UBS | Global Research | 20 October 2016

BPER

Conversion into joint-stock company and withdrawal rights

Equities

Italy
Banks, Ex-S&L

12-month rating	**Buy**
12m price target	**€4.85**
Price	**€4.26**

RIC: EMII.MI **BBG:** BPE IM

Trading data and key metrics

52-wk range	€7.76-2.58
Market cap.	€2.04bn/US$2.24bn
Shares o/s	480m (ORD)
Free float	98%
Avg. daily volume ('000)	6,105
Avg. daily value (m)	€21.2
Common s/h equity (12/16E)	€5.03bn
P/BV (12/16E)	0.4x
Tier 1 ratio	14%

EPS (UBS, diluted) (€)

	UBS	Cons.
12/16E	0.23	0.27
12/17E	0.39	0.47
12/18E	0.58	0.61

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EGM for the conversion to be held on 26th November

On Wednesday BPER called the EGM to approve the transformation from cooperative into a joint-stock company. The EGM will be held on 26th November. This is in line with the "*popolari*" banks reform, which imposed the transformation by the end of 2016. In our coverage Creval already called its EGM for the 28th October. These assemblies are called while both banks' shares enjoy a strong performance thanks to easing systemic concerns and (we believe misplaced) hopes of M&A. We continue to find the valuation of BPER and Creval attractive but see restructuring coming before consolidation.

BPER withdrawal rights price set at €3.807. Reduced risk of capital depletion

BPER has also communicated the price for the withdrawal rights (€3.807) based on the last six months' average price. This makes the rights currently c12% out-of-the-money, although the reference price will be the one after the EGM (see inside for details on the mechanics of withdrawal rights). We saw BPER as the most exposed bank to the risk of sub-optimal capital use through withdrawal (i.e. a buy-back at premium to the market) due to its abundant capital position, which would make it difficult to argue for full rights limitation. However the recent share performance should offer a partial offset.

Rally driven by easing systemic concerns and (misplaced) M&A hopes

Since our initiation last month, Buy-rated BPER and Creval are up 25%, while Neutral-rated Carige is -3% and Credem -2%. Easing of systemic concerns for Italian banks and hopes of M&A following the approval of Banco BPM merger are the main drivers of the positive performance, in our view. We find the optimism on M&A largely misplaced (at least in the short to medium term) as banks will first have to focus on standalone restructuring and balance sheet healing. However we still see potential upside on the names coming from self-help and a further potential normalisation of sentiment on Italian banks if the outcome of the two key risk events ahead (referendum and MPS restructuring plan) is favourable.

Valuation: attractive valuation, despite recent strong performance

BPER trades on 0.44x our P/TBV estimate for 2017 and 7.3x our P/E estimate for 2018. Our Gordon growth-driven price target of €4.85 is based on 5.9% our ROTE estimate for 2018 and 11% COE, with no value attached to excess capital.

Highlights (€m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	2,247	2,217	2,371	2,065	2,067	2,107	2,146	2,184
Profit before tax	67	58	214	162	294	437	541	634
Net earnings (local GAAP)	7	15	221	112	188	279	346	406
Net earnings (UBS)	13	15	55	112	188	279	346	406
Tier 1 ratio %	9.2	10.9	11.3	14.3	14.3	14.5	14.8	15.3
EPS (UBS, diluted) (€)	0.04	0.03	0.12	0.23	0.39	0.58	0.72	0.85
Profitability/valuation	**12/13**	**12/14**	**12/15**	**12/16E**	**12/17E**	**12/18E**	**12/19E**	**12/20E**
ROE (UBS) %	0.3	0.3	1.1	2.2	3.7	5.3	6.3	7.1
P/PPOP (diluted)	2.0	2.9	3.2	2.5	2.5	2.3	2.2	2.1
P/BV x	0.5	0.7	0.7	0.4	0.4	0.4	0.4	0.3
P/BV (UBS) x	0.6	0.7	0.8	0.5	0.4	0.4	0.4	0.4
P/E (UBS, diluted)	NM	NM	64.3	18.3	10.8	7.3	5.9	5.0
Net dividend yield %	0.0	0.3	1.3	2.2	3.7	5.5	6.8	7.9

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of €4.26 on 19 Oct 2016 19:35 BST

UBS Research THESIS MAP a guide to our thinking and what's where in this report

PIVOTAL QUESTIONS

Q: How will BPER use its excess capital?

Unclear, at this stage. Following the c300bps capital benefit of IRB adoption in 2Q16, the bank has not given any indication as to its intentions. We think the main options are likely two: deploying capital to take a more aggressive stance on NPLs, or using capital for inorganic growth through M&A. While the latter is a distinct possibility, we would favour the former given, among other reasons, the bank's high NPLs ratio (c24% gross).

"Risks selectively skewed to the upside – Buy Creval (top pick) and BPER" 19/09/2016→

Q: Is the potential exercise of withdrawal rights a risk to excess capital?

Less than we initially thought, if the shares do not suffer a significant sell-off before the EGM. In fact, withdrawal rights are currently c12% out-of-the-money. This should mitigate the risk we saw of BPER being most exposed to a sub-optimal capital use through withdrawal (a buy-back at premium to the market) due to its abundant capital position, which would make full limitations of the rights difficult.

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Q: Will 2016E prove the bottom for BPER's NII?

Yes, but we expect it to remain flat YoY in 2017E. BPER has suffered less than peers the reduced contribution of the ALCO portfolio, given the smaller size and longer duration. However, it suffered a large compression of the loan yield (c85bps in the last two years, we estimate), which we expect to slow in 2017E (-15bps YoY) and fade in 2018E. This, combined with improving cost of funding, mostly on bonds, should see NII bottom in 2016E and remain fairly stable in 2017E.

"Risks selectively skewed to the upside – Buy Creval (top pick) and BPER" 19/09/2016→

UBS VIEW

Following IRB models approval, BPER is the best-capitalised bank in Italy (14.1% CETR FL). This capital should offer a buffer to face potential systemic risk, unless it is used to fund inorganic growth. Even without additional restructuring, we forecast a 5.9% 2018E ROTE for a 0.44x P/TBV17E.

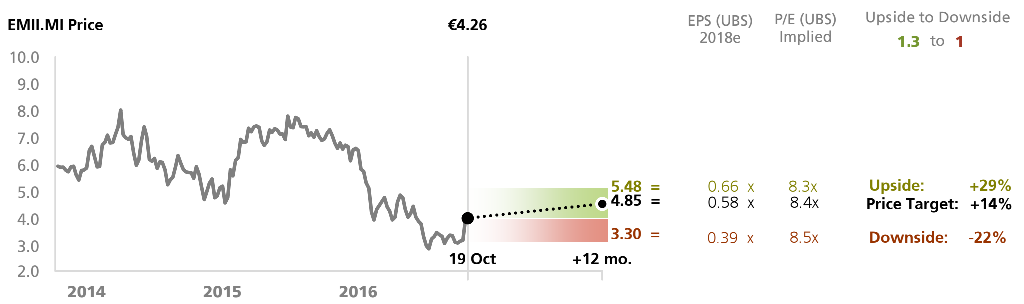
EVIDENCE

We have undertaken detailed modelling of the bank's capital and asset quality, and analysis of the company's costs structure and drivers.

WHAT'S PRICED IN?

The current share price reflects elevated asset quality concerns while attaching modest value to the bank's abundant excess capital, in our view. Moreover, the valuation also appears to discount some fears of capital being deployed in a sub-optimal fashion, e.g. in value-eroding M&A.

UPSIDE / DOWNSIDE SPECTRUM



Value drivers	AUM 2016-18E CAGR (%)	NIM 2018E (%)	CoR 2018E (%)	Adjusted 2018E net income (€m)
€5.48 upside	7.7%	1.87%	0.65%	315
€4.85 base	5.1%	1.87%	0.73%	279
€3.30 downside	2.6%	1.82%	0.90%	188

Source: UBS

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COMPANY DESCRIPTION

BPER is the seventh-largest Italian bank, with a lending market share of c2%. BPER focuses on commercial and retail banking, and has a strong presence in its home region of Emilia...

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PIVOTAL QUESTIONS

return ↑

Q: Is the potential exercise of withdrawal rights a risk to excess capital?

UBS VIEW

Less than we initially thought, if the shares do not suffer a significant sell-off before the EGM on 26th November. In fact, the withdrawal rights are currently c12% out-of-the-money. We saw BPER as the most exposed bank to the risk of sub-optimal capital use through withdrawal (effectively a buy-back at premium to the market) due to its abundant capital position, which would make it difficult to argue for full rights limitation. However, if rights do not get significantly in-the-money, a sizable request to exercise withdrawal rights is unlikely. Even in the case of rights being exercised, we highlight that the capital used to meet withdrawal requests would not be fully eroded but rather returned to shareholders effectively via a buy-back, but only likely to happen at an above-market price.

EVIDENCE

We have reviewed in detail the mechanics, rules and terms of withdrawal rights considering the potential limitations allowed by the "*popolari*" banks reform. We have also reviewed the relevant precedents of other banks that already held their EGM to convert into joint-stock companies.

WHAT'S PRICED IN?

Thanks to the recent positive share performance, which made rights currently out-of-the-money, the market is now less concerned about the risk of capital being depleted by an off-market buy-back.

Focus on withdrawal rights

On Wednesday BPER called the EGM to approve the transformation from cooperative into a joint-stock company. The assembly will be held on 26th November. This is a consequence of the "*popolari*" banks reform implemented in 2015 that forces all "*popolari*" banks to become joint-stock companies by the end of 2016. In our coverage, Creval already called its EGM for the 28th October.

Given that the transformation changes the legal nature of the company from cooperative into joint-stock company, the law envisages that all shareholders that do not vote in favour of the transformation can exercise their withdrawal rights ("*diritti di recesso*" in Italian), in which event they can ask for their shares to be bought back at a pre-agreed price.

Why is it important?

There are two reasons why we think withdrawal rights, despite being a rather technical point, are significant, and investors should keep an eye on them:

(1) **It may lead to excess capital being paid out** to the shareholders exercising withdrawal rights. **This can almost be considered a sort of buy-back but with the risk, described below, of the shares being bought above market**.

More generally, for most of the banks facing this risk (including BPER), returning capital to shareholders when it could be used for self-help, driving restructuring, is neither optimal nor desirable, in our view.

(2) **It might affect the technicals** of the shares should investors that have exercised their rights have to hedge their position if the risk of rights being limited increases.

How does it work?

The transformation into joint-stock company is voted on by a general assembly. In the event of a vote in favour of transformation the company files a transformation resolution with the local company house, from which point shareholders have 15 days to exercise their withdrawal rights. From that moment the **shares become unavailable** until payment is received by the shareholder or the shares are returned in the event rights were limited. This process might take **up to six months,** as before cancelling the shares (or repurchasing them) the company will offer them first to existing shareholders and, failing that, to the market.

By the time of the assembly, each bank must have communicated the two essential components of the withdrawal rights to its shareholders:

(1) **Withdrawal price**: this is the average price during the six months prior to the convocation of the assembly that determines the conversion into joint stock company (typically 30 days before the assembly itself), according to the Italian civil code. In the case of BPER this price is €3.807.

(2) **Withdrawal limitations conditions**: the board can limit or postpone the repayment linked to the exercise of the rights, in view of the "prudential situation" of the bank and in particular its financial situation, liquidity, solvency and capital requirements[1]. Moreover any repayment needs to be approved by the regulator.

The wording of the legislation and of the Bank of Italy circular leaves room for flexibility regarding the limitations the banks can impose. Given this flexibility we thought that BPER could be one of the few banks that might have to (at least partially) meet requests of withdrawal. In fact due to a very large excess capital we think it will likely find it more difficult to argue for a limitation on the grounds of "prudence". This was indeed confirmed on Wednesday, as the bank disclosed the methodology it will use.

BPER has agreed to buy back shares as long as this does not bring its CET1 ratio fully loaded below the aggregated CET1 ratio of the banks regulated by the SSM, as disclosed by the regulator[2].

According to the latest available data, BPER fully loaded ratio was 14.13% (June 2016), while the aggregated CET1 ratio for the banks regulated by the SSM was 13.52% (December 2015). Therefore, in theory and using the latest reported RWAs, BPER could buy back shares for c€192m or, using the withdrawal rights price, 50m shares (c10% of outstanding shares). This kind of buy back, while not the best use of capital in our view given the bank's asset quality, would be

[1] Bank of Italy: Circular n.285 of 17th December 2013, Update n. 9 of 9th June 2015.
[2] While the SSM does not disclose whether the aggregated ratio it publishes is fully loaded or phased-in, given the latter is the official regulatory ratio we think the ratio BPER will be using to compare its fully-loaded ratio is actually phased-in.

significantly EPS accretive nonetheless. This is a clear mitigating factor for the depletion of capital.

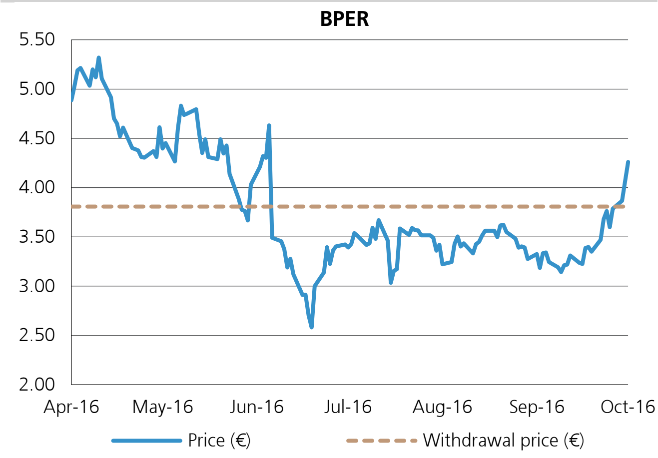
However, the actual amount of shares that the bank will be in a position to buy back can change over the coming months. In fact, following the auction processes discussed above, the bank will determine the amount of capital usable for the buy-back by referring to the latest figures available for both the quantities above (possibly even publishing an *ad-hoc* CET1 ratio outside of the usual reporting dates). For a recent example of how significantly things can change between announcement and exercise of rights, we refer the reader to the case of UBI, reviewed below.

It is also interesting to note that, among other more generic reasons, of why the capital ratio might decrease in the coming months BPER has identified the focus of markets and regulators on asset quality. While this is only a possibility flagged by the bank, a more aggressive stance on NPLs should be welcomed by the market, in our view.

Partially offsetting the likely inability of BPER to fully limit rights exercises is the fact that currently the shares are trading at a c12% premium versus the withdrawal rights price (see Figure 1). For the time being this makes the rights out-of-the-money. However, as described above, what will matter for the exercise of rights is the price immediately before and after the EGM.

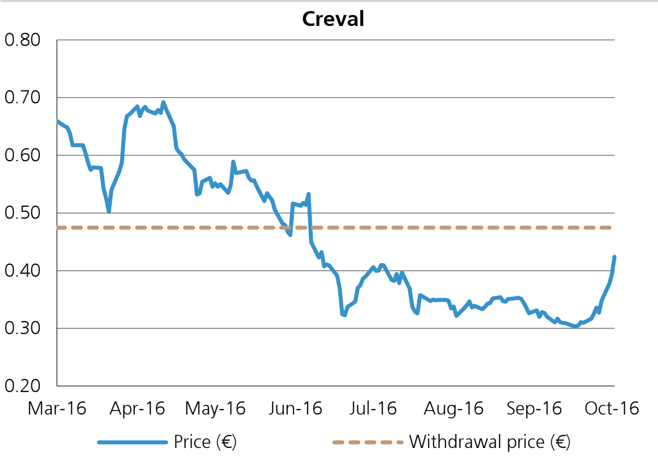
Also in our coverage, Creval rights are in the money (Figure 2), but the company has already informed shareholders that in order to preserve its capital position it will fully limit the rights by not repurchasing any share.

Figure 1: BPER shares are now above the exercise price of the withdrawal rights….



Source: Datastream, Company data and UBS

Figure 2: … while Creval rights are theoretically in the money, but the bank will not buy back any share



Source: Datastream, Company data and UBS

Looking at precedents

As a reference point, we think readers might be interested in the recent precedents of banks that went through the conversion process recently. So far, UBI, Veneto Banca, B.P. di Vicenza, BPM and Banco Popolare have held the EGM to convert from "*popolari*" into joint-stock companies. B.P di Vicenza and Veneto Banca did so when in breach of their capital requirements, and therefore were not in a position to accommodate any withdrawal rights request. BPM and Banco Popolare's EGMs approved the conversion into joint-stock company at the same time as approving their merger, therefore a decision on the potential limitation of

withdrawal rights has been left to the board of the new company. It is then the case of UBI the only one that can give some information regarding the possibility of partial limitation of withdrawal rights.

More in detail, and slightly differently from BPER, UBI determined the limitation to the withdrawal rights by deciding to pay only the excess of its fully-loaded CET1 ratio versus the following quantity ("barrier"):

$$\frac{(SREP + 150bps) + Average\ CET1\ SSM\ banks}{2}$$

where 150bps according to the company was "an estimated prudential assessment of the margin needed to withstand both growth in lending and potential market shocks", i.e. a management buffer. "Average CET1 SSM banks" was the European average CET1 ratio recorded by the ECB with reference to banks subject to the SSM, which in December 2015 stood at 13.5% (up from 12.5% a year earlier, used by UBI). This is the quantity used by BPER as well, and also in this case this ratio is likely on a phased-in basis while it was compared to the bank's fully-loaded ratio (lower than phase-in).

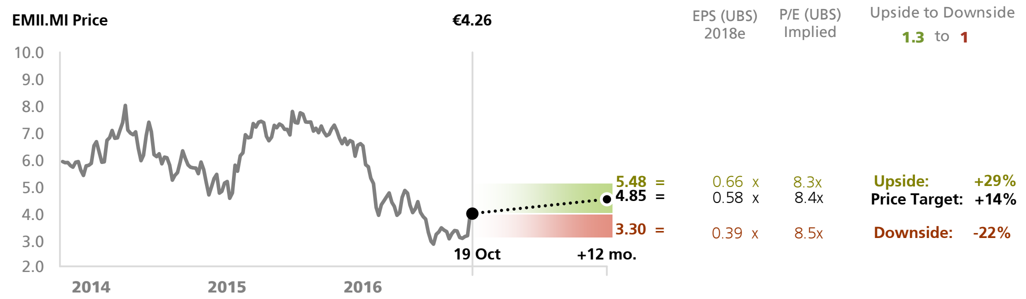
Effectively, while the formula is set in advance, at the time of the application for the withdrawal rights shareholders will not know what amount of capital could be paid out as both the barrier and the CET1 ratio of the bank will be moving in subsequent months. Shareholders do not know either the amount of rights that will be exercised.

In the case of UBI, the bank received withdrawal requests for 3.9% of its shares, equivalent to €258m at the withdrawal price (€7.288 per share) or a theoretical reduction of c40bps versus its fully-loaded CET1. In accordance with the law, the bank offered the shares first to existing shareholders and subsequently to the market; however, in the meantime the shares fell below the offering price and the auction was unsuccessful. Finally, in February 2016 the bank exercised the limitation to the rights as its fully-loaded CET1 ratio had fallen to 11.64% versus a threshold (determined using the formula above) of 11.62%. Therefore only 2bps of capital were used to repurchase shares. This compares with an excess of 59bps available for the rights exercise when the methodology was presented (September 2015).

According to the company's semi-annual report there have been three legal claims presented by shareholders requesting compensation for the losses incurred due to the limitation of their rights. The company deems its position in this debate "sound" and will ask for the claims to be dropped.

UPSIDE / DOWNSIDE SPECTRUM

return ↑



BPER is trading at €4.26 (as of 19 October).

Value drivers	AUM 2016-18E CAGR (%)	NIM 2018E (%)	CoR 2018E (%)	Adjusted 2018E net income (€m)
€5.48 upside	7.7%	1.87%	0.65%	315
€4.85 base	5.1%	1.87%	0.73%	279
€3.30 downside	2.6%	1.82%	0.90%	188

Source: UBS

Risk to the current share price is mildly skewed (1.3:1) to the upside

BPER is trading at **€4.26** (as of 19 October).

Upside (€5.48): We assume a 7.7% 2016-18E AUM CAGR, 50% above our below-consensus base case, a NIM of 1.87%, in line with our base case, but a better cost of risk at 65bps. We arrive at €315m of adjusted net income and a 6.6% ROTE.

Base (€4.85): Our base case implies a 5.1% 2016-18E AUM CAGR, a NIM of 1.87% and a cost of risk of 73bps. That yields €279m of adjusted net income and a 5.9% ROTE.

Downside (€3.30): We assume a 2.6% 2016-18E AUM CAGR, half of our already below-consensus base case, a NIM of 1.82% and a cost of risk at 90bps. We arrive at €170m of adjusted net income and a 3.6% ROTE.

COMPANY DESCRIPTION

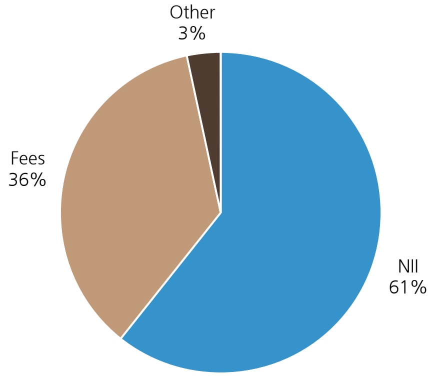
return ↑

BPER is the seventh-largest Italian bank, with a lending market share of c2%. BPER focuses on commercial and retail banking, and has a strong presence in its home region of Emilia Romagna.

Industry outlook

BPER's home market is Italy. After several years of economic downturn, which led to a significant deterioration in banks' asset quality, the country has recently experienced the first signs of stabilisation. This should allow for a continuation of the improving trend in cost of risk, although risks remain. Low rates affected banks' interest margins, but also allowed for strong fee generation in investment services. The sector could enter a consolidation phase, involving, in particular, small- and medium-sized banks.

Revenues mix ex-trading (2015, %)



Source: Company data and UBS

BPER (EMII.MI)

Profit & Loss (€m)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Net income interest	1,290	1,292	1,228	1,167	-4.9	1,172	0.4	1,205	1,238	1,269
Total non interest income	957	926	1,143	898	-21.4	894	-0.4	902	909	915
Total income	**2,247**	**2,217**	**2,371**	**2,065**	-12.9	**2,067**	0.1	**2,107**	**2,146**	**2,184**
Total cash expenses	(1,184)	(1,191)	(1,167)	(1,184)	-1.5	(1,167)	1.4	(1,145)	(1,137)	(1,133)
Pre-depreciation operating profit	**1,063**	**1,026**	**1,203**	**881**	-26.8	**899**	2.1	**962**	**1,009**	**1,051**
Depreciation & amort (excl. goodwill)	(66)	(70)	(80)	(75)	6.5	(75)	0.0	(75)	(75)	(75)
Operating profit pre provisions	**997**	**956**	**1,123**	**806**	-28.2	**824**	2.3	**887**	**934**	**976**
Total provisions	(906)	(897)	(790)	(604)	23.5	(505)	16.5	(425)	(368)	(317)
Operating profit post provisions	**91**	**59**	**333**	**202**	-39.5	**319**	58.3	**462**	**566**	**659**
Income from associates & JVs (pre-tax)	(15)	(1)	(21)	(36)	-69.9	(25)	30.6	(25)	(25)	(25)
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	**76**	**58**	**312**	**166**	-46.9	**294**	77.6	**437**	**541**	**634**
Exceptionals (incl goodwill)	(9)	0	(99)	(4)	95.9	0	-	0	0	0
Profit before tax	**67**	**58**	**214**	**162**	-24.3	**294**	82.0	**437**	**541**	**634**
Tax	(52)	(28)	6	(49)	-	(97)	-100.2	(144)	(179)	(209)
Profit after tax	**15**	**30**	**219**	**113**	-48.4	**197**	74.2	**293**	**362**	**425**
Other post-tax items	1	0	0	0	-	0	-	0	0	0
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(9)	(15)	1	(2)	-	(9)	NM	(13)	(16)	(19)
Net earnings (local GAAP)	**7**	**15**	**221**	**112**	-49.4	**188**	68.8	**279**	**346**	**406**
Net earnings (before pref divs)	**7**	**15**	**221**	**112**	-49.4	**188**	68.8	**279**	**346**	**406**
Net earnings (UBS)	**13**	**15**	**55**	**112**	101.7	**188**	68.8	**279**	**346**	**406**

Per share (€)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
EPS (local GAAP, basic)	0.02	0.03	0.46	0.23	-49.4	0.39	68.8	0.58	0.72	0.85
EPS (UBS, diluted)	0.04	0.03	0.12	0.23	101.7	0.39	68.8	0.58	0.72	0.85
PPOP (diluted)	2.72	2.26	2.34	1.68	-28.2	1.72	2.3	1.85	1.95	2.03
Net DPS	0.00	0.02	0.10	0.09	-7.0	0.16	68.8	0.23	0.29	0.34
BVPS	11.02	10.15	10.47	10.49	0.2	10.79	2.9	11.22	11.71	12.27
BVPS (UBS)	9.67	9.11	9.40	9.44	0.5	9.74	3.2	10.17	10.66	11.22

Balance sheet (€m)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Banking assets (year end)	61,758	60,653	61,261	63,065	2.9	63,953	1.4	64,857	65,780	66,722
Banking assets (average)	61,698	61,205	60,957	62,163	2.0	63,509	2.2	64,405	65,319	66,251
Total assets (year end)	61,758	60,653	61,261	63,065	2.9	63,953	1.4	64,857	65,780	66,722
Risk weighted assets (RWA) (year end)	43,351	40,692	40,102	31,499	-21.5	32,250	2.4	32,973	33,685	34,390
Risk weighted assets (RWA) (average)	44,055	42,021	40,397	35,800	-11.4	31,874	-11.0	32,612	33,329	34,037
Customer loans	46,515	43,920	43,703	44,358	1.5	45,245	2.0	46,150	47,073	48,015
Customer loans (average)	47,282	45,217	43,811	44,031	0.5	44,802	1.8	45,698	46,612	47,544
Interest earning assets (average)	57,379	56,590	56,179	57,522	2.4	59,097	2.7	59,993	60,907	61,839
Customer deposits	33,681	33,964	35,888	36,353	1.3	36,977	1.7	37,746	38,063	38,384
Common s/h equity (year end)	4,033	4,870	5,025	5,034	0.2	5,178	2.9	5,382	5,616	5,883
Common s/h equity (average)	4,048	4,452	4,947	5,029	1.7	5,106	1.5	5,280	5,499	5,750
Total SHF (equity, pref & MI) (year end)	4,712	5,510	5,652	5,710	1.0	5,863	2.7	6,080	6,331	6,617
Total SHF (equity, pref & MI) (average)	4,737	5,111	5,581	5,681	1.8	5,787	1.9	5,971	6,205	6,474
Net tangible assets	4,221	5,012	5,137	5,207	1.4	5,359	2.9	5,576	5,827	6,113

Balance sheet structure (%)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Loans / banking assets (year end)	75.3	72.4	71.3	70.3	-1.4	70.7	0.6	71.2	71.6	72.0
Deposits / banking assets (year end)	54.5	56.0	58.6	57.6	-1.6	57.8	0.3	58.2	57.9	57.5
Loans / deposits	138.1	129.3	121.8	122.0	0.2	122.4	0.3	122.3	123.7	125.1
Total SHF / banking assets (year end)	7.6	9.1	9.2	9.1	-1.9	9.2	1.2	9.4	9.6	9.9

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

BPER (EMII.MI)

Capital adequacy (€m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Tier 1 capital	3,991	4,443	4,528	4,496	4,612	4,784	4,996	5,245
Total capital	5,037	4,455	4,825	4,882	4,998	5,169	5,382	5,631
Risk weighted assets (RWA) (year end)	43,351	40,692	40,102	31,499	32,250	32,973	33,685	34,390
Core tier 1 ratio %	9.2	10.9	11.2	14.2	14.2	14.4	14.8	15.2
Tier 1 ratio %	9.2	10.9	11.3	14.3	14.3	14.5	14.8	15.3
Total capital ratio %	11.6	10.9	12.0	15.5	15.5	15.7	16.0	16.4
Tangible equity	3,542	4,372	4,509	4,530	4,674	4,878	5,113	5,380
Equity / assets %	6.5	8.0	8.2	8.0	8.1	8.3	8.5	8.8
Tangible equity to tangible assets %	5.8	7.3	7.4	7.2	7.4	7.6	7.8	8.1

Asset quality (€m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Non performing assets	10,214	10,998	11,395	11,234	11,007	10,613	10,175	9,652
Total risk reserves	4,041	4,682	5,240	5,085	5,131	5,092	4,997	4,858
NPLs / loans %	20.2	22.6	23.3	22.7	21.8	20.7	19.5	18.3
NPL coverage %	39.6	42.6	46.0	45.3	46.6	48.0	49.1	50.3
Provision charge / average loans %	1.9	1.9	1.7	1.3	1.0	0.9	0.7	0.6
Net NPAs / shareholders funds %	131.0	114.6	108.9	107.7	100.2	90.8	81.8	72.4

Profitability (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Net interest margin (avg assets)	2.09	2.11	2.01	1.88	1.85	1.87	1.89	1.92
Provisions / operating profit	90.9	93.8	70.3	75.0	61.3	48.0	39.4	32.5
ROE (UBS earnings)	0.3	0.3	1.1	2.2	3.7	5.3	6.3	7.1
RoAdjE (UBS earnings & equity)	0.4	0.4	1.2	2.5	4.1	5.9	6.9	7.7
RoRWA (UBS)	0.05	0.07	0.13	0.32	0.62	0.90	1.09	1.25
RoA (UBS earnings)	0.02	0.05	0.36	0.18	0.31	0.45	0.55	0.64

Productivity (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Cost income ratio	55.6	56.9	52.6	61.0	60.1	57.9	56.5	55.3
Cost / average assets	2.03	2.06	2.05	2.03	1.96	1.89	1.86	1.82
Compensation expense ratio	43.8	45.1	40.6	49.1	48.2	45.8	44.4	43.3

Growth (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenue	2.0	-1.3	6.9	-12.9	0.1	2.0	1.9	1.8
Operating profit pre provisions	-0.4	-4.1	17.5	-28.2	2.3	7.6	5.3	4.5
Net earnings (UBS)	-	13.6	273.9	101.7	68.8	48.3	23.9	17.1
Net DPS	-	-	400.0	-7.0	68.8	48.3	23.9	17.1
Total assets (year end)	0.2	-1.8	1.0	2.9	1.4	1.4	1.4	1.4
Customer loans	-3.2	-5.6	-0.5	1.5	2.0	2.0	2.0	2.0
Customer deposits	4.3	0.8	5.7	1.3	1.7	2.1	0.8	0.8

Value (x)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Market cap/revenues	0.9	1.3	1.5	1.0	1.0	1.0	1.0	0.9
Market cap/deposits	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
P/PPOP (diluted)	2.0	2.9	3.2	2.5	2.5	2.3	2.2	2.1
P/E (local GAAP, basic)	NM	NM	16.1	18.3	10.8	7.3	5.9	5.0
P/E (UBS, diluted)	NM	NM	64.3	18.3	10.8	7.3	5.9	5.0
Net dividend yield %	0.0	0.3	1.3	2.2	3.7	5.5	6.8	7.9
P/BV x	0.5	0.7	0.7	0.4	0.4	0.4	0.4	0.3
P/BV (UBS) x	0.6	0.7	0.8	0.5	0.4	0.4	0.4	0.4

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	+13.9%
Forecast dividend yield	3.7%
Forecast stock return	+17.6%
Market return assumption	4.9%
Forecast excess return	+12.7%

Valuation Method and Risk Statement

BPER: We have used a traditional Gordon growth methodology for valuation. Our price target of €4.85 is based on 5.9% ROTE 2018E and 11% COE, with no value attached to excess capital, given the lack of clear indication about its final use.

Creval: Our Gordon growth-derived price target of €0.55 is based on 4.7% adjusted ROTE in 2018E and a 12% COE, higher than peers to reflect execution risks linked to the restructuring plan, and excess capital of c€90m versus an 11% threshold.

Credem: We have used a traditional Gordon growth methodology for valuation. Our price target of €5.55 is based on 8.1% adjusted ROTE in 2018E, 9.5% COE and c€220m excess capital, versus an 11% threshold.

Carige: as we expect the bank to demonstrate its underlying profitability only from 2019E, we base our Gordon growth valuation on that year. Our €0.35 target price is based on a 2.4% adjusted ROTE, 12% COE and a c€80 capital shortfall versus an 11% threshold.

Risks: Industry-wide….

The Italian domestic banks are exposed to macro risks, asset quality risks, unexpected changes in interest rates, a slowdown of the savings industry, regulatory and operational risks, and potential M&A activity, with positive or negative implications for shareholders.

Company-specific…

BPER: sub-optimal use of excess capital and further NII deterioration are the main risks.

Creval: the main risks are linked to the execution of the expected restructuring, including a lack or delay of IRB model
approval.

Credem: lower-than-expected loan growth and margins pressure are the main risks.

Carige: regulatory pressure to raise capital is the main risk.

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	45%	28%
Neutral	FSR is between -6% and 6% of the MRA.	39%	25%
Sell	FSR is > 6% below the MRA.	15%	17%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 September 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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UBS Limited: Francesco Di Giambattista; Ignacio Cerezo.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
BPER[7]	EMII.MI	Buy	N/A	€4.26	19 Oct 2016
Carige[4, 5, 7]	CRGI.MI	Neutral	N/A	€0.31	19 Oct 2016
Credem[7]	EMBI.MI	Neutral	N/A	€5.12	19 Oct 2016
Credito Valtellinese	PCVI.MI	Buy	N/A	€0.42	19 Oct 2016

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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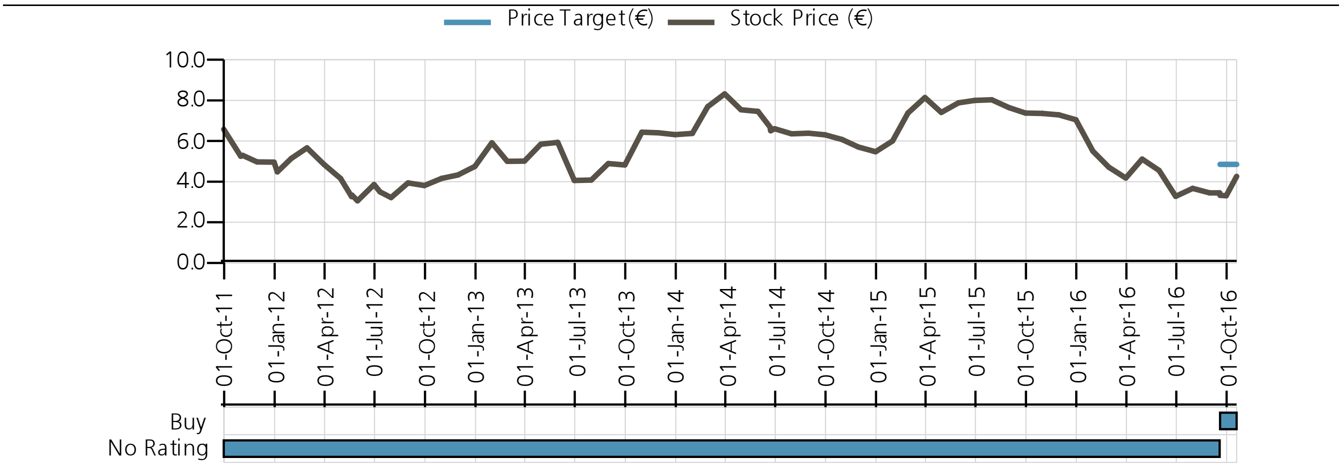
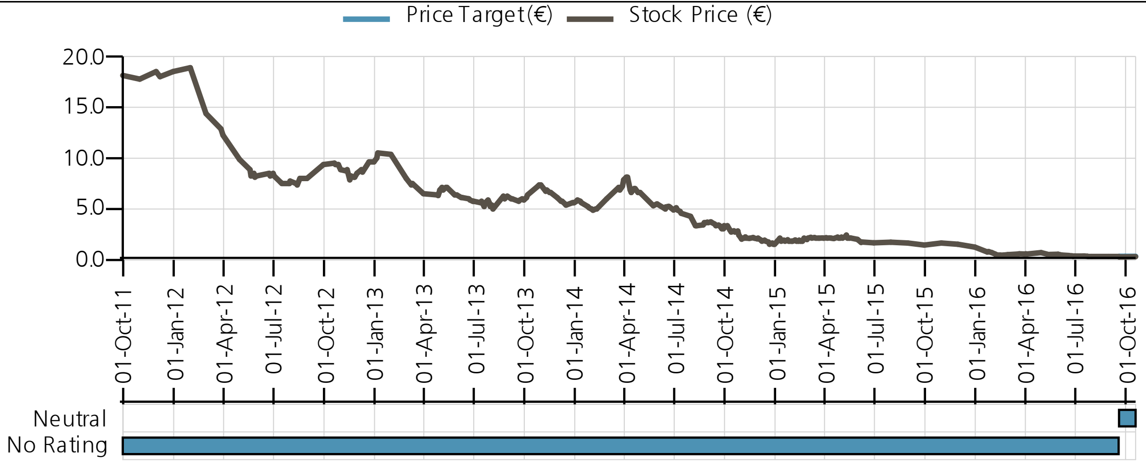
BPER (€)



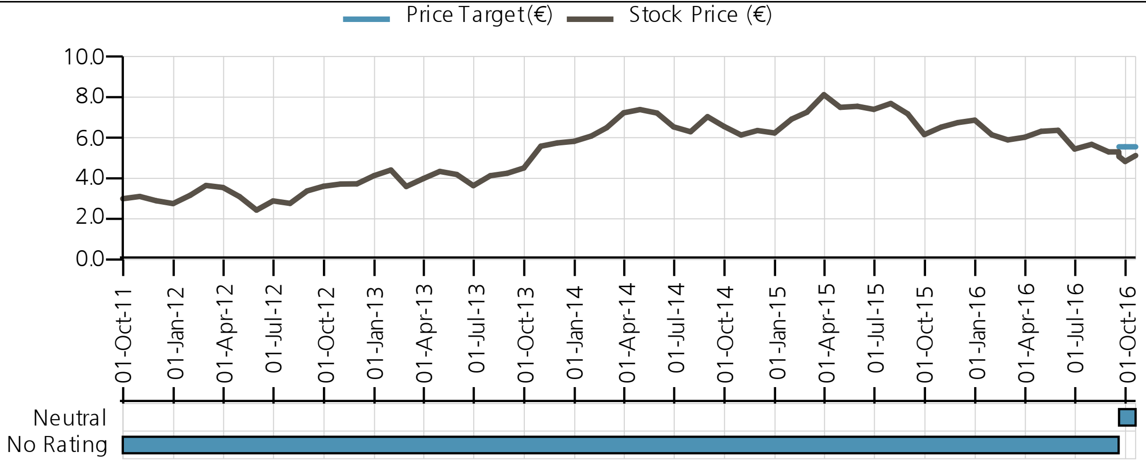
Source: UBS; as of 19 Oct 2016

Carige (€)



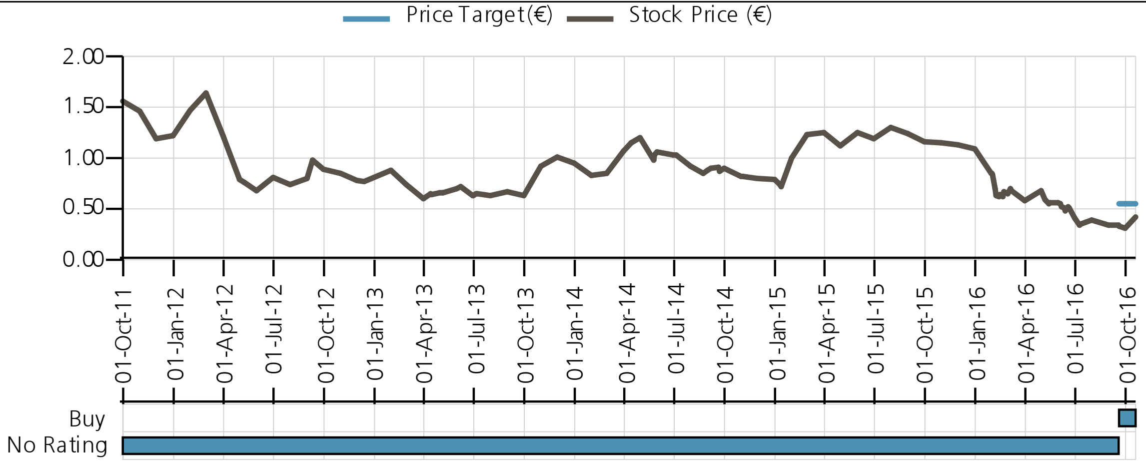
Source: UBS; as of 19 Oct 2016

Credem (€)



Source: UBS; as of 19 Oct 2016

Credito Valtellinese (€)



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