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Italian Banks: Challenges, Profitability and Valuations

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An Out of Fashion Industry

1. The banking sector – in Europe and especially in Italy - ranks at the **bottom of investors' preferences due to regulatory, business and macro challenges**
2. Investors' scepticism towards the industry reflects a combination of a **downbeat earnings outlook, misperception of the risk profile and poor communication**
3. Banks trade at an average P/TE of 0.54x and are incorporating an earnings power **c30% below expectations**
4. or a risk profile implying a >10% premium to the AT1 yield
5. A change in the communication and a **more flexible dividend policy may support a re-rating of market multiples**, in our view

1. Regulatory challenges

Regulatory Pressure to Accelerate from 2021

- The main regulatory challenges impacting the banks are
 - Basel 4
 - Calendar provisioning
 - 2019 SREP recommendations
 - EBA guidelines on input floors

Regulatory Item	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
Net Stable Funding Ratio			X	→					
Revised CVA framework				X	→				
RWA Output floor				50%	→				72.50%
Revised standardised approach for credit risk				X	→				
Revised IRB framework				X	→				
Revised operational risk framework				X	→				
Fundamental Review of Trading Book (FRTB)	X								
TLAC fully loaded				X	→				
MREL fully loaded						X	→		
End Grandfathering period own funds				X	→				
2019 SREP Guidance	X	→							
Calendar provisioning	X	→							
New definition of default (past dues)	X	→							
EBA Guidelines			X	→					

Basel IV

Sources: <https://www.bis.org/bcbs/basel3.htm>

<https://www.bis.org/press/p190704.htm>

<https://www.consilium.europa.eu/en/press/press-releases/2019/05/14/banking-union-council-adopts-measures-to-reduce-risk-in-the-banking-system/>

- Most of the acceleration in the regulatory pressure is expected from 2021 onwards, due to **Basel4 and SREP recommendations**

2019 SREP Recommendations on the Stock of NPE

BCE SREP RECOMMENDATIONS ON THE STOCK OF NPE				
SREP recommendation		Group 1	Group 2	Group 3
		NPE Ratio < 5%	5% < NPE Ratio < 12.5%	NPE Ratio > 12.5%
Secured loans > 7 years	Policy starting date	2020	2020	2020
	Initial coverage target			40%
	Annual coverage increase	10%	10%	10%
	100% coverage in	2024	2025	2026
Unsecured loans > 2 years	Policy starting date	2020	2020	2020
	Initial coverage target	70%	60%	50%
	Annual coverage increase	10%	10%	10%
	100% coverage in	2023	2024	2025

- The acceleration of the **increase in coverage is expected from 2021**
- The incentive to sell NPE increases significantly

2019 SREP Recommendations Imply a Significant Derisking Effort (cont'd)

- The 2019 SREP recommendations may imply a cumulated 2019-2026 capital consumption (**pre cash-flow generation**) of **198bps, corresponding to €18bn of capital**
- The 2019 SREP recommendations imply that the work-out of UTP becomes a **leading indicator of the capital position**

IMPACT OF THE 2019 SREP RECOMMENDATIONS										
	Unicredit	Intesa SanPaolo	Banco BPM	UBI Banca	BPE Banca	BMPS	Credem	Creval	BPSO	Total
Capital consumption (2019-2020E) (€ mn)	-2,088	-1,444	-251	-282	0	0	0	0	0	-4,065
Bps on the CET1	-56	-53	-39	-39	0	0	0	0	0	-44
Net capital generation	8,036	6,561	1,092	652	473	437	357	119	169	17,896
Bps on the CET1	217	239	169	90	121	70	240	117	96	193
Cumulated capital consumption (2019-2026E) (€ mn)	-6,480	-4,667	-1,672	-1,702	-1,185	-1,627	-23	-201	-682	-18,240
Bps on the CET1	-175	-170	-259	-236	-304	-261	-15	-197	-390	-197

Source: Equita SIM estimates and company data

2019 SREP Recommendations Imply a Significant Derisking Effort

- As part of the 2019 SREP process, we expect additional NPE sales for at least €79bn in 2020-2026E, €35n of which represented by UTP

ASSUMED REDUCTION OF NPE								
	Total NPE	o/w: UTP	NPE to sell	o/w: UTP	New NPE	o/w: UTP	Reduction of NPE (%)	o/w: UTP
UCG	34,416	14,353	26,366	11,463	8,050	2,890	-77%	-80%
ISP	34,796	13,610	23,974	9,687	10,822	3,923	-69%	-71%
BANCO BPM	10,663	7,254	6,564	3,922	4,099	3,332	-62%	-54%
UBI	9,002	3,794	5,521	2,457	3,481	1,337	-61%	-65%
BPE	6,937	2,526	4,879	2,223	2,058	303	-70%	-88%
BMPS	15,901	7,434	6,998	3,549	8,903	3,885	-44%	-48%
CE	1,136	409	721	242	415	167	-63%	-59%
CVAL	1,933	999	1,074	600	859	399	-56%	-60%
BPSO	3,933	1,545	3,229	1,298	704	246	-82%	-84%
Total	124,606	54,234	79,327	35,442	45,280	16,481	-64%	-65%

Source: Equita SIM estimates and company data

2019 SREP Recommendations Imply a Significant Derisking Effort

- The 2019 SREP recommendations **implicitly translate into an NPE ratio of 2% (vs 8% today)**

PRO-FORMA NPE RATIO INCLUDING 2019 SREP RECOMMENDATIONS

	Unicredit	Intesa SanPaolo	BancoBPM	UBI Banca	BPE Banca	BMPS	Credem	Creval	BPSO	Total
2019E NPE ratio %	6.7%	7.1%	8.8%	9.5%	11.7%	12.3%	3.6%	9.3%	13.3%	7.9%
Cumulated NPE sale	26,366	23,974	6,564	5,598	4,879	6,998	721	1,074	3,229	79,404
Current stock of NPE	33,285	29,396	9,777	8,728	5,867	11,662	994	1,628	3,731	105,067
New stock of NPE	6,918	5,422	3,213	3,130	989	4,663	273	554	502	25,663
Change %	-74%	-77%	-51%	-44%	-80%	-33%	-62%	-48%	-84%	-68%
PF NPE ratio %	1.5%	1.4%	3.1%	3.6%	2.2%	5.3%	1.0%	3.6%	2.0%	2.0%

Source: Equita SIM estimates and company data

Completion of the Banking Union Implies a Reduction of the Exposure to NPE and BTP

- We are convinced that the completion of the Banking Union cannot be implemented without a **full harmonization of the risk profile across Europe**
- We interpret the harmonisation of the risk profiles as:
 1. a convergence of the **NPE ratio to EU average;**
 2. a reduction in the **domestic sovereign bonds holdings;**
- At sector level, such initiatives should not impact the profitability of the banks significantly, but dispersion of the results is very significant

Derisking Will Translate into a Deflation of NII...

- Reduction in NPE implies a loss in revenues and a reduction in the cost of risk
- In 2018, **12% of the NII was generated** by NPE

REVENUES ON NPE (€ MN)					
	2017	% of interest revenues	2018	% of interest revenues	
UCG	555	5%	653	6%	
ISP	719	10%	1,148	16%	
BANCO BPM	223	11%	464	20%	
UBI	184	11%	279	16%	
BPE	126	11%	86	8%	
BMPS	448	25%	321	18%	
CE	20	4%	12	2%	
CVAL	72	18%	54	15%	
BPSO	n.a.	n.a.	57	11%	
Total	2,346	9%	3,073	12%	

Source: Equita SIM estimates and company data

...but also in the Cost of Risk

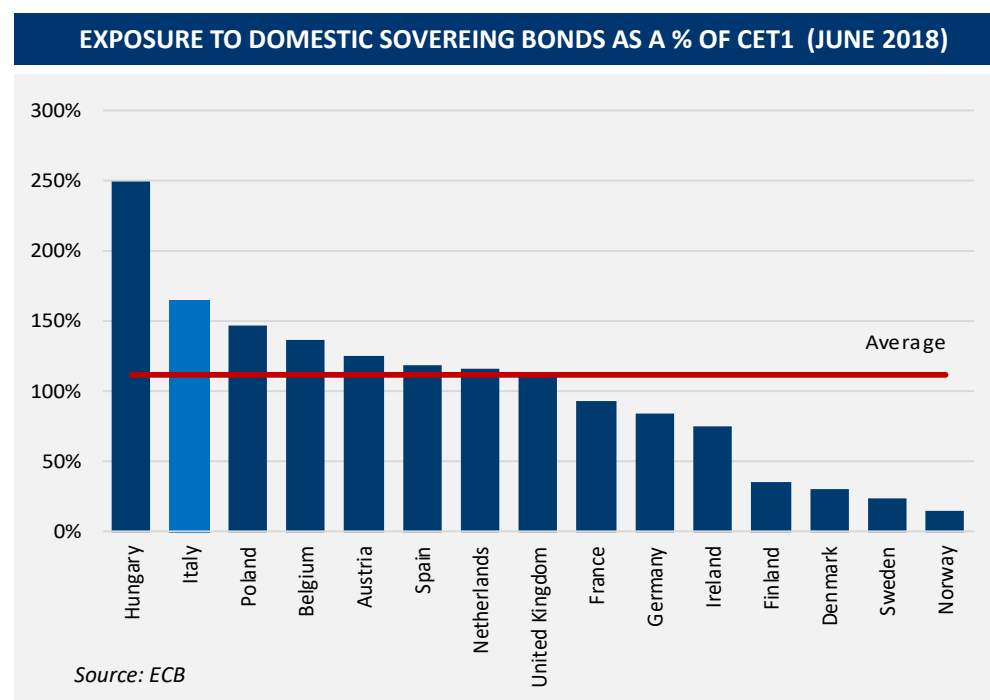
- An high level of NPE also contributes to inflate the cost of risk
- In the last couple of years the LLPs on **UTP exceeded > €4bn, ie more than 46% of total LLPs in 2018**

2017-2018 LLPs ON UTP (€ MN)						
	2017			2018		
	LLPs	o/w: UTP	%	LLPs	o/w: UTP	%
UCG	-2,762	-1,171	42%	-2,615	-1,355	52%
ISP	-3,304	-832	25%	-2,394	-1,033	43%
BANCO BPM	-1,661	-647	39%	-1,941	-435	22%
UBI	-728	-553	76%	-623	-573	92%
BPE	-536	-173	32%	-224	-90	40%
BMPS	-5,410	-679	13%	-629	-476	76%
CE	-81	-36	45%	-61	-46	75%
CVAL	-404	-198	49%	-239	-50	21%
BPSO	-232	-26	11%	-241	-52	22%
Total	-15,118	-4,315	29%	-8,966	-4,110	46%

Source: Equita SIM estimates and company data

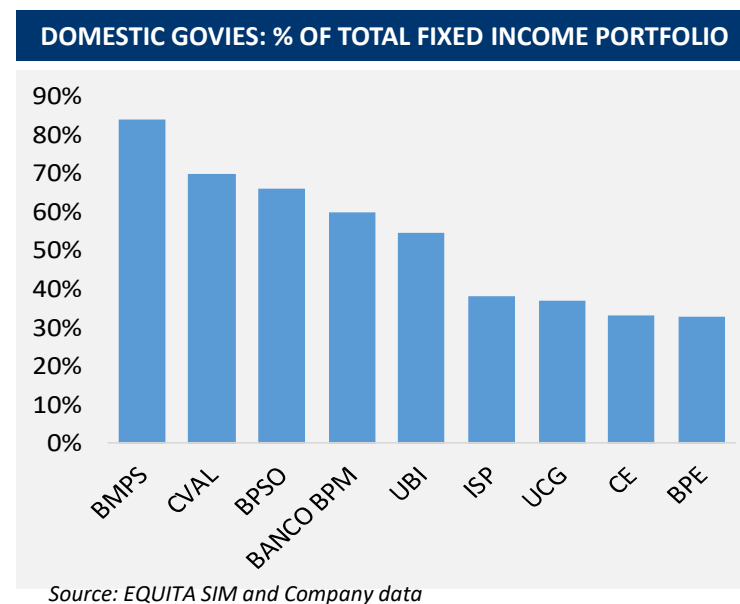
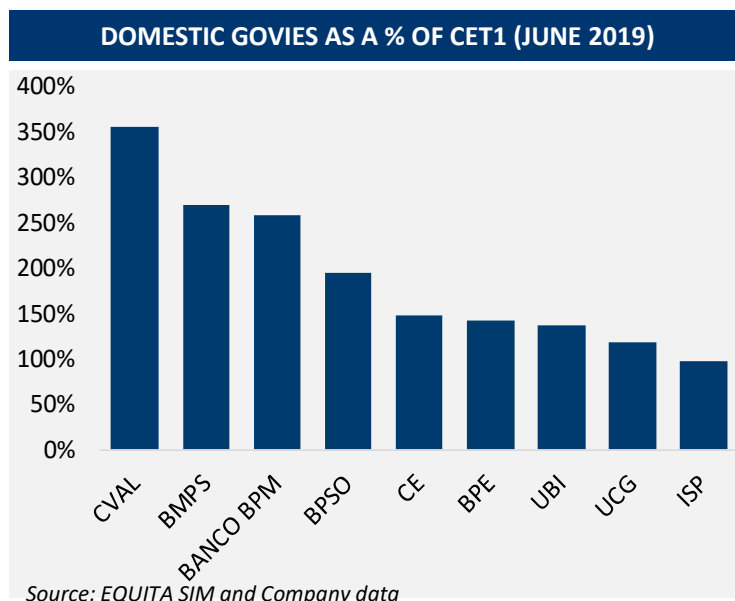
Exposure to Domestic Government Bonds Shows Significant Dispersion in Europe

- A pre-requisite to complete the banking union, in our view, is also represented by an **harmonization of the risk profile in terms of sovereign exposures.**
- Italian banks have an exposure to domestic sovereign bonds of 141% the CET1 vs an EU average of 100% (EBA, June 2018)



High Exposure and Poor Diversification of Domestic Government Bonds Portfolio in Italy

- In Italy, investment strategies are also very different, as the domestic govies **represent between 95% (ISP) and 355% (CVAL) of the CET1**
- Dispersion remains very significant, Italian govies represent **around 80% of the fixed income portfolio of CVAL, but only 32% of BPE's**



Significant Contribution of Govies to NII

- The fixed income portfolios contributes to c13% of interest revenues (17% of NII) and **amount to 34% of the Net Income**
- Average yield of the portfolio of domestic govies was 1.2% in 2018

CONTRIBUTION OF FIXED INCOME PORTFOLIO TO NET INCOME (€ MN)				
	2017		2018	
	interest revenues on bonds	% on NI	interest revenues on bonds	% on NI
UCG	2,418	31%	1,844	33%
ISP	1,043	10%	1,272	22%
BANCO BPM	597	n.m.	574	n.m.
UBI	184	96%	207	34%
BPE	209	83%	199	35%
BMPS	206	n.m.	284	71%
CE	60	23%	71	27%
CVAL	62	n.m.	67	148%
BPSO	38	17%	66	42%
Total	4,817	48%	4,585	34%

Source: Equita SIM estimates and company data

A Reduction of the Exposure to Domestic Govies cannot be Excluded

- We assume that, in the broader context of the risk-sharing across Europe, the exposure to domestic government bonds would be capped at the lowest of:
 - 100% of the CET1** or
 - 25% of the existing fixed income portfolio**
- We obtain an €65bn reduction in the stock of govies (-44%).....

CURRENT AND NEW EXPOSURE TO DOMESTIC BONDS (€ MN)

2Q19	Existing Exposure	New Exposure	Change	Change %
UCG	52,901	35,932	-16,969	-32%
ISP	34,267	22,604	-11,664	-34%
BANCO BPM	19,400	7,540	-11,860	-61%
UBI	9,742	4,471	-5,271	-54%
BPE	5,323	4,077	-1,246	-23%
BMPS	19,209	3,718	-15,492	-81%
CE	2,742	1,832	-911	-33%
CVAL	5,025	1,415	-3,610	-72%
BPSO	6,625	2,516	-4,109	-62%
Total	155,234	84,104	-71,131	-46%

Source: Equita SIM estimates and company data

The New Normal of the Profitability: Low Average Impact but High Dispersion

- In a new normal where banks reduce their exposure to NPE and domestic government bonds, the impact on the **sector profitability is low, but dispersion among the different players remain strong**
- The market seems instead **to incorporate a much worse scenario** (see below)

IMPACT ON NET INCOME OF A 360 DEGREE DERISKING (€ MN)

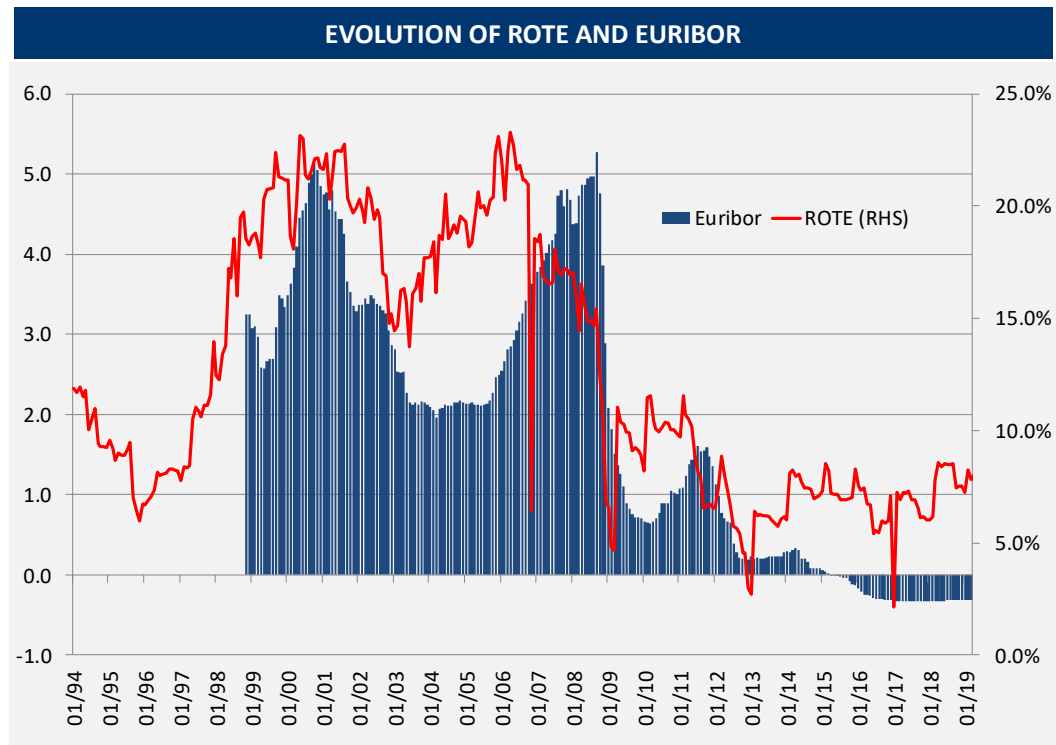
	Net profit 2022E	Lower interest revenues on NPE	Lower LLPs on NPE	Lower interest revenues on italian govies	Total impact (pre-tax)	Total impact (post-tax)	% of the NI
UCG	4,822	-500	1,082	-500	364	255	5.3%
ISP	4,796	-791	735	-791	-220	-154	-3.2%
BANCO BPM	639	-286	235	-286	-185	-130	-20.3%
UBI	477	-171	371	-171	139	98	20.5%
BPE	368	-60	79	-60	4	2	0.7%
BMPS	277	-141	227	-141	-106	-74	-26.8%
CE	184	-8	27	-8	12	8	4.4%
CVAL	97	-30	30	-30	-33	-23	-24.0%
BPSO	89	-46	44	-46	-30	-21	-23.2%
Total	11,749	-853	2,831	-853	-56	-39	-0.3%

Source: Equita SIM estimates and company data

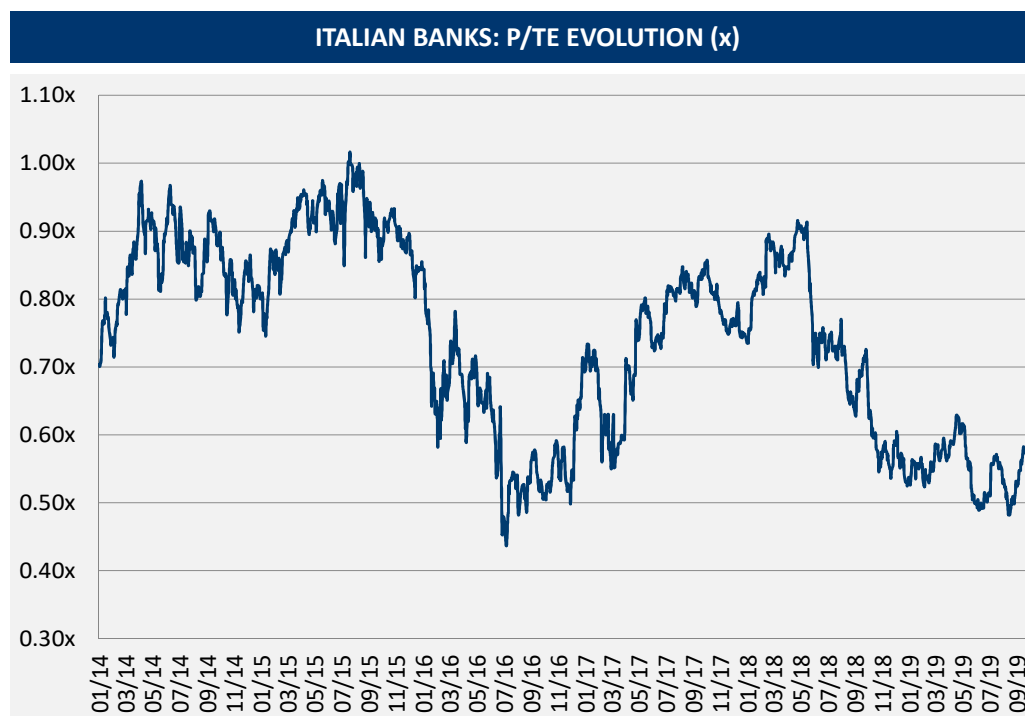
2. Business Challenges

Banks Valuations are Highly Correlated with s/t Rates

- In a negative, lower for ever negative rates environment, Italian banks cannot make money
- The profitability - and the valuations – **collapsed in the last 20 years in parallel with the rates cycle**

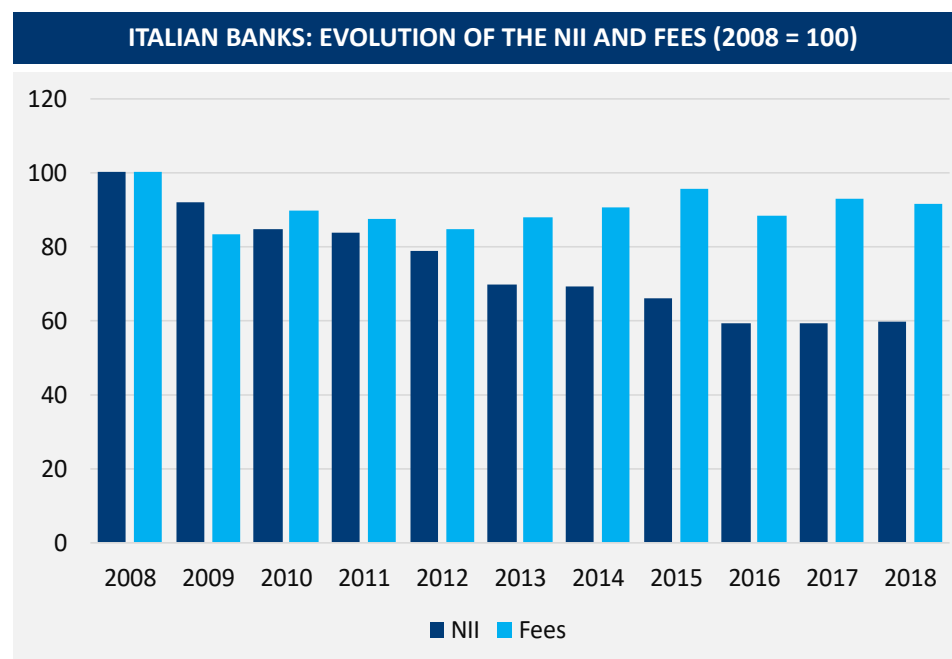


More Recently, Banks Recorded a Relief Rally thanks to Sovereign Spread Tightening



Collapse of the ROTE reflects the Contraction of NII and Core Revenues

- In the last 10 years, the NII collapsed by **40%** and core revenues by **29%**



The Recent ECB Decisions Have No Material Impact on the Profitability

- Based on our estimates, the recent monetary policy decisions (ie tiering) have a minimal impact on the banks profitability

IMPACT OF THE NEW MONETARY POLICY DECISIONS (€ MN)

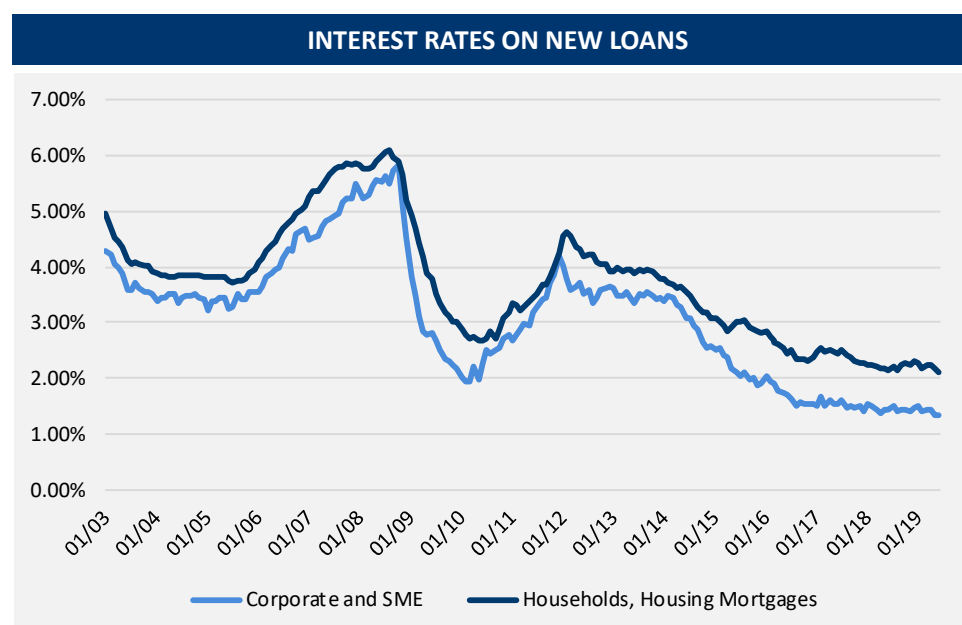
2019E	Current Reserve (1H19)	RR (1H19E)	Amount excl. from neg. rates	Residual liquidity	Savings on liquidity (€ mn) (A)	Lower cost of wholesale repos (€ mn) (B)	Lower E3m (C)	Total impact (€ mn)	% of the NII
Banco BPM	1,251	927	324	0	1	12	-9	4	0.2%
BMPS	6,508	753	4,520	1,235	17	0	-4	13	0.8%
BPER Banca	1,184	390	794	0	3	2	-4	0	0.0%
BP Sondrio (1)	2,100	254	1,524	322	6	0	-6	0	-0.1%
Credito Emiliano	833	248	585	0	2	1	-2	1	0.2%
Credito Valtellinese	393	144	249	0	1	1	0	2	0.7%
Intesa SanPaolo (1)	35,609	4,404	26,421	4,784	101	0	-100	1	0.0%
UBI Banca	10,353	339	2,034	7,980	0	0	-5	-4	-0.3%
Unicredit	9,209	4,571	4,638	0	19	85	-39	64	0.6%
Total	67,439	12,030	41,089	14,321	150	100	-170	81	0.3%

Source: Equita SIM estimates and company data

- Competition and negative interest rates environment contribute to deflate the top-line and profitability of the banks

Competitive Pressure Remains Very Strong

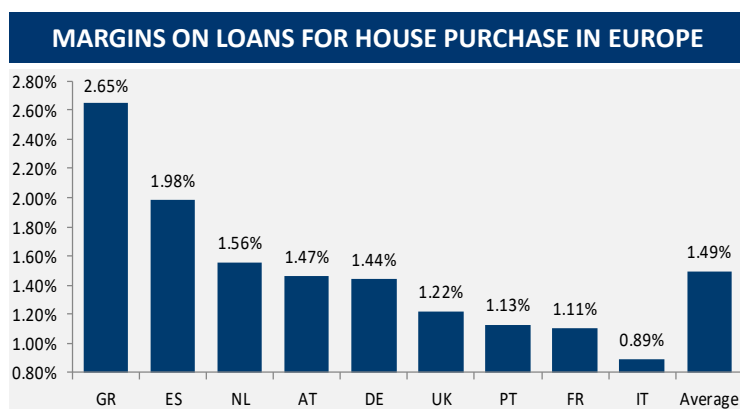
- The competitive pressure remains at historical peaks, also in a European context and even vis-à-vis less concentrated markets



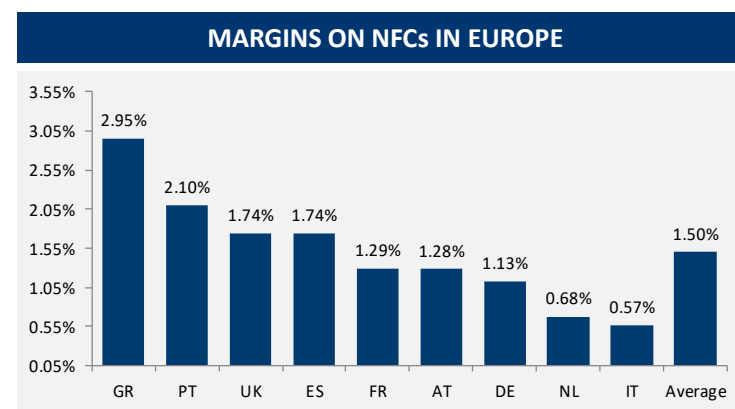
- On the liability side, the funding activity YTD and the issues expected in the next couple of years – also to comply with the MREL requirement – should not negatively impact the spread

Italy is one of the Most Competitive Markets in Europe for Commercial Banking

- The competitive pressure remains at historical peaks, also in a European context and even vis-à-vis less concentrated markets



Source: ECB



Source: ECB

The Cost of Funding Should Not Deflate Significantly the NII

- YTD Italian banks issued €30bn of bonds at an average spread of 274bps

ITALIAN BANKS: FUNDING ACTIVITY IN 1H19 (€ MN)

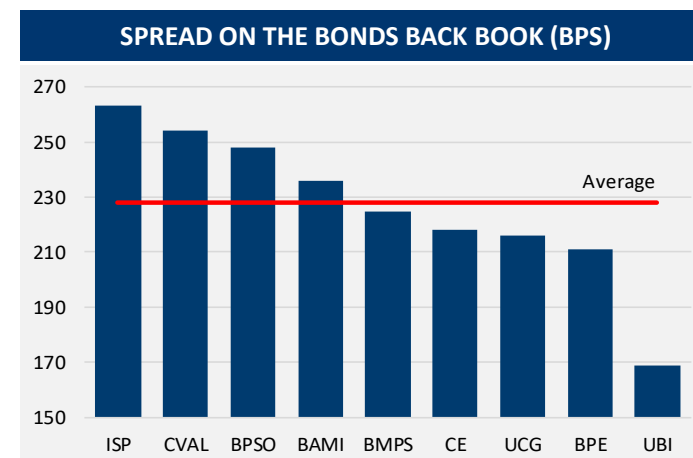
Payment Rank	Amount issued	%	Average spread
			(bps)
AT 1	1,600	5	737
Tier 2	5,005	16	503
Covered Bond	7,350	24	88
Sr Non Preferred	3,884	13	318
Senior	12,695	42	220
Total	30,534	100	274

Source: Equita SIM estimates and company data

- Based on our estimates, the **bond back-book in 2018 had an average spread of around 228bps** – which implies that the funding activity implemented YTD has not inflated significantly the overall funding costs

Cost of New Bonds @ 200-250bps Stabilizes the Funding Cost

- We estimate €50bn of bond issues in the next three years (of which €5bn of net new issues) to complete a c50% reduction in the TLTRO and comply with the MREL requirement (€24bn of new issues)
- We do not see a material erosion to our estimates of NII as long as **the front book spread on new issues remain in the 200-250bps** area – via a combination of covered and subordinated bond issues



ITALIAN BANKS NEW BOND ISSUES IN 2020-2022E (€ mn)

	2020	o/w: MREL	2021	o/w: MREL	2022	o/w: MREL	Total	o/w: MREL	Net new issues
BAMI	4,576	356	1,776	356	1,776	356	8,129	1,069	5,329
BMPS	2,421	1,954	1,721	1,954	1,721	1,954	5,862	5,862	5,162
BPE	1,315	648	315	648	315	648	1,944	1,944	944
BPSO	623	644	655	644	655	644	1,932	1,932	1,400
CE	640	360	859	360	109	360	1,607	1,081	326
CVAL	167	0	-83	0	-83	0	0	0	-250
ISP	7,284	1,721	684	1,721	-2,116	1,721	5,852	5,162	-14,748
UBI	1,652	1,361	1,849	1,361	584	1,361	4,084	4,084	-2,044
UCG	11,757	703	5,222	703	3,188	703	20,167	2,110	3,462
Total	30,434	7,748	12,996	7,748	6,147	7,748	49,578	23,244	-419

Source: Equita SIM estimates and company data

Current Funding Conditions Do Not Require a Repricing of the Loan Book

ASSUMED SPREADS ON NEW ISSUES BY BANK (bps)

	Spread on stock	2020E Covered bonds	MREL	2021E Covered bonds	MREL	2022E Covered bonds	MREL
BAMI	235	50	230	50	230	50	230
BMPS	225	110	400	110	400	110	400
BPE	211	30	200	30	200	30	200
BPSO	248	60	250	60	250	60	250
CE	218	30	170	30	170	30	170
CVAL	254	90	300	90	300	90	300
ISP	263	7	110	7	110	7	110
UBI	169	15	180	15	180	15	180
UCG	216	7	130	7	130	7	130
Average	228	44	219	44	219	44	219

IMPACT ON NII OF THE 2020-2022E FUNDING ACTIVITY (€ MN)

	2020E	% of NII	2021E	% of NII	2022E	% of NII	Increase in loans spread (bps)
BAMI	37	2%	21	1%	6	0%	0
BMPS	-68	-4%	-143	-9%	-219	-14%	12
BPE	6	1%	-6	-1%	-18	-2%	2
BPSO	-12	-3%	-24	-5%	-35	-7%	6
CE	5	1%	13	3%	8	1%	-1
CVAL	5	1%	6	2%	6	2%	-2
ISP	298	4%	428	6%	485	6%	-6
UBI	14	1%	32	2%	30	2%	-2
UCG	212	2%	288	3%	321	3%	-3
Total	498	2%	615	2%	585	2%	-2

Source: Equita SIM estimates

3. Macro Challenges

Worsening of the Macro is More Painful than a Further Decrease in Euribor

- In the short-term, a **worsening macro represents the main headwind** to the earnings of the Italian banks.
- A **5 bps decrease in the Euribor implies a non-material impact on 2020 earnings in our view**

IMPACT OF A 5BPS DECREASE IN EURIBOR (€ MN)							
	Impact	2020E NII	Impact on NII (%)	2020E Net income	Impact on NI (%)	2020E ROTE	2020E New ROTE
Unicredit	-39	10,640	-0.4%	4,210	-0.7%	7.6%	7.5%
Intesa San Paolo	-100	7,035	-1.4%	4,083	-1.8%	10.5%	10.3%
BancoBPM	-9	2,039	-0.5%	565	-1.2%	6.1%	6.0%
Bca MPS	-4	1,623	-0.3%	248	-1.3%	2.6%	2.6%
UBI Banca	-5	1,752	-0.3%	514	-0.7%	6.9%	6.8%
BPER (1)	-4	1,062	-0.4%	311	-1.0%	6.7%	6.7%
Credem	-2	517	-0.4%	178	-0.9%	7.6%	7.5%
Creval (1)	0	352	0.1%	79	0.3%	4.7%	4.7%
BP Sondrio (1)	-6	472	-1.3%	89	-5.1%	3.0%	2.9%
Total	-170	25,492	-0.7%	10,278	-1.2%	6.2%	6.1%

Sensitivity as of december 2018

Source: Equita SIM estimates and company data

Investors' Concerns Should Be on New NPLs rather than on UTPs (cont'd)

- Macro risk, in our view, refers to the possible acceleration of the NPL flows which typically lags by 6-12 months the downturn in GDP
- Investors seem to focus on UTP, but our calculations show that an acceleration of the new **NPE flows may have a c.3x higher negative impact on earnings** vis-à-vis a deterioration of the danger rate
- **A 50% increase in PD would have a 20% negative impact on earnings, while a 50% increase in danger rate by -7%**

IMPACT ON NET INCOME OF A 50% INCREASE IN PD (€ MN)								
	2Q19 PD	Increase (bps)	New PD	New NPE generation	UTP coverage	Increase in LLPs	2020E Net income	Impact on NI (%)
BAMI	0.9%	46	1.4%	1,379	35.5%	-163	565	-20%
BMPS	1.3%	65	2.0%	1,563	45.5%	-237	248	-67%
BPE	1.8%	90	2.7%	1,172	35.3%	-138	311	-31%
BPSO	1.4%	91	2.3%	571	36.1%	-81	85	-67%
CE	0.0%	59	0.6%	147	28.4%	-42	178	-16%
CVAL	1.4%	91	2.3%	319	42.3%	-53	63	-59%
ISP	1.1%	57	1.7%	6,421	37.2%	-795	4,083	-14%
UBI	1.2%	61	1.8%	1,487	26.9%	-133	514	-18%
UCG	1.2%	60	1.8%	8,205	47.9%	-1,310	4,210	-22%
Average	1.4%	70	2.1%	25,188	40.2%	-2,953	10,257	-20%

Source: Equita SIM estimates and company data

Investors' Concerns Should Be on new NPLs rather than on UTPs

IMPACT ON NET INCOME OF A 50% INCREASE IN THE DANGER RATE (€ MN)

	DR (2019E)	Increase (pp)	new DR	UTP (2Q19)	increase in				increase in	2020E Net	Impact on NI
					NPL	NPL coverage	UTP coverage		LLPs	income	(%)
BAMI	13.0%	650	19.5%	7,254	472	57%	35%		-101	565	-12%
BMPS	13.0%	650	19.5%	7,434	483	62%	45%		-79	248	-22%
BPE	13.0%	650	19.5%	2,526	164	67%	35%		-52	311	-12%
BPSO	14.0%	700	21.0%	1,545	108	68%	36%		-35	85	-29%
CE	14.0%	700	21.0%	409	29	68%	28%		-11	178	-4%
CVAL	13.0%	650	19.5%	999	65	81%	42%		-25	63	-28%
ISP	19.0%	950	28.5%	13,610	1,293	66%	37%		-372	4,083	-6%
UBI	21.0%	1050	31.5%	3,794	398	52%	27%		-99	514	-13%
UCG	16.0%	800	24.0%	14,353	1,148	72%	48%		-280	4,210	-5%
Average	18.5%	925	27.8%	51,924	4,160	66%	40%		-1,055	10,257	-7%

Source: Equita SIM estimates and company data

4. Valuations, Risk Perception & Profitability

A Lot Of Pessimism is Implied into Banks' Valuations

- Market prices are indicating a very poor outlook for the profitability of the banks. Market valuations assume a net income generation 40% below our estimates.
- Alternatively, market valuations imply a risk perception on the banks which remains extremely high.
- A decoupling between different asset classes of the same issues (ie AT1 vs the equity) is evident

Cost of Equity and Valuations

- Current market prices (average P/TE of 0.54x) incorporate an even more pessimistic outlook for the earnings of the banks, as they imply a **net income in 2022 of €8.2 ie 30% below our estimates**

P/TE AND IMPLIED COST OF EQUITY										
	Net income (2022E)	New net income (2022E)	Change	ROTE	New ROTE	Current P/TE	Implied ROTE	Implied Net income	Diff vs 2022E	Diff vs 2022E (new)
UCG	4,822	5,077	5%	7.7%	8.1%	0.43x	5.0%	3,095	-36%	-39%
ISP	4,796	4,642	-3%	12.1%	11.7%	0.97x	9.5%	3,768	-21%	-19%
BANCO BF	639	509	-20%	6.3%	5.0%	0.32x	3.3%	338	-47%	-33%
UBI	551	648	18%	6.7%	7.9%	0.41x	3.9%	318	-42%	-51%
BPE	368	370	1%	7.4%	7.4%	0.44x	3.9%	197	-47%	-47%
BMPS	277	203	-27%	2.8%	2.0%	0.18x	1.9%	192	-31%	-5%
CE	184	192	4%	7.1%	7.4%	0.72x	6.9%	177	-4%	-8%
CVAL	97	74	-24%	5.6%	4.2%	0.27x	2.6%	46	-53%	-38%
BPSO	89	68	-23%	3.2%	2.5%	0.28x	2.4%	67	-25%	-3%
Total	11,822	11,783	0%	8.3%	8.2%	0.54x	5.3%	8,198	-31%	-30%

Source: Equita SIM estimates and company data

Cost of Equity and Valuations

- Alternatively, market prices attach a very high risk to banks' long-term profitability, with an **implied cost of equity of 15%** which does not seem consistent with the yield on the most liquid AT1

P/TE AND IMPLIED COST OF EQUITY											
	Net income (2022E)	New net income (2022E)	Change	ROTE	New ROTE	Current P/TE	Estimated Ke	Implied Ke	AT1 Yield	Delta (bps)	
UCG	4,822	5,077	5%	7.7%	8.1%	43%	11.6%	19.0%	5.0%	1,399	
ISP	4,796	4,642	-3%	12.1%	11.7%	97%	9.8%	12.1%	4.3%	783	
BANCO BPM	639	509	-20%	6.3%	5.0%	32%	10.5%	15.8%	7.7%	813	
UBI	551	648	18%	6.7%	7.9%	41%	9.5%	19.3%	6.9%	1,248	
BPE	368	370	1%	7.4%	7.4%	44%	9.0%	17.0%	7.7%	925	
BMPS	277	203	-27%	2.8%	2.0%	18%	10.5%	11.1%	n.a.	n.a.	
CE	184	192	4%	7.1%	7.4%	72%	9.5%	10.3%	7.0%	326	
CVAL	97	74	-24%	5.6%	4.2%	27%	9.7%	15.7%	n.a.	n.a.	
BPSO	89	68	-23%	3.2%	2.5%	28%	8.5%	8.7%	n.a.	n.a.	
Total	11,822	11,783	0%	8.3%	8.2%	0.54x	9.8%	15.4%	n.a.	n.a.	

Source: Equita SIM estimates and company data

The Gold Standard of a Business Plan Presentation in a Poor Outlook

- We believe that banks can improve the communication and the remuneration of the shareholders, partly returning the benefit of the collapsing sovereign spreads to shareholders via dividend distribution
- The golden rule of a business plan presentation are:
 1. “ put is simple” !
 2. avoid back-end loaded targets
 3. elaborate on a sustainable profitability
 4. improve shareholders remuneration via a sustainable dividend policy

The Gold Standard of a Business Plan Presentation in a Poor Outlook

- **Golden rule #1: “Put is simple!”**

Banks must communicate the following data

KPI	Description
Recurring Eps	at least in t+1
Eps CAGR	-
C/I	-
Cost of risk	Sensitivity to worsening / improving macro
CET1 %	Fully loaded for B4
NPE ratio	Contribution of work-out and disposals
Payout	Minimum level

The Gold Standard of a Business Plan Presentation in a Poor Outlook

- **Golden rule #2: “Avoid back-end loaded targets !”**

Banks must disclose t+1 targets, as investors do not incorporate medium term

BANKS BUSINESS PLAN TARGETS VS MARKET CONSENSUS AND OUR ESTIMATES (€ MN)

	Net Income - 2019					Net Income - 2020					Net Income - 2021				
	EQUITA		Market	Diff %	Consensus	EQUITA		Market	Diff %	Consensus	EQUITA		Market	Diff %	Consensus
	Company	SIM				Company	SIM				Company	SIM			
Target	Estimates	Diff %	Consensus	Diff %	Target	Estimates	Diff %	Consensus	Diff %	Target	Estimates	Diff %	Consensus	Diff %	
BPE	n.a.	240	n.a.	198	n.a.	n.a.	311	n.a.	297	n.a.	450	340	-25%	340	-24%
CVAL	n.a.	29	n.a.	62	n.a.	n.a.	63	n.a.	57	n.a.	93	79	-15%	76	-19%
BMPS	570	39	-93%	183	-68%	n.a.	128	n.a.	215	n.a.	1,220	194	-84%	375	-69%
ISP	4,100	4,079	-1%	3,923	-4%	n.a.	4,240	n.a.	3,983	n.a.	6,000	4,501	-25%	4,118	-31%
UCG	4,700	4,575	-3%	4,213	-10%	n.a.	4,243	n.a.	3,854	n.a.	n.a.	4,579	n.a.	4,041	n.a.
BAMI (1)	1,100	521	-53%	465	-58%	n.a.	587	n.a.	481	n.a.	n.a.	631	n.a.	544	n.a.
BAMI (2)	1,100	521	4%	465	-7%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
BAMI (1)	500	521	4%	465	-7%	n.a.	587	n.a.	481	n.a.	n.a.	631	n.a.	544	n.a.
UBI	732	326	-55%	363	-50%	874	421	-52%	499	-43%	n.a.	415	n.a.	493	n.a.

(1) Guidance provided in the 2Q19 conf call

(2) business plan presentation of May 2016

Source: Equita SIM estimates and company data

The Gold Standard of a Business Plan Presentation in a Poor Outlook

- **Golden rule #3: “Elaborate on recurring profitability, for how low it can be”**

Banks must disclose t+1 targets, as investors do not incorporate medium term indications

We believe that banks can improve the communication and the remuneration of the shareholders, partly returning the benefit of the collapsing sovereign spreads to shareholders via dividend distribution

Investors are very sceptical about the business plan targets of the banks

PERFORMANCE AFTER BUSINESS PLAN PRESENTATION

	Date of the plan	+1 week	+2 weeks	+1 month
BPE	28/02/2019	-3.4%	-3.3%	-5.0%
CVAL	18/06/2019	-3.2%	-4.5%	0.6%
BMPS	05/07/2017	n.a.	n.a.	n.a.
ISP	06/02/2018	0.4%	-1.9%	-3.7%
UCG	13/12/2016	-2.7%	-2.6%	-9.9%
BAMI	16/05/2016	3.6%	1.1%	-16.3%
UBI	27/06/2016	-8.8%	-2.6%	2.2%
MB	16/11/2016	-8.6%	-8.7%	-3.3%

Source: Equita SIM estimates and company data

The Gold Standard of a Business Plan Presentation in a Poor Outlook

- Golden rule #4: “Increase shareholders remuneration via on dividend payout”

Stock	Price	DPS			Pay out %			Yield %		
	30.09.19	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Intesa Sanpaolo	2.16	20	17	18	85%	72%	70%	9.1%	8.1%	8.3%
Eni	14.05	86	87	90	72%	56%	53%	6.1%	6.2%	6.4%
Azimut	17.23	105	110	110	52%	69%	67%	6.1%	6.4%	6.4%
Unipol Sai	2.43	15	15	16	69%	65%	66%	6.0%	6.2%	6.4%
Unicredit Group	10.80	62	63	68	30%	33%	33%	5.7%	5.8%	6.3%
Atlantia	21.95	122	134	148	68%	82%	82%	5.6%	6.1%	6.7%
FCA	11.87	65	70	80	23%	21%	21%	5.5%	5.9%	6.7%
Generali	17.86	95	100	110	60%	58%	60%	5.3%	5.6%	6.2%
Snam Rete Gas	4.61	24	25	26	76%	78%	77%	5.2%	5.4%	5.7%
Enel	6.79	33	37	39	70%	70%	70%	4.9%	5.5%	5.8%

Today only **2 banks** are in the **1st quartile** in terms of Dividend yield of the FTSE MIB

Stock	Price	DPS			Pay out %			Yield %		
	30.09.19	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Intesa Sanpaolo	2.16	20	17	18	85%	72%	70%	9.1%	8.1%	8.3%
Unicredit Group	10.80	94	94	94	46%	49%	46%	8.7%	8.7%	8.7%
Banco BPM	1.84	13	13	13	36%	32%	30%	6.8%	6.8%	6.8%
Eni	14.05	86	87	90	72%	56%	53%	6.1%	6.2%	6.4%
Azimut	17.23	105	110	110	52%	69%	67%	6.1%	6.4%	6.4%
Unipol Sai	2.43	15	15	16	69%	65%	66%	6.0%	6.2%	6.4%
BPER Banca	3.52	20	20	20	43%	33%	30%	5.7%	5.7%	5.7%
UBI Banca	2.56	14	14	14	50%	39%	44%	5.6%	5.6%	5.6%
Atlantia	21.95	122	134	148	68%	82%	82%	5.6%	6.1%	6.7%
FCA	11.87	65	70	80	23%	21%	21%	5.5%	5.9%	6.7%

With a revised dividend policy, **5 banks** would be in the **1st quartile** in terms of dividend yield

Annexes

Banking Sector Multiples

Italian Bank Multiples and Ratios on Tangible Book Value *														Performance **				
Large joint-stock banks	Price		2019E				2020E				2021E				Absolute			
	€	Adj PE	PTE	Adj ROTE	cT1 ***	Adj PE	PTE	Adj ROTE	cT1 ***	Adj PE	PTE	Adj ROTE	cT1 ***	1m	3m	6m	12m	
Bca Monte dei Paschi di Siena	1.08	59.9x	0.13x	0.2%	11.3%	8.4x	0.13x	1.5%	11.1%	7.4x	0.12x	1.7%	11.4%	3%	-15%	-28%	-56%	
BancoBPM	1.79	5.2x	0.30x	5.8%	12.0%	4.4x	0.29x	6.6%	12.4%	4.3x	0.27x	6.5%	12.8%	7%	-6%	-9%	-29%	
BancoBPM Stub ⁽¹⁾	1.28	5.9x	0.23x	3.9%	13.0%	3.3x	0.22x	6.9%	13.4%	3.2x	0.21x	13.8%	13.0%	-	-	-	-	
Intesa Sanpaolo	1.88	8.7x	0.85x	9.7%	12.7%	8.1x	0.84x	10.4%	13.0%	7.5x	0.83x	11.2%	12.4%	3%	-15%	-3%	-24%	
Mediobanca (year=june of that year)	9.07	9.8x	0.88x	9.0%	14.6%	10.0x	0.85x	8.7%	14.8%	9.7x	0.81x	8.6%	15.0%	10%	-3%	23%	14%	
Unicredit Group	10.83	5.6x	0.44x	7.9%	11.8%	5.3x	0.42x	8.2%	12.4%	5.0x	0.40x	8.2%	12.4%	6%	-9%	9%	-24%	
Unicredit Stub ⁽²⁾	9.50	5.4x	0.42x	7.9%	12.3%	5.1x	0.40x	8.0%	12.9%	4.8x	0.37x	8.0%	12.9%	-	-	-	-	
UBI Banca	2.40	6.6x	0.37x	5.7%	12.0%	6.9x	0.35x	5.2%	12.3%	8.0x	0.34x	4.4%	12.5%	5%	-2%	-5%	-27%	
BP Emilia Romagna	3.58	7.4x	0.44x	6.0%	12.7%	7.1x	0.37x	5.7%	12.9%	6.0x	0.36x	6.2%	13.2%	6%	-3%	7%	-24%	
Average		14.7x	0.49x	6.3%	12.4%	7.2x	0.46x	6.6%	12.7%	6.8x	0.45x	6.7%	12.8%	6%	-6%	4%	-19%	
Median		6.6x	0.42x	6.0%	12.3%	6.9x	0.37x	6.9%	12.9%	6.0x	0.36x	8.0%	12.8%	6%	-4%	2%	-24%	

Co-operative bank	Price		2019E				2020E				2021E				Absolute			
	€	Adj PE	PTE	Adj ROTE	cT1 ***	Adj PE	PTE	Adj ROTE	cT1 ***	Adj PE	PTE	Adj ROTE	cT1 ***	1m	3m	6m	12m	
BP Sondrio	1.95	9.1x	0.33x	3.6%	12.0%	7.3x	0.32x	4.4%	12.2%	7.2x	0.30x	4.3%	12.4%	-6%	-22%	-26%	-43%	
Average		9.1x	0.33x	3.6%	12.0%	7.3x	0.32x	4.4%	12.2%	7.2x	0.30x	4.3%	12.4%	-6%	-22%	-26%	-43%	
Median		9.1x	0.33x	3.6%	12.0%	7.3x	0.32x	4.4%	12.2%	7.2x	0.30x	4.3%	12.4%	-6%	-22%	-26%	-43%	

Small-cap joint-stock banks	Price		2019E				2020E				2021E				Absolute			
	€	Adj PE	PTE	Adj ROTE	cT1 ***	Adj PE	PTE	Adj ROTE	cT1 ***	Adj PE	PTE	Adj ROTE	cT1 ***	1m	3m	6m	12m	
CR Genova	-	-	-	0.0%	13.6%	-	-	0.0%	12.9%	-	-	0.0%	12.2%	-	-	-	-	
Credito Emiliano	4.24	7.7x	0.62x	8.0%	12.9%	7.2x	0.59x	8.4%	13.1%	7.3x	0.58x	8.0%	13.2%	-5%	-16%	-16%	-33%	
Credito Valtellinese	0.06	12.6x	0.24x	1.9%	14.2%	6.0x	0.23x	4.0%	14.2%	4.9x	0.23x	4.7%	14.4%	-6%	-22%	-23%	-41%	
Average		10.1x	0.43x	3.3%	13.5%	6.6x	0.41x	4.1%	13.4%	6.1x	0.40x	4.2%	13.3%	-5%	-19%	-19%	-37%	
Median		10.1x	0.43x	1.9%	13.6%	6.6x	0.41x	4.0%	13.1%	6.1x	0.40x	4.7%	13.2%	-5%	-19%	-19%	-37%	

Sector average		11.3x	0.41x	4.4%	12.7%	7.0x	0.40x	5.1%	12.8%	6.7x	0.39x	5.1%	12.8%	-2%	-16%	-14%	-33%
Sector median		7.4x	0.42x	5.9%	12.7%	6.9x	0.37x	6.8%	12.9%	6.0x	0.36x	7.3%	12.9%	4.8%	-9%	-5%	-27%

⁽¹⁾ Excluding the stake in Anima SGR and the value of Agos Ducato applying the strike price of the put option with CASA on the entire stake

⁽²⁾ Excluding the stake in Yapi Kredi, Fineco and Mediobanca

* Averages are not market cap weighted

** Excluding dividends

*** Fully loaded for IFRS9 FTA

Source: EQUITA SIM



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