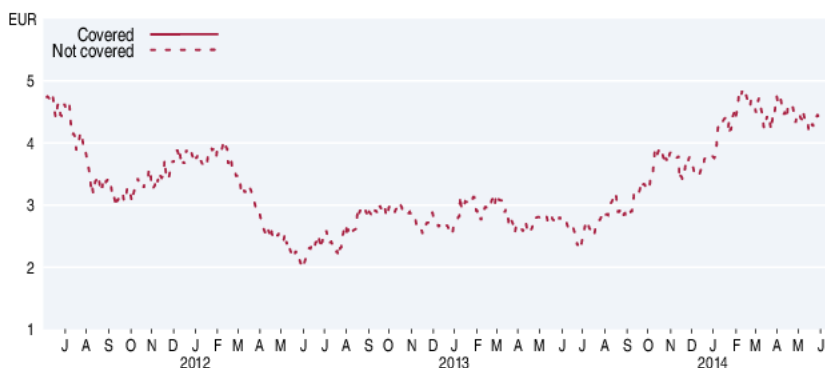
CaixaBank SA (CABK.MC)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Stefan Nedialkov
Covered since March 11 2013



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

UniCredit Group (CRDI.MI)

Ratings and Target Price History

Fundamental Research

Analyst: Azzurra Guelfi



Date	Rating	Target Price	Closing Price
1 1-Aug-11	*2S	*9.88	7.88
2 6-Oct-11	2S	*5.93	5.44
3 7-Oct-11	Stock rating system changed		
4 8-Oct-11	*2H	5.93	5.66
5 15-Nov-11	2H	*5.60	4.87

* Indicates change

Date	Rating	Target Price	Closing Price
6 12-Jan-12	*1H	*4.00	2.90
7 30-Jan-12	1H	*4.65	3.56
8 28-Mar-12	1H	*4.85	3.99
9 8-May-12	1H	*4.00	2.79
10 19-Jul-12	1H	*3.50	2.63

Date	Rating	Target Price	Closing Price
11 12-Sep-12	*2H	*3.70	3.81
12 7-Aug-13	2H	*4.25	4.36
13 11-Oct-13	2H	*5.80	5.43
14 7-Feb-14	*1H	*6.60	5.69
15 12-Mar-14	*1	*7.30	6.45

Rating/target price changes above reflect Eastern Standard Time

UniCredit Group (CRDI.MI)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Azzurra Guelfi



	Date	Rating	Target Price	Closing Price
1	7-Nov-11	*ADD LP	-	5.21
2	12-Jan-12	*REM LP	-	2.90

* Indicates change

	Date	Rating	Target Price	Closing Price
3	2-Jul-12	*ADD MP	-	2.94
4	28-Aug-12	*REM MP	-	3.14

Rating/target price changes above reflect Eastern Standard Time

Bankia SA (BKIA.MC)

Ratings and Target Price History

Fundamental Research

Analyst: Stefan Nedialkov

Covered since February 5 2014



	Date	Rating	Target Price	Closing Price
1	7-Oct-11	Stock rating system changed	-	-

* Indicates change

	Date	Rating	Target Price	Closing Price
2	5-Feb-14	*2	*1.45	1.33

	Date	Rating	Target Price	Closing Price
3	16-Apr-14	*1	*1.70	1.47

Rating/target price changes above reflect Eastern Standard Time

Bankia SA (BKIA.MC)

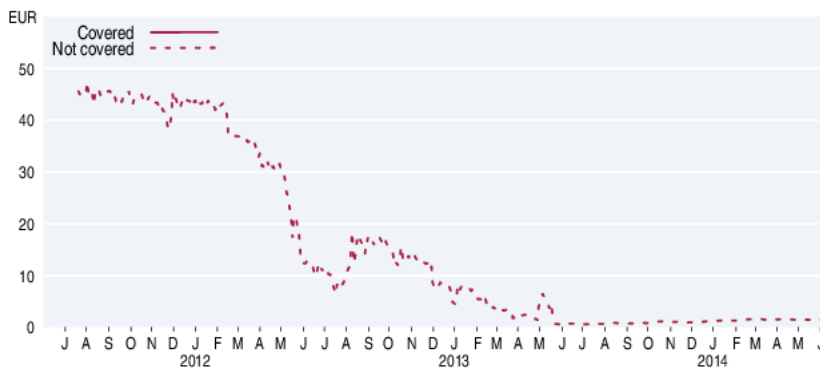
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Stefan Nedialkov

Covered since February 5 2014



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Banco Espirito Santo (BES.LS)

Ratings and Target Price History

Fundamental Research

Analyst: Stefan Nedialkov

Covered since May 22 2014



	Date	Rating	Target Price	Closing Price
1	22-Jun-11	*1H	*1.74	1.41
2	7-Oct-11	Stock rating system changed		
3	20-Oct-11	1H	*1.56	0.87
4	3-Nov-11	1H	*1.36	0.77
5	5-Dec-11	1H	*1.31	0.76

* Indicates change

	Date	Rating	Target Price	Closing Price
6	31-Jan-12	1H	*1.36	0.69
7	2-Apr-12	1H	*1.25	0.72
8	21-May-12	1H	*0.74	0.46
9	24-Oct-12	1H	*1.06	0.69
10	23-Nov-12	1H	*1.11	0.68

	Date	Rating	Target Price	Closing Price
11	14-May-13	1H	*1.17	0.69
12	23-Oct-13	1H	*1.27	0.84
13	21-Jan-14	1H	*1.36	1.12
14	18-Feb-14	1H	*1.58	1.25

Rating/target price changes above reflect Eastern Standard Time

Banco Espirito Santo (BES.LS)

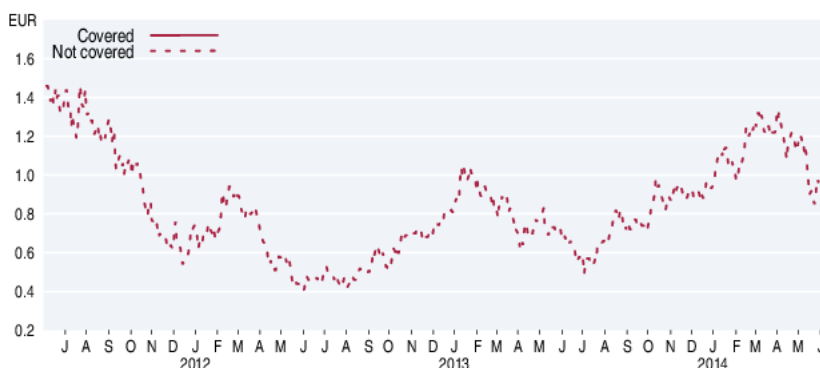
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Stefan Nedialkov

Covered since May 22 2014



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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<i>Data current as of 31 Mar 2014</i>	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Research Global Fundamental Coverage	49%	40%	12%	1%	98%	1%
% of companies in each rating category that are investment banking clients	55%	53%	45%	58%	53%	42%

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