7 February 2014 | 48 pages

Diversified Banks
Western Europe

Italian Banks

Getting Closer to the End of the Tunnel

- **More Positive on Italian Banks** — We move our stance on the Italian banks from underweight to neutral as we now expect them to benefit from a better macro (lower sovereign yields, higher Euribor rates, some recovery in macro conditions) and more self-help (eg cleaner balance sheet after AQR, increased efficiency) than we envisaged previously. Some of these positives have started to be included in bank valuations and, while Italian banks are not so cheap on P/TBV vs Europe (also considering profitability), they seem more attractive in terms of P/GOP.
- **Stock View** — We upgrade UCI from Neutral/High Risk to Buy/High Risk as, following the recent sell-off, we think it could benefit from AQ clean-up and better future profitability/capital allocation; the key risks are capital levels and EM exposure. We also upgrade Intesa to Neutral/High Risk from Sell/High Risk as we think a better macro is supportive of group profitability, the bank has a solid capital position and short-term negative catalysts are absent, but valuation is at a premium to peers. Both stocks could benefit from potential positive surprises from upcoming business plans. BP could be an interesting recovery story, but we think investors need to be confident on the group's NPL ratio and coverage levels as well as future profitability. We see UBI as a safer play on Italy among Popolari banks. We remain positive on Mediobanca and cautious on MPS (main shareholder developments are key catalyst for the stock). Our rating, TP and estimate changes are summarised below. We have also published a report reiterating our positive view on asset gatherers.
- **Key Risks or Key Opportunities?** — The main risks for Italian banks are the low level of profitability (we expect c8% in 2017) and the high level of NPLs, but for brever investors those could be where the opportunities lie. Capital positions differ among banks (ISP higher, MPS lower). Other key risks include any negative development on political/macro, lending/funding/efficiency and consolidation.
- **High NPLs: Trick or Treat?** — Italian banks' level of NPLs on loans is among the highest in Europe and the level of coverage is lower than it used to be pre crisis (despite increased collateral). The AQR will be based on 2013 results, hence we expect 4Q13 to show balance sheets clean-up to pass it. Disposal (sale or bad bank) and recovery of NPLs could be positive catalysts for banks with high NPL portfolios. We look at historical data on NPL sales and recovery levels.

Azzurra Guelfi
+44-20-7986-4174
azzurra.guelfi@citi.com

European Banks Team
Rahul Bajaj
Andrew Coombs
Ronit Ghose
Nicholas Herman
Kinner Lakhani
Stefan Nedialkov
Simon Nellis
Florent Nitu
Vikas Sharma
Yafei Tian

Figure 1. Italian Banks – Key Metrics

	Rating				Current	Target Price		2013E EPS		2014E EPS		2015E EPS	
	New	Old		ETR	Price	New	Old	New	Old	New	Old	New	Old
UCI	1-H	2-H	€	25%	5.42	6.60	5.80	0.18	0.20	0.33	0.32	0.51	0.50
ISP	2-H	3-H	€	6%	2.03	2.10	1.45	0.05	0.07	0.13	0.12	0.17	0.15
MDBI	1-H	1-H		18%	6.81	8.00	8.00	0.09	0.09	0.59	0.59	0.71	0.71
MPS	3-H	3-H	€	-13%	0.17	0.15	0.15	-0.03	-0.03	-0.02	-0.02	0.01	0.01
UBI	2-H	2-H	€	7%	5.48	5.80	4.70	0.13	0.15	0.25	0.23	0.33	0.30
BP	2	2	€		1.22			-0.01	-0.01	0.12	0.12	0.16	0.16
BPM	2	2	€	2%	0.44	0.45	0.45	-0.01	-0.01	0.04	0.04	0.05	0.04

Source: Powered by dataCentral. Note: Prices as of 5 Feb 2014.

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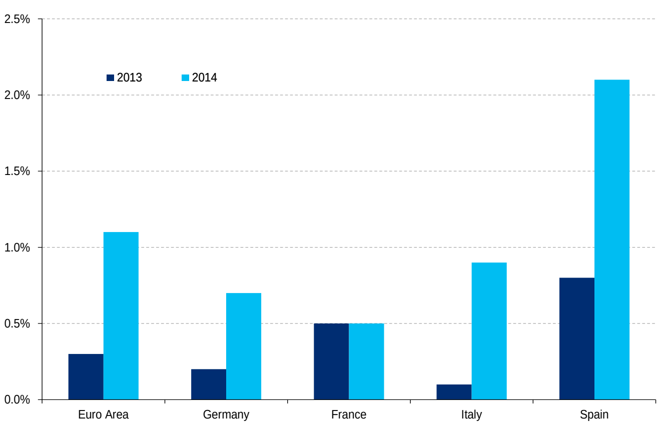
More Positive on Italian Banks

More Positive on Italy: macro backdrop improving

We upgrade the subsector from Underweight to Neutral, due to more optimistic expectations in the macro backdrop from the one we envisaged in the past: lower sovereign yield, higher Euribor rates, some recovery in macro conditions, better data for consumer confidence, development in the political scene and also banks improvement on funding and possible actions to improve "self-help" (cost cutting and actions on NPLs). Some of these positives have started to be discounted in banks valuation in some cases, and recent sell off could be an opportunity. Italian banks are not cheap in term of P/TBV vs Europe (given also the capital and profitability profile), but seem more attractive in term of P/GOP and also earning momentum seem more positive than in the past. Also, the political conditions in the country seem less critical than last year and the market could be more constructive on pending reforms (eg electoral law, Job Act) if government position became stronger. Also, our Strategy team is optimistic about the development of the wider equity market and expect further market rerating (2014 European Market Outlook - Staying Bullish — Re-leveraging Optionality; Re-leveraging Optionality), with equity being attractive also for non-typical equity investors and showing a bias towards financial over cyclical or defensive sector.

Figure 2. Euro Area – Change in GDP Forecasts (Jan 2014 vs May 2013)

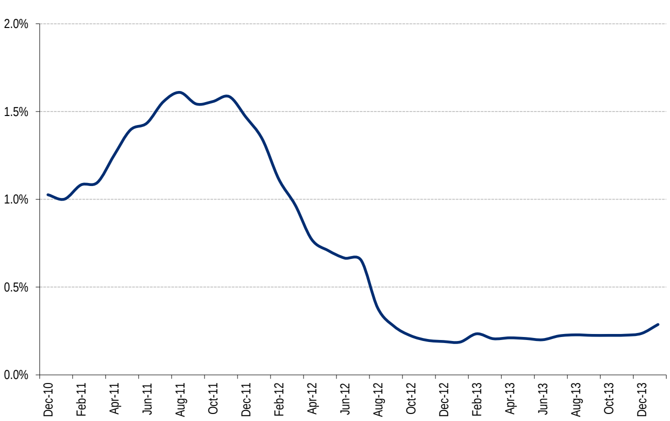


Source: Citi Research

Figure 3. Sovereign Spreads

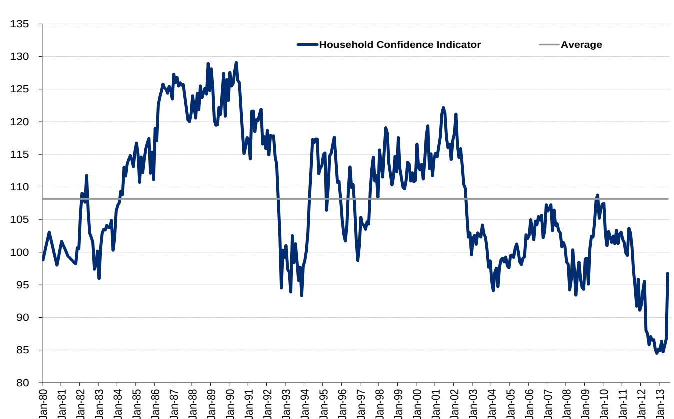
Source: Bloomberg

Figure 4. Euribor



Source: Datastream

Figure 5. Italy – Consumer Confidence



Source: Datastream

Risk or Opportunities?

Could the big risks become opportunities? We believe that Italian banks are in an unusual position, where the biggest risks could swing sharply and become the biggest opportunity. In our view, major risks/opportunities include: high level of NPLs level, low level of profitability, volatility in sovereign spreads, low interest rate and future movements, negative lending growth, development in funding market, high level of C/I ratio, capital adequacy, macro conditions, sector consolidation and regulation. There are still challenging situations, especially for the smaller and/or non-listed banks, but the recent sharp move in rates and sovereign spreads, and the less challenging macro prospects, coupled with a possible clean up coming from the pending asset quality review, could support larger banks (and drive EPS upgrades).

Upgrade UCI to Buy

We upgrade UCI to Buy/High Risk from Neutral/High Risk as the recent pull back in the share (c-15% in the last 2 weeks) is, in our view, mostly related to fear on high NPLs clean up driving a potential capital increase and lower earning coming from EM (especially Turkey/Russia following the currency devaluation and regulatory actions), and in our view represent a more attractive entry point (c0.6x P/TBV and c3.0x P/GOP). Our positive view on the stock is based on: group ability to show improving profitability, mostly through improvement in cost of risk and the potential of cost cutting to be exploited in coming years as well as its ability to generate capital. We forecast c€3.9bn of provisions in 4Q, and a core tier 1 fully loaded Basel 3 of 9.6%. While this level is below the 10% targeted by BP recently, UCI is focused on generating capital and could avoid a capital increase due to: 1) UCI is able to generate capital organically (we expect c70bp in 2014), 2) UCI could exploit non organic capital accretive actions to generate further capital (looking at disposal of its asset portfolio, better capital distribution within the group, sale/listing of some subsidiary) and 3) timing on the market, as there are some other Italian banks also raising capital in the market in 1H 2014, with lower capital ratio than UCI.

Upgrade ISP to Neutral

We upgrade Intesa Sanpaolo to Neutral/High Risk from Sell/High Risk as the different macro background is supportive for the stock, and we see no negative catalysts in the short term, although valuation remains at premium to peers. Intesa has c90% of its business in Italy and any improvement in the country macro/political situation results in positive gearing for the group profitability, and is also reflected in possibly lower cost of equity. The group has a strong capital position and even in the event of high loan loss provisions to be booked in 4Q (we expect c€2.7bn) the capital position should remain stronger than peers. The upcoming presentation of the new business plan could be a support for the share performance, and result in higher long term profitability (NII and provision are key variables). We are looking forward to see the new strategy to be present by the management team lead by Mr Messina (who has a long and successful track record within the group in several roles). Intesa remains the most expensive of the Italian banks in term of both P/TBV (at c0.9x vs 0.6x) and P/GOP (c3.9x vs c3.3x for the sector).

View on Popolari

Among small cap, BP seems the one with more gearing to the recovery of both macro and NPLs, but the capital positions remain the main risk for investors, while we believe UBI is a better option, given better capital position and possibly safer underwriting criteria in the past; BPM remains a call on governance, and new management will have to show evidence that something is changing (ahead of the capital increase), in order to unlock the group potential value in our view.

Risks or Opportunities?

The macro environment is a key driver of banks share prices, even more for Italian banks given their simpler business model and high gearing to corporate lending. This has represented a major negative for Italian banks in the past 2 year. We believe that Italian banks are in an unusual position, where the biggest risks could swing sharply and become the biggest opportunity for investor if the macro backdrop stabilizes further.

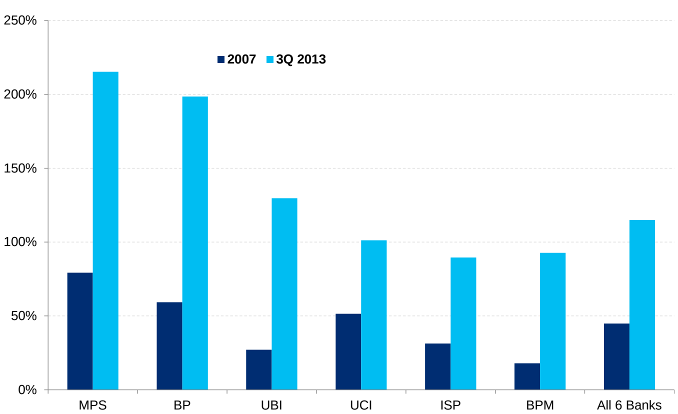
In our view the current major risks/opportunities we see for the sector are: high level of NPLs level and their coverage ratio (ahead of AQR), low level of profitability, volatility in sovereign spreads, low interest rate and future movements, negative lending growth, development in funding market, efficiency level below European banks, capital adequacy, macro conditions, sector consolidation and regulation.

1 High Level of NPLs

High NPLs level, a potential opportunity for the future?

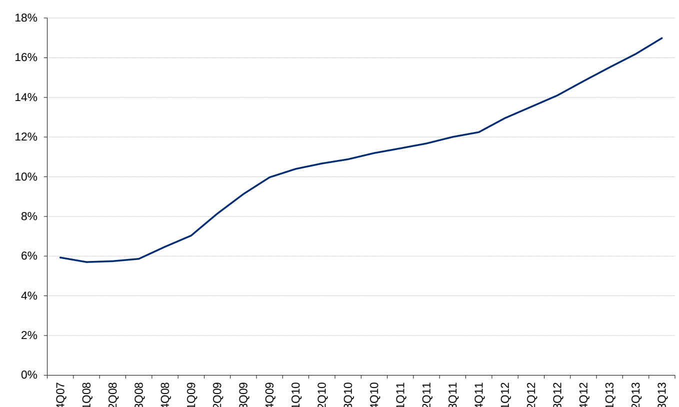
Italian banks level of NPLs has increased significantly in the last 6 years (in 3Q 2013 the NPLs ratio stood at c17% vs c6% in 2007, and total net NPLs increased by 241% since 2007), and also the coverage ratio has decreased significantly (in 3Q2013 is c10pp lower than in 2007), despite showing increase in level of collateralized lending. This high portfolio of NPLs negatively affects the bank level of provisions and has a funding costs/opportunity as well as absorbing capital. The pending AQR could be a step toward a needed review of the bank book and we expect high provisions to be booked in 4Q 2013.

Figure 6. Italian Banks – Net Total NPLs on Tangible Equity



Source: Company data and Citi Research. MPS includes Monti Bondi in Tangible Equity

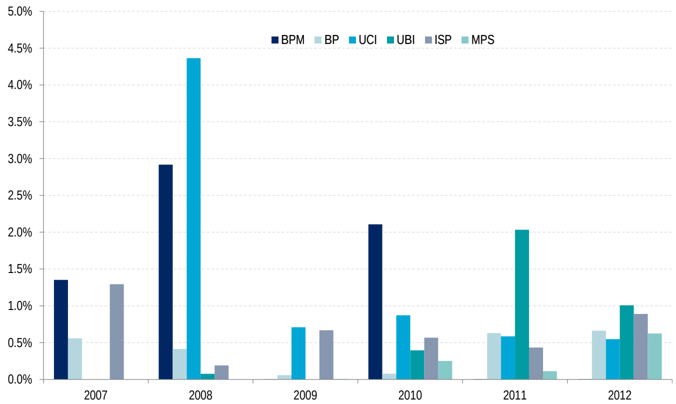
Figure 7. Italian Banks – Gross NPLs on Loans



Source: Company data and Citi Research

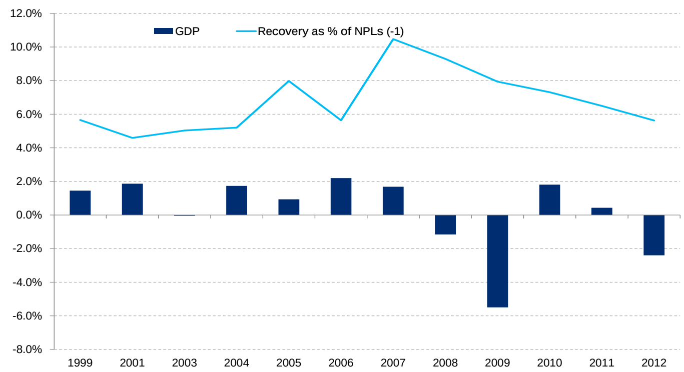
Fast forwarding after the 4Q and AQR, there could be 2 main opportunity on the NPLs portfolio for banks: disposals (eg sale to external investors, creation of bad bank) and recovery of previously booked provisions (write backs). We have looked at last 10-15Y history of provisions recovery as % of NPLs, and not surprisingly the current level are below the historical average. The creation of a bad bank to manage NPLs/Real Estate portfolio could free up capital and unlock potential value and give more visibility to the core business. Banks might need to assess current coverage and try to minimize capital loss in the transfer process to the separated special vehicle (best case scenario). So far, there are not comparable examples of strict NPLs bad banks managed by private institutions in Europe.

Figure 8. Italian Banks – NPLs Sale as % of Loans



Source: Company data and Citi Research

Figure 9. Italy – Recovery as % of NPLs (T-1) and GDP Growth



Source: Company data, Datastream and Citi Research

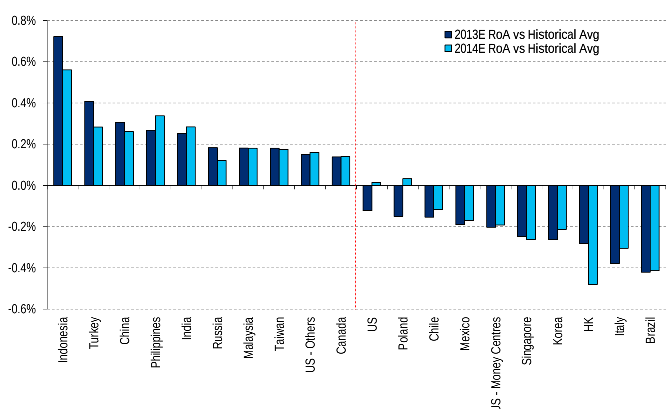
2 Low Level of Profitability

We expect bank ROTE at c8% in 2017

Italian banks profitability has been under pressure for the last 4 years due to low NII and high cost of risk, given the low rate environment, the funding stress and sharp decrease of GDP, as well as higher capital requirements. If macro and funding conditions normalize, the profitability would benefit. We expect average ROA to increase from the current depressed level of 0.1% to c0.5% in 2017, even if this will remain below the level of pre-crisis (c0.6%/0.7%) which benefitted also from significantly higher level of interest rate, higher leverage and different market development. The main drivers of bank profitability remain NII and provisions, so macro/rate conditions remain a key variables.

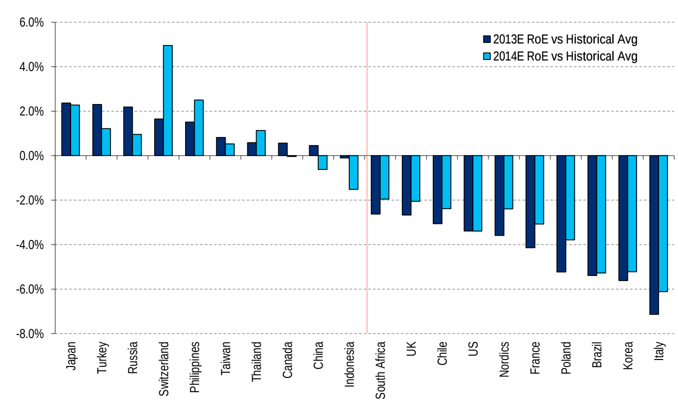
Italian banks profitability (ROA/ROTE) is lower than the last 15Y historical average. We expect it to improve in the next years (normalized ROA expected at c0.5%, normalized ROTE at c8%) due to a normalisation in cost of risk, lower funding costs and also further cost cutting, but still to remain below historical level due to different rates, macro and balance sheet/leverage development. Recovery loan growth could be an additional positive catalyst. Among banks we expect ISP to show the highest return (c10% ROTE and 0.6% ROA).

Figure 10. Global Banks – ROA vs Average



Source: Company data and Citi Research

Figure 11. Global Banks – ROE vs Average



Source: Company data and Citi Research

Figure 12. Italian Banks – Adj ROA and ROTE

	2006	2007	2008	2009	2010	2011	2012	2013E	2014E	2015E	2016E	2017E
NII on assets	1.62%	1.72%	1.83%	1.77%	1.57%	1.57%	1.45%	1.36%	1.38%	1.41%	1.44%	1.47%
Revenues on Assets	3.12%	3.09%	2.76%	2.89%	2.65%	2.64%	2.65%	2.63%	2.66%	2.71%	2.77%	2.81%
Cost to Assets	-1.76%	-1.70%	-1.67%	-1.66%	-1.58%	-1.60%	-1.54%	-1.54%	-1.52%	-1.48%	-1.44%	-1.41%
Loan Losses on Assets	-0.25%	-0.27%	-0.43%	-0.74%	-0.60%	-0.62%	-0.91%	-0.94%	-0.67%	-0.59%	-0.53%	-0.45%
Adj ROA	0.67%	0.60%	0.38%	0.24%	0.19%	0.19%	0.11%	0.08%	0.21%	0.33%	0.41%	0.51%
ROTE	18.0%	15.8%	11.7%	6.1%	4.7%	4.6%	2.4%	1.5%	3.8%	5.9%	7.2%	8.3%

Source: Company data and Citi Research

Volatility in Sovereign Spreads

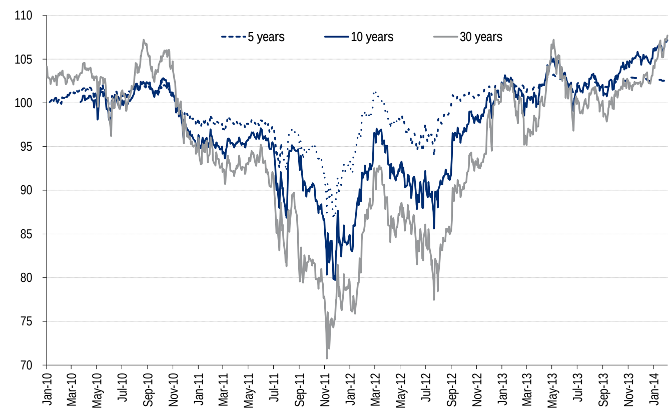
Lower sovereign spread YTD

Sovereign spreads have been very volatile during 2013, due to the political uncertainty and macro developments, and also ECB statement/actions. Investors seem still showing demand for periphery sovereign bond, and sovereign spread could tighter even further if positive sentiment continues, supporting bank capital and possibly lowering the funding cost. Also lower sovereign yield should results in decreasing cost of equity.

Figure 13. Italy – Sovereign Bond Spread vs German 10Y Bond

Source: Bloomberg

Figure 14. Italy – Sovereign Bond Price



Source: Bloomberg

Italian banks have a large portfolio of sovereign bond (equal to c200% of equity). Most of it is booked as asset AFS, and could results in higher shareholder capital (benefitting from increasing AFS reserve) if sovereign bonds continue to show tighter spreads, with ISP and UBI being the one benefitting more probably.

Figure 15. Italian Banks – Sovereign Exposure

€ bn	ISP	UCI	MDBI	MPS*	UBI	BP*	BPM*
Italy Gov Bonds	100	49	8	26	20	14	9
As % of							
Total Assets	15%	5%	10%	12%	15%	11%	17%
Tangible Equity	292%	106%	118%	302%	283%	172%	217%
Shareholders' Equity	204%	80%	111%	392%	198%	163%	239%

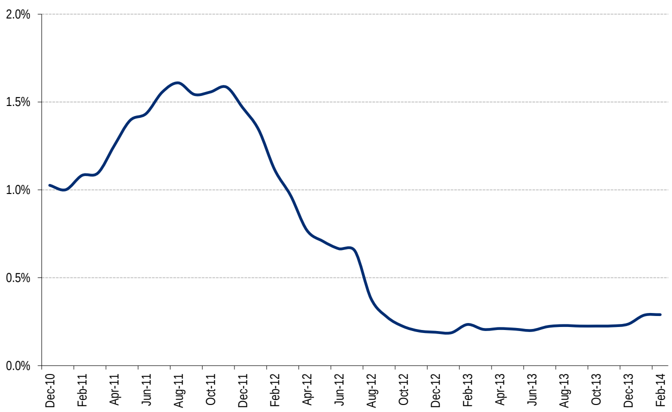
Source: Company data and Citi Research. *Proforma announced capital increase.

Interest Rate Level

Euribor starting to recover

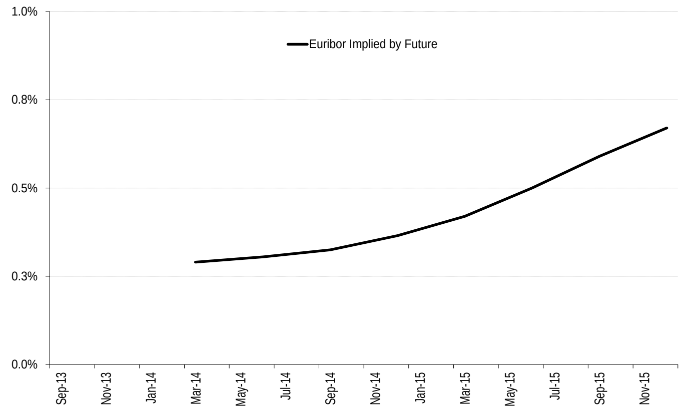
The low level of interest rate has significantly penalized Italian banks in the last 3 years. The NII is sensitive to rate movements (even if less than in the past), mostly due to improving deposit spread. Rising Euribor rate is positive for deposit spread and also could make asset re-pricing easier. Any decrease in market/ policy rates could be a treat for Italian banks NII. 3M Euribor is up to c0.3%, vs 0.2% in December and the forward rate curve implies further increase in 2014, at level higher than 3 months ago.

Figure 16. 3M Euribor



Source: Datastream

Figure 17. 3M Euribor – Forward Rate Implied Level



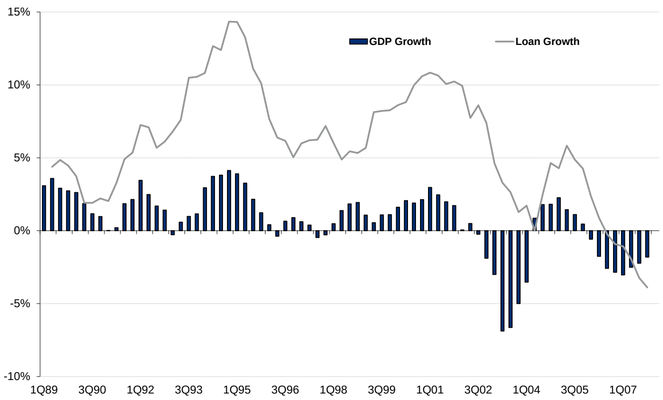
Source: Bloomberg

Negative Lending Growth

There is a strong link between Loans and GDP

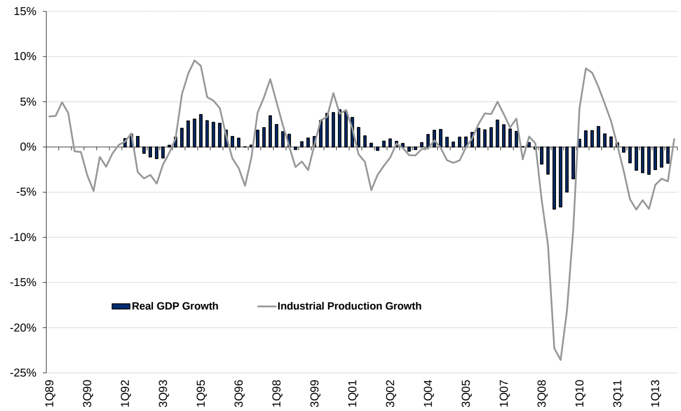
Volume growth is still in negative territory, and this is the first time since we track the series in late '80s. There is a close link between lending growth and GDP in Italy as well as between industrial production and GDP. Industrial production has started recovering in 4Q and this has been a good leading indicator for GDP development in the past. Volume growth has also in the past show a strong correlation with GDP, mirroring in most case the GDP trend (eg GDP recovering = increasing lending conditions the same quarter or the following), possibly due to the strong gearing to corporate in the lending for Italy. We believe that now, there could be a wider time lag between the movements in loan growth in relation to GDP, also due to the more stringent capital requirement rules. Simulating a possible 1 or 2 quarter of time lag, vs almost historically synchronized movement, we could expect some sign of recovery in lending growth in mid/end 2014, if economic conditions continue to stabilize (and there are no more regulatory capital requests). We believe recovery in lending growth to be essential for the future growth of the banking sector and its earnings (supporting NII).

Figure 18. Italy – Loans and GDP



Source: Bank of Italy and Datastream

Figure 19. Italy – GDP and Industrial Production



Source: Datastream

Development in Funding Market

Lower funding cost in 2014

Italian banks funding conditions have improved in the last 2 years also thanks to the ECB LTRO financing, and lately for lower sovereign spreads. Italian banks in 2014 will have to start substituting LTRO and any additional shock in the funding market could make this refinancing more difficult/expensive, hence putting pressure on NII. Retail funding cost is decreasing following lower sovereign spread and the rolling off of expensive time deposits written in 2011. The funding costs still remain high on the wholesale funding, compare to the inventory expiring in most part of 2014, but the YoY comparison is easing. Banks are facing the challenge of substituting LTRO funding, but this could be easier if sovereign spread remain low and macro normalize. So far we have seen limited evidence of bank repaying LTRO, with the exception of Intesa, which has swapped its LTRO funding with other ECB short term funding. Reducing ECB reliance, could affect the bank sovereign bond portfolio size or the potential benefit to P&L (depending on alternative financing source), this is more significant for the smaller banks in our coverage, as the carry trade benefit represent a larger component of NII compared to UCI for example.

Figure 20. Italian Banks – LTRO Funding and Government Bond Exposure

€ bn	LTRO	Repayment*	Residual LTRO	IT Government Bond
Unicredit	26	-2	24	49
Intesa	36	-36	0	100
Monte dei Paschi	29	-1	28	26
UBI	12	0	12	19
BP	13	0	13	14
BPM	4	0	4	9

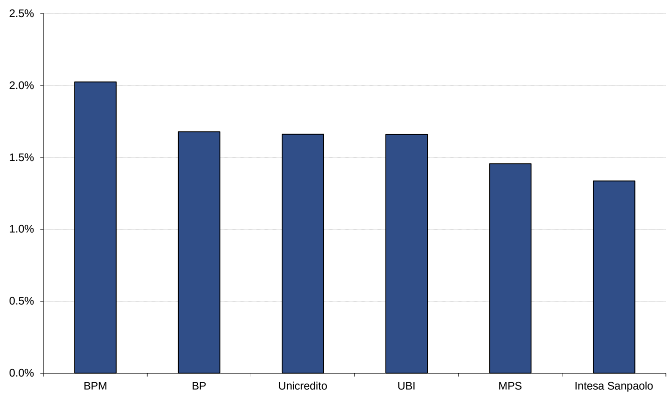
Source: Citi Research. *As disclosed so far.

High Cost Income Business

More scope for cost cutting

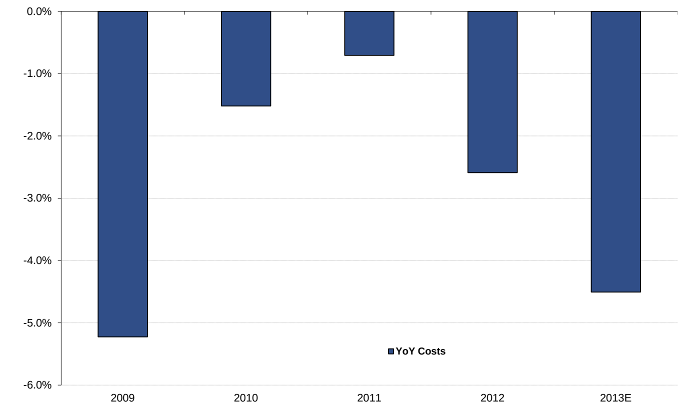
Italian banks cost/income ratio are among the highest with European Retail banks. The limited improvement in C/I ratio over the last few years, is mostly the results of the compression on the revenues side, more that lack of focus from management on cost actions. Overall reported operating costs have been reduced by c13% since 2007. We believe that looking at cost to asset ratio is a better indicator to assess the bank ability to reduce cost in the last few years.

Figure 21. Italian Banks – Cost to Asset Ratio (2013E)



Source: Company data and Citi Research

Figure 22. Italian Banks – Reported Operating Costs YoY Change



Source: Company data and Citi Research

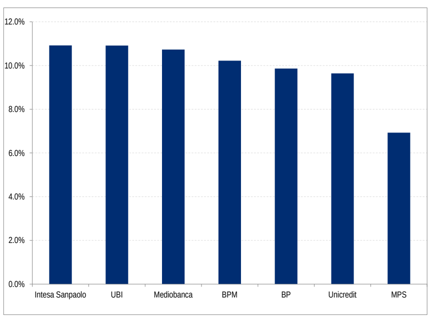
We expect banks to continue the cost cutting effort via reduction of the branch network (both real estate costs and staff), simplification of group structure, improvement in other administrative costs. We expect UCI to show potential increasing effort in Italy and Germany. BPM remain the bank with the lowest P&L leverage, and the new management will have to continue focus on this. The potential benefit on the bottom line from higher cost cutting effort will not be a key swing factor to the bank profitability, if NII and provisions remain at current level.

Is Capital Adequate?

What is the magic number for Core Tier 1?

Capital position has been increase in the last years thanks to capital increased, RWAs reduction and limited dividend payment, following the higher regulatory requests. Overall the sector has no significant capital shortfall (for the banks that we cover proforma announced capital increases), but this is also dependent on the possible outcome of the AQR, given banks large NPLs portfolio. Larger banks have more comfortable capital positions than some smaller one (ex UBI),and the market is carefully monitoring the capital development at UCI. Three banks have pending announced capital increases (BP, MPS and BPM) to be completed in the coming months for a total of c€5bn. We expect all the banks in our coverage will have a core tier 1 fully loaded Basel 3 above 10% at the end of 2014, with the exclusion of MPS. We expect MPS to reach a c8.6% core tier 1 fully loaded Basel 3 in 2017, below management guidance of 9.3%, and while we can see that the group will remain below the peer group given its recent history, we cannot rule out a risk of higher capital request based on the potential upcoming balance sheet clean up. To assess the adequacy of Italian banks capital ratio, we believe investor should also consider the potential losses coming from the clean up ahead of the AQR process.

Figure 23. Italian Banks – CT1 FL B3



Source: Citi Research

We also include our proforma calculation for the pending capital increases for BP, MPS and BPM.

Figure 24. MPS – Simulation of Capital Increase Effects on EPS and Tangible Book Value (€ m)

Capital Increase	3,000
% of Market Cap	144%
Current Market Cap	2079
Current Price	0.18
Current n of share (m)	11,682

Discount to current price	0%	-10%	-20%	-30%	-40%	-50%	-60%	-70%
Issue Price	0.18	0.16	0.14	0.12	0.11	0.09	0.07	0.05
New Shares to be issued (m)	16,854	18,727	21,067	24,077	28,090	33,708	42,135	56,180
Proforma Total n of shares fully diluted (m)	28,535	30,408	32,749	35,759	39,771	45,389	53,816	67,861
Proforma 2014 Tangible Book Value PS(€)	0.28	0.26	0.24	0.22	0.20	0.17	0.15	0.12
Dilution	-34%	-38%	-42%	-47%	-52%	-58%	-65%	-72%

Source: Citi Research, Reuters. The simulated issue discount is based on current price, discount to TERP would be different.

Figure 25. BP – Simulation of Capital Increase Effects on EPS and Tangible Book Value (€ m)

Capital Increase	1,500
% of Market Cap	69%
Current Market Cap	2,169
Current Price	1.23
Current n of share (m)	1,763

Discount to current price	0%	-10%	-20%	-30%	-40%	-50%	-60%	-70%
Issue Price	1.23	1.11	0.98	0.86	0.74	0.66	0.54	0.42
New Shares to be issued (m)	1,220	1,355	1,524	1,742	2,033	2,258	2,772	3,587
Proforma Total n of shares fully diluted (m)	2,983	3,118	3,288	3,506	3,796	4,022	4,535	5,350
Proforma 2015 EPS (€)	0.10	0.10	0.09	0.09	0.08	0.08	0.07	0.06
Dilution	-36%	-39%	-42%	-46%	-50%	-53%	-58%	-64%
Proforma 2014 GOP per share (€)	0.46	0.44	0.42	0.40	0.37	0.34	0.31	0.26
Dilution	-40%	-43%	-45%	-49%	-53%	-55%	-60%	-66%
Proforma 2014 Tangible Book Value PS(€)	2.63	2.52	2.39	2.24	2.07	1.95	1.73	1.47
Dilution	-24%	-27%	-31%	-35%	-40%	-43%	-50%	-58%

Source: Citi Research, Reuters. The simulated issue discount is based on current price, discount to TERP would be different. For reference in our simulation a c25% discount to TERP would be equal to a c40% discount to current price

Figure 26. BP Milano – Simulation of Capital Increase Effects on EPS and Tangible Book Value (€ m)

Capital Increase	500
% of Market Cap	35%
Current Market Cap	1,432
Current Price	0.45
Current n of share (m)	3,254

Discount to current price	0%	-10%	-20%	-30%	-40%	-50%	-60%	-70%
Issue Price	0.44	0.40	0.35	0.31	0.26	0.22	0.18	0.13
New Shares to be issued (m)	1,136	1,263	1,420	1,623	1,894	2,273	2,841	3,788
Proforma Total n of shares fully diluted (m)	4,390	4,516	4,674	4,877	5,148	5,527	6,095	7,042
Proforma 2015 EPS (€)	0.05	0.04	0.04	0.04	0.04	0.04	0.03	0.03
Dilution	-2%	-5%	-8%	-12%	-16%	-22%	-29%	-39%
Proforma 2014 GOP per share (€)	0.15	0.14	0.14	0.13	0.13	0.12	0.11	0.09
Dilution	-23%	-25%	-28%	-31%	-35%	-39%	-45%	-52%
Proforma 2014 Tangible Book Value PS(€)	0.91	0.89	0.86	0.82	0.78	0.73	0.66	0.57
Dilution	-15%	-18%	-20%	-24%	-28%	-33%	-39%	-47%

Source: Citi Research, Reuters. The simulated issue discount is based on current price, discount to TERP would be different.

Bank of Italy revaluation has not effect on 2013 capital ratio

The potential benefit on P&L and balance sheet from the revaluation of the stake in the Bank of Italy (value updated to €7.5bn following the law of 29 Jan 2014), will not have capital accretive effect in 2013 and it is unclear what will be the effect in coming year depending on the accounting and level of the stake. We provide indication of the potential benefit for banks, with ISP and UCI showing the largest capital gain and potential benefit on TBV (c5% for ISP and c2% for UCI). We include in our estimates the simulated capital gain on P&L and book value and give no capital uplift from it.

Figure 27. Italian Banks – Bank of Italy Stake

	Book Value	Stake	Potential Gross Gain
Intesa	624	42%	2,545
UCI	285	22%	1,327
UBI	2.2	0.4%	26
BP	36.5	1.2%	72
BPM	8.7	0.3%	17

Source: Company data and Citi Research

Consolidation

Consolidation in late 2014?

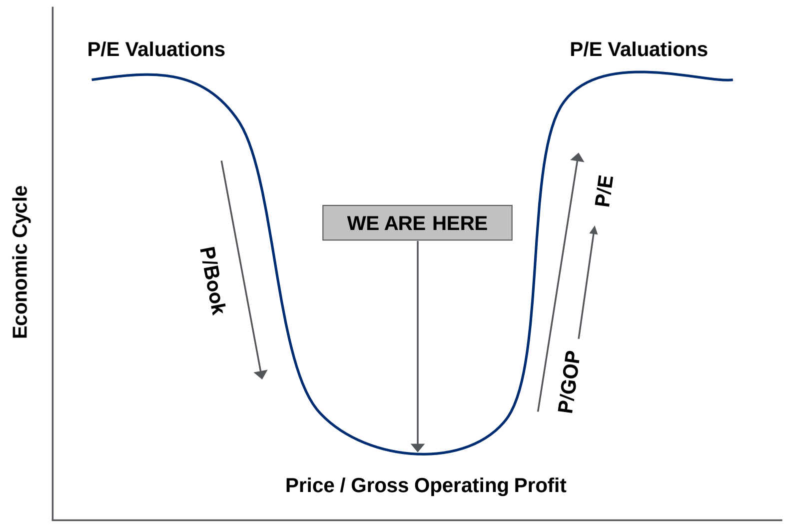
We cannot rule out further consolidation in the Italian banking space. History suggests that consolidation in Italy is mostly visible after a crisis period is over (eg end of 2014). This could represent an opportunity for the sector to become more efficient, but the final outcome will also depend on the price paid, the banks involved and the timing of this. Given the market distribution, the market might see as more likely merger among the popolari bank or the smaller banks in Italy, than any big transformational deal for the larger ones.

Which Valuation Methodology To Use?

Different valuations in different point in the economic cycle

What is the best methodology for valuing banks and selecting among them? The answer seems to be: it depends on the time in the economic cycle. When macroeconomic conditions are positive and there is visibility on future earnings, the market tends to focus on P/E metrics. During crisis time and when the market might envisage future losses, the main valuation tools move from P/E to P/BV valuation (or P/TBV or even P to stressed book). We believe that now we are in the middle in between these scenarios, as visibility of future earnings is still limited given loan losses cycle for Italian banks, but the worst of the crisis seems to be over, but potentially given pressure on NII our GOP could be still conservative. In order to assess Italian banks valuation vs European peers we are adding to our P/TBV screen also the P/GOP screen.

Figure 28. Banks Valuation Methodology and Economic Cycle



Source: Citi Research

Italian banks trade at discount to the sector on P/TBV, as Italy trade at c0.7x vs 1.1x for European banks. Optically this seem a cheap and attractive valuation, but need to be also contestualised with the level of expected future profitability (we expect c6% for Italian banks in 2015 vs c11% for European banks), hence the discount seem more justified. ISP is the bank showing the highest level of P/TBV multiple, while BPM and BP are the lowest (PF capital increase).

More Attractive on P/GOP

On P/GOP Italian banks trade at discount vs both historical level and also vs European peers (Italy trades at c3.9x vs c5.0x for Europe). This is still linked to in some cases uncertainty on the number of shares as some banks have pending capital increase (eg BP, MPS and BPM) and partially also to the significant difference in the revenue profile of the banks, given significant difference vs historical conditions (eg rates environment, now ECB rate at c0.25% vs historical average level in the 2000-2010 of c3%), but we expect growth in GOP.

Figure 29. Italian Banks – Summary Valuation

		Adj P/E		PTBV	ROTE		PGOP
	Price	2014E	2015E	2014E	2014E	2015E	2014E
Unicredit	5.42	16.4x	10.7x	0.7x	4.1%	6.1%	3.2x
Intesa Sanpaolo	2.03	16.3x	11.9x	0.9x	5.7%	7.5%	4.0x
Mediobanca	6.81	10.5x	8.9x	0.8x	7.7%	8.5%	4.8x
MPS	0.17	nm	nm	0.7x	nm	nm	3.4x
UBI	5.48	21.9x	16.9x	0.7x	3.1%	4.0%	3.7x
BP	1.22	10.4x	7.7x	0.4x	3.4%	4.4%	1.6x
BPM	0.44	11.7x	9.3x	0.4x	3.4%	4.1%	2.2x
Italy Average		15.3x	11.3x	0.7x	4.6%	5.7%	3.9
Europe		10.7x	9.0x	1.1x	10.3%	11.5%	5.1x

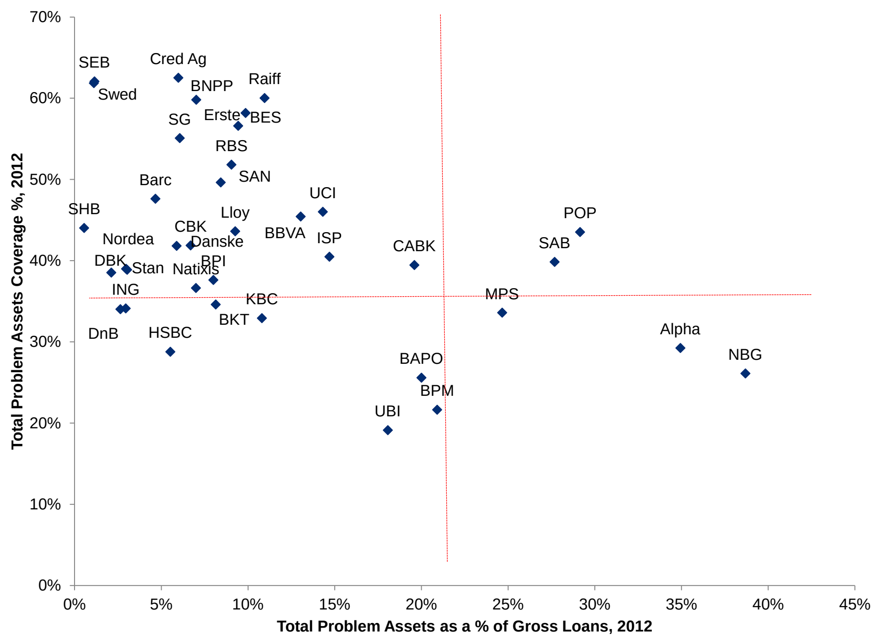
Source: Datastream and Citi Research

NPLs: Trick or Treat?

High level of NPLs

Italian banks show a high level of NPL, and this is also coupled with relatively lower coverage ratio than most European banks. This relatively weaker position of Italian banks (and other periphery banks) vs European banks seems widely known in the market. Can there be value in it and not just risk? This section of the note explores the current status quo of Italian asset quality and potential opportunities.

Figure 30. Total Problem Asset as % of loans vs Coverage Ratio

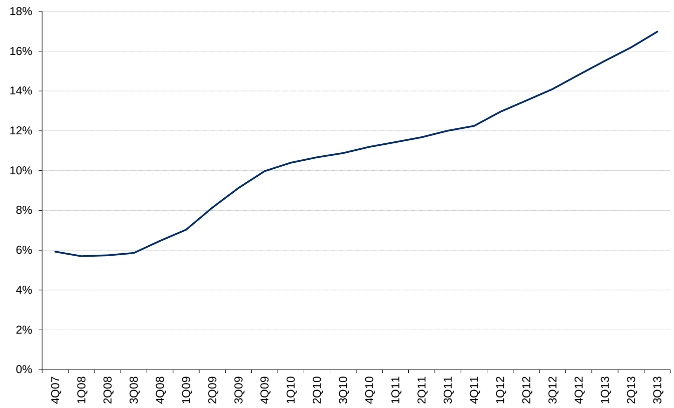


Source: Citi Research. Note: 1) Problem asset add-ons (where available) include 90 day past due loans but unimpaired, foreclosed assets and performing/substandard restructure loan; Total Problem Assets = NPLs + Problem assets add-ons. 2) The coverage ratio excludes collateral.

Stringent NPLs definition, but recent evidence leave open question on AQR scope

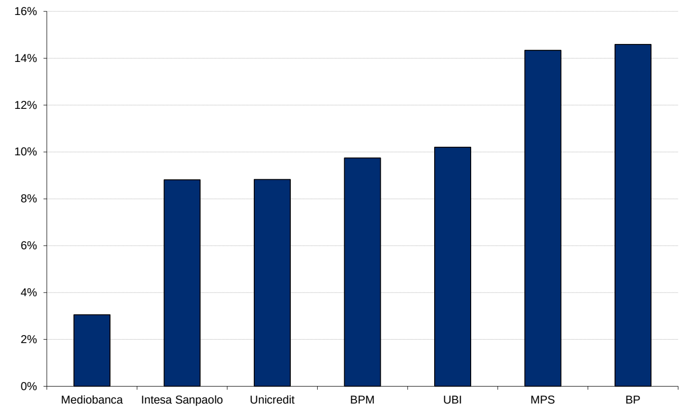
We believe that the Italian definition of NPLs is among the most stringent in Europe, but the uncertainty on the EBA definition of NPLs and the scope of the revision of the banks performing loans remain a key risk, in Italy and also elsewhere. The recent pre-announcement on higher loan loss provisions from BP in 4Q (albeit no disclosure is available yet on NPLs/coverage) leave open questions on the need for banks to reclassify some performing position into NPLs, and whether it was just a BP specific need to realign its NPLs criteria or something more wide at system level. BP will provide full disclosure of NPLs and coverage on 28th February and by then the market will have a better understanding on the one-off reclassification effect (eg and more precise read across for the sector), as well as NPLs underlying trends. We expect broadly stable coverage and significant increase in NPLs.

Figure 31. Italian Banks – NPLs Ratio (2007-3Q 2013)



Source: Company data and Citi Research

Figure 32. Italian Banks – NPLs Ratio by Bank (3Q 2013)



Source: Company data and Citi Research

Other problematic loans

In addition to the reported NPLs, we have also looked at what could be additional risky positions among the performing book of Italian banks, but this could not fully overlap with the new EBA definition and possibly include loans that might not be aggressively stressed.

Figure 33. Italian Banks – Other Problematic Loans

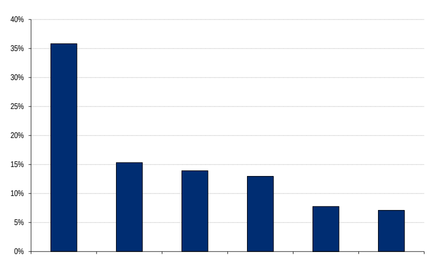
€ m	Moratoria	Past Due <30 days	Past due 30< 60	Past Due >60 days
Intesa	8,103	3706	334	740
Unicredit	3,684	197	193	
MPS	4,336			
BP	2,827	1	1	0
UBI	1,483	5	0	2
BPM	172	1593	2012	206

Source: Company data and Citi Research

What is the weight of restructured loans?

Given that Italian banks also include in the NPLs definition also the restructured loans, we have also looked at the banks that have higher level of NPLs in this category and what is their coverage ratio. This could give an indication of the level of conservativeness of the bank in classifying those loans, and while might not be a perfect answer to AQR NPLs definition risk, it could be an initial screening. On this UCI and BPM show the highest level of restructured loans over total NPLs. UCI coverage ratio on restructured loans is c36%, well above the average of the peers (c12%), followed by UBI (c15%).

Figure 34. Italian Banks – Restructured Loan Coverage



Source: Company data and Citi Research

Figure 35. Italian Banks – Gross NPLs Breakdown

	Sofferenze	Incagli	Restructured	Past Due
Intesa Sanpaolo	59%	31%	5%	6%
Unicredit	56%	28%	10%	6%
MPS	59%	27%	5%	9%
UBI	46%	41%	6%	8%
BP	48%	32%	5%	14%
BPM	47%	35%	14%	4%
All	56%	30%	7%	7%

Source: Company data and Citi Research

Lower coverage than in the past

The coverage of non-performing loans is lower than European average and has also decreased significantly since 2007 (c-11pp of which c70% due to the effective coverage deterioration in each category and c30% to the NPLs mix) and the NPLs formation at system level show still rising trend. Our analyses are based on the stated coverage ratio, and for popolari banks the level would be higher if we were to include the level of loan written off, for example for BP it would increase from 25.3% to 36.7%.

Figure 36. Italian Banks – NPLs Coverage Development

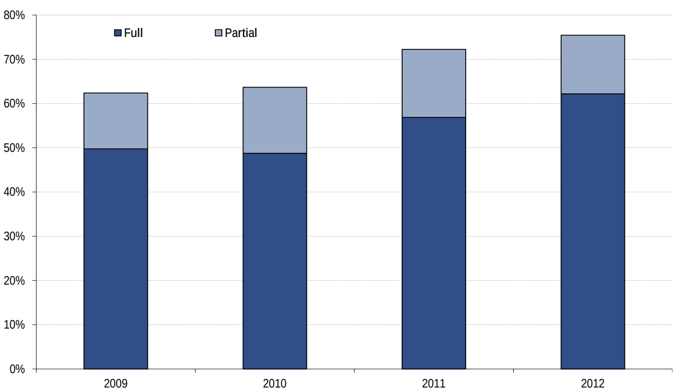
	2007	3Q 2013	Diff	Mix	Coverage Deterioration
Intesa	53.1%	44.5%	-8.6%	10%	90%
Unicredit	57.2%	44.6%	-12.6%	34%	66%
MPS	44.1%	40.8%	-3.2%	44%	56%
UBI	37.4%	25.9%	-11.6%	27%	73%
BP	36.1%	25.3%	-10.8%	1%	99%
BPM	46.9%	33.4%	-13.5%	1%	99%

Source: Company data and Citi Research

Collateral has increased

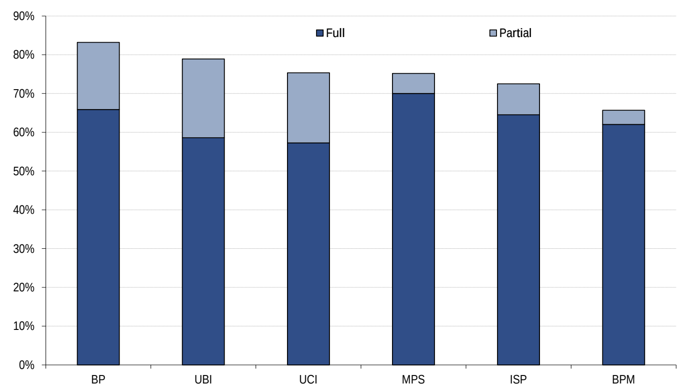
Our analysis also excludes the potential support of collaterals, which have been increasing as percentage of NPLs and loans since 2009, but key market question around collateral remain the potential value of recovery and the timing of recovery.

Figure 37. Italian Banks – NPLs with Some Collateral



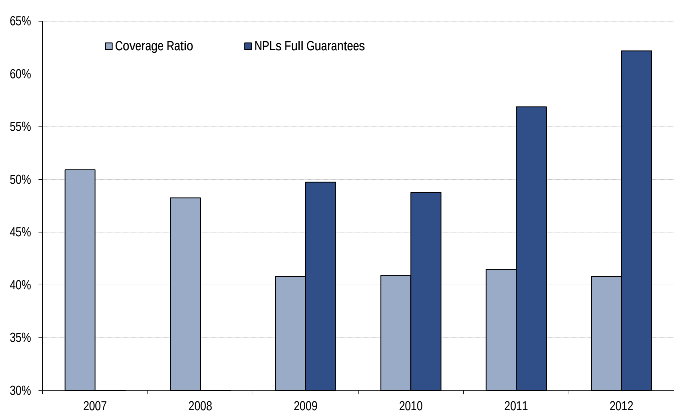
Source: Company data and Citi Research

Figure 38. Italian Banks – Collateralized NPLs by Banks



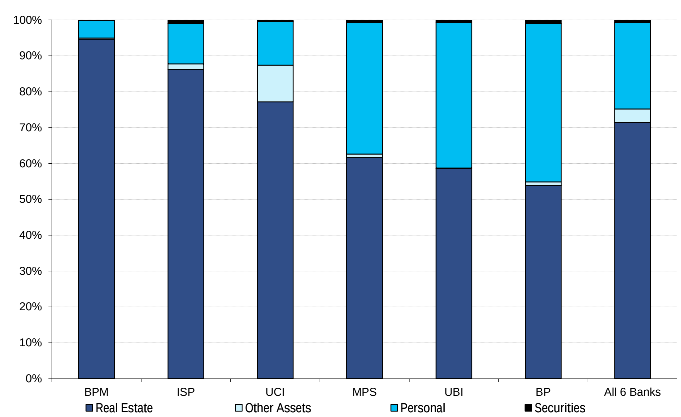
Source: Company data and Citi Research

Figure 39. Italian Banks – Coverage and Collateral Level



Source: Company data and Citi Research

Figure 40. Italian Banks – Collateral Breakdown



Source: Company data and Citi Research

Brighter Future after AQR?

Now that we have a picture of the current asset quality conditions and that we have highlighted the biggest risk in our view (classification of NPLs as well as coverage rebuilding). The asset quality review still represents a burden for banks (we expect sizable loan loss provisions to be charged by bank in 4Q), but if the AQR exercise will be rigorous, it could also be the opportunity for accelerating balance sheet revision and support future earnings generation(via lower loan loss provisions).

We believe two main positive developments could transform the biggest risk of Italian banks (eg the high level of NPLs) into an opportunity: NPLs disposals and recovery on previously provisioned positions.

1. Sale of NPLs: all about the transfer price

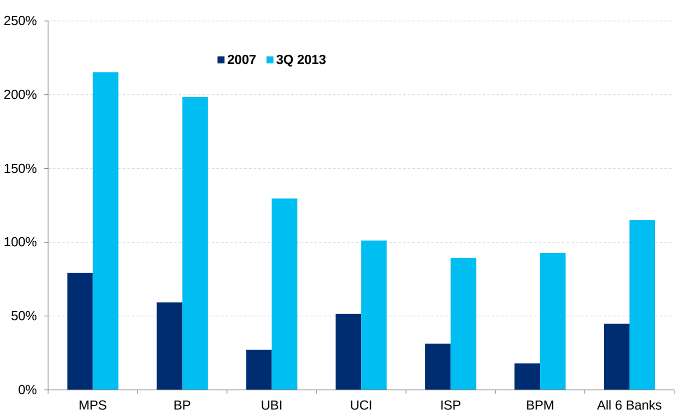
We have looked at the history of banks NPLs sale since 2007 (when the last wave of consolidation started) and those have always been pretty limited. This is the result of complex regulation, lack of securitization (vs the past), but also depends on the low coverage level and the bank approach in keeping NPLs to benefit of future recovery after the crisis period. This time, if macro improves and after AQR, given the capital and funding implication, banks could be more inclined in disposing NPLs. NPL disposal would be a clear signal that coverage is adequate and would provide confidence on banks asset quality conditions in our view.

The main positive could come from reducing risk profile of the bank, lower loan loss provisioning in the future, free up of capital for potential growth and better visibility on profitability trend of the core business. The banks that could have higher benefit from disposals of NPLs in term of market sentiment are the ones with higher NPLs ratio (MPS and BP, and also UCI on the Italian business).

There are limited recent evidences of NPLs disposals in the market possibly due to a difference between potential interested party offer price and bank carrying value of the NPLs, but following AQR and improving macro conditions, the difference over price could reduce. The last sizable transaction was a disposal of €9bn gross Sofferenze (covered at c80%) by Intesa in May 2005.

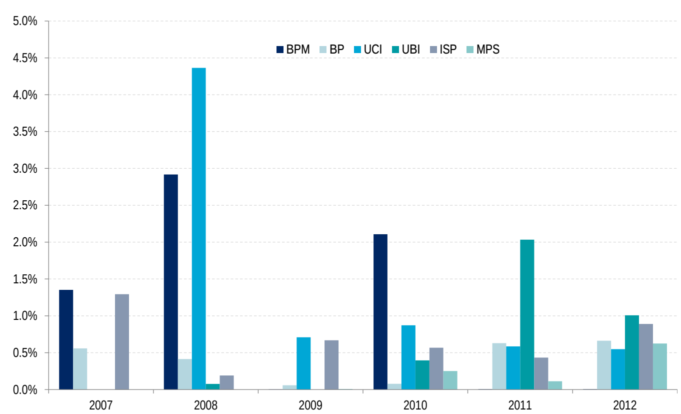
We have started to notice more interest in the market for Italian NPLs and also some banks have announced small transaction recently (UCI in December/February and MPS in January), but in most cases the disclosure of the deal is limited, and the portfolio included highly covered loans.

Figure 41. Italian Banks – Net Total NPLs on Tangible Equity



Source: Company data and Citi Research. MPS includes Monti Bond in Tangible Equity

Figure 42. Italian Banks – NPLs Sale as % of Loans



Source: Company data and Citi Research

Bank of Italy also flagging NPLs disposal an opportunity

In the most recent stability report, the Bank of Italy also indicated that the stock of NPLs will have to be reduced in the future and that in the past NPLs securitisation and sale of NPLs to non-bank credit recovery institution have been the main techniques to reduce them. Bank of Italy indicated that "securitisation market is impeded today by the difference between these assets' carrying value and what investors are willing to pay to acquire them" and the ongoing assessment as well as improvement of fiscal condition for the treatment of loan losses could be supportive for more NPLs sale. Also, Bank of Italy indicated that a speeding up of the credit recovery procedure would make a positive contribution.

Bad Bank an Option?

One additional option would be the creation of one or more bad bank in order to create a separate vehicle to which contribute the NPLs and then have more focus/transparency on the recovery process on the underlying profitability of the group core business. This option could bring benefit in term of capital allocation if a third party would step in the shareholding of the vehicle. Recent newspaper articles were mentioning that ISP could be looking at a bad bank option, and also UCI could be involved.

While awaiting for potential newsflow on this, the best case scenario for us would be the creation of a separated entity, with also third party shareholders (eg a distressed fund, or recovery specialist) completely segregated from the banking group and with a dedicated management team to work-out the NPLs or real estate portfolio allocated. In this case banks might have to accept a potential capital loss in the selling process, but there could be some capital relief as well as optimisation of the funding. In the event of a simple reclassification of the asset in a division, with no clear segregation, we believe the market would be less incline to give full benefit of the transaction. We have limited example of bad bank in Europe only including NPLs and privately funded/managed . In some countries the 'bad bank' was created for a specific institution, while other 'bad banks' have been made available to all financial institutions within the country and in UK or Germany there are some bad bank, but include also non core asset and not only NPLs portfolio.

2. Recovery can lower cost of risk

As acting on the stock of NPLs might not be the easier solution, banks could also focus on increasing the effort of recovering on NPLs, once macro conditions starts to improve again. Recovery represents a positive on cost of risk, and could represent an area of market focus once macro starts to improve more markedly.

Historical Analysis on Recovery

We have analysed the trend in recovery on NPLs for the last 10-15 year for the 6 commercial banks we cover (depending on the banks and on the available disclosure and run pro-forma calculations for recent merger where data were available).

We have looked at recovery both in terms of benefit on P&L (eg positive contribution to loans loss provision as % of loans) as they can represent a positive contribution to the bank ROTE. In term of P&L contribution, recoveries are running at the highest level, but this is also a consequence of the lower level of loans and higher level of gross cost of risk.

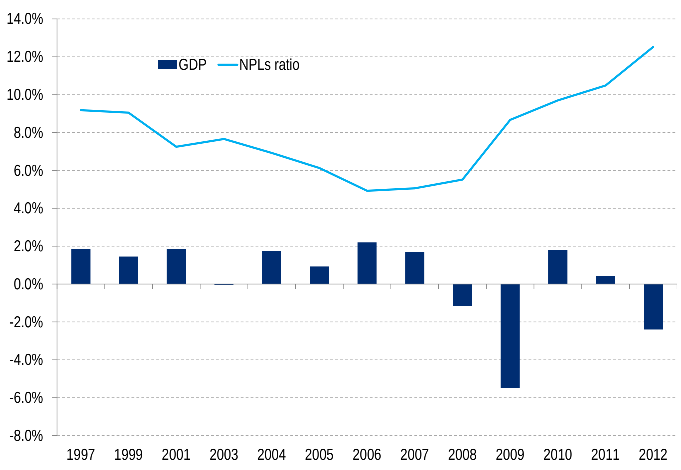
Figure 43. Italian Banks – Cost of Risk Breakdown

	1996	1997	1999	2001	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Gross Cost of Risk	-1.44%	-1.08%	-1.12%	-1.15%	-1.16%	-0.96%	-0.64%	-0.74%	-0.80%	-1.07%	-1.60%	-1.56%	-1.65%	-2.04%
Recovery	0.37%	0.36%	0.39%	0.32%	0.39%	0.38%	0.34%	0.32%	0.43%	0.43%	0.45%	0.63%	0.64%	0.60%
Others	-0.15%	-0.10%	-0.04%	-0.03%	-0.02%	0.01%	-0.17%	-0.02%	-0.10%	-0.04%	-0.03%	-0.05%	0.01%	-0.08%
Cost of Risk	-1.22%	-0.81%	-0.77%	-0.87%	-0.78%	-0.57%	-0.46%	-0.44%	-0.47%	-0.68%	-1.17%	-0.98%	-1.00%	-1.52%

Source: Company data and Citi Research

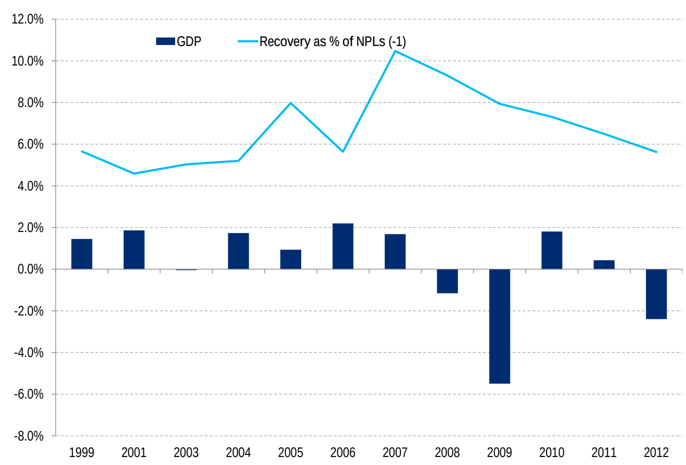
We have also looked at the development of recoveries vs the existing stock of NPLs, as this is in our view a better way to simulate the potential effect in the future, as level of recoveries depend on the level of coverage and the level of the NPLs stock. The current level (not surprisingly) is below the historical average level, given larger NPLs size, difficult macro backdrop and lower coverage. In our time series there is usually a c1 year of time lag from when recovery level start to pick up versus when GDP start to improve again. Also, we have noted that after any crisis the level of recoveries is above the peak level of the previous time.

Figure 44. Italy – NPLs Ratio and GDP



Source: Company data, Datastream and Citi Research

Figure 45. Italy – Recovery as % of NPLs (T-1) and GDP



Source: Company data, Datastream and Citi Research

If we simulate the level of recovery to realign to the average level, this could be a c15bp potential benefit on loan loss provisions vs historical level. If we were to align to the peak level or recoveries (adjusted by the lower level of coverage), the benefit on cost of risk could be c30bp, or circa a potential uplift of c2.5% on ROTE.

Figure 46. Italian Banks – Recovery as % of NPLs (T-1)

	2012 Recovery Rate	Average Recovery Rate	Peak Recovery Rate
Intesa Sanpaolo	5%	6%	9%
Unicredit	5%	7%	10%
MPS	3%	6%	9%
UBI	4%	5%	8%
BP	5%	5%	9%
BPM	3%	5%	7%
All	5%	6%	9%

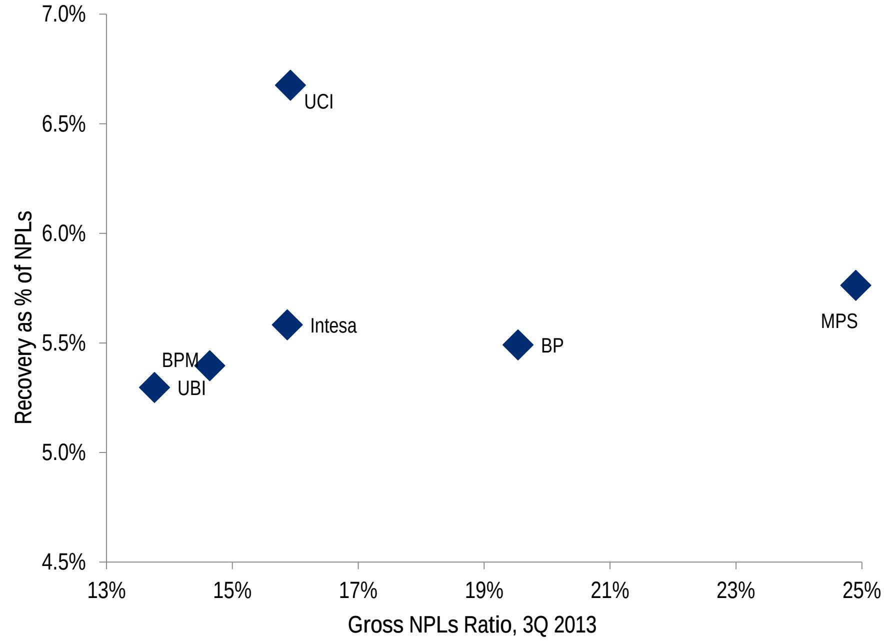
Source: Company data and Citi Research

UCI seems the bank more geared to recovery

In order to assess which banks could be better placed to benefit from recovery in the future, we need to look at the level of NPLs of the bank, its level of coverage (and compare to history) and the level of collateral.

Based on the level of current NPLs ratio and latest recovery disclosure, banks like UCI seems better placed to benefit from some recovery in the coming years.

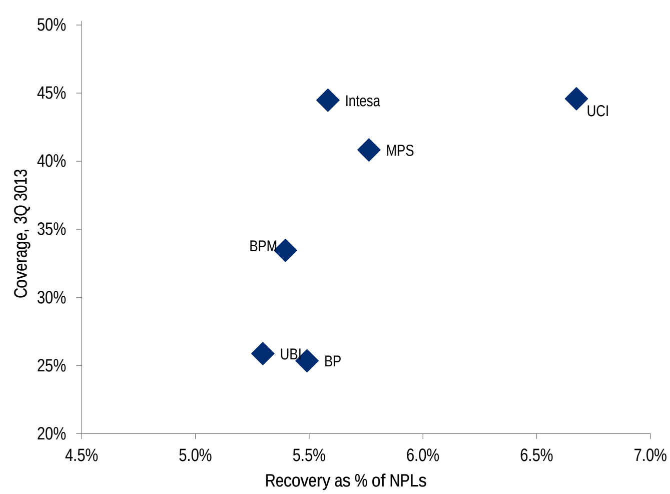
Figure 47. Italian Banks – Historical Recovery Ratio and Gross NPLs Ratio



Source: Company data and Citi Research

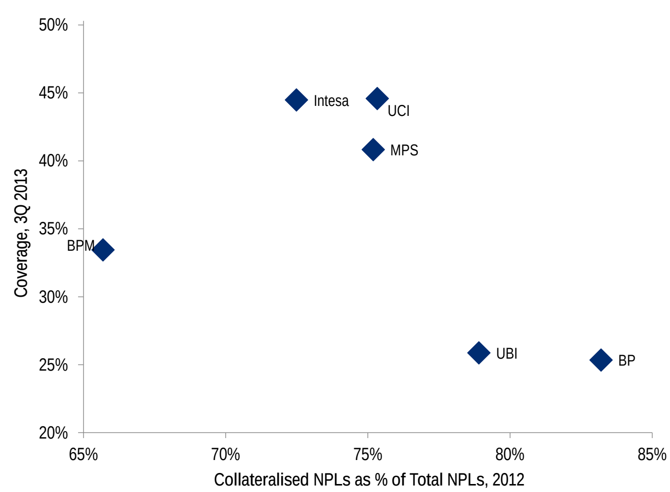
Popolari banks have lower stated coverage (also due to write off policy), but have among the highest level of collateralized loans, given also the loan breakdown.

Figure 48. Italian Banks – Recovery and Coverage



Source: Company data and Citi Research

Figure 49. Italian Banks – Coverage Ratio and Collateral



Source: Company data and Citi Research

Estimate and Target Price Changes

We have updated our estimates to account for higher loan loss provisions in 4Q 2013 to account for the potential effect of clean up ahead of pending asset quality review. We have updated our estimates for the most recent industry data in term of loan growth, interest rate and macro development. For UCI we have also accounted for the recent weakness in the currency, affecting its CEE franchise, mostly Turkey and Russia.

Figure 50. Italian Banks – Adjusted EPS Changes

	2013E	2014E	2015E	2016E	2017E
Unicredit	-9%	3%	3%	4%	5%
Intesa Sanpaolo	-21%	4%	15%	17%	13%
UBI	-12%	10%	8%	10%	6%
BPM	-7%	4%	4%	3%	2%
Average	-8%	4%	5%	6%	4%

Source: Citi Research

We have increased our target price for Intesa from €1.45 to €2.10 to account for the positive estimate revision and for the reduction in the cost of equity (from c12% to c11%).

We have increased our target price for UCI from €5.80 to €6.60 to account for the estimate revision and reduction of the cost of equity from (from c12% to c11%).

We have increased our target price for UBI from €4.70 to €5.80 to account for the estimate revision and reduction of the cost of equity from (from c11% to c10%).

Figure 51. Italian Banks – Target Price Change

	Old	New
Unicredit	5.80	6.60
Intesa Sanpaolo	1.45	2.10
MPS	0.15	0.15
Mediobanca	8.00	8.00
UBI	4.70	5.80
BP	na	na
BPM	0.45	0.45

Source: Citi Research

Company Section

UniCredit Group

Company description

Unicredit (UCI) is one of Italy's largest banking groups. It was created by the merger of Credito Italiano and Rolo Banca 1473 with regional banks in 1999. In the late 1990s, UCI started to grow in Eastern Europe. In 2005 UCI acquired HVB Group in Germany, including Bank Austria and CEE operations. In 2007 it bought Capitalia in Italy. UCI offers universal banking services (retail and corporate lending, asset management, private banking and investment banking) in Italy, Germany, Austria and CEE.

Investment strategy

We have a Buy/High Risk rating on Unicredit. Our positive view on the stock is based on: group ability to show improving profitability, mostly through improvement in cost of risk and the potential of cost cutting to be exploited in coming years as well as its ability to generate capital, and the opportunity to better allocate capital among the group. Management has a positive track record in addressing the main issues of the group during the crisis. UCI has above average risk on its balance sheet and business mix (IB exposure, Italy restructuring and CEE), but solid funding and upside potential from restructuring. Group profitability is low and could significantly benefit from a strong restructuring of the commercial banking operation with lower cost of risk and higher efficiency (mainly in Western Europe) and further action aimed at improving the asset quality. CEE is the main engine for growth and could further benefit from refocusing of the activities in different geography, but currency volatility could be a risk. We expect UCI to show a core tier 1 fully loaded Basel 3 at c9.6% in 2013 and while this is below 10%, the group has ability to generate capital organically and via potential disposals. Investor main concerns include the development of the capital and AQR and profitability.

Valuation

We have a €6.60 target price for UCI. In valuing UCI, we focus primarily on a DDM valuation, using a c11% cost of equity and a c9% 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 c0.8x price to tangible book valuation.

Risks

We have a High Risk rating on UCI. Asset quality development seems the main risk for group capital ratio level and profitability: several other key risks need to be considered as deteriorating macroeconomic conditions and sovereign volatility, credit rating agency action, political development in Italy, liquidity risk 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 in case of fear over EM profitability or in case of volatility over this downturn. 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. These risks could prevent the shares from achieving our target price.

Figure 52. Unicredit – Group Data by Year

€ m	2009	2010	2011	2012	2013E	% Chg	2014E	% Chg	2015E	% Chg	2016E	% chg	2017E	% Chg
GROUP P&L														
Net Interest Income	17,429	15,721	15,252	14,174	13,158	-7%	13,173	+0%	13,474	+2%	14,031	+3%	14,495	+3%
Dividends and other income	312	407	380	396	340	-14%	347	+2%	355	+2%	363	+2%	371	+2%
Net fees and commissions	7,655	8,455	8,048	7,738	7,880	+3%	8,161	+4%	8,487	+4%	8,731	+3%	8,982	+3%
Net trading income	1,803	1,053	1,099	2,808	2,516	nm	2,234	-11%	2,276	+2%	2,351	+3%	2,428	+3%
Net other expenses/income	373	438	233	253	342	nm	347	+1%	360	+4%	364	+1%	367	+1%
Total revenues	27,572	26,074	25,012	25,370	24,236	-4%	24,264	+0%	24,952	+3%	25,840	+4%	26,644	+3%
Staff expenses	-9,098	-9,205	-9,169	-8,916	-8,666	-3%	-8,447	-3%	-8,262	-2%	-8,149	-1%	-8,079	-1%
Other expenses	-4,945	-4,995	-5,136	-5,002	-4,866	-3%	-4,741	-3%	-4,612	-3%	-4,521	-2%	-4,441	-2%
Depreciation	-1,281	-1,124	-1,126	-1,054	-1,087	+3%	-1,083	-0%	-1,074	-1%	-1,066	-1%	-1,057	-1%
Total operating expenses	-15,324	-15,324	-15,431	-14,971	-14,619	-2%	-14,271	-2%	-13,949	-2%	-13,736	-2%	-13,577	-1%
Operating profit	12,248	10,750	9,581	10,399	9,618	-8%	9,993	+4%	11,003	+10%	12,104	+10%	13,067	+8%
Goodwill	0	-362	-8,677	-30	0	nm	0	nm	0	nm	0	nm	0	nm
Provisions for risks and charges	-609	-766	-718	-166	-590	nm	-587	-1%	-589	+0%	-594	+1%	-584	-2%
Loan Loss Provisions	-8,313	-6,892	-5,733	-9,448	-8,365	-11%	-5,755	-31%	-5,248	-9%	-4,812	-8%	-3,968	-18%
Net results on investments & securities	232	-36	-664	-192	1,715	nm	-25	nm	0	nm	0	nm	0	nm
Integration costs	-258	-282	-270	-277	-43	nm	0	nm	0	nm	0	nm	0	nm
Profit before tax	3,300	2,414	-6,483	287	2,334	nm	3,626	nm	5,167	+42%	6,698	+30%	8,514	+27%
Taxes	-1,009	-595	-1,414	1,539	-670	nm	-1,313	nm	-1,783	+36%	-2,311	+30%	-2,937	+27%
Profit (Loss) from Disc. Operations	0	0	-136	-168	14	nm	0	nm	0	nm	0	nm	0	nm
Net Profit	2,291	1,819	-8,032	1,658	1,679	+1%	2,313	nm	3,384	+46%	4,387	+30%	5,577	+27%
Minority interests	-332	-321	-365	-357	-378	+6%	-393	nm	-423	+8%	-526	+24%	-613	+17%
Net profit ex PPA	1,959	1,498	-8,397	1,300	1,300	+0%	1,920	nm	2,961	+54%	3,861	+30%	4,963	+29%
PPA	-257	-175	-809	-435	-392	-10%	-370	-6%	-350	-5%	-330	-6%	-310	-6%
Attributable profit	1,702	1,323	-9,205	866	908	+5%	1,550	nm	2,611	+68%	3,531	+35%	4,653	+32%
Adjusted attributable profit	1,977	1,110	1,648	1,609	1,023	-36%	1,936	nm	2,961	+53%	3,861	+30%	4,963	+29%
PER SHARE FIGURES														
EPS - basic (reported/reported)	0.67	0.45	-3.14	0.15	0.16	nm	0.27	nm	0.45	+68%	0.61	+35%	0.80	+32%
EPS - adjusted	0.78	0.38	0.56	0.28	0.18	nm	0.33	nm	0.51	+53%	0.67	+30%	0.86	+29%
Dividend per share (ordinary)	0.03	0.03	0.00	0.09	0.09	+0%	0.10	+15%	0.14	+35%	0.20	+40%	0.27	+40%
Book value per share (reported)	23.44	21.93	17.57	10.64	10.59	-0%	10.77	+2%	11.11	+3%	11.58	+4%	12.19	+5%
Tangible book value per share	15.39	14.95	13.62	8.62	8.57	-1%	8.75	+2%	9.10	+4%	9.57	+5%	10.18	+6%
Tangible book value (all Int) per share	13.30	13.19	12.26	7.93	7.91	-0%	8.09	+2%	8.44	+4%	8.91	+6%	9.51	+7%
OPERATING RATIOS		5.79%	2.89%											
Revenues on avg RWAs	5.71%	5.75%	5.47%	5.72%	5.91%		6.30%		6.71%		7.05%		7.24%	
Costs to assets ratio	1.65%	1.65%	1.69%	1.62%	1.65%		1.60%		1.54%		1.49%		1.45%	
Cost / income ratio	56%	59%	62%	59%	60%		59%		56%		53%		51%	
Provision charge / customer loans	1.47%	1.24%	1.03%	1.73%	1.59%		1.12%		1.02%		0.93%		0.76%	
Tax rate	31%	25%	-22%	-537%	29%		36%		35%		35%		35%	
RO Tangible Equity (adj / tangible all)	5.8%	2.9%	4.6%	3.5%	2.2%		4.1%		6.1%		7.5%		9.0%	
SHARES OUTSTANDING														
Fully diluted total number of shares (mn)	2,546	2,929	2,930	5,789	5,789	+0%	5,789	+0%	5,789	+0%	5,789	+0%	5,789	+0%
BALANCE SHEET ITEMS														
Total Assets	928,760	929,488	913,567	926,827	884,907	-5%	891,986	+1%	905,366	+2%	918,947	+2%	935,488	+2%
Net customer loans	564,986	555,653	555,946	547,144	525,064	-4%	515,918	-2%	511,984	-1%	517,769	+1%	523,943	+1%
Total customer deposits	596,396	583,239	557,448	579,965	562,032	-3%	572,463	+2%	583,837	+2%	595,487	+2%	607,419	+2%
Shareholders Equity	59,689	64,224	51,479	61,579	61,297	-0%	62,326	+2%	64,338	+3%	67,059	+4%	70,580	+5%
REGULATORY CAPITAL														
Risk-Weighted Assets	452,388	454,850	460,395	427,127	392,430	-8%	377,550	-4%	365,705	-3%	367,259	+0%	369,033	+0%
Tier 1 ratio	8.6%	9.5%	9.3%	11.4%	12.1%		13.0%		14.0%		14.7%		15.6%	
'Core" Tier 1 ratio	7.6%	8.6%	8.4%	10.8%	11.6%		12.3%		13.3%		14.1%		15.0%	
'Core" Tier 1 ratio (B3)					9.6%		10.4%		11.4%		12.2%		13.1%	
Total ratio	12.0%	12.7%	12.4%	14.5%	15.4%		16.4%		17.6%		18.3%		19.3%	

Source: Company Reports and Citi Research Estimates

Intesa Sanpaolo

Company description

In 2006, Banca Intesa merged with Sanpaolo IMI to create the largest bank in Italy. The group offers corporate and retail banking, investment banking, private banking, leasing, asset management and life insurance. The group has leading market share in lending (c17%) and saving (c18% in deposit, c25% in savings) in Italy. Banca Intesa was formed from the merger of Cariplo and Banco Ambrosiano Veneto (1998), and Banca Commerciale Italiana (1999). Sanpaolo was created from the merger of Istituto Bancario San Paolo di Torino and Istituto Mobiliare Italiano (1997), Banco di Napoli (2000) and Cardine (2001). Major shareholders include foundations (Compagnia di Sanpaolo 9.9%, Cariplo 4.7%, F Padova & Rovigo 4.9%, F Bologna 2.7%, Ente CR Firenze 3.4%), Credit Agricole 6.0%, Generali 5.1% and Carlo Tassara 2.5%.

Investment strategy

We have a Neutral/High Risk rating on ISP. The group benefits from strong market share, a solid liquidity and capital position as well as some further cost cutting potential and profitability recovery. The group's capital position looks solid and stronger than peers with a core tier 1 fully loaded t c11%. ISP has a new CEO (with a successful and long history as part of the group management team in different role) and the group will present a new business plan to the mark in March, this could be a potential positive catalyst. We are cautious on Italian banks asset quality given the large size of NPLs. The group operations are mostly in Italy (c90%) and The group has significant exposure to Italian sovereign debt this could add volatility based on Italy macro and political development. Trends in NII and provisions are key to assess profitability, we expect ROTE at c10% in 2017, above peers, but valuation is already at premium to peers.

Valuation

We have a €2.10 price target on ISP. We focus primarily on a DDM valuation, using a c11% cost of equity and a c10% sustainable tangible ROE. We cross-check this with a price-to-book methodology. At our target price, the stock would trade at c0.9x price to 2014 tangible book valuation, a premium to Italian banks given its stronger capital position. ISP has a defensive business model and cost-cutting potential, but the weak Italian economy, high sovereign exposure and low profitability could weigh on share price performance after the recent rally.

Risks

We have a High Risk rating on ISP. Among the potential risks for the stock that could prevent the achievement of our target price we would highlight: AQR clean up on asset quality, ECB interest rate moves; trend in Italian economy; deterioration of asset quality, development in the liquidity and sovereign conditions, trend in the group profitability. Among the fundamental risks that could cause the shares to deviate from our target price, key variables are credit quality, the sensitivity of net interest margins to base rates, and credit market rates and volumes.

Figure 53. Intesa Sanpaolo – Group Data By Year

€ m	2009	2010	2011	2012	2013E	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg	2017E	% Chg
GROUP P&L														
Net Interest Income	10,525	9,700	9,780	9,430	8,124	-10%	8,314	+2%	8,432	+1%	8,699	+2%	9,022	+3%
Dividends and income from equity inv	5	29	72	39	-38	nm	53	nm	54	nm	55	nm	56	nm
Net Commission Income	5,364	5,652	5,466	5,451	6,063	+11%	6,166	+2%	6,328	+3%	6,489	+3%	6,654	+3%
Trading Gains (Losses)	1,122	460	920	2,182	1,485	nm	1,301	nm	1,292	nm	1,303	nm	1,315	nm
Insurance Result	589	654	540	828	871	+5%	876	+1%	885	+1%	893	+1%	902	+1%
Other Net Operating Income	54	34	7	-49	54	nm	38	nm	42	nm	44	nm	45	nm
Total revenues	17,659	16,529	16,785	17,881	16,560	-7%	16,748	+1%	17,032	+2%	17,484	+3%	17,994	+3%
Staff expenses	-5,618	-5,528	-5,419	-5,338	-4,917	-8%	-4,868	-1%	-4,818	-1%	-4,798	-0%	-4,778	-0%
Other expenses	-3,224	-3,174	-3,080	-2,921	-2,762	-5%	-2,689	-3%	-2,637	-2%	-2,591	-2%	-2,560	-1%
Depreciation	-681	-602	-638	-654	-694	+6%	-693	-0%	-692	-0%	-691	-0%	-692	+0%
Total operating expenses	-9,523	-9,304	-9,137	-8,913	-8,373	-6%	-8,250	-1%	-8,148	-1%	-8,080	-1%	-8,030	-1%
Operating profit pre provisions	8,136	7,225	7,648	8,968	8,187	-9%	8,498	+4%	8,885	+5%	9,405	+6%	9,964	+6%
Goodwill Amortisation	0	0	-10,233	0	0	nm	0	nm	0	nm	0	nm	0	nm
Provisions for Risks and Charges	-298	-366	-218	-245	-192	-22%	-222	+16%	-222	-0%	-221	-0%	-220	-0%
Net Bad Debt Charges	-3,706	-3,170	-4,243	-4,714	-6,727	+43%	-4,231	-37%	-3,448	-19%	-3,024	-12%	-2,617	-13%
Net Writedowns on Fin. Fixed Assets	-240	-95	-1,069	-282	-427	nm	-192	nm	-17	nm	-17	nm	-17	nm
Gain (Loss) on HTM and Other Invest	545	273	-99	-117	2,457	nm	0	nm	0	nm	0	nm	0	nm
Profit before tax	4,437	3,867	-8,214	3,610	3,298	nm	3,853	nm	5,198	+35%	6,142	+18%	7,109	+16%
Taxes	-1,008	-1,372	910	-1,523	-1,146	nm	-1,662	nm	-2,183	+31%	-2,518	+15%	-2,844	+13%
Restructuring Charges / PPA	-599	-469	-873	-433	-347	nm	-340	nm	-305	nm	-295	nm	-285	nm
Gains (Loss) on Assets Due to be Disposed	169	694	0	0	0	nm	0	nm	0	nm	0	nm	0	nm
Net Profit	2,999	2,720	-8,177	1,654	1,805	nm	1,852	nm	2,710	+46%	3,329	+23%	3,981	+20%
Minority interests	-194	-16	-13	-49	-63	nm	-110	nm	-167	+52%	-192	+15%	-219	+14%
Attributable profit	2,805	2,703	-8,190	1,605	1,742	nm	1,742	nm	2,543	+46%	3,137	+23%	3,761	+20%
Adjusted attributable profit	2,206	2,285	2,021	1,528	28	nm	2,082	nm	2,848	+37%	3,432	+20%	4,046	+18%
PER SHARE FIGURES														
EPS - basic (reported/reported)	0.22	0.21	-0.50	0.10	0.11	nm	0.11	-0%	0.15	+46%	0.19	+23%	0.23	+20%
EPS - adjusted (adj earnings, dilution)	0.17	0.18	0.12	0.09	0.00	nm	0.13	nm	0.17	+37%	0.21	+20%	0.25	+18%
Dividend per share (ordinary)	0.08	0.08	0.05	0.05	0.05	+0%	0.07	+30%	0.09	+40%	0.13	+40%	0.18	+40%
Dividend per share (saving)	0.09	0.09	0.05	0.06	0.07	+10%	0.08	+22%	0.12	+44%	0.16	+39%	0.23	+37%
Special Dividend	0.00	0.00	0.00	0.00	0.00	nm	0.00	nm	0.00	nm	0.00	nm	0.00	nm
Book value per share (reported)	4.12	4.19	2.86	3.02	3.07	+2%	3.13	+2%	3.22	+3%	3.32	+3%	3.42	+3%
Tangible book value per share	2.65	2.69	2.33	2.49	2.54	+2%	2.60	+3%	2.69	+3%	2.79	+4%	2.89	+4%
Tangible book value (all Int) per share	2.10	2.15	1.94	2.12	2.17	+2%	2.24	+3%	2.33	+4%	2.42	+4%	2.52	+4%
OPERATING RATIOS														
Revenues on avg RWAs	4.74%	4.76%	5.11%	5.73%	5.84%		6.29%		6.43%		6.54%		6.66%	
Cost / income ratio	54%	56%	54%	50%	51%		49%		48%		46%		45%	
Costs on asset ratio	1.52%	1.42%	1.43%	1.32%	1.32%		1.33%		1.30%		1.28%		1.26%	
Provision charge / customer loans	0.99%	0.84%	1.13%	1.25%	1.95%		1.24%		1.00%		0.87%		0.74%	
Tax rate	23%	35%	11%	42%	35%		43%		42%		41%		40%	
Return on Equity (Adj / Tangible all)	8.2%	8.3%	6.3%	4.4%	0.1%		5.7%		7.5%		8.6%		9.8%	
SHARES OUTSTANDING														
Fully diluted total number of shares (mn)	12,782	12,782	16,427	16,434	16,434	+0%	16,434	+0%	16,434	+0%	16,434	+0%	16,434	+0%
BALANCE SHEET ITEMS														
Total Assets	624,844	657,025	639,221	673,472	633,370	-6%	622,031	-2%	626,385	+1%	632,649	+1%	639,608	+1%
Net customer loans	374,033	379,200	376,744	376,625	345,580	-8%	341,556	-1%	344,398	+1%	348,915	+1%	353,492	+1%
Total customer deposits	396,781	399,177	357,410	377,358	361,702	-4%	366,792	+1%	373,491	+2%	382,956	+3%	392,693	+3%
Shareholders Equity	52,681	53,533	47,040	49,613	50,377	+2%	51,481	+2%	52,940	+3%	54,557	+3%	56,190	+3%
REGULATORY CAPITAL														
Risk-Weighted Assets	361,648	332,200	325,206	298,619	268,404	-10%	263,888	-2%	265,644	+1%	268,758	+1%	271,911	+1%
Tier 1 ratio	8.4%	9.4%	11.5%	12.1%	12.7%		13.2%		13.5%		13.7%		13.9%	
'Core" Tier 1 ratio	7.1%	7.9%	10.1%	11.2%	11.6%		12.1%		12.4%		12.7%		12.9%	
'Core" Tier 1 ratio PF Basel 3				9.9%	10.9%		11.4%		11.7%		12.0%		12.2%	
Total ratio	11.8%	13.2%	14.3%	13.6%	14.6%		15.2%		15.5%		15.7%		15.9%	

Source: Company Reports and Citi Research Estimates

Mediobanca

Company description

Mediobanca was founded in 1946 by Comit, Credit and Banco di Roma to support and rebuild Italian industry through medium/long term lending and advisory services to corporates. Mediobanca's business has diversified over the years and now it has a unique positioning in Italy; it is a market leader in Italian investment banking (CIB accounts for c70% of total group RWAs) and consumer credit. Also, since 2008, it has developed a more traditional retail banking operation (CheBanca!) and is active in the private banking segment. Mediobanca has expanded its CIB activities abroad. The group also owns significant investment in Italian equity stakes, although its strategic plan targets a reduction of equity investments.

Investment strategy

We have a Buy/High Risk rating on Mediobanca. Mediobanca is focused on leveraging its CIB leadership position, strengthening its retail and asset management position, resizing its portfolio of holdings and improving its returns. We expect group ROTE to improve from 2% in 2013E (the trough level) to c9% in 2016E. The transformation story and market positioning are unique in the Italian banking space, and we see management's strategy as ideal for the company development. We are cautious on Italian banks, but believe that Mediobanca is different from the banks we are already cover given the potential improvement in ROTE from the uplift of profitability in CIB, the development of its retail offering (CheBanca! is still in a growth phase vs mature positioning for peers) and restructuring through the divestment of the equity stakes. Also, Mediobanca has better asset quality metrics than peers and lower exposure to the sovereign. We also believe that Mediobanca's investment case fits our 3 key themes (the "3 Rs") to be positive on banks: Return on/of capital; Restructuring and Regulation.

Valuation

We have a €8.0 target price for Mediobanca. In valuing Mediobanca, we focus on a SOTP valuation given its diversified business mix. We value the CIB business based on P/E methodologies, the retail business on P/BV, based on long term potential profitability, and the investment portfolio at current market valuation. We also cross check it with a dividend discount methodology (DDM), based on a c11% cost of equity and a c10% sustainable tangible ROE. At our target price, Mediobanca would trade at 0.9x 2014E P/tangible book value.

Risks

We have a High Risk rating on Mediobanca due to its business mix, the macro conditions and other company and industry specific factors. Among the major risks to our target price and forecasts, we highlight: weaker than expected Italian macroeconomic and sovereign development adding pressure on revenues and asset quality, funding pressure, political development in Italy, liquidity and capital regulatory risk; credit rating agency action, and slowdown in the market activity in the advisory and capital market business as well as in the trading activities. Also, among company specific risks, we note: pressure on the funding market, given the high level of bonds maturing in the next 2 years; weaker than expected implementation of the Generali business plan; slower than expected disposal of equity stakes; share price pressure from potential disposals of stake by key shareholders; and management risk in the case of top management leaving, thus risking implementation of the strategic plan.

Figure 54. Mediobanca – Group Data by Year

€ m	2009	2010	2011	2012	2013	2014E	% Chg	2015E	% Chg	2016E	% Chg
GROUP P&L											
Net Interest Income	861	917	1,070	1,070	1,028	1,084	+5%	1,106	+2%	1,167	+5%
Trading Gains (Losses)	422	354	189	267	169	126	-25%	228	+81%	284	+13%
Net Commission Income	512	534	520	484	410	398	+3%	455	+14%	516	+14%
Dividends and income from equity inv	-19	214	203	170	-10	254	nm	289	nm	277	nm
Total revenues	1,776	2,018	1,983	1,990	1,597	1,863	17%	2,079	+12%	2,244	+8%
Staff expenses	-370	-388	-419	-393	-384	-382	-0%	-396	+4%	-412	+4%
Other expenses	-360	-385	-405	-396	-373	-372	-0%	-372	-0%	-380	+2%
Depreciation	0	0	0	0	0	0	nm	0	nm	0	nm
Total operating expenses	-730	-773	-824	-789	-757	-754	0%	-768	+2%	-792	+3%
Operating profit pre provisions	1,046	1,245	1,159	1,201	840	1,108	32%	1,310	+18%	1,452	+11%
Goodwill Amortisation	0	0	0	0	0	0	nm	0	nm	0	nm
Gains (losses) on AFS, HTM and other	0	0	20	32	48	124	nm	17	nm	17	nm
Net Bad Debt Charges	-504	-517	-349	-468	-507	-590	+16%	-521	-12%	-516	-1%
Net Write downs on Fin. Fixed Assets	-451	-150	-275	-604	-404	-3	nm	-1	nm	-1	+0%
Other income (losses)	0	5	0	45	-5	0	nm	0	nm	0	nm
Profit before tax	91	583	554	206	-27	640	nm	805	+26%	952	+18%
Taxes	-89	-181	-181	-126	-157	-138	nm	-196	+43%	-242	+23%
Restructuring Charges / PPA	0	0	0	0	0	0	nm	0	nm	0	nm
Gains (Loss) on Assets Due to be Disposed	0	0	0	0	0	0	nm	0	nm	0	nm
Net Profit	2	402	374	80	-184	502	nm	609	+21%	710	+17%
Minority interests	1	-1	-5	1	4	0	nm	0	nm	0	nm
Attributable profit	2	401	369	81	-180	502	nm	608	+21%	709	+17%
Adjusted attributable profit	361	498	2,013	474	73	509	nm	609	+20%	710	+17%
PER SHARE FIGURES											
EPS - basic (reported/reported)	0.00	0.47	0.43	0.09	-0.21	0.58	nm	0.71	+21%	0.82	+17%
EPS - adjusted (adj earnings, dilution)	0.44	0.58	2.34	0.55	0.09	0.59	nm	0.71	+20%	0.82	+17%
Dividend per share (ordinary)	0.00	0.17	0.17	0.05	0.00	0.10	nm	0.17	70%	0.29	70%
Dividend per share (saving)	0.00	0.00	0.00	0.00	0.00	0.00	nm	0.00	nm	0.00	nm
Book value per share (reported)	6.96	7.82	8.03	7.55	7.94	8.61	8%	9.21	+7%	9.87	+7%
Tangible book value per share	6.51	7.39	7.60	7.12	7.52	8.18	9%	8.79	+7%	9.44	+7%
Tangible book value (all Int) per share	6.41	7.30	7.52	7.05	7.47	8.13	9%	8.74	+7%	9.39	+7%
OPERATING RATIOS											
Revenues on avg RWAs (B3)	3.37%	3.74%	3.60%	3.40%	2.69%	3.16%		3.59%		3.97%	
Cost / income ratio	41%	38%	42%	40%	47%	40%		37%		35%	
Costs on asset ratio	1.20%	1.24%	1.37%	1.24%	1.27%	1.18%		1.19%		1.22%	
Provision charge / customer loans	1.43%	1.53%	0.96%	1.29%	1.51%	1.82%		1.59%		1.53%	
Tax rate	98%	31%	33%	61%	nm	22%		27%		27%	
Return on Equity (Adj / Tangible all)	6.9%	7.9%	31.1%	7.8%	1.1%	7.3%		8.1%		8.8%	
SHARES OUTSTANDING											
Fully diluted total number of shares (mn)	820	861	861	861	861	861	0.0%	861	+0%	861	+0%
BALANCE SHEET ITEMS											
Total Assets	60,702	62,258	60,182	63,759	59,740	64,057	+7%	64,422	+1%	65,118	+1%
Net customer loans	35,233	33,702	36,226	36,310	33,455	32,430	-3%	33,108	+2%	34,224	+3%
Total customer deposits	6,213	9,561	9,960	11,634	11,874	13,766	3%	14,234	+3%	14,718	+3%
Shareholders Equity	5,706	6,731	6,913	6,500	6,841	7,411	8%	7,933	+7%	8,496	+7%
REGULATORY CAPITAL											
Tier 1 ratio	10.3%	11.1%	11.2%	11.5%	11.7%	12.4%		13.4%		14.5%	
'Core" Tier 1 ratio	10.3%	11.1%	11.2%	11.5%	11.7%	12.4%		13.4%		14.5%	
Risk-Weighted Assets	52,738	55,045	55,026	55,164	52,372	51,467	-2%	50,190	-2%	48,962	-2%
'Core" Tier 1 ratio PF Basel 3	10.3%	11.1%	11.2%	10.0%	10.2%	10.7%		11.7%		12.7%	
Total ratio	11.8%	14.3%	14.4%	14.2%	15.6%	16.5%		17.6%		18.9%	

Source: Company Reports and Citi Research Estimates

Banca Monte dei Paschi di Siena SpA

Company description

Monte dei Paschi di Siena is the world's oldest bank, mainly active in Tuscany and the Central and Northern regions of Italy. The bank offers retail as well as corporate banking services, plus private banking and asset management activities. The bank acquired Banca Antonveneta, strengthening its presence in the North East of Italy. MPS is majority owned by the Monte dei Paschi Foundation.

Investment strategy

We have a Sell/High Risk rating on MPS, given concern on the bank profitability, high execution risk in the bank's turnaround and dilution risk. Management's recently presented turnaround plan seems realistic as a strategy, but bears high execution risk and seem challenging on the revenue side. We are concerned about Italian asset quality, and MPS has a high stock of NPLs. The group is now pending a €3bn capital increase that should allow the partial reimbursement of the government support and will improve the quantity and quality of its capital in light of further regulatory requirement (eg Basel 3), but capital increase execution risk remain high, and capital level post capital increase will remain below peers. Liquidity seems to have been addressed with ECB support in the 3Y LTRO, but the market will likely continue to carefully monitor the bank's liquidity developments and LTRO reimbursements plan update, as well as the profitability of the core business and the effect of the decrease of the risk in the investment portfolio. The main risk and fundamental reason for being cautious on MPS are: low capital position, execution risk on capital increase/restructuring plan, high level of NPLs, low profitability, reliance on ECB, high level of sovereign bonds.

Valuation

We have a €0.15 target price for MPS. In valuing MPS, we focus primarily on a DDM valuation using a c110% cost of equity and a c6% sustainable tangible ROE. We cross-check this with a price-to-book methodology. On P/Tangible book, the stock at our target price would trade at c0.5x, reflecting the group lower level of profitability, capital position and execution risk in the restructuring process.

Risks

We have a High Risk rating on MPS shares. The share price could move on the back of newsflow on the development of regulatory views on capital and liquidity, as well as sovereign development, potential M&A activity and macroeconomic trends. Also, newsflows on the current investigation could add volatility to the share. The new restructuring plan represents a significant transformation for the banks and brings execution risk. Also, newsflow on deterioration of asset quality, development on asset disposal, cost cutting, funding, rating agency actions and liquidity are key for the stock. Among the fundamental risks that could cause the shares to deviate from our target price, key variables are credit quality, the sensitivity of net interest margins to base rates, and credit market rates and volumes. MPS activities are concentrated in Italy, so profitability could be affected by any deterioration in the Italian macro-economic environment.

If the impact from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our financial and price targets. However, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

Figure 55. MPS – Group Data by Year

€ m	2009	2010	2011	2012	2013E	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg	2017E	% Chg
GROUP P&L														
Net Interest Income (NII)	3,577	3,588	3,454	2,830	2,099	-26%	2,081	-1%	2,254	+8%	2,290	+2%	2,346	+2%
Net Commission Income	1,841	1,915	1,762	1,633	1,672	+2%	1,707	+2%	1,763	+3%	1,844	+5%	1,922	+4%
Dividends and Equity Investments Profits	110	92	71	75	119	+58%	105	nm	106	+1%	107	+1%	108	+1%
Gain (Loss) from Financial Transactions	66	-23	72	454	372	nm	310	nm	295	-5%	280	-5%	280	+0%
Other Revenues	-2	-1	-32	3	0	nm	1	+1%	1	+1%	1	+1%	1	+1%
Insurance Result	0	0	0	0	0	+0%	0	+0%	0	+0%	0	+0%	0	+0%
Total revenues	5,593	5,571	5,327	4,995	4,262	-15%	4,204	-1%	4,419	+5%	4,522	+2%	4,657	+3%
Personnel Costs	-2,300	-2,211	-2,132	-1,989	-1,805	-9%	-1,727	-4%	-1,685	-2%	-1,690	+0%	-1,695	+0%
Other Operating Expenses	-1,158	-1,045	-1,096	-1,108	-991	-11%	-842	-15%	-766	-9%	-720	-6%	-681	-5%
Tang. and Intang. Assets Depreciation	-162	-175	-193	-199	-172	-14%	-197	+15%	-199	+1%	-199	+0%	-199	+0%
Total operating expenses	-3,620	-3,431	-3,421	-3,296	-2,967	-10%	-2,766	-7%	-2,650	-4%	-2,609	-2%	-2,576	-1%
Operating profit pre provisions	1,972	2,140	1,906	1,699	1,295	-24%	1,438	+11%	1,769	+23%	1,913	+8%	2,081	+9%
Goodwill Impairment	0	0	-4,274	-1,654	0	nm	0	nm	0	nm	0	nm	0	nm
Provisions for Risks and Charges/ Others	-220	-193	-346	-326	-102	nm	-104	+2%	-102	-2%	-100	-2%	-97	-3%
Net Bad Debt Charges	-1,466	-1,156	-1,297	-2,672	-2,280	nm	-1,529	-33%	-1,304	-15%	-1,215	-7%	-1,038	-15%
Net Impairment Losses on Assets	-44	-39	-153	-223	-60	nm	-40	nm	-40	nm	-40	nm	-35	nm
Gain (Loss) from Disposal of Investments	40	734	10	-51	-32	nm	0	nm	0	nm	0	nm	0	nm
Integration Costs	-87	-20	-26	-311	-18	nm	-10	nm	0	nm	0	nm	0	nm
Profit before tax	195	1,467	-4,180	-3,537	-1,197	nm	-246	nm	323	nm	557	nm	911	nm
Taxes	-100	-393	-223	385	252	nm	-110	nm	-132	nm	-223	nm	-365	nm
Profit (Loss) from Discontinued Operations	265	23	-212	11	-194	nm	0	nm	0	nm	0	nm	0	nm
Net Profit	360	1,098	-4,615	-3,141	-1,139	nm	-356	nm	190	nm	334	nm	547	nm
Minority interests	-5	-2	4	22	0	nm	4	nm	-2	nm	-3	nm	-5	nm
PPA	-134	-111	-83	-50	-42	-17%	-40	-5%	-38	-5%	-36	-5%	-34	-5%
Net Attributable profit	221	985	-4,694	-3,170	-1,181	nm	-392	nm	151	nm	295	nm	507	nm
Adjusted Attributable Profit	119	468	174	-609	-338	nm	-346	nm	196	nm	360	nm	551	nm
PER SHARE FIGURES														
EPS - basic (reported/reported)	0.03	0.14	-0.40	-0.27	-0.10	nm	-0.02	nm	0.01	-138%	0.01	nm	0.02	nm
EPS - adjusted (adj earnings, dilution)	0.02	0.07	0.01	-0.05	-0.03	-45%	-0.02	nm	0.01	nm	0.01	nm	0.02	nm
Dividend per share (ordinary)	0.02	0.02	0.00	0.00	0.00	nm	0.00	nm	0.01	nm	0.01	nm	0.01	nm
Dividend per share (saving)	0.03	0.03	0.00	0.00	0.00	nm	0.01	nm	0.02	nm	0.01	nm	0.01	nm
Book value per share	2.49	2.49	0.85	0.55	0.52	-5%	0.33	-37%	0.34	+3%	0.34	+2%	0.36	+5%
Tangible book value per share	1.53	1.55	0.66	0.49	0.46	-6%	0.29	-36%	0.30	+3%	0.31	+2%	0.32	+5%
Tangible book value (all Int) per share	1.38	1.39	0.60	0.45	0.42	-7%	0.27	-34%	0.28	+3%	0.29	+2%	0.31	+6%
OPERATING RATIOS														
Revenues on avg RWAs	4.42%	4.84%	4.97%	5.05%	4.84%		5.14%		5.57%		5.74%		5.88%	
Cost to Assets ratio	1.61%	1.43%	1.42%	1.51%	1.46%		1.47%		1.45%		1.46%		1.45%	
Cost / income ratio	65%	62%	64%	66%	70%		66%		60%		58%		55%	
Provision charge / customer loans	0.98%	0.74%	0.88%	1.88%	1.70%		1.25%		1.10%		1.05%		0.91%	
Tax rate	51%	27%	-5%	11%	21%		-44%		41%		40%		40%	
Return on Tangible Equity (adj/ tan, all)	1.6%	6.1%	3.4%	-18.4%	-7.0%		-4.6%		2.5%		4.5%		6.6%	
SHARES OUTSTANDING														
Fully diluted total number of shares (mn)	6,900	6,899	11,681	11,682	11,682	+0%	27,471	+135%	27,471	+0%	27,471	+0%	27,471	+0%
BALANCE SHEET ITEMS														
Total Assets	224,815	239,162	240,702	218,882	203,833	-7%	188,545	-8%	182,889	-3%	179,231	-2%	177,439	-1%
Net Customer Loans	150,109	155,329	146,608	142,015	134,208	-5%	122,353	-9%	118,518	-3%	115,740	-2%	114,661	-1%
Customer Deposits	131,488	132,124	124,109	121,242	120,291	-1%	119,299	-1%	119,548	+0%	120,625	+1%	121,777	+1%
Shareholder Equity	17,175	17,156	9,964	6,396	6,048	-5%	8,957	+48%	9,208	+3%	9,389	+2%	9,840	+5%
REGULATORY CAPITAL														
Risk-Weighted Assets	120,899	109,238	105,189	92,828	83,447	-10%	80,109	-4%	78,667	-2%	78,982	+0%	79,337	+0%
Tier 1 ratio incl. Monti Bonds	7.5%	8.4%	11.1%	9.6%	11.7%		11.2%		11.5%		11.6%		12.1%	
Tier 1 ratio excl. Monti Bonds	5.9%	6.6%	9.3%	7.6%	6.8%		9.9%		10.5%		11.1%		12.1%	
'Core" Tier 1 ratio incl. Monti Bonds	7.0%	7.8%	9.5%	8.9%	11.0%		10.4%		10.7%		10.8%		11.4%	
'Core" Tier 1 ratio excl. Monti Bonds	5.4%	6.0%	7.7%	6.9%	6.1%		9.1%		9.8%		10.4%		11.4%	
Total ratio incl. Monti Bonds	11.9%	12.9%	15.7%	13.8%	16.5%		16.3%		16.8%		17.1%		17.8%	

Source: Company Reports and Citi Research Estimates

Unione Banche Italiane

Company description

UBI was created on 1 April 2007 from the merger of BPU and Banca Lombarda. BPU was formed from BP Bergamo (BPB) and BP Commercio Industria (BPCI) in 2003. Banca Lombarda was a local bank in northern Italy. Both banks were strongly based in their local area. UBI is the fifth-largest Italian banking group in terms of customer loans. UBI is the second largest 'Popolare' (cooperative) banking group in terms of branches in Italy. UBI is active in all major sectors, from household and corporate lending to asset management, life insurance and corporate advisory.

Investment strategy

We have a Neutral/High Risk rating on UBI. UBI has a solid balance sheet structure, a retail-based business model, and management has a conservative and credible track record. The capital position is comfortable and the group could have further benefit from the migration on Basel 2 advance of some part of its portfolio. We see more limited balance sheet risk for the bank in terms of asset quality vs peers, but it will remain under pressure for the next few years, given the need to cover new flows and also rebuild coverage ratio. Group profitability is expected to recover overtime, but the return should still remain low due to low level of interest rates and still-challenging asset quality conditions, despite investment on government bonds. The main positive could come from the successful implementation of further cost cutting measures and recovery in macro conditions in Italy.

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.

Figure 56. UBI Banca – Group Data by Year

€ m	2009	2010	2011	2012	2013E	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg	2017E	% Chg
GROUP P&L														
Net Interest Income (NII)	2,463	2,204	2,069	1,901	1,772	-7%	1,849	+2%	1,896	+3%	1,958	+3%	2,046	+4%
Dividends and Other Income	11	24	20	16	10	-34%	14	nm	17	+22%	21	+23%	26	+24%
Income (Loss) from Equity Investments	35	18	10	44	56	nm	59	nm	60	+1%	60	+1%	61	+1%
Net Commission Income	1,215	1,185	1,194	1,182	1,203	+2%	1,262	+5%	1,304	+3%	1,337	+3%	1,374	+3%
Gain (Loss) from Financial Transactions	127	34	7	257	213	nm	160	nm	163	+2%	166	+2%	170	+2%
Insurance Result	31	0	0	0	0	nm	0	nm	0	+0%	0	+0%	0	+0%
Other Net Operating Income	87	92	188	163	125	-23%	120	-4%	121	+1%	122	+1%	124	+1%
Total revenues	3,968	3,557	3,488	3,563	3,379	-5%	3,464	+3%	3,560	+3%	3,665	+3%	3,800	+4%
Staff costs	-1,466	-1,452	-1,423	-1,374	-1,298	-5%	-1,279	-1%	-1,266	-1%	-1,256	-1%	-1,246	-1%
Other expenses	-777	-770	-718	-702	-678	-3%	-665	-2%	-662	-1%	-658	-1%	-655	-1%
Depreciation	-171	-172	-179	-171	-163	-5%	-163	-0%	-163	-0%	-163	-0%	-163	-0%
Total operating expenses	-2,413	-2,394	-2,320	-2,247	-2,140	-5%	-2,107	-2%	-2,091	-1%	-2,077	-1%	-2,064	-1%
Operating profit pre provisions	1,555	1,164	1,168	1,317	1,240	-6%	1,357	+9%	1,469	+8%	1,588	+8%	1,737	+9%
Goodwill	0	0	-2,191	0	0	nm	0	nm	0	nm	0	nm	0	nm
Bad Debt Provisions	-865	-707	-607	-847	-932	+10%	-799	-14%	-735	-8%	-662	-10%	-585	-12%
Net Value Adj. to Fin. Assets	-49	-50	-135	-55	-27	nm	-24	nm	0	nm	0	nm	0	nm
Provisions for risks and charges	-37	-27	-32	-49	-28	nm	-31	nm	-31	+1%	-31	-1%	-31	-1%
Gain (Loss) from Sale of Investments	100	91	7	15	30	nm	0	nm	0	nm	0	nm	0	nm
Profit before tax	704	470	-1,789	380	282	nm	503	nm	703	+40%	894	+27%	1,121	+25%
Taxes	-296	-276	57	-139	-142	nm	-277	nm	-368	+33%	-456	+24%	-561	+23%
Integration Costs and PPA	-102	-82	-72	-138	-34	-75%	-35	+2%	-31	-11%	-27	-13%	-23	-15%
Profit (Loss) from Discont'd Operations	5	83	0	0	0	nm	0	nm	0	nm	0	nm	0	nm
Net Profit	311	196	-1,804	104	105	nm	192	nm	304	+58%	411	+36%	538	+31%
Minority interests	-41	-24	-38	-21	-19	nm	-23	nm	-39	+15%	-53	+15%	-70	+15%
Attributable profit	270	172	-1,842	83	86	nm	169	nm	264	+56%	358	+36%	468	+31%
Adjusted attributable profit	295	245	205	136	120	-12%	228	Nm	295	+30%	385	+30%	491	+28%
PER SHARE FIGURES														
EPS - basic	0.42	0.27	-2.04	0.09	0.10	nm	0.19	nm	0.29	+56%	0.40	+36%	0.52	+31%
EPS - adjusted FD	0.46	0.38	0.23	0.15	0.13	-12%	0.25	nm	0.33	+30%	0.43	+30%	0.54	+28%
Dividend per share (ordinary)	0.30	0.15	0.05	0.05	0.05	+5%	0.11	nm	0.18	+56%	0.22	+24%	0.26	+19%
Book value per share (reported FD)	17.9	17.3	9.9	10.8	11.1	+3%	11.3	+1%	11.5	+2%	11.7	+2%	12.0	+3%
Tangible book value per share FD	11.0	10.4	7.1	8.0	8.3	+4%	8.5	+2%	8.6	+2%	8.9	+3%	9.2	+3%
Tangible book value (all int) / share FD	9.2	8.7	6.6	7.5	7.9	+5%	8.0	+2%	8.2	+2%	8.4	+3%	8.7	+4%
OPERATING RATIOS														
Revenues on avg RWAs	4.52%	3.95%	3.76%	4.25%	4.92%		5.65%		5.71%		5.76%		5.85%	
Cost to asset ratio	1.97%	1.83%	1.79%	1.70%	1.69%		1.65%		1.63%		1.60%		1.58%	
Cost / income ratio	61%	67%	67%	63%	63%		61%		59%		57%		54%	
Provision charge / customer loans	0.88%	0.69%	0.61%	0.91%	1.05%		0.88%		0.80%		0.70%		0.60%	
Tax rate	42%	59%	nm	37%	51%		55%		52%		51%		50%	
Return on Equity (Adj / Tangible , All)	5.0%	4.4%	3.4%	2.0%	1.7%		3.1%		4.0%		5.1%		6.4%	
SHARES OUTSTANDING														
Fully diluted total number of shares (mn)	639	639	902	902	902	+0%	902	+0%	902	+0%	902	+0%	902	+0%
BALANCE SHEET ITEMS														
Total Assets	122,313	130,559	129,804	132,434	126,252	-5%	127,519	+1%	128,539	+1%	129,567	+1%	130,604	+1%
Net customer loans	98,007	101,815	99,690	92,888	88,948	-4%	90,693	+2%	92,507	+2%	94,634	+2%	97,473	+3%
Total Customer Deposits	97,214	106,760	102,809	98,818	93,073	-6%	96,005	+3%	98,768	+3%	101,620	+3%	104,565	+3%
Shareholder Equity	11,411	11,061	8,939	9,738	10,043	+3%	10,173	+1%	10,336	+2%	10,536	+2%	10,807	+3%
REGULATORY CAPITAL														
Risk-Weighted Assets	85,677	94,307	91,010	76,589	60,885	-21%	61,776	+1%	63,012	+2%	64,272	+2%	65,558	+2%
Tier 1 ratio	8.0%	7.5%	9.8%	10.8%	13.0%		13.1%		13.1%		13.2%		13.4%	
'Core" Tier 1 ratio	7.4%	7.0%	8.6%	10.3%	12.3%		12.5%		12.5%		12.6%		12.8%	
'Core" Tier 1 ratio B3					10.9%		11.0%		11.1%		11.2%		11.4%	
Total ratio	11.9%	11.2%	14.2%	15.9%	18.9%		18.9%		18.9%		19.0%		19.3%	

Source: Company Reports and Citi Research Estimates

Banco Popolare

Company description

Banco Popolare started trading on 1 July 2007, and was created by the merger of Banco Popolare Verona Novara (the bank originated by the merger of BP Verona and BP Novara in 2002) and Banca Popolare Italiana (a popolare bank created by the merger of several popolari banks). The group is a cooperative regional bank, active mainly in retail banking in the North/Centre of Italy and in asset management. BP is the second largest popolare bank in terms of loans.

Investment strategy

We have a Neutral rating on BP shares. BP has a lower than peers capital position and higher level of asset quality risk (high level of NPL and low stated coverage), and also has a pending capital increase to complete likely in 1H 2014. The recent announcement of a capital increase for €1.5bn represents a step to address the capital position and allow for higher provisions, addressing the main issue for the stock, but expected profitability remain a key debate, given also the reliance on LTRO benefit on NII. The integration of Italease and deteriorating asset quality in Italy resulted in a worsening of the asset quality metric, which is a key market focus, and driven high extraordinary provisions in 2013. The group seems to have a solid liquidity profile. Any reassurance on asset quality trend/coverage, further disposal of NPLs, disposals of non-core assets earlier than expected by the market are key market variable. Any further slippage in the asset quality could be a negative for the market. The market is also carefully monitoring the profitability recovery in the retail operations, mostly in the NII and commissions line, given the difficult macroeconomic outlook for Italy, as well as further cost cutting actions that could be implemented and any development at the consumer credit subsidiary.

Valuation

This company has a Neutral rating. We have not assigned a target price and therefore no valuation methodology is applicable.

Risks

Company-specific risks relate mainly to the group asset quality both at the bank network as well as at Italease), profitability and the group capital position. The stock also presents risks related to the integration and restructuring process at in the retail franchises. Among the main fundamental risks, we highlight: credit quality; sensitivity to ECB rates and credit market movements; rising cost of funding; the Italian macroeconomic environment; rating agency actions; margin pressure in lending; sovereign portfolio development in light also of sovereign spreads and developments in asset management. Also, any decision upon the conversion of the convertible bond or governance would affect the share price movements.

Figure 57. BP – Group Data by Year

€ m	2009	2010	2011	2012	2013E	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg	2017E	% Chg
GROUP P&L														
Net Interest Income (NII)	1,953	1,807	1,805	1,759	1,698	-3%	1,709	+1%	1,742	+2%	1,800	+3%	1,868	+4%
Dividends and Equity Investments Profits	104	39	-8	-67	-53	nm	21	-140%	22	+4%	23	+4%	24	+4%
Net Commission Income	1,211	1,264	1,272	1,364	1,427	+5%	1,463	+3%	1,484	+1%	1,518	+2%	1,559	+3%
Gain (Loss) from Financial Transactions	-84	539	697	-7	271	nm	202	nm	206	+2%	211	+2%	215	+2%
Other Operating Income	462	58	44	87	184	nm	175	-5%	177	+1%	178	+1%	180	+1%
Insurance Result	0	0	0	0	0	nm	0	nm	0	nm	0	nm	0	nm
Total revenues	3,646	3,707	3,810	3,137	3,527	+12%	3,571	+1%	3,631	+2%	3,730	+3%	3,846	+3%
Staff costs	-1,498	-1,535	-1,505	-1,395	-1,462	+5%	-1,375	-6%	-1,361	-1%	-1,362	+0%	-1,366	+0%
Other Operating Expenses	-761	-756	-744	-705	-683	-3%	-676	-1%	-674	-0%	-667	-1%	-660	-1%
Tang. and Intang. Assets Depreciation	-161	-147	-149	-161	-158	-2%	-157	-1%	-157	-0%	-157	+0%	-157	+0%
Total operating expenses	-2,419	-2,439	-2,398	-2,261	-2,303	+2%	-2,207	-4%	-2,192	-1%	-2,187	-0%	-2,184	-0%
Operating profit pre provisions	1,227	1,268	1,412	876	1,225	nm	1,364	+11%	1,439	+6%	1,544	+7%	1,662	+8%
Goodwill Impairment	-9	-1	-2,833	-443	95	nm	0	nm	0	nm	0	nm	0	nm
Provisions for Risks and Charges	-56	-236	-64	-13	-1	nm	-17	nm	-23	+39%	-23	+0%	-23	+0%
Net Bad Debt Charges	-740	-770	-749	-1,284	-1,707	nm	-802	-53%	-762	-5%	-726	-5%	-690	-5%
Net Impairment Losses on Assets	-32	-96	-93	-43	-167	nm	-30	nm	-25	nm	-20	nm	-20	nm
Gain (Loss) from Disposal of Investments	116	13	68	5	-4	nm	0	nm	0	nm	0	nm	0	nm
Profit Before Tax	506	177	-2,258	-902	-558	nm	515	nm	630	+22%	775	+23%	929	+20%
Taxes	-240	115	17	-22	-47	nm	-181	nm	-293	+61%	-348	+19%	-405	+16%
Profit (Loss) from Discontinued Operations	-8	38	12	-26	-1	nm	0	nm	0	nm	0	nm	0	nm
Restructuring/Integration costs and PPA	0	0	0	0	0	nm	1	nm	1	+0%	1	+0%	1	+0%
Net Profit	258	331	-2,229	-950	-605	nm	335	nm	338	+1%	428	+27%	525	+23%
Minority interests	9	-24	-19	5	-9	nm	-21	nm	-27	+28%	-33	+20%	-39	+18%
Net Attributable profit	267	307	-2,249	-945	-614	nm	314	nm	311	-1%	396	+27%	486	+23%
Adjusted attributable profit	184	-8	186	-205	-23	nm	207	nm	279	+35%	369	+32%	465	+26%
PER SHARE FIGURES														
EPS - basic	0.42	0.17	-1.28	-0.54	-0.35	nm	0.18	-151%	0.18	-1%	0.22	+27%	0.28	+23%
EPS - adjusted	0.29	0.00	0.11	-0.12	-0.01	nm	0.12	-991%	0.16	+35%	0.21	+32%	0.26	+26%
Dividend per share (ordinary)	0.08	0.05	0.00	0.00	0.00	nm	0.03	nm	0.05	+98%	0.08	+49%	0.10	+23%
Book value per share (reported)	18.01	6.52	5.12	4.88	4.59	-6%	4.77	+4%	4.92	+3%	5.09	+3%	5.28	+4%
Tangible book value per share	11.02	4.02	4.21	3.98	3.69	-7%	3.86	+5%	4.01	+4%	4.19	+4%	4.38	+5%
Tangible book value (all Int) per share	9.74	3.59	3.79	3.57	3.28	-8%	3.46	+5%	3.61	+4%	3.78	+5%	3.98	+5%
OPERATING RATIOS														
Revenues on avg RWAs	4.38%	3.95%	4.12%	4.32%	6.55%		6.82%		6.94%		7.04%		7.13%	
Cost to Asset ratio	1.78%	1.80%	1.79%	1.71%	1.77%		1.69%		1.67%		1.64%		1.61%	
Cost / income ratio	66%	66%	63%	72%	65%		62%		60%		59%		57%	
Provision charge / customer loans	0.78%	0.80%	0.80%	1.40%	1.93%		0.91%		0.86%		0.80%		0.75%	
Tax rate	47%	-65%	1%	-2%	nm		35%		47%		45%		44%	
Return on Equity (Adj / Tangible All)	2.9%	-0.1%	2.8%	-3.3%	-0.4%		3.4%		4.4%		5.5%		6.6%	
SHARES OUTSTANDING														
Fully diluted total number of shares (mn)	640	1,763	1,763	1,763	1,763	+0%	1,763	+0%	1,763	+0%	1,763	+0%	1,763	+0%
BALANCE SHEET ITEMS														
Total Assets	135,709	135,872	134,127	131,921	130,207	-1%	130,337	+0%	131,641	+1%	133,484	+1%	135,886	+2%
Net Customer Loans	95,350	96,468	93,394	91,481	88,374	-3%	87,923	-1%	88,801	+1%	90,187	+2%	92,098	+2%
Customer Deposits + FV	105,183	120,111	100,200	102,653	104,402	+2%	107,512	+3%	110,983	+3%	114,572	+3%	118,282	+3%
Shareholder Equity	11,533	11,499	9,037	8,612	8,090	-6%	8,404	+4%	8,668	+3%	8,970	+3%	9,318	+4%
REGULATORY CAPITAL														
Risk-Weighted Assets	92,623	94,878	90,034	55,105	52,626	-4%	52,100	-1%	52,621	+1%	53,357	+1%	54,585	+2%
Tier 1 ratio	6.2%	7.1%	8.3%	11.2%	10.2%		11.5%		11.6%		12.0%		12.2%	
"Core" Tier 1 ratio	4.7%	5.7%	7.1%	10.0%	9.4%		10.2%		10.4%		10.8%		11.0%	
Total ratio	9.2%	10.7%	11.7%	14.0%	11.4%		12.7%		12.9%		13.3%		13.4%	
Core Tier 1 PF capital increase					12.3%		13.1%		13.3%		13.6%		14.0%	
Core Tier 1 PF capital increase B3					9.4%		10.2%		10.4%		10.7%		11.1%	

Source: Company Reports and Citi Research Estimates

Banca Popolare di Milano

Company description

BP Milano is a popolare bank in Italy with a c2% market share. The franchise is concentrated in the North of Italy (with c66% of group branches in Lombardy). The group is active mainly in retail and corporate banking, and also asset management, bancassurance and investment banking services.

Investment strategy

We have a Neutral rating on BPM. The group has addressed the capital request and has also restructured its governance and management team. We see the pending review of governance (to be voted in the summer by the EGM) as a positive catalyst, as it could result in easier restructuring and potentially M&A. BPM has less operating leverage than peers to offset weakness in revenues, given its cost structure, but pending efforts on cost cutting could start to address this. Also recent results showed better trend than peers vs expectations. We see scope for BPM to further exploit restructuring on its cost base, ROE remains low and should remain below the cost of capital until 2015E. The cost of credit is an area of concern, given the weak macroeconomic conditions in Italy. The significant clean up in 4Q 2012 has resulted in significant increase in coverage ratio and improved BPM relative position vs peers. BPM has announced a capital increase of €500m to launch by October, and while further improving capital position will result in some dilution. Management actions on cost, governance and capital shows the commitment to have a clear discontinuity vs the past. The market focus is on cost cutting, governance review, revenues trends and asset quality, and also capital development.

Valuation

We have a €0.45 target price for BPM shares. We calculate the target price as a weighted average of the fair value (calculated with DDM) in the different scenarios. Under our favorable scenario we assume a marked governance improvement, and the stock fair value would be c€0.56 per share, in the less favorable scenario (eg no governance and profitability changes from current status) the fair value would be c€0.34. At our target price, the stock would trade at c0.4x price to tangible book valuation.

Risks

Among the main fundamental risks, we highlight: development of the asset quality and cost of risk; cost of funding; sensitivity to ECB and market rate rises; outcome of the group governance review; capital increase execution; the Italian macroeconomic environment; rating agency actions; sovereign risk; and margin pressure due to competition. Given the still high level of the cost/income ratio, any changes in revenue would be amplified at the EPS level due to the higher P&L gearing. Also any changes in capital and liquidity regulation could affect the stock. Any significant newsflow on Popolari regulation could impact the group. These risks could cause the stock price to deviate significantly from our target price.

Figure 58. BP Milano – Group Data By Year

€ m	2009	2010	2011	2012	2013E	% Chg	2014E	% Chg	2015E	% Chg	2016E	% Chg	2017E	% Chg
GROUP P&L														
Net Interest Income (NII)	886	733	825	859	842	-2%	852	+1%	853	+0%	887	+4%	920	+4%
Net Commission Income	568	611	523	496	544	+10%	555	+2%	567	+2%	581	+3%	593	+2%
Income (Loss) from Equity Investments	-1	0	-4	22	24	nm	25	nm	26	+2%	26	+2%	27	+2%
Dividend and Trading	294	86	-27	129	198	nm	117	nm	118	+1%	120	+1%	121	+1%
Other Net Operating Income	37	34	35	44	58	+31%	54	-6%	55	+1%	55	+1%	56	+1%
Insurance results	0	0	0	0	0	nm	0	nm	0	nm	0	nm	0	nm
Total revenues	1,784	1,464	1,352	1,550	1,665	nm	1,603	nm	1,618	+1%	1,669	+3%	1,717	+3%
Staff expenses	-831	-700	-651	-812	-632	-22%	-622	-2%	-610	-2%	-597	-2%	-589	-1%
Other expenses	-308	-320	-308	-299	-301	+1%	-287	-5%	-278	-3%	-270	-3%	-264	-2%
Depreciation	-77	-80	-86	-72	-72	+0%	-72	-1%	-72	+0%	-72	+0%	-72	+0%
Total operating expenses	-1,216	-1,100	-1,045	-1,183	-1,006	-15%	-981	-3%	-960	-2%	-939	-2%	-925	-2%
Operating profit pre provisions	568	364	307	367	659	nm	622	nm	658	+6%	729	+11%	792	+9%
Goodwill	0	0	-336	-367	0	nm	0	nm	0	nm	0	nm	0	nm
Bad Debt Provisions	-332	-245	-483	-566	-581	+3%	-340	-42%	-325	-4%	-317	-2%	-254	-20%
Provisions for risks and charges	-17	-11	-112	-32	-30	nm	-36	nm	-36	+1%	-37	+1%	-37	+1%
Net Value Adj. to Fin. Assets	0	55	-83	0	0	nm	0	nm	0	nm	0	nm	0	nm
Gain (Loss) from Sale of Investments	0	-178	0	0	15	nm	0	nm	0	nm	0	nm	0	nm
Profit before tax	219	-15	-707	-598	63	nm	246	nm	296	+20%	375	+27%	501	+33%
Taxes	-103	-87	67	163	-107	nm	-124	nm	-142	+14%	-176	+24%	-235	+33%
Profit (Loss) from Disc Operations	21	213	19	0	0	nm	0	nm	0	nm	0	nm	0	nm
Net Profit	138	111	-621	-435	-44	nm	122	nm	154	+26%	199	+29%	265	+33%
Minority interests	1	-5	7	5	0	nm	-2	nm	-3	+26%	-4	+29%	-5	+33%
Attributable profit	138	106	-614	-430	-44	nm	120	nm	151	+26%	195	+29%	260	+33%
Adjusted attributable profit	239	40	-122	-46	-22	nm	120	nm	151	+26%	195	+29%	260	+33%
PER SHARE FIGURES														
EPS - basic	0.33	0.26	-0.19	-0.13	-0.01	nm	0.04	nm	0.05	+26%	0.06	+29%	0.08	+33%
EPS - adjusted	0.57	0.10	-0.04	-0.01	-0.01	nm	0.04	nm	0.05	+26%	0.06	+29%	0.08	+33%
Dividend per share (ordinary)	0.10	0.10	0.00	0.00	0.00	nm	0.00	nm	0.02	+26%	0.03	+29%	0.04	+33%
Book value per share (reported)	9.38	9.26	1.24	1.23	1.06	-14%	1.10	+3%	1.14	+4%	1.18	+3%	1.24	+4%
Tangible book value per share	7.46	7.61	1.14	1.23	1.06	-14%	1.10	+3%	1.14	+4%	1.18	+3%	1.24	+4%
Tangible book value (all Int) per share	5.81	5.95	0.96	1.06	1.04	-2%	1.08	+4%	1.12	+4%	1.16	+3%	1.22	+5%
OPERATING RATIOS														
Revenues on avg RWAs	5.20%	4.11%	3.26%	3.48%	3.88%		3.79%		3.82%		3.87%		3.90%	
Cost to asset ratio	2.44%	2.04%	2.01%	2.25%	2.02%		2.05%		1.98%		1.91%		1.84%	
Cost / income ratio	68%	75%	77%	76%	60%		61%		59%		56%		54%	
Provision charge / customer loans	1.01%	0.69%	1.35%	1.63%	1.72%		1.01%		0.95%		0.90%		0.70%	
Tax rate	47%	-586%	9%	27%	170%		50%		48%		47%		47%	
RO Tangible Equity (Adj / Tangible, all)	9.9%	1.6%	-4.0%	-1.3%	-0.7%		3.4%		4.1%		5.2%		6.6%	
SHARES OUTSTANDING														
Fully diluted total number of shares	415	415	3,230	3,254	3,254	+0%	3,254	+0%	3,254	+0%	3,254	+0%	3,254	+0%
BALANCE SHEET ITEMS														
Total Assets	44,281	53,957	51,931	52,475	49,723	-5%	47,764	-4%	48,481	+2%	49,305	+2%	50,192	+2%
Net customer loans	32,852	35,537	35,686	34,791	33,740	-3%	33,741	+0%	34,247	+1%	35,274	+3%	36,333	+3%
Total customer deposits	34,174	35,888	34,031	37,521	36,481	-3%	37,188	+2%	38,118	+2%	39,167	+3%	40,247	+3%
Shareholder Equity	3,892	3,843	4,014	4,015	3,453	-14%	3,573	+3%	3,724	+4%	3,851	+3%	4,023	+4%
REGULATORY CAPITAL														
Risk-Weighted Assets	34,238	37,034	45,800	43,162	42,748	-1%	41,898	-2%	42,735	+2%	43,590	+2%	44,462	+2%
Tier 1 ratio incl. Tremonti Bonds	8.6%	7.5%	8.6%	9.0%	7.8%		8.2%		8.2%		8.3%		8.5%	
'Core" Tier 1 ratio inc. Tremonti Bonds	7.9%	6.8%	8.0%	8.4%	7.1%		7.6%		7.6%		7.7%		7.9%	
'Core" Tier 1 ratio post Cap Increase					8.3%		8.8%		8.8%		8.9%		9.0%	
'Core" T1 ratio post Cap Incr ex Add on					10.2%		10.8%		10.8%		10.9%		11.0%	

Source: Company Reports and Citi Research Estimates

Notes

Appendix A-1

Analyst Certification

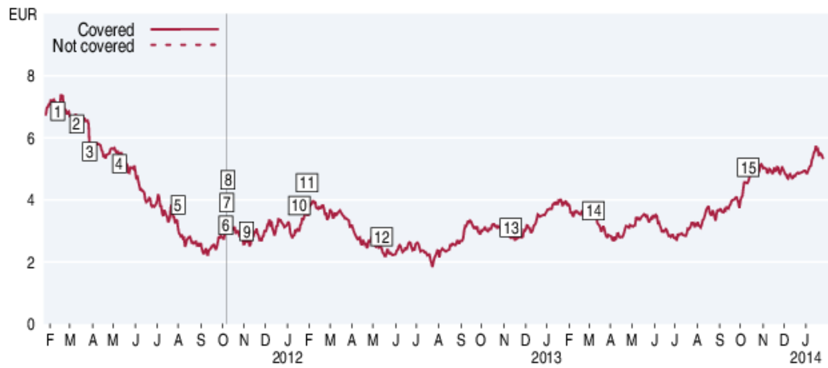
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Unione Banche Italiane (UBI.MI)

Ratings and Target Price History
Fundamental Research

Analyst: Azzurra Guelfi



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*2M	*7.77	6.98
2	10-Mar-11	2M	*7.49	6.64
3	29-Mar-11	2M	*6.27	5.64
4	10-May-11	2M	*5.90	5.51
5	1-Aug-11	*2S	*3.80	3.09

	Date	Rating	Target Price	Closing Price
6	6-Oct-11	2S	*3.00	2.99
7	7-Oct-11	Stock rating system changed		
8	8-Oct-11	*2H	3.00	2.96
9	4-Nov-11	2H	*2.85	2.66
10	18-Jan-12	2H	*3.20	2.99

	Date	Rating	Target Price	Closing Price
11	30-Jan-12	2H	*3.70	3.51
12	13-May-12	*2	-	2.50
13	12-Nov-12	*2H	*2.85	2.78
14	7-Mar-13	2H	*3.50	3.47
15	11-Oct-13	2H	*4.70	4.60

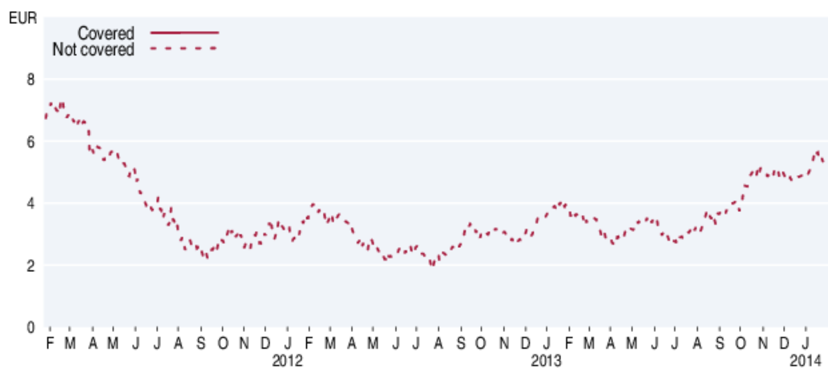
* Indicates change

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



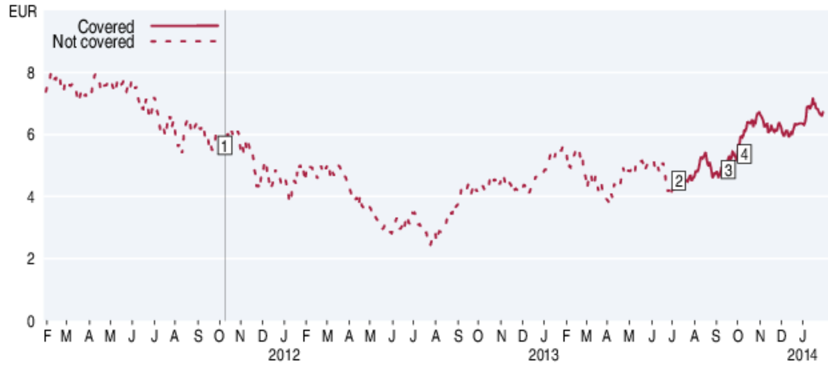
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Mediobanca (MDBI.MI)

Ratings and Target Price History
Fundamental Research

Analyst: Azzurra Guelfi
Covered since July 10 2013



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		
2	10-Jul-13	*1H	*5.60	4.47
3	18-Sep-13	1H	*6.00	5.25
4	10-Oct-13	1H	*7.20	6.15

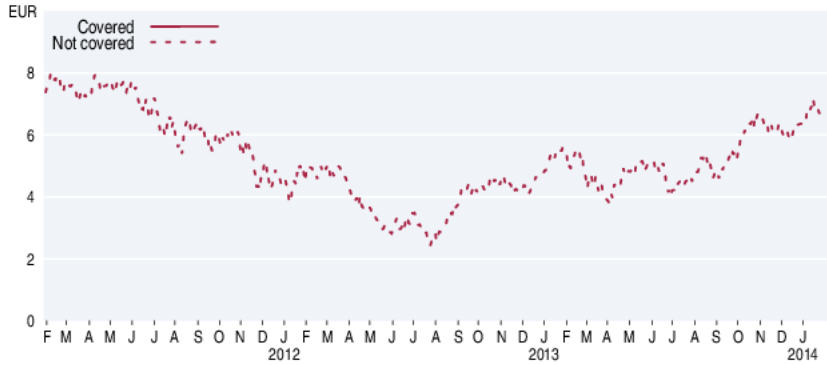
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Mediobanca (MDBI.MI)

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

Analyst: Azzurra Guelfi
Covered since July 10 2013



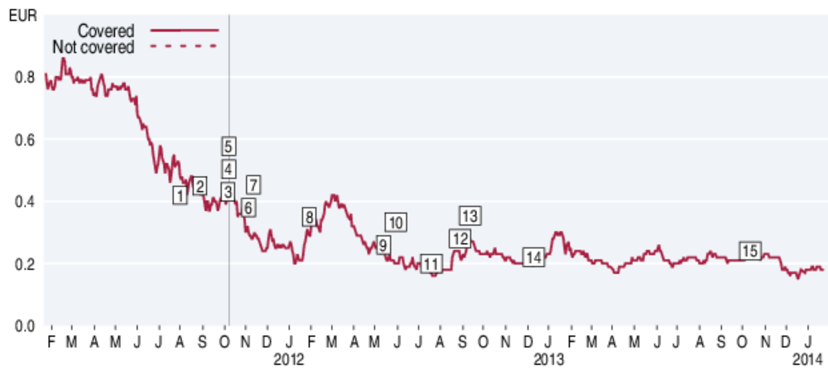
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Banca Monte dei Paschi di Siena SpA (BMPS.MI)

Ratings and Target Price History
Fundamental Research

Analyst: Azzurra Guelfi



	Date	Rating	Target Price	Closing Price
1	1-Aug-11	*2S	*0.60	0.48
2	29-Aug-11	2S	*0.54	0.43
3	6-Oct-11	2S	*0.45	0.42
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*2H	0.45	0.41
6	4-Nov-11	2H	*0.35	0.30
7	11-Nov-11	2H	*0.33	0.29
8	30-Jan-12	2H	*0.35	0.29
9	13-May-12	2H	*0.28	0.24
10	30-May-12	2H	*0.24	0.20
11	19-Jul-12	2H	*0.19	0.17
12	29-Aug-12	*3H	*0.17	0.22
13	12-Sep-12	3H	*0.19	0.28
14	11-Dec-12	3H	*0.17	0.20
15	11-Oct-13	3H	*0.19	0.23

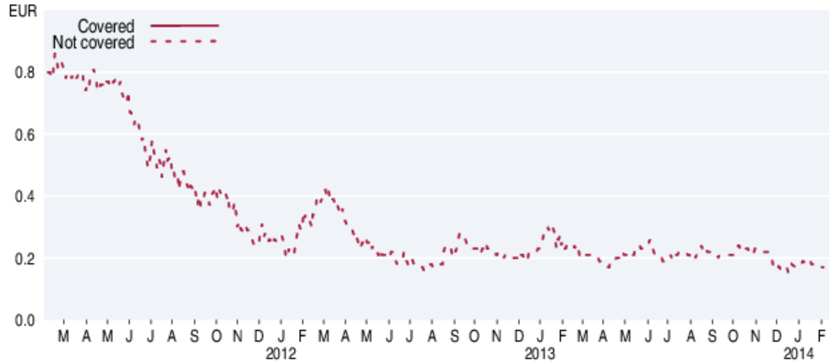
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Banca Monte dei Paschi di Siena SpA (BMPS.MI)

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

Analyst: Azzurra Guelfi



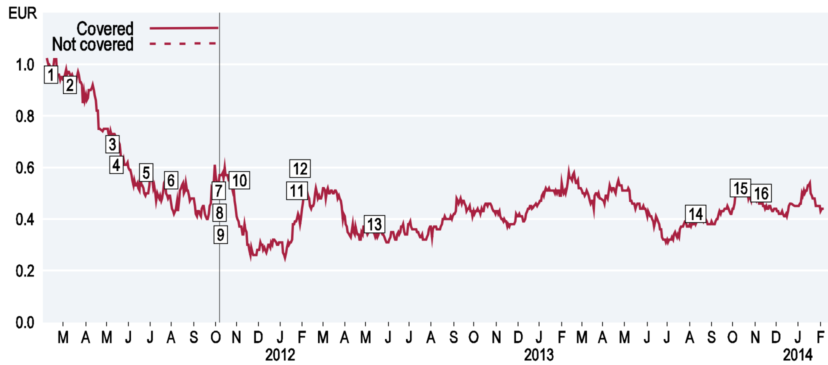
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Banca Popolare di Milano (PMII.MI)

Ratings and Target Price History
Fundamental Research

Analyst: Azzurra Guelfi



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	3H	*0.96	0.98
2	10-Mar-11	3H	*0.94	0.96
3	10-May-11	3H	*0.68	0.73
4	16-May-11	3H	*0.65	0.71
5	27-Jun-11	3H	*0.45	0.50
6	1-Aug-11	*3S	*0.42	0.46
7	6-Oct-11	3S	*0.49	0.54
8	7-Oct-11	Stock rating system changed		
9	8-Oct-11	*3H	0.49	0.57
10	4-Nov-11	3H	*0.35	0.37
11	25-Jan-12	*2H	*0.40	0.40
12	30-Jan-12	2H	*0.45	0.38
13	13-May-12	*2	-	0.35
14	9-Aug-13	2	*0.40	0.38
15	11-Oct-13	2	*0.51	0.50
16	11-Nov-13	2	*0.45	0.46

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Banca Popolare di Milano (PMII.MI)

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

Analyst: Azzurra Guelfi

	Date	Rating	Target Price	Closing Price
1	10-Nov-11	*ADD LP	-	0.34
2	12-Jan-12	*REM LP	-	0.31

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Intesa Sanpaolo (ISP.MI)

Ratings and Target Price History
Fundamental Research

Analyst: Azzurra Guelfi

	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*2M	*2.58	2.30
2	10-Mar-11	2M	*2.49	2.22
3	16-Mar-11	2M	*2.34	2.01
4	10-May-11	2M	*2.16	2.01
5	1-Aug-11	*2S	*1.90	1.49
6	6-Oct-11	2S	*1.30	1.24
7	7-Oct-11	Stock rating system changed		
8	8-Oct-11	*2H	1.30	1.28
9	18-Jan-12	2H	*1.45	1.28
10	30-Jan-12	2H	*1.60	1.42
11	16-Mar-12	2H	*1.70	1.56
12	13-May-12	2H	*1.30	1.07
13	15-May-12	2H	*1.15	0.98
14	19-Jul-12	2H	*1.05	1.00
15	12-Sep-12	*3H	*1.10	1.37
16	11-Oct-13	3H	*1.45	1.78

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Intesa Sanpaolo (ISP.MI)

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

Analyst: Azzurra Guelfi

	Date	Rating	Target Price	Closing Price
1	12-Jun-12	*ADD LP	-	0.99

* 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	11-Feb-11	2H	*13.17	12.27
2	10-May-11	2H	*12.51	10.93
3	1-Aug-11	*2S	*9.88	7.88
4	6-Oct-11	2S	*5.93	5.44
5	7-Oct-11	Stock rating system changed		
6	8-Oct-11	*2H	5.93	5.66
7	15-Nov-11	2H	*5.60	4.87
8	12-Jan-12	*1H	*4.00	2.90
9	30-Jan-12	1H	*4.65	3.56
10	28-Mar-12	1H	*4.85	3.99
11	8-May-12	1H	*4.00	2.79
12	19-Jul-12	1H	*3.50	2.63
13	12-Sep-12	*2H	*3.70	3.81
14	7-Aug-13	2H	*4.25	4.36
15	11-Oct-13	2H	*5.80	5.43

* Indicates change

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
3	2-Jul-12	*ADD MP	-	2.94
4	28-Aug-12	*REM MP	-	3.14

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

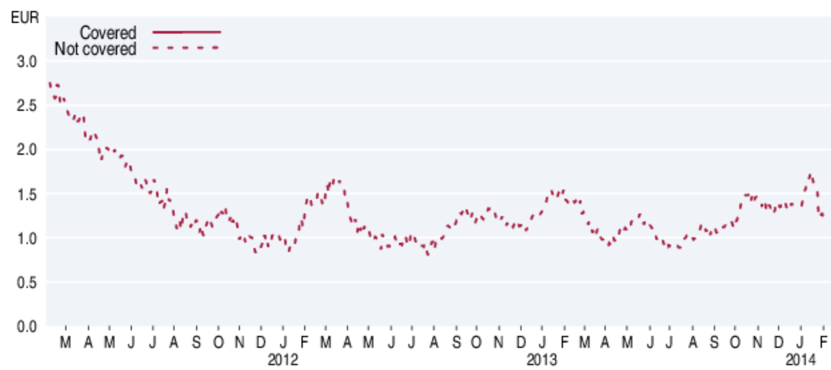
Banco Popolare (BAPO.MI)
Ratings and Target Price History
Fundamental Research
Analyst: Azzurra Guelfi

	Date	Rating	Target Price	Closing Price
1	11-Feb-11	2H	*2.75	2.60
2	10-Mar-11	2H	*2.60	2.39
3	10-May-11	2H	*2.20	2.00
4	1-Aug-11	*2S	*1.45	1.24
5	6-Oct-11	2S	*1.35	1.29
6	7-Oct-11	Stock rating system changed		
7	8-Oct-11	*2H	1.35	1.27
8	4-Nov-11	2H	*1.15	0.99
9	30-Jan-12	2H	*1.30	1.12
10	19-Mar-12	2H	*1.65	1.63
11	21-Mar-12	2H	*1.80	1.65
12	13-May-12	*2	-	1.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Banco Popolare (BAPO.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

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Data current as of 31 Dec 2013	Buy	Hold	Sell	Buy	Hold	Sell
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