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Banca Popolare di Vicenza Group

European Banks

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BPVi is the 10th largest bank with 2% market share by loans in Italy with a footprint mainly in the wealthy Veneto region where it has a market share of ~7% by loans and branches. The business model is simple, based on distribution and customer acquisition, and historically its client franchise has been focused on mid corporates. The group had total assets of €39.8bn at end-2015, and operates through 579 branches. Total customer loans were €25.2bn (59% corporates) and direct funds €21.9bn at end-2015. The group aims to raise €1.5bn of capital in the IPO to improve CET1 above 12%, and new management has laid out a new strategy, risk management and turnaround to make €309m of net profits and 8.2% ROTE in 2020.

- **New management addressing legacy issues**: Management has been entirely changed and the new team has carried out a major clean-up of the balance sheet with material loan impairments and full deduction from CET1 for the €1.1bn loans-for-shares scheme. Some litigation risks remain with possible client disputes and prosecutors still investigating alleged market violations and claims of deceiving regulators. BPVi has received claims of ~€600m, including ~€400m for financed capital. Issues around financed capital are fully provisioned, and BPVi booked €136m provision for risks & charges to address potential claims and risks on BPVi treasury shares.
- **High gearing to Italian macro and market rates:** BPVi targets a 4.1% revenue CAGR 2015-20, mostly driven by a 5.8% Net Interest Income CAGR, with a loans CAGR of 3.7%, rising rates (with 3m Euribor at 59bp in 2020) and increases in government bond exposure. Our estimates assume: a) more modest lending volumes as we expect the bank to recover only part of the lost funding, b) more limited rates increases and c) more margin pressure. We forecast NII increasing at a 3.9% CAGR 2015-20 and total revenues growing at just 2.0%. Profit sensitivity to NII is high – every 1% additional loan growth per year over 2015-2020 would increase net earnings by ~€20m in 2020e, and every 10bp lower funding costs would add ~€14m.
- **Asset quality improvement is key for earnings growth:** After provisioning €1.3bn or 529bp in 2015, the group expects cost of risk to drop to 77bp in 2018 and 70bp in 2020. BPVi has a high level of impaired loans at 30.9% of total, mostly as a result of the bad loans to SMEs. Impaired loan coverage at 40.6% end-2015 will have to be improved further towards 46.3% in 2020e (vs. target 45.4%), in our view. We expect cost of risk to decline to 94bp in 2018 and 81bp in 2020. Should macro recovery be stronger than expected, there could be upside to our estimates – every 10bp lower cost of risk would add €20m of net profits.
- **The key risks, in our view, are:** 1) Margin pressure from very negative interest rates; 2) high level of impaired loans with room still to improve impaired loan coverage; 3) vulnerable liquidity position, due to the reliance on short-term funding, with close to half of the funding coming from corporates and institutionals; 4) capitalization levels highly sensitive to earnings – mostly driven by the pace of improvement in provisioning levels; and 5) governance and the credit risk management structures that have been redesigned by new management, but which are untested.

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Table of Contents

Executive summary

BPVi is targeting €1.5bn of capital in the IPO to improve CET1 above 12%, and new management has laid out a strategy, risk management and structural turnaround to make €309m of net profits and 8.2% ROTE in 2020. The bank faced funding challenges in H2 15 due to the negative headlines around the loans-for-shares scheme, and also following the bail-in of the four small Italian banks. A successful €1.5bn IPO should, however, help restore investor confidence.

Key considerations

- **Without the €1.5bn IPO, the bank could be resolved, imposing losses on shareholders and creditors**, as the bank would fail to meet the ECB requirements of a Basel 3 CET1 of 10.25%, with phased in CET1 at 6.65% end 2015.
- **Unicredit has fully guaranteed the €1.5bn IPO,** hence, if the take-up is lower than expected, Unicredit would buy any unsold shares, and could become the main shareholder of the bank. Although proceeds would be secured, management does not view this scenario as desirable, and as such, has lined up 5 banks to market the transaction.
- **Disposals and adoption of AIRB models would provide additional capital of ~€225m,** on our estimates. The group intends to sell its ~20% stake in Italian asset manager Arca, its consumer finance subsidiary, PrestiNuova, its online subsidiary servicing pharmacies, FarBanca, its private equity subsidiary, NEM SGR, and its real estate company, Immobiliare Stampa.
- **Banca Popolare di Vicenza could be seen as an attractive M&A target**, in our view, given its strong presence in Veneto, which accounts for 14% of total national exports and 9% of total Italian GDP. Veneto accounts for 39% of BPVi's total loans, and the group has a loan market share of 7% in the region.

Key risks

- **Litigation risk**: Vicenza prosecutors are still investigating alleged market violations and deceiving regulators, and several consumer groups could consider taking legal action against the bank and/or its former employees.
- **Liquidity risk**: BPVi's liquidity position could remain vulnerable with only €1bn of unencumbered assets and LCR of >80%, due to its reliance on short-term funding, with close to half of its funding coming from corporates and institutions. According to the company, 43% of total direct funding is from retail customers that have more than €100,000 in direct funding and bonds, and should there be concerns on the bank's solvency, these customers could reduce their deposits below the €100,000 threshold to avoid participating in the bail-in process. In addition, 90% of BPVi shareholders are also customers with deposits at the bank – private shareholders had €1.8bn of direct funding at the bank, of which €530m was bonds, €87m subordinated bonds. Should capital be at risk, shareholders could withdraw deposits from the bank. The €1.5bn IPO and estimated €4.7bn TLTRO II should, however, help reduce liquidity risk, in our view.
- **Interest rate risk**: NII growth is highly dependent on lending volumes, Euribor rates increases and the government bond portfolio. While the bank has put in place some interest rate hedges, there could be further downside risks in a very

negative rates environment, in our view, with increased pressure on asset spreads and limited offset from commissions.

- **Asset quality risk:** BPVi had a high level of impaired loans, at 30.9%, and impaired loan coverage, at 40.6% at end-2015. Coverage will have to be improved significantly towards 46.3% in 2020e, in our view, which limits the speed of recovery in cost of risk. The bank has conducted a clean-up of the loan book by reclassifying €2.4bn of performing loans into impaired in 2015, on top of the €1.2bn already done in 2014; however, we believe we cannot rule out further loan reclassifications.
- **Capital risk**: Including the €1.5bn IPO, Basel 3 CET1 FL would stand at 12.4% pro forma end-2015. However, we expect some decreases in capital levels to 12.0% at end-2020e, as CET1 is eroded by losses in 2016e (largely related to restructuring costs), followed by limited capital build. Capitalization levels remain highly sensitive to earnings, in particular NII and cost of risk. Any large loan impairment would reduce the capital buffer. In addition, if the EBA stress test in 2016 unveils further weaknesses, the ECB could raise the SREP requirement of 10.25% for BPVi.
- **Governance risk**: In its 2015 review, the ECB highlighted issues around governance and internal controls of BPVi. In response, BPVi has already started to implement the relevant actions, and is to submit a special action plan, after receiving the ECB's "final decision". Governance and the credit risk management structures have been redesigned by new management, but are untested. In addition, the management team is relatively new and has a limited track record at the bank.
- **Estimate risk**: As is the case with other comparable banks, the net income forecasts we have for the company will vary significantly if any of our underlying assumptions for net loan growth, rates, or cost of risk are changed by small amounts. If the company achieves lower net loan growth and/or suffers greater margin pressure with higher cost of risk than we assume in our current forecasts, it may not become profitable until after 2018.

JPM estimates vs. company targets

Our estimates are 30% below company targets, with net profits of €141m in 2018e vs. targeted €202m, and €218m in 2020e vs. targeted €309m, mainly due to lower Net Interest Income and fees & commissions.

- **Net Interest Income growth of 3.9% CAGR 2015-20e vs. targeted growth of 5.8%**: We forecast more modest lending volumes with a CAGR of 2.4% vs. targeted 3.7%, as we expect the bank to recover only part of the lost funding. We also see more margin pressure with: 1) commercial spreads improving 27bp from ~170bp in 2015 to 197bp in 2020e on funding cost repricing, vs. targeted improvement of ~50bp by 2020; and 2) lower market rates with Euribor at 29bp only in 2020e vs. 59bp assumed by management in the business plan.
- **Net fees and commission CAGR of ~4% 2015-20e vs. targeted 7.1%:** We forecast a solid net fees & commissions CAGR of ~4%, with indirect funding progressing at a 4.4% CAGR and AuM at a 6.7% CAGR. This is, however, lower than the targeted 7.1% CAGR in fees and 7.2% CAGR in indirect funding, including a 12.1% CAGR in AuM.

- **Cost reduction in line with management:** We expect group expenses to decrease at a ~4% CAGR 2015-20, broadly in line with management's target, supported by a branch reduction of 79 and staff cut of ~485 by 2020. Our cost/income ratio is, however, higher at 57.6% in 2018e and 52.4% in 2020e vs. the targeted 54.4% and 47.6% respectively, due to lower revenues.
- **Cost of risk 81bp in 2020e vs. targeted 70bp:** We expect slightly slower improvement in provisions from 529bp to 81bp in 2020e vs. targeted 70bp, as we see impaired loan coverage increasing from 40.6% at end-2015 to 46.3% at end-2020e vs. targeted 45.4% in 2020.

We note that the company's business plan and our estimates do not include the benefit from ACE ("allowance for corporate equity") in terms of lower tax, for the period 2016-2020 stemming from the planned €1.5bn IPO, equivalent to €8.9m in 2016 and €14.6m per year starting from 2017.

Table 1: BPVi – Summary P&L & balance sheet 2015-2020e – JPMe estimates vs. company targets

€ million

	2015 Actual	2018e JPMe	2020e JPMe	2018 Target	2020 Target	2015-2018e CAGR JPMe	2015-2020e CAGR JPMe	2015-2018 CAGR Target	2015-2020 CAGR Target
Net Interest Income	504	561	609	579	669	3.6%	3.9%	4.7%	5.8%
Net commissions	322	354	394	401	453	3.2%	4.1%	7.5%	7.0%
Trading income	163	80	80	84	85	-21%	-13%	-20%	-12%
Other	63	80	80	79	82	8%	5%	8%	5%
Total revenues	1,053	1,075	1,163	1,143	1,289	0.7%	2.0%	2.8%	4.1%
Operating expenses	-754	-619	-610	-622	-613	-6.4%	-4.2%	-6.2%	-4.1%
Pre-provision profits	298	456	553	521	676	15.2%	13.1%	20%	18%
Loan loss provisions	-1,333	-250	-230	-220	-214	-43%	-30%	-45%	-31%
Other provisions & other	-858	0	0	-	-	-	-	-	-
Pretax	-1,893	206	323	-	-	-	-	-	-
Net income	-1,407	141	218	202	309	-	-	-	-
Net Loans*	25,051	26,346	28,150	28,174	30,073	1.7%	2.4%	4.0%	3.7%
Direct Funding ex CCG	21,943	24,772	26,147	26,439	28,231	4.1%	3.6%	6.4%	5.2%
Indirect Funding**	14,550	16,468	18,018	18,628	20,584	4.2%	4.4%	8.6%	7.2%
Tangible equity***	2,523	4,046	4,215	3,607	3,768	17.0%	10.8%	12.7%	8.4%
NIM	1.52%	1.69%	1.78%	-	-				
Cost/Income	71.6%	57.6%	52.4%	54.4%	47.6%				
Cost of risk****	5.29%	0.94%	0.81%	0.77%	0.70%				
ROTE Adjusted	-36.2%	3.5%	5.2%	5.6%	8.2%				
Capital and liquidity									
Basel 3 CET1 fully loaded	5.9%	12.0%	12.0%	12.0%*****	12.9%				
RWAs	24.9	25.9	27.2	26.8	28.2				
Texas ratio – BPVi definition	210.9%	-	-	110.7%	95.3%				
LCR	47.5%	-	-	115.4%	122.0%				
Net loans (ex CCG) / Direct Funding*	114%	107%	108%	107%	107%				
Asset quality									
NPL/Bad loans ratio	15.1%	15.9%	15.0%	14.7%	13.8%				
Total impaired loan ratio	30.9%	27.5%	24.3%	25.0%	22.7%				
NPL/bad loans coverage ratio	56.8%	57.0%	56.5%	54.3%	55.5%				
Total impaired loan coverage	40.6%	44.9%	46.3%	43.4%	45.4%				

Source: J.P. Morgan estimates, Company data. Note: Basel 3 CET1 fully loaded estimates including JPMe assumption of dividend payout of 50% from 2017 in line with BPVi management guidance. * Net loans outstandings excluding repurchase agreements with Cassa Compensazione e Garanzia. ** Indirect funding excludes own shares held by customers. *** Tangible equity in 2015 excluding the €1.5bn IPO. **** cost of risk on end period net loans. ***** transitional target

SWOT analysis

Table 2: BVPi SWOT Analysis

Strengths	Weaknesses
• Strong presence in wealthy Veneto region accounting for 39% of its total loans and 38% of total group branches with market share of ~7% both by loans and branches in this region. • Simple bank business model, based on strong distribution and client acquisition capabilities with loyal customer base – average net increase in customer base of over 55k per year. • New management team with strong track record in other Italian banks including ISP, UBI and PMI – 13 out of the 16 management team members are newly appointed. CEO Francesco Iorio benefits from his previous experience in bank turnaround/restructuring.	• High level of impaired loans at 30.9% end-2015 makes the bank vulnerable to changes in the credit cycle, limits the speed of recovery in cost of risk to normalized levels. Impaired loan coverage at 40.6% end-2015 will have to be improved significantly, in our view. • Vulnerable liquidity position due to the reliance on short-term funding, with close to half of the funding coming from corporates and institutions. Some 43% of total direct funding is from retail customers that have more than €100,000 in deposits and bonds. In addition, 90% of BPVi shareholders are also customers with deposits at the bank – should capital be at risk, shareholders could withdraw deposits from the bank • Capitalization levels highly sensitive to earnings – mostly driven by the pace of improvement in provisioning levels. • Governance and the credit risk management structure has been redesigned with new management but untested
Opportunities	**Threats**
• Improved cost efficiency from further branch closures and headcount reduction beyond current targets • Higher commissions revenues from increased cross selling and client coverage for core segment with new and greater numbers of relationship managers. • Potential capital release from disposals of non-strategic assets, internal model adoption (AIRB) and reimbursement of financed capital. • BPVi could be seen as an attractive target Italian banking sector consolidation: in our view, given its strong presence in Veneto. • BPVi has made no comment on any participation in the Italian government's guarantee scheme for NPL securitisations (GACS), however, this scheme could potentially help the NPL disposal process further.	• Potential litigation and reputation risk related to financed capital: While the €1,139m financed capital has been fully deducted from CET1 capital and adequately provisioned, there could be potential reputation risks and litigation risks in the short/medium term – risks of disputes with customers, and Milan prosecutors are still investigating alleged market violations and deceiving regulators. • Dependence on lending volume growth, Euribor rates increases and government bond portfolio for NII growth. Very negative rates could have unintended consequences on NII progression and group profitability, in our view. • Additional regulatory constraints on sovereign exposures – cap on sovereign holdings as percentage of total assets/capital or potentially higher risk weightings for sovereign holdings. Any big changes would put the NII growth at risk, in our view, given government bonds account for 90% of the securities portfolio and 13% of total assets.

Source: J.P. Morgan estimates.

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Valuation methodology

Price to earnings (P/E)

P/Es have historically been used to value banks. However, banks' earnings can be volatile and, hence, sustainable or normalized earnings should be used while using this method and 12m forward earnings may not be appropriate for all banks.

Price to tangible book or net asset value (P/TNAV)

P/TNAV has also been used to value banks. However, it should be looked at in conjunction with potential for losses that may deplete TNAV and also take into account any excess capital, prospective returns, business mix and growth opportunities.

Key P&L and balance sheet overview

Table 3: Italian Banks: Key Metrics

€ million

	BPVi	BMPS	Pop Milano	Banco Popolare	Pop Emilia	UBI Banca	Carige	Credito Valtellinese	ISP	UCG
Market cap	-	1,355	2,376	1,778	1,934	2,738	450	601	37,021	17,501
Total assets	39,783	169,012	50,203	120,510	61,261	117,201	30,356	26,902	676,496	860,433
Total branches	579	2,548	655	1,813	1,216	1,554	620	526	5,600	6,934
Total staff	5,473	25,961	7,747	16,731	11,447	17,718	5,100	4,123	91,000	125,510
Total Loans 2015	25,178	111,366	34,187	78,422	43,703	84,586	21,473	19,050	350,010	473,999
Direct funding 2015	21,943	119,275	37,602	82,141	47,256	91,512	23,422	21,695	372,183	584,268
Asset quality - 2015										
Gross Bad debt ratio	15.1%	19.8%	8.9%	12.3%	14.5%	7.9%	14.3%	13.1%	10.2%	9.9%
Total Gross NPL ratio	30.9%	34.8%	16.3%	24.2%	23.3%	15.1%	27.8%	26.2%	16.5%	15.4%
Bad debt coverage	56.8%	63.4%	54.5%	38.3%	58.2%	38.6%	60.4%	57.1%	61.8%	61.0%
Total NPL coverage	40.6%	48.5%	39.6%	31.9%	44.2%	27.9%	42.4%	40.2%	47.6%	51.2%
Annualised cost of risk*	-5.00%	-1.70%	-1.03%	-1.02%	-1.61%	-0.94%	-1.27%	-2.32%	-0.96%	-0.87%
Texas ratio	117%	147%	86%	158%	119%	112%	129%	132%	95%	95%
Loan loss provisions	-1,333	-1,991	-342	-804	-706	-803	-287	-442	-3,306	-4,114
Capital - 2015										
Tangible Equity	4,023	9,192	4,627	6,451	4,509	8,224	2,378	2,009	39.035	42,429
Basel 3 CET1 FL	12.4%	11.7%	12.2%	12.4%	11.2%	11.6%	-	13.5%	13.1%	10.94%
ECB capital requirements**	10.25%	10.75%	9.0%	9.55%	9.25%	9.25%	11.25%	8.3%	9.50%	10.75%
Liquidity - 2015										
LCR***	48%	222%	-	181%	>100%	>100%	140%	>100%	>100%	-
Net loans/Direct Funding	115%	93%	91%	95%	92%	92%	92%	88%	94%	81%
Profitability - 2017e										
NII % revenues	51%	49%	50%	43%	57%	49%	49%	55%	41%	52%
Fees % revenues	32%	49%	38%	44%	36%	42%	41%	36%	47%	37%
Other % revenues	17%	1%	12%	13%	7%	9%	10%	9%	11%	11%
Cost/Income	61%	58%	58%	63%	58%	63%	83%	63%	49%	58%
Net profits	62	298	286	372	310	369	4	85	2,739	1,694
ROE	1.6%	4.0%	5.9%	4.1%	5.6%	3.4%	-1.0%	3.8%	8.6%	5.9%

Source: J.P. Morgan estimates, Company data, Bloomberg (COB 5 April 2016). Note: BPVi capital is proforma €1.5bn IPO. Profitability 2017e is Bloomberg consensus for Pop Milano, Pop Emilia, BP, UBI, Carige, CreVal . * on average loans ** on a fully loaded basis as of 1 Jan 2019 *** LCR for BPVi was > 80% in Jan 2016. Texas ratio is calculated as gross non-performing loans over the sum of equity and loan loss reserves. Tangible equity for UCG and ISP is excluding AT1 and savings shares and related cost

Peers comparison

Table 4: European Banks: Summary Valuations 2016E-2017E

lcl currency, %

		P/E		P/TNAV		RoNAV		Div yield	
	Price	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
UK									
Barclays	147p	11.2x	6.6x	0.5x	0.5x	4.9%	8.2%	2.0%	2.0%
HSBC	418p	8.8x	10.2x	0.8x	0.8x	8.9%	7.8%	8.6%	8.6%
Lloyds	67p	8.7x	8.0x	1.1x	1.1x	13.6%	13.8%	6.7%	9.0%
Royal Bank of Scotland	211p	10.9x	9.1x	0.7x	0.6x	5.7%	7.1%	0.0%	4.7%
Standard Chartered	433p	21.1x	8.2x	0.5x	0.5x	2.4%	5.9%	0.0%	4.6%
Ireland									
Bank of Ireland	0.255€	10.3x	9.1x	1.0x	1.0x	10.0%	10.8%	2.4%	5.0%
France & Netherlands									
BNP Paribas	€43.0	8.4x	8.2x	0.8x	0.7x	9.5%	9.1%	4.2%	4.2%
CASA	€9.1	8.1x	8.5x	0.8x	0.7x	9.8%	8.7%	4.4%	4.4%
Natixis	€4.2	11.4x	10.8x	1.0x	1.0x	8.9%	9.0%	5.7%	6.0%
Societe Generale	€31.1	8.2x	7.6x	0.6x	0.6x	7.4%	7.8%	3.9%	3.9%
ABN AMRO	€17.4	9.1x	8.5x	0.9x	0.9x	10.6%	10.8%	4.9%	5.9%
ING	€10.1	8.4x	8.2x	0.8x	0.7x	9.3%	9.1%	7.4%	7.9%
Spain									
Bankinter	€6.1	17.5x	12.1x	1.4x	1.4x	11.4%	11.3%	2.9%	4.1%
BBVA	€5.5	9.3x	8.1x	0.9x	0.9x	10.3%	11.2%	5.4%	4.3%
Popular	€2.1	12.5x	9.0x	0.4x	0.4x	3.6%	4.8%	1.9%	2.8%
Sabadell	€1.5	11.3x	9.2x	0.7x	0.7x	6.7%	7.8%	4.8%	5.4%
Santander	€3.7	8.3x	7.0x	0.9x	0.8x	10.7%	11.6%	5.5%	5.5%
Caixabank	2.5	10.9x	8.2x	0.6x	0.6x	5.9%	7.7%	4.8%	5.5%
Bankia	€1	9.5x	8.9x	0.7x	0.7x	7.5%	7.7%	3.7%	5.1%
Italy									
Intesa Sanpaolo	€2.2	10.7x	9.3x	1.0x	1.0x	9.0%	10.3%	8.1%	9.5%
Montepaschi	€0.5	8.7x	4.0x	0.1x	0.1x	1.7%	3.6%	0.0%	0.0%
UniCredit	€2.9	6.8x	5.8x	0.4x	0.4x	6.0%	6.9%	3.3%	4.6%
Investment Banks									
Credit Suisse	SwF 12.9	36.4x	11.8x	0.7x	0.6x	-0.8%	4.4%	0.0%	0.0%
UBS	SwF 14.4	11.5x	10.2x	1.1x	1.1x	10.0%	11.0%	5.2%	6.2%
Deutsche Bank	€14.0	7.4x	5.6x	0.4x	0.4x	5.2%	6.8%	0.0%	0.0%
Germany & Switzerland									
Julius Baer	SwF39.1	11.7x	11.0x	3.2x	2.8x	27.5%	25.1%	3.1%	3.1%
Commerzbank	€7.3	8.7x	7.3x	0.3x	0.3x	4.1%	4.6%	2.7%	4.1%
Deutsche Pfandbriefbank	€8.8	8.0x	7.0x	0.5x	0.5x	5.7%	6.6%	6.3%	7.2%
Nordics									
Danske Bank	Dkr 177.0	9.8x	8.8x	1.1x	1.1x	12.0%	12.6%	5.1%	5.7%
DNB	NKr 94.1	8.4x	8.4x	0.8x	0.8x	10.1%	9.5%	4.7%	6.0%
Handelsbanken	SKr 100.6	13.2x	12.9x	1.6x	1.6x	12.4%	12.3%	6.0%	6.0%
Nordea	SKr 74.7	9.2x	8.7x	1.1x	1.1x	12.5%	12.8%	8.3%	8.8%
SEB	SKr 77.2	10.2x	9.4x	1.3x	1.2x	12.5%	13.1%	7.4%	8.1%
Swedbank	SKr 160.7	10.7x	10.4x	1.6x	1.5x	14.8%	14.6%	7.0%	7.2%
CEEMA									
Erste	€24.6	8.5x	7.2x	1.1x	1.0x	12.9%	13.9%	3.5%	4.8%
Raiffeisen	€12.8	10.8x	4.5x	0.5x	0.5x	4.8%	10.7%	0.0%	0.0%
KBC	€45.6	9.8x	8.5x	1.4x	1.3x	14.7%	16.0%	5.6%	8.6%
Weighted avg.		10.5x	8.8x	0.9x	0.9x	9.5%	10.1%	5.2%	6.0%

Source: J.P. Morgan estimates, priced from Bloomberg COB 5th April 2016

We show below valuation multiples, financial targets and key financial and performance metrics for Banca Popolare di Vicenza peer group, which we identify as owing to relative similarities in business models.

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Table 5: Italian bank valuations 2016e-18e

	PE 2016e	PE 2017e	PE 2018e	P/BV 2016e	P/BV 2017e	P/BV 2018e	ROE 2016e	ROE 2017e	ROE 2018e	Div Yield 2016e	Div Yield 2017e	Div Yield 2018e
Intesa SanPaolo	10.7	9.3	8.2	0.8	0.8	0.8	7.5%	8.5%	8.8%	8.1%	9.5%	11.3%
Monte Paschi di Siena	8.7	4.0	2.9	0.1	0.1	0.1	1.6%	3.4%	4.6%	0.0%	0.0%	0.0%
Unicredit	6.8	5.8	4.9	0.3	0.3	0.3	3.1%	5.5%	6.5%	3.3%	4.6%	5.6%
UBI Banca	10.5	7.6	6.1	0.3	0.3	0.3	2.5%	3.4%	3.9%	6.2%	6.2%	6.9%
Banco Popolare	6.2	4.9	4.2	0.2	0.2	0.2	3.2%	4.3%	4.9%	6.1%	6.1%	9.0%
Pop Milano	10.0	8.1	7.3	0.5	0.5	0.5	5.1%	6.0%	6.2%	6.1%	6.1%	6.5%
Pop Emilia	9.1	6.3	5.2	0.4	0.4	0.3	4.2%	5.8%	6.3%	6.2%	6.2%	7.8%
Banca Carige				0.2	0.2		-4.3%	-1.2%	-0.2%			
Italian Banks average*	8.9	6.6	5.5	0.4	0.4	0.4	3.9%	5.3%	5.9%	5.2%	5.5%	6.7%
Europe Banks average**	10.5	8.8	-	-	-	-	-	-	-	5.2%	6.0%	-

Source: J.P. Morgan estimates, priced from Bloomberg (COB 5 April 2016), Bloomberg consensus for UBI, BP, Pop Milano, Pop Emilia, and Carige. * ex Carige ** banks in our coverage universe.

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Bank in transition

Financed capital, reputation and litigation risks

The ECB conducted two inspections of the bank in H1 15 to evaluate risk management and risk governance, focused on 1) the procedures for the subscription to the bank's 2013 and 2014 capital increases (€1.3bn in total) and 2) the trading on treasury shares. These inspections revealed serious anomalies and failures to comply with MIFID regulations in the placement of the last capital increases.

BPVi Group carried out two capital increases in 2013 and 2014:

- In 2013, the bank raised €606m of capital via €253m in an extraordinary capital increase, €100m in a capital increase intended for new shareholders and €253m in convertible bonds that were converted into shares in 2015.
- In 2014, the bank raised ~€700m via: 1) a €608m capital increase, which included an option for subscribers of the rights issue to subscribe to five-year registered bonds with annual return of 4%. The shares were offered at a price of €62.5 (1 share for every 9 shares held and 1 share for every 9 convertible bonds held), while the bonds were offered at the nominal value of €62.5; and 2) €102m capital increase aimed at expanding the membership base with shares offered to parties that did not own any of the bank's shares and to shareholders owning fewer than 100 shares.

Parts of the subscriptions/purchases of the bank's shares in the 2013-14 capital increases were linked to loan transactions for the purchase of such shares, i.e. the bank financed shareholders' participation in the right issues. Other anomalies were identified in the management of relations with shareholders.

The bank provided €1,086m of loans for the purchase or subscription of its shares. Out of the €1,086m loans outstanding, €508m is considered performing, €578m non-performing. In addition, €52m of anomalous capital is made up of commitment letters.

The €1,139m amount of financed capital was fully derecognized from CET1 capital as of end-Dec 2015, through:

- **€466m of loan loss provisions**, mainly to cover the €578m of non-performing exposure. Provisions were booked for clients/shareholders who were not in a financial position to reimburse the loans.
- **€353m of provisions for risk and charges**, mainly to cover the €508m of performing exposures – these client/shareholders are financially sound, however, most of the financed capital is not likely to be recovered.
- **€321m deducted from CET1 capital as "prudential filter"** imposed by the ECB.

Overall, the total €1,139m exposure was ~72% covered by provisions, with performing exposure ~55% covered and non-performing exposure ~87% covered. The bank believes that part of the €321m deducted for prudential purposes could be recovered over time, which would result in potential capital relief.

Table 6: BPVi Group – Breakdown of non-eligible capital

€ million

	Lending exposures/ financed capital	Loan loss provisions	Prov. for risk and charges	Total provisions	Coverage	Regulatory filter
Gross Performing Exposures	508	10	272	282	55.5%	226
Gross NPE	578	456	45	501	86.6%	77
Commitment letters	52	0	36	36	68.8%	16
Total as of 31/12/2015	1,139	466	353	819	71.9%	321

Source: Company data.

BPVi received claims of ~€600m, including ~€400m for financed capital, according to the company. Issues around financed capital are already adequately provisioned. In addition, **the bank booked additional €136m of provisions for risk and charges to address potential claims and other risks on BPVi treasury shares**. The €136m includes ~€40m for potential MiFID claims. The company has also assessed the potential litigation risks from shareholders that were not part of the financed capital scheme (2013-2014), and management estimates the potential claims at €50m-80m, but reminded that there are no real grounds for shareholders claims from a legal perspective (with investments well documented).

BPVi also wrote down €142m of its €350m investment in two Luxembourgian funds – the Athena and Optimum multi-strategy funds – which, according to the press[1], investigators suspect underwrote the bank's shares because the bank invested in the funds.

Overall, BPVi booked total €955m of provisions in 2015 related to the issues around financed capital and treasury shares, split €466m loan loss provisions and €489m provisions for risk and charges, which explain the great majority of the €1.4bn net loss in 2015.

While the €1,139m financed capital has been fully deducted from CET1 capital and adequately provisioned for, there could be potential reputation risks and litigation risks in the short/medium term:

- **There are risks of disputes with customers** related to the improper application of MIFID regulation, which could generate further liabilities. Some consumer groups filed complaints (e.g. Adusbef in 2008) related to the granting of loans tied to the purchase of shares[2], and there could be potentially more complaints or disputes. According to the bank, several consumer groups are active and are likely to file civil joinders in the perspective of criminal trial, or sue the bank and/or its former employees in civil court.
- **Prosecutors are still investigating alleged market violations and claims of deceiving regulators.** According to Italian law, a company cannot lend money for the purchases of its own shares, except under specific circumstances and after adequately informing shareholders about the risks of such transactions. Former bank Chairman Gianni Zonin, two board members, former CEO Samuele Sorato and two other former top executives have been placed under investigation. The bank is fully cooperating with authorities. While the investigation is focused on former executives, claims and damages against the bank rather than individuals only cannot be ruled out at this stage. The case is pending before the prosecutor's

[1] Il Sole, 22 Sept 2015
[2] http://www.reuters.com/article/italy-banks-popvicenza-probe-idUSL5N11V28H20150929

office of Vicenza and the preliminary investigation phase is still ongoing (maximum length being 18 months from the case filing in summer 2015).

- **Italy's antitrust authority has opened an investigation** for possible unfair practice related to twinned sale of mortgages and loans. [3] The antitrust authority has claimed that the bank had appeared to make "the concession of financing to clients such as mortgages, personal loans and credit on current accounts dependent on the purchase of the bank's shares and convertible bond".

Funding & liquidity

BPVi Group went through funding challenges twice in H2 15 – once at end-Sept as a result of the bad press around the ECB investigation into the loans-for-shares scheme, and then again following the failure of the four small Italian banks in Dec.

Overall, BPVi experienced €8.4bn of outflows in 2015, equivalent to ~28% of direct funding, including €1.8bn outflows related to Cassa di Compensazione e Garanzia (CCG), the CCP owned by Borsa Italiana. Of the €6.7bn outflows ex CCG:

- **€2.6bn came from financial institutions and large corporates** including asset managers, family offices and institutionals – management are confident that the outflows can be fully reversed post capital increase
- **Net €4bn outflows from retail clients (individuals and SMEs)**, split €7.4bn outflows partly offset by €3.7bn of inflows (including €1bn inflows from new clients). Out of the €7.4bn outflows, €1.1bn came from customers who by end-2015 had removed all deposits from the bank, and the remaining €6.3bn outflows resulted from clients reducing their deposits by ~55% on average. Note that management believes that most of the €6.3bn of outflows could also be reversed. Overall, most of the outflows resulted from decreases in current accounts, with €2.7bn outflows from clients reducing their deposits at the bank to below the €100,000 guaranteed level.

As a result, net loans to direct funding (net of CCG) deteriorated from 96% at end-2014 to 114% at end-2015. We expect the planned €1.5bn IPO to help restore confidence, and have assumed the bank would recover part of the €2.6bn outflows from large corporates and institutions, with direct funding increasing 9% to €24.0bn at end- 2016e and net loans to direct funding improving back to 107% at end-2016e. Funding gap been stable so far in 2016 compared to the end of 2015, which is encouraging. Management expects that a large part of total €9bn outflows (€2.6bn from large corporates & institutionals + €6.3bn from retail clients) can be recovered post IPO.

With some normalisation of funding trends in 2016e post IPO, we expect direct funding to increase at a 2.2% CAGR 2016-2020e. We expect slightly higher deposit growth, at a 2.4% CAGR 2016-2020e, vs. wholesale funding & retail bonds growth at a 1.9% CAGR (€4.9bn of maturing debt in the next four years fully refinanced), partly reflecting the structural shift from senior bonds and retail bonds to asset management and insurance. Note, however, that our estimates remain below company targets at €24.8bn of direct funding in 2018 vs. the target €26.4bn and €26.1bn in 2020 vs. the target €28.2bn.

[3] http://www.reuters.com/article/us-italy-popvicenza-probe-idUSKCN0WA28A, March 6,2016

Table 7: BPVi – Direct Funding vs. customer loans 2014-2020e

€ million

	2014	2015	2016e	2017e	2018e	2019e	2020e	2015	2016e	2017e	2018e	2019e	2020e
Current accounts	13,963	11,410	13,122	13,253	13,386	13,519	13,655	-18%	15.0%	1.0%	1.0%	1.0%	1.0%
Term deposits	2,579	1,712	2,054	2,259	2,485	2,734	3,007	-34%	20.0%	10.0%	10.0%	10.0%	10.0%
Other funding	12,071	8,821	8,795	8,600	8,901	9,196	9,485	-27%	-0.3%	-2.2%	3.5%	3.3%	3.1%
Total direct funding	28,613	21,943	23,970	24,112	24,772	25,449	26,147	-23%	9.2%	0.6%	2.7%	2.7%	2.7%
Total customer loans*	28,111	25,178	25,647	25,764	26,473	27,243	28,277	-10%	1.9%	0.5%	2.8%	2.9%	3.8%
Net loans / Direct funding	98%	115%	107%	107%	107%	107%	108%						

Source: J.P. Morgan estimates, Company data. * including CCG

The bank had LCR of 47.5% at end-2015, but improved this to above 80% by end Jan 2016, thanks to several funding initiatives:

- €400m bridge financing to the securitization Berica RMBS,
- €240m contribution of Banca Nuova and Farbanca as well as the parent company to the group, and
- €97m sale of Berica ABS 4 notes.

Post these measures, BPVi had €1bn of unencumbered assets in early Feb 2016, double the end-2015 level of €510m.

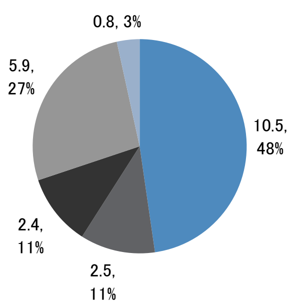
With the €1.5bn IPO, LCR ratio should improve to well above 100%, vs. target 115% in 2018 and 122% in 2020.

While the 2015 outflows were entirely the result of the extraordinary events, liquidity at the bank remains structurally more volatile as:

- **Close to half of the funding comes from corporates and institutions**, which tend to be less sticky than retail (Figure 1).
- **43% of total direct funding of commercial client segments (Community banking and Corporate & private banking) is from customers that have more than €100,000** in deposits and bonds, and should there be concerns on the bank's solvency, these customers could reduce their deposits below the €100,000 threshold to avoid participating in the bail-in process.
- **Many BPVi shareholders are also customers with deposits at the bank**. Some 90% of the 119,000 shareholders of BPVi are customers of the bank, and private shareholders had €1.8bn of deposits at the bank, €530m of bonds and €87m of subordinated bonds. Should capital be at risk, shareholders could withdraw deposits from the bank.

Figure 1: BPVi – Split of €21.9bn direct funding (net of CCG) at end-2015

€ billion



Source: Company reports.

BPVi offset the lost direct funding with increased reliance on ECB liquidity (through MRO), while encumbered assets (government bonds mostly) increased to €7.8bn at end-2015 from €4.6bn at end-2014. The planned €1.5bn IPO should help free up encumbered assets and reduce ECB liquidity; however, liquidity position remains vulnerable due to the reliance on short- term funding, in our view.

ECB TLTRO II reduces funding/liquidity risk, in our view. Banks will be able to borrow up to 30% of their euro area loans (excluding mortgages) for up to four years at the cost of the MRO (currently zero); for BPVi, we estimate the eligible loans amount to ~€15.7bn, which implies that the bank can take up a maximum of €4.7bn in TLTRO II auctions. The first TLTROs (€1.85bn for BPVi) can be rolled over into

TLTRO II and, in terms of lending volumes, if the bank deleverages less, it will be able to borrow at the rate of the deposit facility (currently -40bp). In our view, BPVi is likely to replace €4.7bn of its current €6.5bn ECB funding with the new TLTRO II, with positive funding benefits (-40bp under TLTRO II four-year funding vs. 5bp cost for old ECB funding with mostly short duration). Overall, ECB TLTRO II is a clear positive for funding, in our view.

Table 8: BPVi – Liquidity and net interbank position

€ million

	2013	2014	2015	Feb-16
LCR	-	95.3%	47.5%	> 80%
NSFR	-	102.1%	94.2%	-
Unencumbered assets	3,015	3,963	510	987
Encumbered assets	6,893	4,578	7,843	-
Total	9,908	8,541	8,353	-
Net interbank position	-4,259	-2,503	-7,823	-
ow ECB funding	-2,916	-1,544	-6,543	-
ow LTRO/TLTRO	-3,300	-1,249	-1,849	-
ow Other ECB	384	-295	-4,694	-
ow repo exposure	-738	-594	-851	-
ow other secured exposure	-374	-340	-675	-
ow Other	-231	-25	246	-

Source: Company reports.

Asset quality to be further improved

Significant loan book clean-up in 2015 and positive industry trends so far

BPVi's new management has conducted an in-depth review of the loan portfolio, resulting in loan loss impairments of €1.3bn in 2015, as 1) the group reclassified €2.4bn of performing loans to impaired loans, mostly unlikely-to-pay loans of €2.1bn, and 2) impaired loans coverage was increased to 42.4%, including write-offs, at end-2015 from 37.9% at end-2014.

Most of the €2.4bn reclassification and €1.3bn impairment in 2015 was related to management's in-depth review and the introduction of new impairment triggers (e.g. reduction on collateral values, real estate values, revenues, equity by 25%), and comes on top of the €1.25bn reclassifications done in 2014 and goes well beyond the requirements related to the ECB Asset Quality Review. Overall, the bank has reclassified total loans of €3.66bn to impaired loans over 2 years, equivalent to 12% of total gross loans, which is quite significant for a small multi-regional player.

Note that a significant part of the loan book clean-up was also related to the reclassification of €578m out of the total €1,139m loans provided in the context of financed capital, which triggered €466m of impairments.

Looking at the asset quality quarterly trends over the past three years, excluding the impact of the clean-up in 2015, there have been some encouraging signs with gross impaired loan formation declining, with gross inflows of 1.4% of performing loans in Q4 15, down from peak 3.0% in Q3 13 (Figure 2).

These trends are supported by lower inflows of gross bad loans (NPLs sofferenze) in the Italian banking industry, as illustrated in Figure 2 below. Based on Bank of Italy data, Italian NPLs were still growing at 9% YoY in Jan 2016. However, the growth has been slowing vs. an average of ~23% YoY growth over 2014. With higher lending volumes and performing loans outstanding picking up, NPL ratio should peak in the near term.

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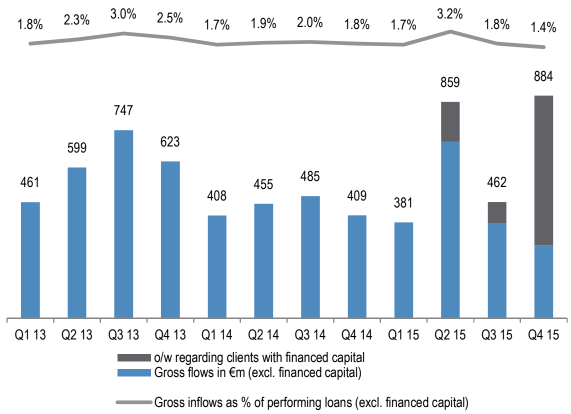
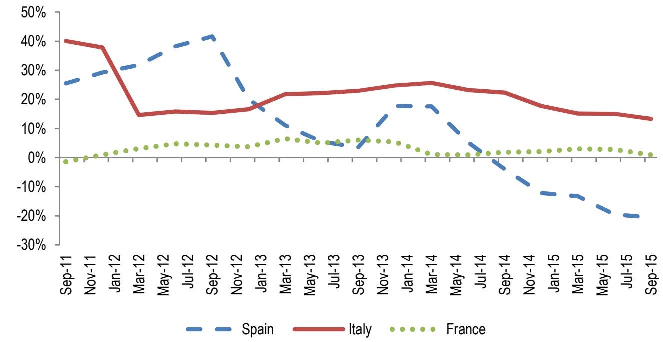
Figure 2: BPVi – Total gross impaired loans quarterly formation dynamics



Source: Company data. Note: Impaired loans include NPL sofferenze (bad loans), unlikely to pay loans and past due loans.

Figure 3: Italy NPL/bad loans YoY growth vs. other European countries



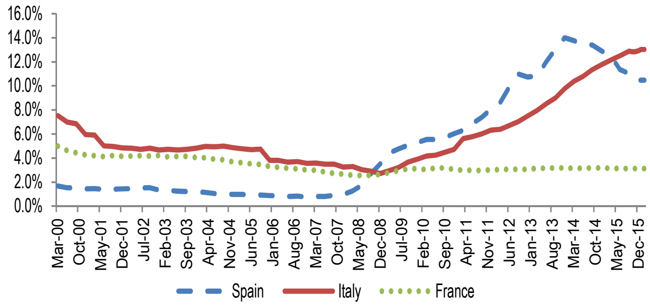
Source: Bank of Spain, Bank of Italy and Banque de France, World Bank. NPL definitions based on individual national central banks criteria.

High impaired loans levels at BPVi

The challenge, however, is that impaired loan levels are relatively high at BPVi in the context of an Italian banking sector where they are already high by European standards. This makes the bank vulnerable to changes in the credit cycle, and the decrease in NPLs will take much longer if the pick-up in macro fails to materialize.

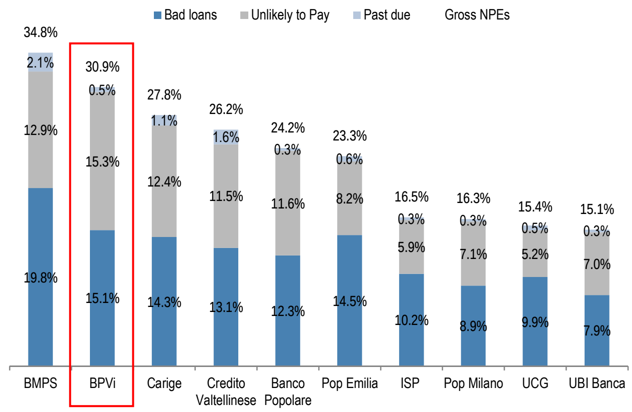
- **NPL levels in Italy are high compared to the European average** at 16.7% compared 5.6%, according to EBA data as of end-June 2015. NPLs are also high in Spain but have been decreasing by over 20% since end-2014 based on Bank of Spain data (see Figure 3).
- **Impaired loans levels at BPVi are high relative to Italian peers**, at 30.9% end-2015, vs. average 22.5% for listed popolari banks and average ~16.0% for the two large Italian banks. The only bank with a higher impaired loan ratio is BMPS. Looking at NPLs/bad loans (sofferenze) specifically, the gap to peers is smaller, but still high, with BPVi bad loan ratio at 15.1% end-2015 vs. average ~13% for listed popolari banks and ~10% for the two large banks (Figure 5).

Figure 4: Europe NPL/bad loans ratios: High NPLs in the periphery vs. core Europe



Source: Bank of Spain, Bank of Italy and Banque de France, World Bank. NPL ratios is defined NPL/loans, based on individual national central banks criteria.

Figure 5: BPVi – Gross impaired loan ratio vs. Italian peers (end-2015)



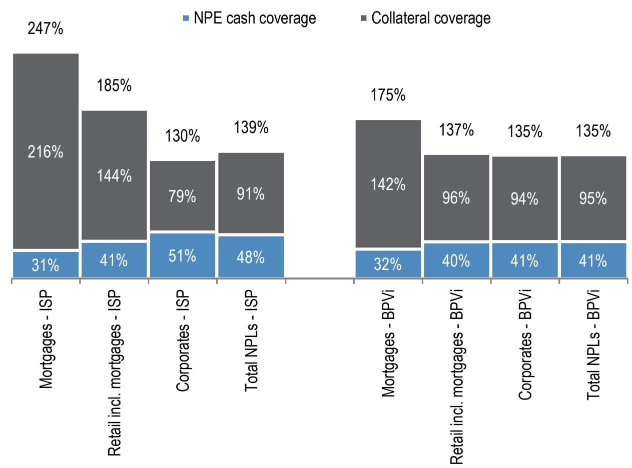
Source: Company data. Note: BPVi impaired loan ratio excluding write-offs.

Including collateral, BPVi gross impaired loan coverage would amount to 135.3% at end-2015, with impaired retail loan coverage at 136.6% and impaired corporate loan coverage at 134.9%.

However, we still see room to improve coverage, especially compared to Intesa Sanpaolo, which gives more disclosures than peers (Figure 6). ISP impaired loan coverage was 139% (excluding personal guarantees) with cash coverage of 48%. For retail mortgages, coverage including collateral was 247% vs. 175% for BPVi, while coverage for impaired corporate loans is at more comparable levels of 130% for ISP and 135% for BPVi. Note, however, that on corporates, part of the difference on cash coverage vs. ISP comes from BPVi's lower exposure to unsecured loans to large corporates (only 8.5% of total loans outstandings); BPVi has more exposure to secured lending to SMEs.

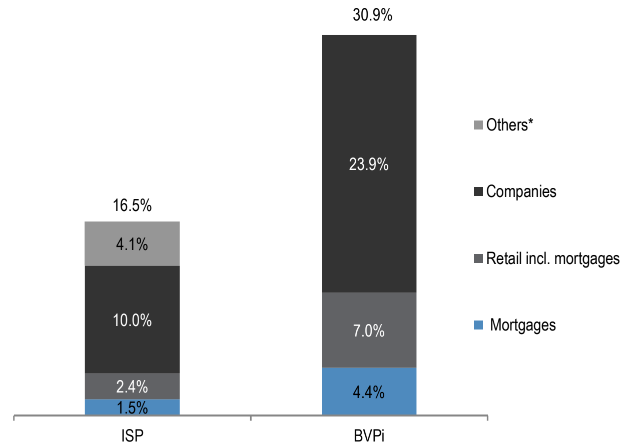
BPVi's higher impaired loan ratio at 30.9% vs. 16.5% for ISP – mostly due higher impaired corporate loans as shown in Figure 6– could have justified a higher coverage ratio, in our view.

Figure 6: BPVi impaired loan coverage vs. ISP (end-2015)



Source: Company reports.

Figure 7: BPVi gross impaired loan ratio vs. ISP (end-2015)



Source: Company reports. * International subsidiaries and product companies.

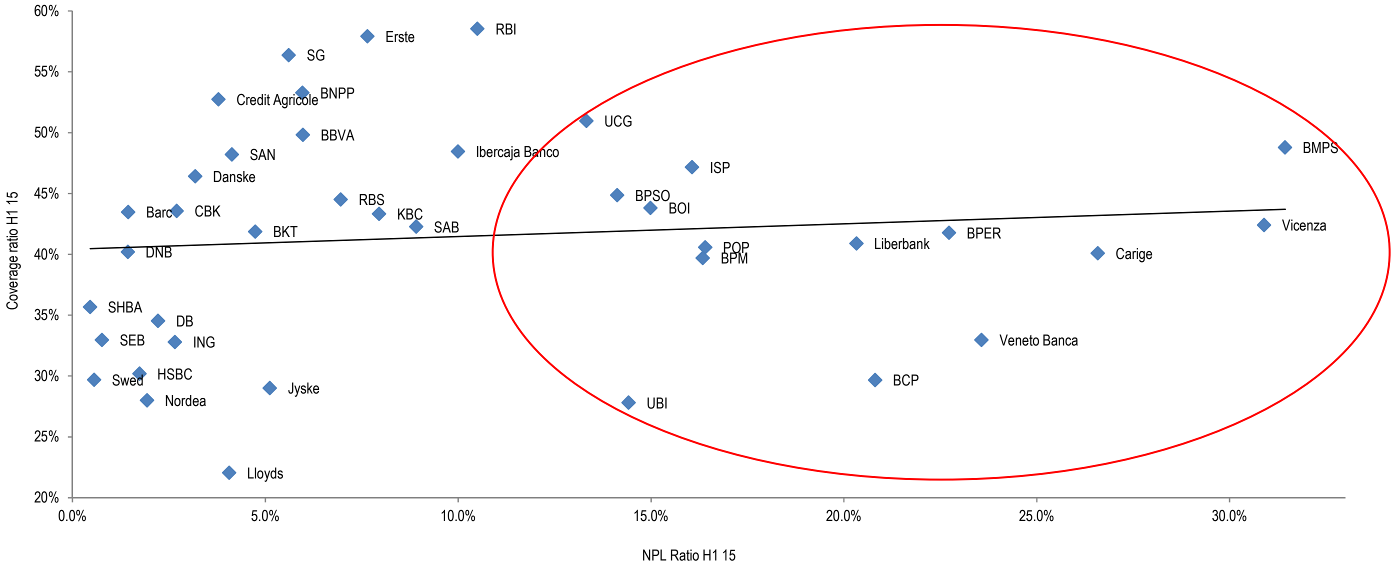
Room to improve impaired loan coverage

The impaired loan coverage ratio for all European Banks has remained broadly stable post ECB AQR, but BPVi has gone further with a ~4.5 percentage point improvement to 42.4% including write-offs.

However, we still see room for impaired loan coverage to improve further for BPVi, given the high impaired loan ratio vs. listed Italian peers (Figure 5).

- **Overall, Italian banks impaired loan coverage, at 45.4% on average, could still be improved, in our view** (ranging from 27.8% for UBI to 50.9% for Unicredit at end-June 2015, based on EBA data). Italian coverage was similar to the European average of 43.4%; however, weaker asset quality could justify higher NPL coverage, and we would see Italian levels as still a bit low vs. European peers.)
- **In the Italian context, BPVi has improved its coverage to 42.4% including write-offs, but we still see room for further improvement** vs. average 45.4% for Italian banks, especially given the higher impaired loan ratio of 30.9%.

Figure 8: European Banks NPL ratio vs. NPL coverage ratio based on EBA data end June-15

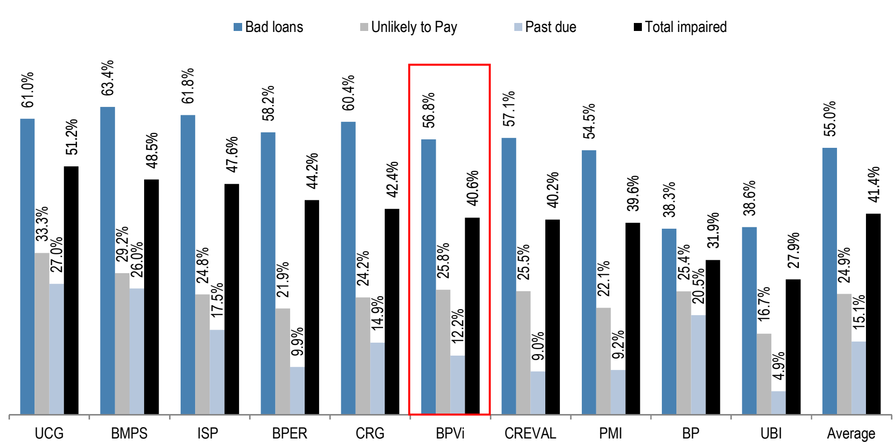


Source: European Banking Authority (EBA). NPL coverage ratio for EU countries based on uniform EBA definitions: Non-performing exposures are:(a) material exposures that are more than 90 days past-due, and/or (b) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due. Note RBI referred in this chart is Raiffeisen-Landesbanken-Holding GmbH is the majority shareholder of Raiffeisen Zentralbank Österreich AG, which is in turn the majority shareholder of Raiffeisen Bank International AG.

Looking at the split of impaired loan coverage, BPVi' total ratio, at 40.6% excluding write-offs, appears marginally below the listed Italian banks average of ~41.5%. But, coverage of NPL/bad loans and unlikely to pay could be improved, in our view.

- NPL/bad loan coverage at 56.8% looks slightly low, given bad loan ratio is higher than peers at ~15% vs. ≤ 14% for listed Italian peers.
- Coverage of unlikely to pay loans stood at 25.8% at end-2015, lower than 33.3% for UCG and 29% for BMPS, although unlikely to pay ratio at ~15% for BPVi was the highest among listed Italian peers.

Figure 9: BPVi – Impaired loan coverage ratios vs. listed Italian peers end-2015



Source: Company reports.

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Another way to look at this is with Texas ratio, given that the ECB has been increasingly focused on this ratio, in our view. The Texas ratio is defined as the ratio of gross non-performing loans over the sum of equity and loan loss reserves.

Based on the Texas ratio, BPVi also screens among the weakest at ~147% at end-2015, based on JPM calculations (different from company). **However, post a €1.5bn IPO, BPVi's Texas would improve to 117% pro forma at end-2015, more in line with Italian peers, but well above EU average.**

- **BPVi's Texas ratio stood at 117% at end-2015, pro forma of the IPO**, broadly in line with listed Italian banks average of ~119% – better than BP at 158% or BMPS at 147%, but worse than Unicredit and Intesa Sanpaolo at ~95% and PMI at 86% (Figure 10).
- **However, Italian banks generally look vulnerable on this measure with an average Texas ratio of ~119% vs. estimated average ~50% for EU banks**. In our view, the unfavorable tax treatment of loan losses in Italy, which has only been changed recently, has not helped, and the Texas ratio does not account for the value of collateral and guarantees, which tends to be high in Italy; however, the unresolved issue in Italy is asset quality of SME loans.

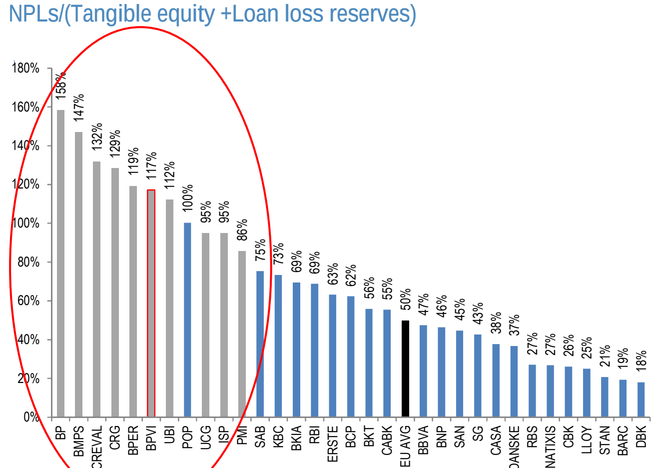
Table 9: Gross NPLs/(Tangible equity +loan loss reserves) – Italy still high

%

	EU Banks	Euro area banks	Spain	Italy	France	Germany
Dec-08	38%	37%	33%	70%	54%	37%
Dec-09	46%	45%	42%	86%	60%	49%
Dec-10	47%	46%	47%	90%	60%	40%
Dec-11	52%	54%	59%	97%	59%	31%
Dec-12	52%	56%	64%	102%	54%	26%
Dec-13	54%	59%	75%	108%	51%	25%
Jun-14	53%	64%	69%	105%	50%	30%

Source: J.P. Morgan analysis based on ECB data.

Figure 10: European Banks: Texas Ratio 2015e – Gross NPLs/(Tangible equity +Loan loss reserves)



Source: J.P. Morgan estimates.

While impaired loan ratios for Italian banks could decline progressively over the few years, impaired loan coverage increase and Texas ratio reduction could continue, in our view, which to a certain extent limits the speed of recovery in cost of risk to and below normalized levels and hence the path to more normalized earnings, in our view.

We expect BPVi to increase impaired loan coverage from 40.6% at end-2015 to 46.3% at end-2020e, mainly due to the increase in NPL/bad loans and a slight improvement in coverage on NPL/bad loans (Table 10 below).

- **Gross impaired loans declining, but mix deteriorating with NPL/bad loans rising further:** We forecast gross impaired loans to decline at a 3% CAGR, from €9.0bn at end-2015 to €7.79bn at end-2020e, driven by the decrease in unlikely-to-pay loans, down at a 10% CAGR from €4.44bn at end-2015 to €2.62bn at end-2020e. However, we expect gross NPL/bad loans to continue to grow at 2%

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CAGR from €4.37bn at end-2015 to €4.83bn at end-2020e, despite €1.5bn of disposals over the period.

- **Gross impaired loans, however, improve from 30.9% at end-2015 to 24.3% at end-2020e**, mainly driven by 1) lower inflows of performing to impaired, and 2) €1.5bn of NPLs/bad loans disposals split €1bn in 2017e and €500m in 2019e, as flagged by management.
- **Impaired loan coverage increases to 46.3% at end-2020e from 40.6% at end-2015** (excluding write-offs), driven by coverage requirements. We expect NPLs/bad loans coverage to be maintained at 56.5% end-2020e vs. 56.8% at end-2015 despite €1.5bn disposals over the period of the plan. We also see coverage rising for unlikely-to- pay loans from 25.8% at end-2015 to 32.0% in 2020e.

Table 10: BPVi – Asset quality trends 2015-2020e

€ million

	2015	2016e	2017e	2018e	2019e	2020e	2016e	2017e	2018e	2019e	2020e
Gross NPLs	4,369	5,024	4,522	4,838	4,597	4,826	15%	-10%	7%	-5%	5%
Gross Unlikely to Pay loans	4,439	3,995	3,596	3,236	2,913	2,621	-10%	-10%	-10%	-10%	-10%
Gross Past Due loans	154	193	241	314	329	346	25%	25%	30%	5%	5%
Total gross impaired loans	8,963	9,213	8,359	8,388	7,839	7,794	3%	-9%	0%	-7%	-1%
Total gross performing loans	20,005	20,605	21,223	22,072	23,175	24,334	3%	3%	4%	5%	5%
Total gross loans	28,967	29,818	29,582	30,460	31,014	32,128	2.9%	-0.8%	3.0%	1.8%	3.6%
Gross NPL ratio	15.1%	16.9%	15.3%	15.9%	14.8%	15.0%	-	-	-	-	-
Gross Unlikely to Pay ratio	15.3%	13.4%	12.2%	10.6%	9.4%	8.2%	-	-	-	-	-
Gross Past Due loan ratio	0.5%	0.6%	0.8%	1.0%	1.1%	1.1%	-	-	-	-	-
Total gross impaired loan ratio	30.9%	30.9%	28.3%	27.5%	25.3%	24.3%	-	-	-	-	-
NPL coverage ratio	56.8%	57.0%	56.5%	57.0%	56.5%	56.5%	-	-	-	-	-
Unlikely to Pay loan coverage	25.8%	28.0%	29.0%	30.0%	31.0%	32.0%	-	-	-	-	-
Past Due loan coverage	12.2%	12.0%	12.0%	12.0%	12.0%	12.0%	-	-	-	-	-
Gross impaired loan coverage	40.6%	43.5%	43.4%	44.9%	45.2%	46.3%	-	-	-	-	-

Source: J.P. Morgan estimates, Company data.

While our gross impaired loans forecasts are in line with management targets, we expect higher gross impaired loan ratios and higher coverage ratios.

- We estimate gross impaired loan ratio of 24.3% at end-2020e with gross NPL ratio of 15.0%, higher than the company targets of 22.7% and 13.8% respectively, mainly due to lower total gross loans – we forecast only a 4.0% 2015-2020e CAGR in gross performing loans compared to BPVi's relatively optimistic 5.7%.
- We also expect higher gross impaired coverage of 46.3% in 2020e vs. targeted 45.4%, mainly due to higher NPL/bad loans coverage of 56.5% vs. 55.5% targeted.

Table 11: BPVi – Asset quality trends – JPM estimates vs. company targets

€ million

	2015 Actual	2018e JPMe	2020e JPMe	2018 Target	2020 Target	2015-2018e CAGR JPMe	2015-2020e CAGR JPMe	2015-2018 CAGR Target	2015-2020 CAGR Target
Gross NPLs	4,369	4,838	4,826	4,747	4,712	3.5%	2.0%	2.8%	1.5%
Gross Unlikely to Pay loans	4,439	3,236	2,621	2,999	2,680	-10.0%	-10.0%	-12.3%	-9.6%
Gross Past Due loans	154	314	346	319	353	26.6%	17.5%	27.4%	18.0%
Total gross impaired loans	8,963	8,388	7,794	8,065	7,745	-2.2%	-2.8%	-3.5%	-2.9%
Total gross performing loans	20,005	22,072	24,334	24,195	26,374	3.3%	4.0%	6.5%	5.7%
Total gross loans	28,967	30,460	32,128	32,260	34,119	1.7%	2.1%	3.7%	3.3%
Gross NPL ratio	15.1%	15.9%	15.0%	14.7%	13.8%	-	-	-	-
Gross Unlikely to Pay ratio	15.3%	10.6%	8.2%	9.3%	7.9%	-	-	-	-
Gross Past Due loan ratio	0.5%	1.0%	1.1%	1.0%	1.0%	-	-	-	-
Total gross impaired loan ratio	30.9%	27.5%	24.3%	25.0%	22.7%	-	-	-	-
NPL coverage ratio	56.8%	57.0%	56.5%	54.3%	55.5%	-	-	-	-
Unlikely to Pay loan coverage	25.8%	30.0%	32.0%	29.6%	32.0%	-	-	-	-
Past Due loan coverage	12.2%	12.0%	12.0%	11.9%	11.7%	-	-	-	-
Gross impaired loan coverage	40.6%	44.9%	46.3%	43.4%	45.4%	-	-	-	-

Source: J.P. Morgan estimates, Company data.

Cost of risk to remain higher than peers

Whilst impaired loan ratio is declining, we expect cost of risk to improve from 500bp on average loans in 2015 to 96bp in 2018e and 83bp in 2020e, as the group continues to build up impaired loan coverage.

At 96bp in 2018e, BPVi would remain well above Italian peers average of ~78bp. In our view, the group loan losses will stay at higher levels due to higher NPL ratio levels and ongoing increases in coverage given the mix.

While we already assume normalisation of cost of risk for most European banks, Italian banks provisioning overall will remain above normalised levels in our view, due to the weaker asset quality with NPLs outstandings still not decreasing. Compared to European peers, Italian banks still have high cost of risk of 88bp on average in 2017e vs. European average of 44bp.

Table 12: Italian Banks Cost of Risk on average loans 2010-2018e – cost of risk in Italy still below normalised level

bp

	2010	2011	2012	2013	2014	2015	2016e	2017e	2018e
UCG	-116	-105	-174	-261	-90	-87	-76	-70	-65
UBI	-71	-60	-88	-104	-107	-94	-78	-66	-58
ISP	-82	-112	-125	-198	-133	-96	-82	-74	-66
BP	-81	-81	-139	-190	-429	-102	-93	-84	-76
PMI	-72	-135	-160	-173	-130	-103	-82	-73	-69
CARIGE	-47	-45	-152	-375	-265	-127	-98	-84	-83
BPER	-81	-72	-199	-165	-180	-161	-107	-81	-67
BMPS	-75	-86	-185	-202	-625	-172	-150	-134	-125
BPVi	-62	-58	-80	-148	-294	-500	-118	-126	-96
Average Italy	-76	-84	-145	-202	-250	-160	-98	-88	-78
Average Europe	-93	-92	-131	-101	-89	-66	-48	-44	-

Source: J.P. Morgan estimates, Company data, Bloomberg consensus estimates for UBI, BP, PMI, BPER, CARIGE in 2016e-18e. Note: Simple average. Note: BPVi cost of risk in 2017e includes €50m impairment related to NPL disposal of €1bn.

With room to improve NPL coverage and potential impact from the introduction of IFRS9, we see possible small downside risk to our provisioning estimates. In addition, while our estimates look achievable for now, there could be some downside risk if the recovery is slower than expected.

Due to the higher NPL/bad loans, BPVi profitability and capital levels remain quite sensitive to provisioning outlook. We highlight below the sensitivity of 2020e net profits, ROTE and Basel 3 CET1 to cost of risk.

Table 13: BPVi – Sensitivity of net profits, ROTE and Basel 3 CET1 to cost of risk* 2020e

€ million

Cost of risk (bp)	Resulting Loan loss provisions	Resulting Net profits	Resulting ROTE	Resulting Basel 3 CET1	CET1 impact
0.35%	-97	307	7.4%	12.21%	0.16%
0.45%	-125	288	6.9%	12.17%	0.13%
0.55%	-153	269	6.5%	12.14%	0.10%
0.65%	-180	251	6.0%	12.11%	0.06%
0.75%	-208	232	5.6%	12.07%	0.03%
0.83% - current estimates	-230	218	5.2%	12.04%	0.00%
0.90%	-250	204	4.9%	12.02%	-0.02%
1.00%	-278	186	4.5%	11.99%	-0.06%
1.10%	-305	167	4.0%	11.95%	-0.09%
1.20%	-333	149	3.6%	11.92%	-0.13%
1.30%	-361	130	3.1%	11.88%	-0.16%
1.40%	-389	111	2.7%	11.85%	-0.20%

Source: J.P. Morgan estimates. * on average net loans.

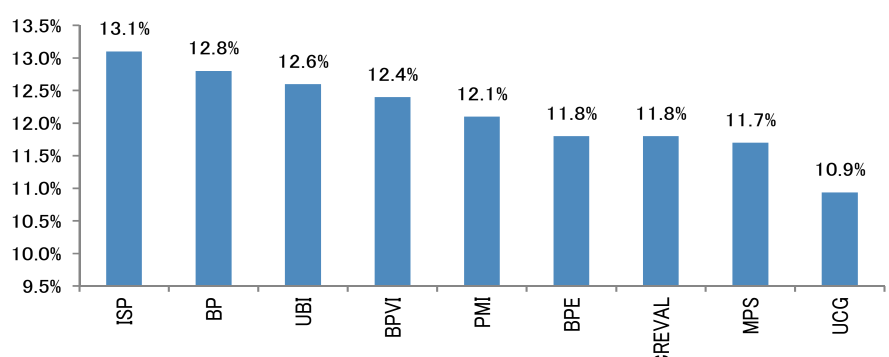
Capital more in line with peers post IPO

New management has carried out a comprehensive balance sheet "clean-up", to include in the 2015 accounts not only the provisions required by the ECB Asset Quality Review, but also additional loan loss provisioning from further loan reclassification into NPL. As a result, the ECB has reduced the minimum capital requirement from 11% in Feb 2015 to 10.3% in May 2015 and 10.25% in Dec 2015.

With a €1.5bn IPO, Basel 3 CET1 fully loaded would improve from 5.87% at end-Dec 2015 to 12.4% on a pro forma basis, well above ECB SREP requirement of 10.25% and more in line with Italian peers' average.

Figure 11: Italian Banks – Basel 3 CET1 fully loaded ratios at end-2015 – BPVi post €1.5bn IPO vs. peers

%



Source: Company reports.

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However, we expect no capital progression with Basel 3 CET1 fully loaded at 12.0% at end-2020e, down slightly vs. 2015 proforma of 12.4%, due to earnings losses in 2016e and capital generation limited with 50% of earnings paid out in dividends.

Overall, we forecast capital ratios remaining well above minimum requirement of 10.25%, however, we see a limited increase in the buffer vs. target, with pressure in the first few year of the plan: ~40bp decrease in 2016e with results impaired by restructuring costs of €65m and further impairments/provisioning, and limited pick-up in retained earnings before 2020e.

Table 14: BPVi – Basel 3 CET1 fully loaded progression 2016-2020e

€ million

	2014	2015	2016e	2017e	2018e	2019e	2020e
CET1 FL beginning period	2,515	2,955	1,461	3,006	3,037	3,107	3,168
Net income (ex goodwill)	-339	-1,107	-79	62	141	121	218
ow Exceptional provisions and gains on disposals	0	-664	0	0	0	0	0
Dividends based on 50% dividend payout guidance	0	0	0	-31	-71	-60	-109
Capital increase	710	253	1,500	0	0	0	0
Valuation reserves	0	17	0	0	0	0	0
ECB prudential filter	0	-321	0	0	0	0	0
Other	69	-336	124	0	0	0	0
CET1 FL end period	2,955	1,461	3,006	3,037	3,107	3,168	3,276
RWA beginning period	28,061	28,985	24,884	25,133	25,384	25,892	26,410
Change	924	-4,101	249	251	508	518	792
RWA end period	28,985	24,884	25,133	25,384	25,892	26,410	27,202
Basel 3 CET1 FL beginning period	8.96%	10.19%	5.87%	11.96%	11.96%	12.00%	11.99%
Basel 3 CET1 FL end period	10.19%	5.87%	11.96%	11.96%	12.00%	11.99%	12.04%
Change	*1.23%*	*-4.32%*	*6.09%*	*0.00%*	*0.04%*	*-0.01%*	*0.05%*
Basel 3 CET1 management target	-	-	> 12%	-	12.0%	-	12.9%
ECB SREP requirement	-	-	10.25%	-	-	-	-

Source: J.P. Morgan estimates, Company data.

Our Basel 3 CET1 fully loaded estimates, at 12.0% in 2018e and 12.0% in 2020e, are below management targets of 12.9% in 2020, mainly as a result of lower earnings expectations with net profits of €218m net profits in 2020e vs. €309m target.

Our estimated capital progression accounts for:

a) **Dividend payout of 50% from 2017e** in line with BPVi management guidance on dividend policy (subject to regulatory requirements); note, however, that based on earnings and payout targets by the company, implied yield would amount to ~6.7% in 2018 and ~10.3% in 2020.

b) **RWA CAGR 2015-20e of 1.8%** vs. target CAGR of 2.6% , as a result of our more modest lending volume growth expectations.

c) **No impact from potential Basel regulatory changes:** with BPVi mostly using the standardised approach and RWA density high at > 60%, we see limited regulatory risks.

d) Our estimates exclude additional capital coming from: 1) up to €150m (including any share premium) reserved for the "brownshoe option" as part of the listing process; 2) up to €38m reserved for instruments or rights to be

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assigned to shareholders for a loyalty-building purpose as part of the planned €1.5bn IPO; and 3) up to €75m (including any share premium) reserved for instruments or rights to be assigned to shareholders for an incentive purpose as part of the IPO.

Table 15: BPVi – Capital and dividends – JPM estimates vs. targets

€ million

	2018e JPMe	2020e JPMe	2018 Company Target	2020 Company Target
Net income	141	218	202	309
Dividend payout	50%	50%	50%	50%
Dividends based on 50% payout guidance	71	109	101	155
Yield on €1.5bn IPO	4.7%	7.3%	6.7%	10.3%
Retained earnings	141	218	101	155
CET1 capital fully loaded	3.1	3.3	3.2*	3.6
RWA fully loaded	25.9	27.2	26.8*	28.2
Basel 3 CET1 fully loaded	12.0%	12.0%	12.0%*	12.9%

Source: J.P. Morgan estimates, Company data. * Transitional

Overall, capitalisation levels are highly sensitive to earnings – mostly driven by the pace of improvement in provisioning levels – and RWA growth, as highlighted in Table 16 below.

Table 16: BPVi – Basel 3 CET1 fully loaded ratio at end-2020e – sensitivity to higher retained earnings and RWA growth

€ million

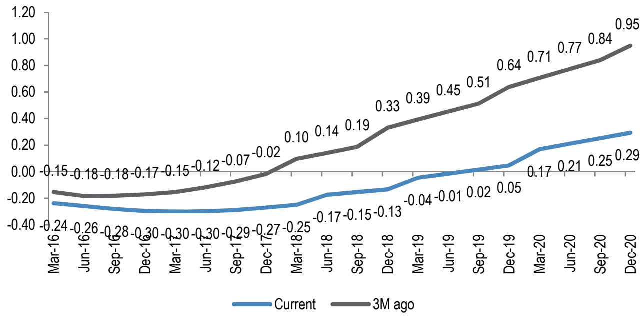
		Sensitivity to additional net profits every year vs. JPMe							
		-200	-100	-50	0	50	100	200	300
Resulting cumulative retained earnings 2015-2020e		-346	154	404	192	589	683	923	1,173
RWA growth CAGR 2015-2020e	-0.50%	10.5%	12.2%	12.9%	13.5%	14.1%	14.7%	16.0%	17.2%
	0.00%	10.2%	11.9%	12.6%	13.2%	13.8%	14.4%	15.6%	16.8%
	0.50%	10.0%	11.6%	12.3%	12.8%	13.4%	14.0%	15.2%	16.4%
	1.00%	9.7%	11.3%	12.0%	12.5%	13.1%	13.7%	14.8%	16.0%
	1.50%	9.5%	11.0%	11.7%	12.2%	12.8%	13.3%	14.5%	15.6%
	1.80%	9.3%	10.9%	11.5%	12.0% JPMe Base case	12.6%	13.1%	14.3%	15.4%
	2.00%	9.2%	10.8%	11.4%	11.9%	12.5%	13.0%	14.1%	15.2%
	2.50%	9.0%	10.5%	11.1%	11.6%	12.2%	12.7%	13.8%	14.8%
	3.00%	8.8%	10.3%	10.8%	11.4%	11.9%	12.4%	13.4%	14.5%
	3.50%	8.6%	10.0%	10.6%	11.1%	11.6%	12.1%	13.1%	14.1%
	4.00%	8.4%	9.8%	10.3%	10.8%	11.3%	11.8%	12.8%	13.8%
	4.50%	8.2%	9.5%	10.1%	10.6%	11.0%	11.5%	12.5%	13.5%

Source: J.P. Morgan estimates.

Sensitivity to more negative rates

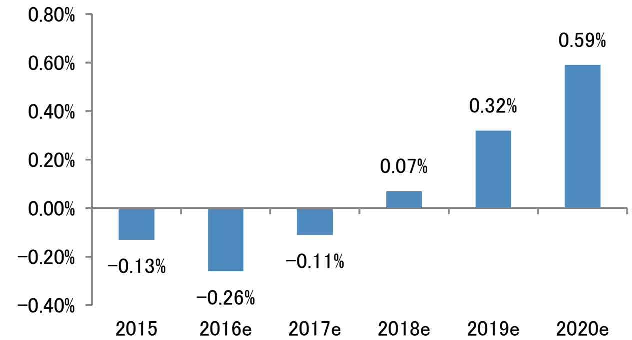
We view management's assumptions of a ~70bp increase in Euribor 3M to 59bp in 2020 as optimistic (Figure 13). The forward market is currently implying a 53bp increase in 3M Euribor to 29bp end-2020 vs. a 110bp increase to 95bp three months ago (Figure 12).

Figure 12: 3M Euribor forward curve (%)



Source: Bloomberg, priced 21 March 2016

Figure 13: BPVi assumptions for 3M Euribor over 2015-2020



Source: Company data.

We believe focus on loan growth is overestimated by the market and, from an earnings perspective, NIM is more important for bank earnings. Lending volumes have been lower than expected in Italy, but NIM declined further for most listed Italian popolari banks and BMPS as the funding cost repricing was more than offset by increased lending spreads pressure.

As illustrated in Table 17 below, lending spreads have declined by 27bp over the past year in line with Euribor 3M decreases. Lending margin pressure was, however, not fully offset by deposit spread repricing, which was only 15bp on average. As a result, commercial spreads declined by ~11bp on average.

Table 17: Italian Banks – Lending spreads and deposit spreads evolution Q1 14-Q4 15

%

	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	Q4 15 vs Q4 14
Lending spreads									
UBI	2.78%	2.77%	2.86%	2.81%	2.75%	2.68%	2.59%	2.56%	-0.25%
PMI	2.93%	2.92%	2.99%	2.95%	2.87%	2.77%	2.70%	2.67%	-0.28%
BP	2.92%	2.94%	2.90%	2.79%	2.75%	2.66%	2.57%	2.53%	-0.26%
BPER	3.00%	2.96%	2.98%	2.97%	2.88%	2.74%	2.68%	2.64%	-0.33%
BMPS	3.53%	3.53%	3.59%	3.57%	3.52%	3.49%	3.40%	3.36%	-0.21%
Average	3.03%	3.02%	3.06%	3.02%	2.95%	2.87%	2.79%	2.75%	-0.27%
Deposit spreads									
UBI	-0.98%	-0.95%	-0.99%	-0.96%	-0.89%	-0.86%	-0.85%	-0.84%	0.12%
PMI	-0.85%	-0.77%	-0.80%	-0.78%	-0.70%	-0.60%	-0.55%	-0.55%	0.23%
BP	-1.08%	-1.03%	-1.06%	-0.99%	-0.89%	-0.85%	-0.83%	-0.83%	0.16%
BPER	-0.83%	-0.80%	-0.89%	-0.90%	-0.78%	-0.75%	-0.73%	-0.70%	0.20%
BMPS	-1.30%	-1.25%	-1.23%	-1.07%	-0.99%	-1.04%	-1.03%	-1.02%	0.05%
Average	-1.01%	-0.96%	-0.99%	-0.94%	-0.85%	-0.82%	-0.80%	-0.79%	0.15%
Commercial spreads*									
UBI	1.80%	1.82%	1.87%	1.85%	1.86%	1.82%	1.74%	1.72%	-0.13%
PMI	2.08%	2.15%	2.19%	2.17%	2.17%	2.17%	2.15%	2.12%	-0.05%
BP	1.84%	1.91%	1.84%	1.80%	1.86%	1.81%	1.74%	1.70%	-0.10%
BPER	2.17%	2.16%	2.09%	2.07%	2.10%	1.99%	1.95%	1.94%	-0.13%
BMPS	2.23%	2.28%	2.36%	2.50%	2.53%	2.45%	2.37%	2.34%	-0.16%
Average	2.02%	2.06%	2.07%	2.08%	2.10%	2.05%	1.99%	1.96%	-0.11%

Source: Company reports. *lending spreads minus deposit spreads

We expect Net Interest Income to grow +4% CAGR 2015-20e, on an improved lending volumes CAGR of 2.4% (ex CCG, partly impacted by NPL disposals of €1.5bn over the period) and lower funding costs more than offsetting margin pressure on lending spread. Overall, NII should be supported by funding cost repricing with commercial spreads increasing 27bp over the period to 197bp end 2020e, still below targeted improvement of ~50bp by 2020.

Table 18: BPVi – Total Net Interest Income trends (2013-2020e)

€ million

	2013	2014	2015	2016e	2017e	2018e	2019e	2020e	2016e	2017e	2018e	2019e	2020e
NII on client margin	379	420	416	409	441	465	487	528	-2%	7.9%	5.4%	4.8%	8.3%
o/w Customer activities	336	451	475	468	483	507	529	569	-1%	3.2%	4.9%	4.4%	7.7%
Loans	932	975	836	762	758	757	765	791	-9%	-0.5%	-0.1%	1.1%	3.4%
Deposits & Securities	-596	-524	-362	-294	-275	-251	-237	-222	-19%	-6.4%	-8.9%	-5.6%	-6.3%
ow Deposits	-327	-265	-150	-122	-112	-95	-88	-80	-19%	-8.4%	-15%	-7.3%	-8.4%
ow Securities issued	-269	-259	-212	-172	-164	-156	-149	-142	-19%	-5.0%	-4.6%	-4.6%	-5.0%
o/w Interbank	-68	-56	-36	-39	-22	-22	-22	-22					
ow Hedging derivatives	111	26	-23	-20	-20	-20	-20	-20					
NII on securities portfolio	150	91	87	86	92	96	91	81	-2%	8%	4%	-5%	-11%
Total Net Interest Income	528	511	504	494	534	561	578	609	-1.9%	7.9%	5.1%	3.1%	5.3%
NIM on client margin	1.30%	1.42%	1.56%	1.61%	1.72%	1.78%	1.81%	1.90%					
o/w NIM Customer activities	1.21%	1.52%	1.70%	1.69%	1.78%	1.85%	1.89%	1.97%					
Loan spread	3.20%	3.30%	3.14%	3.00%	2.95%	2.90%	2.85%	2.85%					
Deposits & Securities	-1.99%	-1.78%	-1.44%	-1.31%	-1.17%	-1.05%	-0.96%	-0.88%					
ow Deposit spread	-1.53%	-1.18%	-0.78%	-0.70%	-0.60%	-0.50%	-0.45%	-0.40%					
ow Cost securities issued	-3.71%	-3.80%	-3.56%	-3.40%	-3.30%	-3.10%	-2.90%	-2.70%					
o/w Interbank cost	2.06%	1.67%	0.69%	0.56%	0.35%	0.35%	0.35%	0.35%					
Yield on financial assets	3.52%	1.68%	1.40%	1.30%	1.32%	1.40%	1.35%	1.30%					
NIM on Int. Earnings Assets	1.62%	1.41%	1.52%	1.54%	1.62%	1.69%	1.71%	1.78%					

Source: J.P. Morgan estimates, Company data.

In Table 19 below, we show earnings sensitivity to decreases in lending spreads and funding costs (cost of deposits, cost of securities issued). Overall, BPVi is relatively sensitive to any large mismatch between lending and funding spreads, especially with net loans to direct funding (ex CCG) of 114% in 2015. Every 10bp fall in commercial spread (lending spreads minus funding spreads) would reduce net earnings by <€18m.

Table 19: BPVi – Sensitivity to lending spreads and funding costs – impact on 2016e earnings

€ million

Decline in lending spreads	-5bp	-10bp	-20bp	-30bp	-40bp	-50bp	-60bp	-70bp	-80bp	-90bp	-100bp
Decline in funding costs											
-5bp	-1	-9	-25	-41	-57	-73	-89	-105	-121	-137	-153
-10bp	6	-2	-18	-34	-50	-66	-82	-98	-114	-130	-146
-20bp	20	12	-4	-20	-36	-52	-68	-84	-100	-116	-132
-30bp	34	26	10	-6	-22	-38	-54	-70	-86	-102	-118
-40bp	49	41	25	9	-7	-23	-39	-55	-71	-87	-103
-50bp	63	55	39	23	7	-9	-25	-41	-57	-73	-89
-60bp	77	69	53	37	21	5	-11	-27	-43	-59	-75
-70bp	91	83	67	51	35	19	3	-13	-29	-45	-61
-80bp	105	97	81	65	49	33	17	1	-15	-31	-47
-90bp	119	111	95	79	63	47	31	15	-1	-17	-33
-100bp	134	126	110	94	78	62	46	30	14	-2	-18

Source: J.P. Morgan estimates.

Note that we could be overestimating NII sensitivity to rates due to hedging put in place by the bank. Management commented that if short-term interest rates do not increase, NII impact would be negligible due to ALM hedging strategies in place – including the expected increase in government bond holdings, and conversion of floating rate loans into fixed rate, and conversion of fixed rate funding to floating. BPVi estimates that 50bp increase in interest rates would have a positive impact of €20m on NII.

Sensitivity to more loan growth

We view management's assumptions of a 2015-20 loan CAGR of ~4% as optimistic .We forecast lower lending volumes with a 1.7% 2015-18e CAGR, with more pick-up in 2018-20e, compared to management's target of a ~3.7% CAGR from 2015-20. We estimate a net lending volume increase of €3bn vs. target €5bn cumulative over 2015-2020.

In Table 20 below, we show earnings sensitivity to increase in loan growth. Every 1% increase in the loan CAGR from 2015-2020 would increase net earnings by ~€20m in 2020e.

Table 20: Sensitivity of net profits from loan growth

€ million

Net profit	2016e	2017e	2018e	2019e	2020e
CAGR 2015-2020 loan growth 0.3%	-84	48	119	91	180
CAGR 2015-2020 loan growth 1.3%	-81	55	130	106	198
CAGR 2015-2020 loan growth 2.3%-JPMe Base Case	-79	62	141	121	218
CAGR 2015-2020 loan growth 3.3%	-77	69	153	136	238
CAGR 2015-2020 loan growth 4.3%	-74	76	164	152	258

Source: J.P. Morgan estimates. Note: net loans outstandings including CCG.

Below, we show a comparison of our estimates on gross performing loan growth for BVPi, which is broadly in line with other Italian banks in our coverage.

Table 21: Italian Banks: gross performing loans forecast

%

Gross performing loans	2015	2016e	2017e	2018e	2019e	2020e
BPVi	-17%	3%	3%	4%	5%	5%
BMPS	-10%	0%	1%	3%	-	-
ISP	4%	2%	2%	3%	-	-
UCG	1%	1%	2%	3%	-	-

Source: J.P. Morgan estimates, Company data.

Governance

The management team has been renewed starting from 1 June 2015, with the appointment of Francesco Iorio as new CEO, Iacopo De Francisco as new deputy General Manager and head of Markets Division, and other experienced professionals in the Finance and Loans divisions. The management structure for the control functions (Internal Audit, Risk Management, and Compliance and Anti-Money laundering department) has also been fully revamped. In 2015, the bank booked a €10m one-off charge related to the resignation costs for the former management and retention scheme for new management. The management team is relatively new and has a limited track record at the bank.

In its 2015 review, the ECB highlighted issues around governance and internal controls of BPVi. In a draft decision delivered on 19 January 2016, the ECB confirmed that BPVi will be required to: 1) define and implement new internal policies to improve processes related to pricing policies, financial investments, approval of new products and hedge accounting; 2) provide a more efficient allocation of responsibilities and a greater articulation and separation of roles in the internal governance structure; 3) strengthen the monitoring of operational risks and set limits for transactions in line with best practice; 4) improve processes and content of reporting to the management of the bank; and 5) strengthen control functions.

In response, BPVi has already started to implement the relevant actions, and is to submit a special action plan, after receiving the ECB's "final decision".

BPVi has re-modelled its credit risk management structure, with: 1) a complete separation between the credit and the commercial process; 2) lending criteria and a responsibility matrix approved by the board of directors; 3) a credit committee (chaired by the CEO) and/or board of directors, which are responsible for decision-making in the case of large exposures or high risk loans. The organization structure has changed with the creation of regional loan offices with credit granting powers and specialized HQ offices to manage the process for early-warning and unlikely-to-pay loans, a new credit recovery department and a new specialized unit to manage real estate exposure and restructured exposure. The new business plan also includes initiatives aimed at exploring further enhancements of the existing indicators, including forborne exposures as well as the track record of recovery of NPLs, where databases have a relatively recent history.

Key considerations

Capital increase guaranteed by Unicredit

BPVi aims to raise €1.5bn (up to €1.8bn including the brownshoe and other incentive instruments, according the company press release) to comply with ECB requirements. The ECB has warned that without a capital increase, the lender could be resolved, imposing losses on creditors.

In September 2015, the bank and UniCredit signed a preliminary underwriting agreement, subject to customary market terms and conditions, up to €1.5bn in the context of the Bank's IPO.

According to company guidance, the IPO will be structured with a standard book building and open price mechanism with the aim of executing a market standard transaction and, for this reason, the bank has mandated a syndicate of five banks to lead the transaction and market the IPO to institutional investors. Up to 45% of the capital increase is to be reserved for current shareholders, at least 50% of the capital increase is to be reserved for institutional investors, and 5% for retail investors.

Should the take-up be lower than expected, Unicredit would buy any unsold shares, and could become the main shareholder of the bank.

Potential disposals

BPVi's business plan does not include potential capital release from disposals of non-strategic assets, internal model adoption (AIRB) and reimbursement of financed capital.

BPVi management guided for a potential capital release of €0.8bn-1bn, which is undiscounted in the business plan, according to the company presentation.

- **€321m reversal on financed capital**: The bank currently deducts €321m from CET1 as a prudential filter, as requested by the ECB. However, management believe that the bank can fully recover on these loans granted to clients for their participation in the 2013-14 capital increases.
- **€100m from disposals of non-strategic assets**: The group intends to sell its ~20% stake in Italian Asset Manager Arca (€2.5bn AuM invested in Arca, book value €38.7m), its consumer finance subsidiary PrestiNuova (100% owned, €35m book value), its online subsidiary servicing pharmacies FarBanca (70.77% owned, €43.9m book value, €527m loans), its private equity subsidiary NEM SGR (100% owned, €2.4m book value, €99.4m funds under management), and its real estate properties (€497m book value as per company guidance). Management estimate that total gains from disposals could amount to at least €100m.
- **We estimate ~€125m from adoption of AIRB model for RWAs:** BPVi uses the standardised approach for credit risk, market risk and the basic method for operational risks. The bank has applied for the AIRB internal model for credit risk, which could release at least 50bp of capital, according to management guidance. This would be equivalent to €1bn of RWA reduction or ~€125m of capital release, in our estimates. Timing of the AIRB approval by the ECB and adoption is, however, uncertain, in our view, given that the ECB will be reviewing internal models for European banks in the next three years and might

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not provide approvals until the internal model framework has been harmonised across Europe.

- **~€350m excess capital over minimum 11%:** The group currently targets Basel 3 CET1 phased in above 12%; however, management suggested that ECB SREP was only at 10.25% and operating with 11% in the long run might be enough. This would release some ~€350m of capital, on our estimates.

Table 22: BPVi – Potential capital relief from disposals, recovery on financed capital and AIRB model adoption

€ million

	2015	Capital relief
Basel 3 CET1 FL capital pro forma of the right issue	3,085	
RWA	24,884	
Basel 3 CET1 FL pro forma of the right issue	12.4%	
Excess over 11% minimum	348	
Recovery on financed capital	321	1.29%
Gains on disposals	100	0.40%
Estimated €1bn RWA reduction from AIRB model	124	0.52%
Sub total	545	2.28%
Resulting CET1 FL capital	3,506	
Resulting RWAs	23,884	
Resulting CET1 FL ratio	14.7%	2.28%
Excess over 11%	879	

Source: Company data, J.P. Morgan estimates.

Our Basel 3 CET1 FL estimates have not factored in the potential capital benefits from disposals (~40bp) and AIRB model approvals for RWAs (~50bp), which would very positive, in our view. Pro forma, Basel 3 CET1 FL would stand at 12.9% end-2020e, in line with management target, equivalent to ~260bp buffer over minimum SREP of 10.25% and ~190bp over 11%.

We would, however, remain skeptical at this point on the recovery of financed capital, given the litigation risks outstanding.

Sector consolidation

BPVi could participate in domestic sector consolidation in the long run, in our view. Italy has one of the most fragmented banking systems in Europe, with the top five banks accounting for only ~40% of the system vs. >60% in most European countries (Figure 14 below).

With the top 12 banks in Italy accounting for only ~53% of loan market shares and the overwhelming number of banks having less than 2% market share (Figure 15 below), there is significant room for consolidation, in our view. A highly fragmented market is a key reason for Italian banks' lack of profitability historically. Consolidation would help smaller banks to expand their market share and generate better returns through potential costs and revenue synergies.

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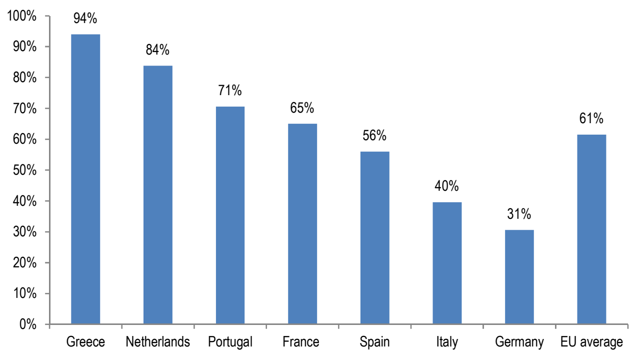
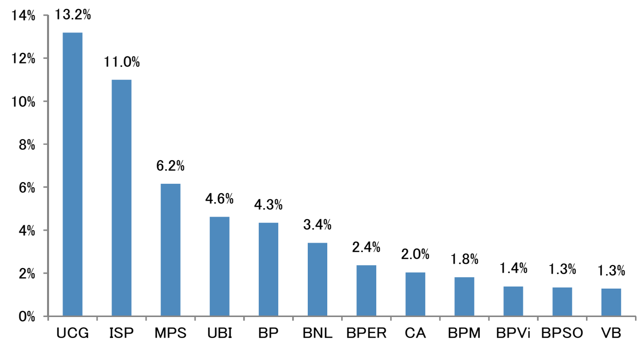
Figure 14: Europe – Market share of top 5 banks (total assets)



Source: ECB.

Figure 15: Italy – Net loans market shares of the top 12 banks (~53% of the market)



Source: J.P. Morgan estimates, company data. Data as of Sept 2015.

The popolari reform, with the abolishment of "one shareholder one vote" in Jan 2015, paved the way for consolidation in the Italian banking sector, which we believe will likely happen this year. The new governance rule requires 10 banks with total assets > €8bn to convert into joint stock companies by end-2016.

Banca Popolare di Vicenza is one of the 10 popolari banks affected by the reform – the others are UBI, Banco Popolare, BPM, Bper, Creval, Popolare di Sondrio, Banca Etruria[4], Veneto Banca and Popolare di Bari, with a combined lending market share of ~20%, on our estimates.

Note that UBI, BPVi and Veneto Banca have already transformed into joint stock companies. Banca Etruria became a joint stock company following the resolution and created Nuova Banca Etruria.

Table 23: List of Italian banks that could participate in sector consolidation, in our view

€ billion

	Market cap	Assets	Book value of equity	Customer loans	Market share lending
BMPS	1.4	169.0	9.6	111.4	7%
UBI	2.7	117.2	10.0	84.6	5%
Banco Popolare	1.8	120.5	8.5	78.4	4%
Popolare dell'Emilia Romagna	1.9	61.3	5.0	43.7	2%
Popolare di Milano	2.4	50.2	4.6	34.2	2%
Banca Popolare di Sondrio	1.4	35.5	2.6	24.0	1%
Carige	0.5	30.4	2.5	21.5	1%
Credito Valtellinese	0.6	26.9	2.2	19.1	1%
Banca Popolare di Vicenza	-	39.8	2.5	25.2	1%
Veneto Banca	-	33.3	2.0	22.7	1%

Source: Bloomberg (COB 5 April 2016) and Company data. Lending Market share is JPM estimated. Note: data as of end 2015

Banca Popolare di Vicenza could be seen as an attractive target, in our view, given its strong presence in Veneto, which accounts for 14% of total national exports and 9% of total Italian GDP. Veneto accounts for 39% of BPVi's total loans, and the group has a loan market share of 7% in the region. We note that none of the larger popolari banks have strong presence in Veneto, with the exception of Banco Popolare (less than 5% market share in terms of branches) – UBI has less than 2% market share, BPER less than 2.5% and BPM only 0.2%.

[4] One of the 4 small Italian banks that were resolved end 2015

BPVi would also bring some presence in Tuscany, which accounts for 13% of the group's loans and where the group has a loan market share of 3.4%. The region is, however, less attractive than the northern regions. The only other popolari with sizeable presence in Tuscany is Banco Popolare with 9% market share in terms of branches, vs. UBI, BPM and BPER which have limited presence.

Overall, BPVi offers an attractive client franchise in Veneto, and cost synergy potential from reducing branches in other regions. Veneto currently accounts for 221 branches or 38% of BPVi's total of 579 branches. There would be most branch overlap with Banco Popolare in Tuscany, Lombardy, Sicily and Friuli-Venezia Giulia, but also to some extent with UBI in Lombardy and Calabria and with BPM in Lombardy, but less with BPER (only Calabria really).

We note, however, that key considerations for M&A will not be limited to client acquisition and branch overlap. Success factors to consider include capitalization levels, credit quality, governance (incl. role of foundations, unions and local entrepreneurs), industrial logic with synergies with asset management and insurance.

Changes to the labour law are also necessary, in our view, to support FTE cuts and cost reductions. Many banks have gone through several waves of headcount reductions, and while branch overlap could still generate savings, we believe the opportunities for cost synergies would likely be lower than in the past. The “jobs act”, introduced in 2015, has eased the individual dismissals for the “larger” firms by watering down Article 18, which limited the flexibility for large employers to lay off staff. However, it is only applicable to new permanent hires.

NPL disposals

BPVi management targets total gross non-performing loans to increase from €4.37bn in 2015 to €4.75bn in 2018 and €4.71bn in 2020, including NPL disposals of €1bn in 2017 and €500m in 2019. Partly due to the disposals, BPVi guides to NPL coverage of 55.5% in 2020, down from 56.8% in 2015. The group aims to align the NPL recovery rates with market levels, through a long-term strategic partnership with a respected operator on selected NPL portfolios as well as some improvement of the in-house management for high-value positions.

BPVi has made no comment on any participation in the Italian government's guarantee scheme for NPL securitisations (GACS); however, this scheme could potentially help the NPL disposal process further. The scheme will enable Italian banks to securitize and offload NPLs to separate, individually managed entities. Participation would be on a voluntary basis and banks would benefit from a state guarantee on the senior tranches only, but pay a fee for the guaranteed price on a basket of Italian CDS spreads.

The scheme could be positive for BPVi from a funding perspective in our view as:

- **According to the Italian Treasury, the scheme would reduce funding costs** on securitizations ~200bp on average for Italian banks, given the fee paid for the guarantee would be significantly lower than what the banks would get in the market.
- **It could also free up liquidity for BPVi**, which would be welcomed given that unencumbered assets stood at only €1bn. Banks could also use the state guaranteed bonds as collateral for ECB financing operations, which would free

up liquidity, if the Italian government gets an agreement with the ECB. NPLs currently account for ~31% of the bank's loan book and 11% of total assets, and securitizing these illiquid assets would be positive.

More importantly, the scheme could potentially release some capital, depending on valuations. BPVi currently uses the standardised approach for credit risk, with NPL risk weighted at 100% and, hence, disposals would result in RWA reduction.

We run a sensitivity analysis below, assuming that BPVi can sell additional €1bn of gross NPLs through the guarantee scheme for securitisation. Note that €1bn of gross NPL would be a significant amount already, accounting for 28% of total €3.6bn gross NPLs to corporates & SMEs and 21% of total €4.8bn gross NPLs in 2020e in our estimates.

We assume that the €1bn of gross NPLs to be sold through securitization would have broadly the same level of coverage as the rest of the NPL book – 56%, on our estimates, for 2020, implying net book value sold of €0.44bn without discounts.

We show in Table 24 below the sensitivity to discounts on net book values or implied discounts on gross book values, with BPVi potentially booking some losses based on the valuation, structure of the securitisation and the level of risk ownership in the riskier equity/mezzanine tranches (below 50% stake).

Our sensitivity analysis shows that up to additional 7% discount to net book value or implied 59.1% discount on gross book value would result in no negative CET1 impact and could even release some capital. Above 10% discount on net book values, the negative impact on CET1 would start to be material at >10bp and the bank would have less incentive to sell, in our view.

Table 24: BPVi – Sensitivity to discount rates assuming €1bn gross NPL disposals through the scheme – impact on Basel 3 CET1 end-2020e

€ billion

	Implied discount on gross book value	Impact on capital	Net NPL transferred/sold	Resulting CET1	CET1 impact
Current level	56.0%	-	0.44	12.04%	-
1% discount on net book value - impact on capital	56.4%	-0.004	0.44	12.15%	0.10%
2% discount on net book value - impact on capital	56.9%	-0.009	0.43	12.13%	0.08%
3% discount on net book value - impact on capital	57.3%	-0.013	0.43	12.11%	0.07%
4% discount on net book value - impact on capital	57.8%	-0.018	0.42	12.09%	0.05%
5% discount on net book value - impact on capital	58.2%	-0.022	0.42	12.08%	0.03%
6% discount on net book value - impact on capital	58.6%	-0.026	0.41	12.06%	0.01%
7% discount on net book value - impact on capital	59.1%	-0.031	0.41	12.04%	0.00%
8% discount on net book value - impact on capital	59.5%	-0.035	0.40	12.02%	-0.02%
9% discount on net book value - impact on capital	60.0%	-0.040	0.40	12.01%	-0.04%
10% discount on net book value - impact on capital	60.4%	-0.044	0.40	11.99%	-0.06%
20% discount on net book value - impact on capital	64.8%	-0.088	0.35	11.81%	-0.23%
30% discount on net book value - impact on capital	69.2%	-0.132	0.31	11.64%	-0.41%
40% discount on net book value - impact on capital	73.6%	-0.176	0.26	11.46%	-0.58%
50% discount on net book value - impact on capital	78.0%	-0.220	0.22	11.29%	-0.75%

Source: J.P. Morgan estimates. Notes: a) we assume no tax offset for the loss on disposal, b) we assume that NPL transferred/sold have a risk weighting of 100%.

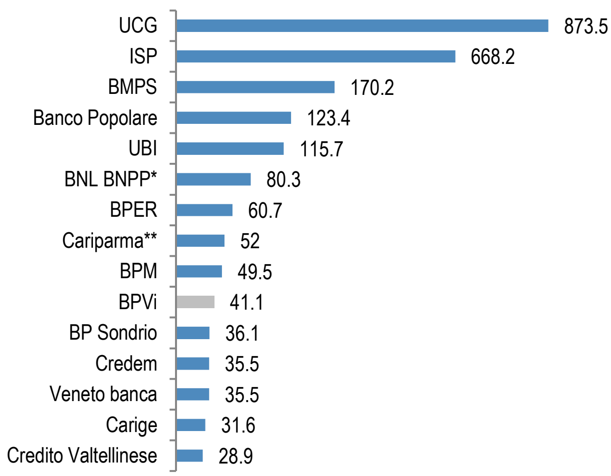
Overall, we view the guarantee scheme as a positive backstop that could help accelerate the NPL disposal process. However, we note there are many challenges involved including: 1) operational challenges, with a significant amount of information required on the NPL portfolios to get the external credit rating and valuation; 2) recovery times that will have to improve significantly as the scheme assumes a recovery process of up to 7 years; 3) finding the right level of guarantee and private investor participation with investors buying on a case-by-case basis.

Company overview

Banca Popolare di Vicenza Group is the 10th largest Italian banking group by total assets and loans, with a 2% market share nationally by total branches and 1.4 m clients (90% individual clients, 10% Corporates/SMEs).

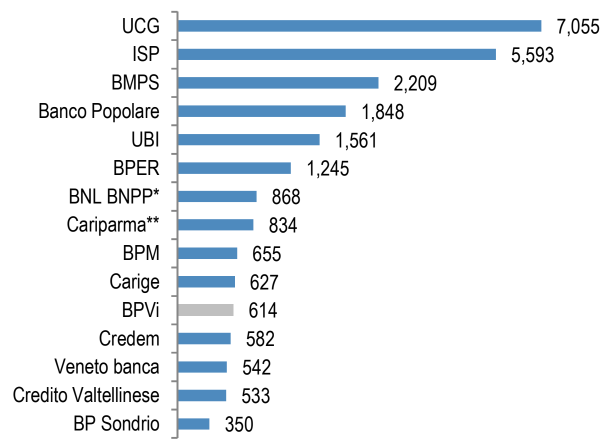
The group had total assets of €39.8bn at end-2015 and operates through 579 branches – 11th largest network in Italy. Total customer loans were €25.2bn at end-2015 and direct funds €21.9bn. Overall, BPVi is smaller than most of the listed popolari banks, but a similar size to other banks like Banca Popolare di Sondrio, Veneto Banca and Credem.

Figure 16: Banks in Italy - Total assets (€bn)



Source: Company reports. Note: Data as of September 2015; * Data as of December 2014; **Data as of June 2015

Figure 17: Banks in Italy – by branches



Source: Company reports. Data as of September 2015; * Data as of December 2014; **Data as of June 2015

The group has 579 branches nationwide with branches in most regions, but is mostly focused in the North East and Veneto, in particular. Its top 3 regions – Veneto, Lombardy and Tuscany (c. 65% of bank's loans) – account for nearly 50% of Italian exports.

The group is mainly active in commercial banking through its parent company **BPVi (**485 branches, net loans of €22bn), **Banca Nuova** (100% owned, 93 branches, €2.8bn loans) and **Farbanca** (71% owned, 1 branch and €527m loans – non strategic, up for sale).

BPVi is mostly distribution oriented, with third-party product platforms. The group operates through strategic partnerships and commercial agreements with specialist operators:

- **Consumer finance** through Prestinuova (100% owned but non strategic and up for sale), BPVi Multicredito (100% owned) and a commercial partnership with Compass (Mediobanca Group).
- **Bancassurance through a commercial agreement with Cattolica Assicurazioni** (15% stake). Bancassurance had €2.1bn in life insurance products as at end-2015.

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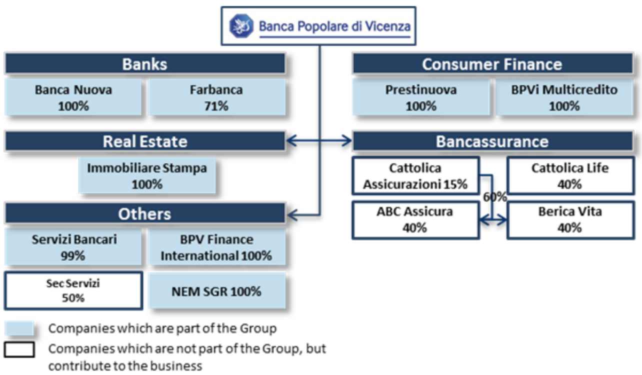
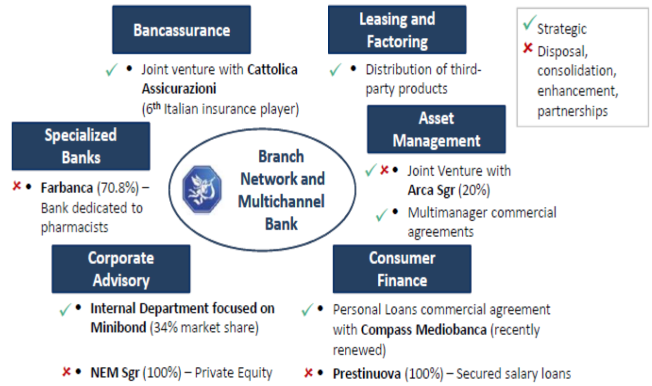
- **Asset management through a commercial agreement with Arca** (20% stake that is non strategic and up for sale). Arca SGR is one of the largest independent asset managers in Italy and has a book value of €38.7m. The group has €4.9bn of AUM, of which 51% are invested in Arca.

Figure 18: Simplified group structure



Source: Company reports

Figure 19: Distribution model with presence of JV's and commercial agreement



Source: Company reports

Brief history of the group

Banca Popolare di Vicenza was founded in Vicenza in 1866. It was the first cooperative bank set up in Veneto region. The group has expanded both by external acquisitions and internally generated growth.

- **1980-2000 – Expansion in north-east Italy:** Over two decades, the group expanded its branches in north-east Italy through several acquisitions (Banca Popolare Agricola di Lonigo, Banca Popolare di Thiene, Banca Popolare dei Sette Comuni-Asiago, Banca Popolare di Venezia, Banca Popolare di Castelfranco Veneto and Banca Popolare di Trieste, Banca Popolare della Provincia di Belluno, Banca Popolare "C. Piva" di Valdobbiadene and Banca Popolare Udinese). Total number of branches increased to 264.
- **2000-2003 – Expansion in south and central Italy:** In 2000, the group acquired Banca Nuova di Palermo and Banca del Popolo di Trapani, and merged in the new Banca Nuova in 2002. In 2002, the group acquired Cassa di Risparmio di Prato-Cariprato from BMPS. Total number of branches increased to 453.
- **2004-2007 – Strategic growth**: BPVi established its consumer finance company, Prestinuova SpA, bought an online specialist servicing pharmacies, Farbanca, and started a commercial agreement with Cattolica Assicurazioni. In 2007, it also acquired 61 branches from UBI Banca, mainly based in the Provinces of Brescia and Bergamo. Total number of branches increased to 628.
- **2010-2013 – Group consolidation:** In 2010, Cariprato was absorbed within the holding company. Over 2010-2013, the group opened new offices and branches in Italy (Milan, Rome, Turin) and abroad (Sao Paolo, New York, Shanghai, Hong Kong, New Delhi). Total number of branches increased to 640 and reduced to 579 end 2015.

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Branch network – strong footprint in Veneto

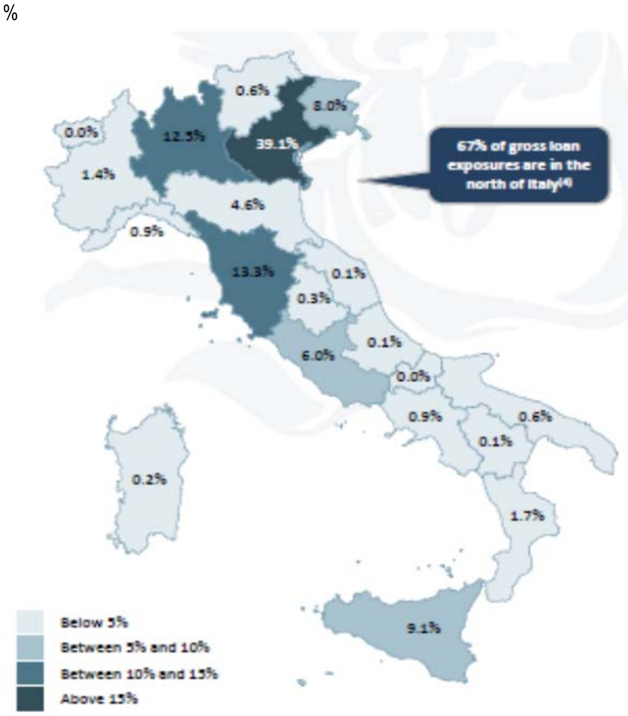
The group had 579 branches at end-2015 with a presence in 16 Italian Regions. The northern part of Italy (Veneto, Friuli Venezia Giulia, Lombardy and Tuscany mainly) is covered directly by the parent company BPVi, while Sicily and Calabria regions are covered by subsidiary Banca Nuova.

BPVi has a strong regional footprint in some of wealthiest regions of north-east Italy, **specifically Veneto, which accounts for 39% of its total gross loans and 38% of group branches with market share of ~7% both by loans and branches in this region.**

- **Strong presence in Veneto** with 7.3% market share by branches, 7.2% by loans. Veneto is one of Italy's wealthiest areas with the highest concentration of SMEs and mid-corporates. The region accounts for 9% of total Italian GDP and 14% of total domestic exports. Currently, Veneto accounts for 221 of the group total of 579 branches and has a strong concentration of loans, ~39% of group total.
- **Strong presence in Friuli Venezia Giulia** with 7.1% market share by branches and 7.4% by loans. The group has 57 branches here and ~8% of total group loans are concentrated in the region that accounts for 2-3% of national GDP & exports.
- **Good footprint in Tuscany and Sicily:** It has a branch market share of 3.6% in Tuscany and 5.0% in Sicily. It has significant loan concentration of 13% in Tuscany and 9% in Sicily with loan market share of 3.4% and 4.5% respectively.
- **Presence in Lombardy but low market shares:** We note that although it has significant loan concentration at 12.5% and 75 branches in Lombardy, the market share remains low at 1.4% by branches and 0.9% loans.

Figure 20: BPVi – Split of €27.8bn gross loans (net of repos) end-2015

%



Source: Company reports.

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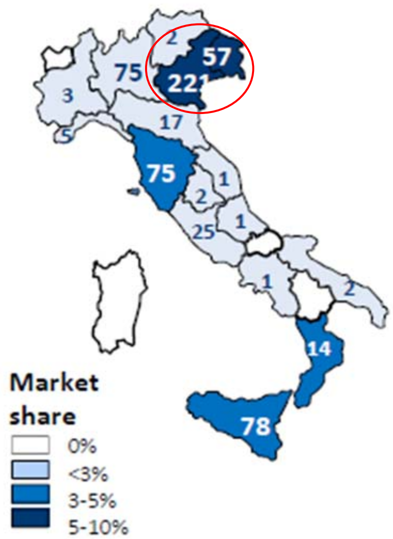
Figure 21: BPVi branch network end-2015



Source: : Company Reports

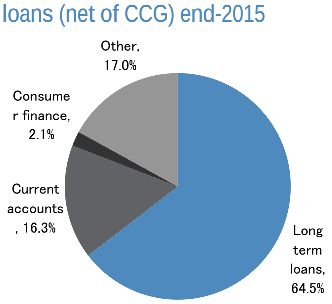
Figure 22: BPVi group branch distribution in Italy

# of branches[1] (main regions)		Market share[2] Branches	Loans	Deposits	% BPVi loans[3]	% BPVi deposits[3]	GDP/capita (€K - 2014)	% of tot. GDP (2014)	% of tot. exports[4]
Veneto	221	7.3%	7.2%	5.0%	39.1%	35.7%	30	9%	14%
Tuscany	75	3.6%	3.4%	2.8%	13.3%	10.0%	29	7%	8%
Lombardy	75	1.4%	0.9%	0.5%	12.5%	7.9%	35	22%	27%
Sicily	78	5.0%	4.5%	2.7%	9.1%	8.2%	17	5%	2%
Friuli-Venezia Giulia	57	7.1%	7.4%	3.9%	8.0%	4.4%	28	2%	3%
Total Italy	579	2.0%	1.9%	1.1%	99.5%	82.0%	27	100%	100%

Source: Company Reports. Notes: 1) As of 31/12/2015; (2) Data referred to Family and Business clients as of 30/9/2015. Source: "Banca d'Italia, Segnalazioni di vigilanza, data di riferimento 30/09/2015"; (3) As of 31/12/2015, net of Repos. Loans and deposits are calculated based on the customer residence and refer to the sum of the data for the 3 commercial banks of the Group (residual value to 100% refer to non – resident customers and to securities issued by the bank which are not deposited at the bank); (4) Share of total national exports (2014), "Banca d'Italia, Segnalazioni di vigilanza, data di riferimento 30/09/2015", ISTAT ("Conti nazionali (edizione di novembre 2015)"), ISTAT-Coeweb ("Statistiche del commercio estero (aggiornamento di dicembre 2015)")

In addition to branches, the BPVi Group sales network includes 13 finance shops and 35 private customer points. The bank also has an established range of electronic channels, alternative to ordinary branches, through which individual customers and businesses can make queries and give instructions in relation to their accounts.

Figure 23: BPVi – split of €25bn net loans (net of CCG) end-2015



Source: Company reports. Other: LRO securities and repo with clients, cash collateral, debtors/creditors, self-liquidating, bank overdraft

BVPi loan portfolio

Banca Popolare di Vicenza has total gross loans (net of repos) of €27.8bn end-2015, of which 59% corporate loans (€16.5bn) and 38% retail loans (€10.6bn).

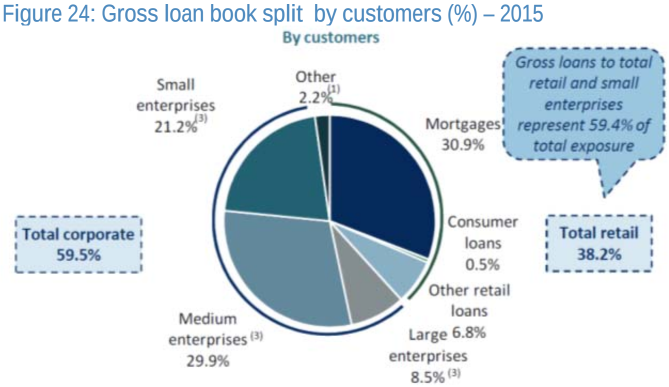
Net of provisions, total customer loans amounted to €25.2bn at end-2015, mostly long term (64.5% of total), as illustrated in Figure 23.

The loan portfolio is, though, largely focused on retail & small enterprises, which account for 59% of total exposure (retail 38%, small enterprise 21% – Figure 24). Based on the new customer segmentation, Community Banking accounted for 55% of total net loans at end-2015 and Corporate & Private 27% (Figure 25).

- **Retail mostly mortgages**: The retail loans mainly consist of mortgages, which account for 30.9% group total gross loans, while other retail loans account for 6.8% of total, according to the company presentation.
- **Historical focus on mid-corporates**: Among the corporates, medium enterprises (revenues up to €250m) account for 29.9% of group total gross loans followed by small enterprises (revenues up to €10mn) at 21.2% and large enterprises at 8.5%.
- **Loan concentration mostly in Veneto, Lombardy and Tuscany:** In terms of geography, the group has strong concentration of loans in north Italy and Tuscany

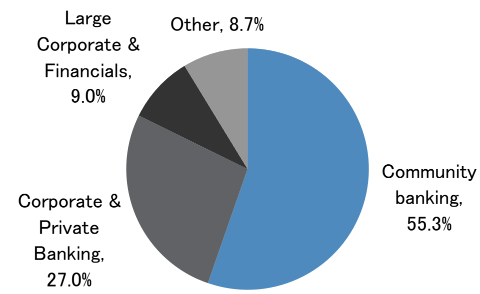
accounting for ~67% of the total gross loans with highest concentration in Veneto at 39%and Lombardy at 12.5%.

Figure 24: Gross loan book split by customers (%) – 2015



Source: Company Reports. Note: 1) Other not classified exposures for c.€0.6bn 2) Gross loan book of the banking entities, net of repos 3) Small enterprises (revenues up to €10mn); Medium enterprises (revenues up to €250mn) and Large enterprises (revenues over €250mn)

Figure 25: Net loan book split by customer segment – 2015



Source: Company Reports. Other: LRO securities, NPLs, funds (total), BPV Finance uses, bridge vs. management accounts.

Retail loan portfolio – mainly mortgage focused – accounts of 80.7% of gross retail loans

BPVi's retail loan portfolio was €10.6bn at FY15, accounting for 38.2% of total gross loans. The retail portfolio mainly consists of mortgage loans, €8.6bn, accounting for 80.7% of gross retail loans. Other retail loans were €1.9bn accounting for 17.9% of gross retail loans and consumer loans were only €0.1bn accounting for 1.4% of gross retail loans.

- **Asset quality**: The retail portfolio has total NPE ratio of 18.3% (mortgage 14.3%, other retail 35.0%). The coverage currently stands at 40.4% for retail portfolio (mortgage 32.4%, other retail 54.2%) improved from 31.2% in 2014, following the comprehensive balance sheet "clean-up" by the new management in 2015. Including the collateral, i.e. only real guarantees, total NPE coverage stands at 136.6% (mortgage 174.6%, other retail 71.6%).
- **LTV:** Average LTV of the portfolio is 59.5%. Some 18.3% of the mortgages portfolio is below 40% LTV, 34.8% at 40-60% LTV, 35% at 60-80% LTV, 6.6% at 80-100% and only 1.7% is above 100% LTV.
- **Collateralisation:** 20% of the retail loan portfolio is unsecured, 1% is collateralised by real guarantees and 79.1% by real estate.

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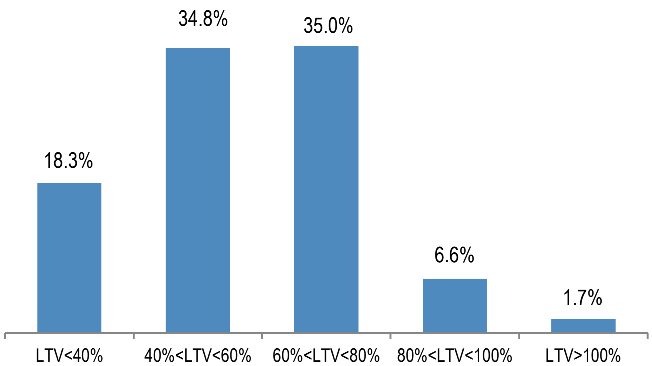
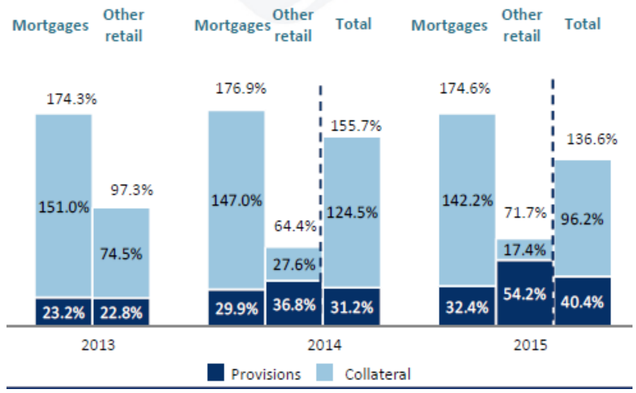
Figure 26: Mortgage loan portfolio LTV% – 2015



Source: Company Reports.

Figure 27: Gross retail NPE provision and collateral coverage



Source: Company Reports Note: collateral included only real guarantees

Corporate loans portfolio

Banca Popolare di Vicenza corporate loan portfolio was €16.5bn at FY15 (accounting for 59.5% of total gross loans) split into small enterprise loans of €5.9bn, medium enterprise loans of €8.3bn and large enterprise loans of €2.3bn.

- **Sectoral distribution:** Within corporate loans, manufacturing accounts for 26.4% of total gross corporate exposure, followed by services at 18.6%, trade at 18%, real estate for 16.5% and construction at 15.4%.
- **Collateralization:** Some 40.2% of the corporate loan portfolio is unsecured, 4.8% is collateralised by guarantees, 14.3% by working capital and 40.6% by real estate.
- **Loans concentration:** The top 5 clients have €0.3bn exposure in total (1.7% of the total gross corporate loan exposure) and the next top 15 clients have €1.37bn exposure (8.3% of the total gross corporate loan exposure).
- **Asset quality:** The corporate portfolio has a total NPE ratio of 40.2% (small enterprise 34.7%, medium enterprises 50.4%, and large enterprises 40.2%). NPE coverage currently stands at 40.4% for corporates (small enterprise 36.7%, medium enterprises 43.5%, and large enterprises 30.8%) improved from 35.3% in 2014, following the comprehensive balance sheet "clean-up" by the new management in 2015. Including the collateral, i.e. only real guarantees and working capital, total NPE coverage stands at 134.9% (small enterprise 129.6%, medium enterprises 138.0%, large enterprises 129.6%).

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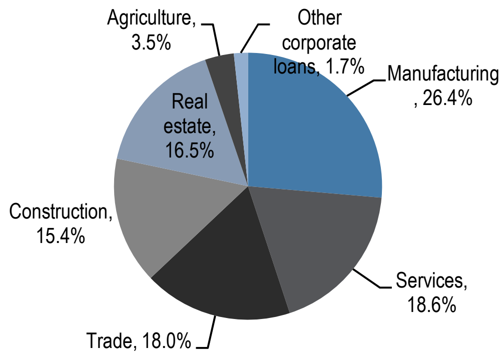
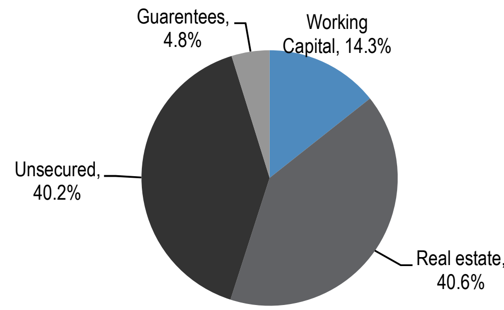
Figure 28: Gross corporate loan book split by sectors (%) – 2015



Source: Company Reports.

Figure 29: Corporate loans by collateral type



Source: Company Reports

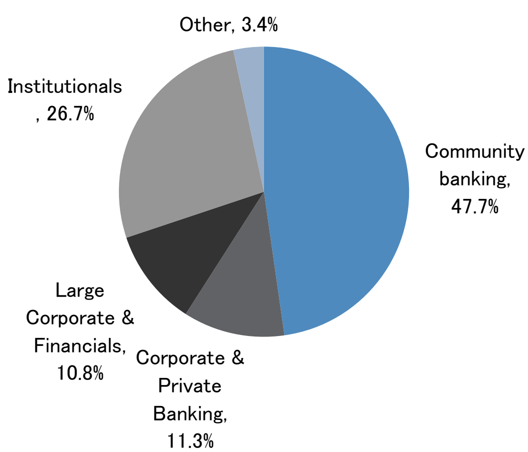
Funding

Direct funding amounted €21.9bn at end-2015, mostly from current accounts (€11.4bn or 52% of total), term deposits (€1.7bn or 7.8%) and retail bonds (€2.6bn or 11.8%), while wholesale funding accounted for €6.2bn or 28%, as illustrated in Table 25 below.

By customer segment, direct funding is mostly provided by community banking (€10.5bn or 47.7%) and Corporate & Private Banking (€2.5bn or 11.3%), which account for the main clients of the bank. Large corporates, financials and institutions, however, provide €9bn or 41% of the remaining funding.

BPVi also relies on ECB funding as of end-2015, with €6.5bn of liquidity or 84% of total €7.8bn net interbank position, according the company presentation.

Figure 30: BPVi – Split of direct funding €21.9bn (net of CCG) by customer segment end-2015



Source: Company Reports.

Table 25: BPVi – Split of direct funding (net of CCG) and net interbank position end-2015

€ million

	2015	%
Direct Funding	21,943	100.0%
ow Current accounts	11,410	52.0%
ow Term deposits	1,712	7.8%
ow Retail bonds	2,589	11.8%
ow EMTN & PP	3,094	14.1%
ow Securitisations	2,063	9.4%
ow Other	1,097	5.0%
Net interbank position	7,823	100.0%
ow ECB funding	6,543	83.6%
ow Repo exposures	851	10.9%
ow Other secured exposures	675	8.6%
ow Debt securities and cash collateral	-909	-11.6%
ow Unsecured exposures	664	8.5%

Source: Company data. Other: Certified cheques, third party funds, cash collateral and other creditors positions (including pre-paid), grants received

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Management and Strategy

New team

Banca Popolare di Vicenza almost completely renewed its management team in 2015. Thirteen of the 16 members are new including the CEO/General Manager, Senior Deputy General Manager and Chief Risk Officer and have experience in other banks, including ISP, UBI, and PMI.

Chief Executive Officer (CEO) & General Manager: Francesco Iorio

Francesco Iorio was appointed General Manager and CEO from 1 June 2015. He comes from UBI Banca where he held the positions of General Manager and Operating Director. He has 24 years experience working with leading banking and insurance companies, and has also worked with consultancy firms such as Accenture and Bain & Company. He was Deputy General Manager and Head of Business Management of the Banca Popolare Commercio e Industria Group from 2002 to 2003; he became Deputy General Manager of the BPU Banca Group when it was established, and also acted as Head of the Business Area and Credit Policies of the Group up to 2007. He was Deputy General Manager of UBI Banca S.c.p.A. and Head of the Macro Business Area from 2007 to 2009. He was Joint Manager, then General Manager of Banca Popolare Commercio e Industria from 2009 to 2012. He became General Manager of UBI Banca in May 2012 and Operating Director of the bank in April 2013.

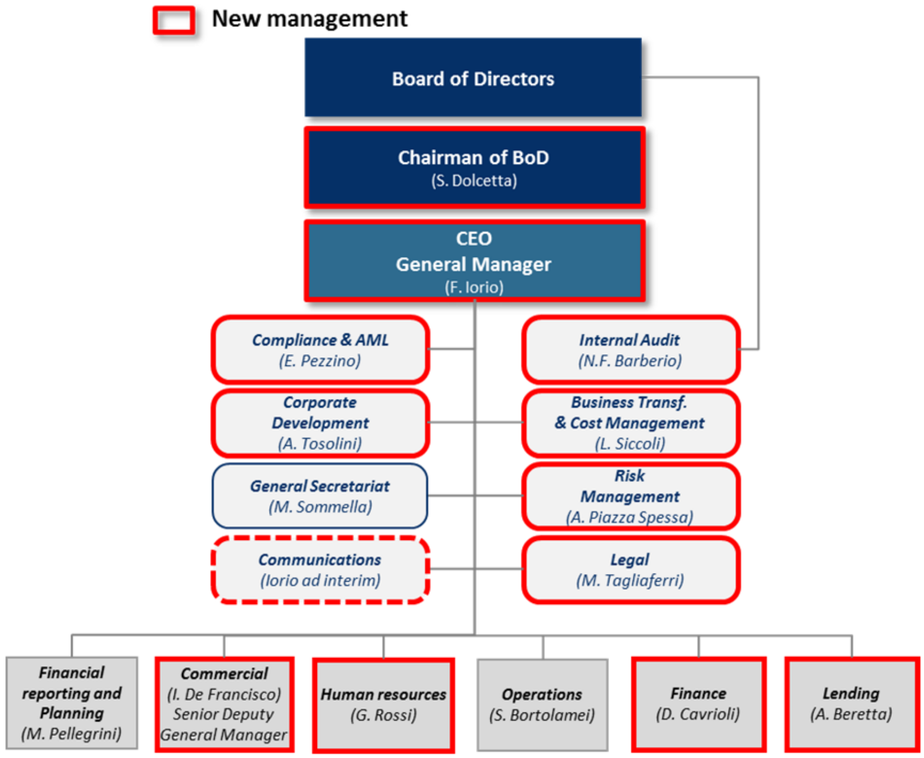
Chief Business Officer and Senior Deputy General Manager: Iacopo De Francisco

Iacopo De Francisco was appointed Senior Deputy General Manager and Head of the Markets Division in June 2015. He comes from Banca Popolare di Milano where he served as Chief Commercial Officer and Member of the Board of Directors of Banca Popolare di Mantova and Banca Akros, with consolidated experience in the banking and consulting industry. Iacopo De Francisco has 18 years experience working for leading banking and consulting companies. From 2002 to 2011, he was a Partner in McKinsey & Co., in charge of the Practice Banking Organization in EMEA and of the Practice Organization in the Mediterranean, and Core Leader of the CIB Practice in EMEA. In 2012, he became Chief Commercial Officer of Banca Popolare di Milano, in charge of the group's commercial activities with retail, private and corporate clients, leading the geographic network and the product and marketing organizations.

Chief Risk Officer (CRO): Alberto Piazza Spessa

Alberto Piazza Spessa was appointed Head of risk management department, coming from Banca Popolare di Milano where he was Head of Risk Management. He has 24 years' experience in banking and consulting companies. After 10 years with KPMG Advisory as Associate Partner, Financial Risk Management, from 2006 to 2007, he was Head of the Methodologies and Quantitative Models Office of BPU Banca. From 2007 to 2010 he served as the Head of the Risk Capital & Policies Area of UBI Banca, and in 2010 he was appointed as UBI Banca's Head of Risk Management.

Figure 31: Management team – 13 out of 16 members are new



Source: Company Presentation

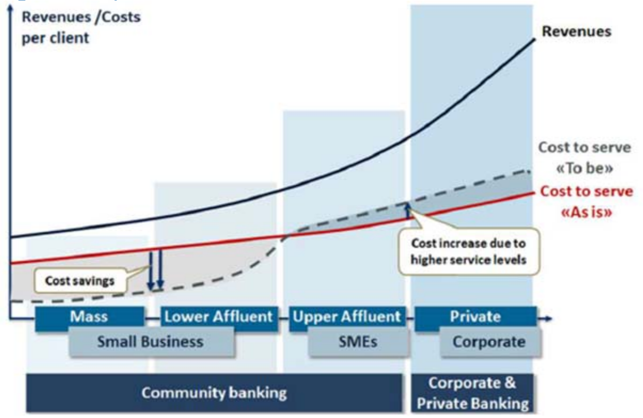
Company strategy

Banca Popolare di Vicenza's new strategy is based on a customer re-segmentation – Community Banking on the one hand and Corporate/SME & Private Banking on the other. This aims to build on the bank's key strengths: strong distribution and client acquisition capabilities with a loyal customer base.

In a nutshell, Banca Popolare di Vicenza is seeking to exploit cross-selling potential from the existing customer base, re-building wealth advisory services and reshaping its client service model to optimise "cost to serve" by hiring more relationship managers to serve its core clients while reducing its number of branches.

The bank plans to increase the number of core-client relationship managers to 1,120 by 2018 from 784 at end-15, according to the company presentation, and reduce number of branches to 500 by 1H2016 from current 579. Core client segments comprise affluent, private banking, small businesses and corporate clients, together accounting for 75% of the banks' client revenues. The group plans to focus on its core client segment as it believes this offers significant growth potential in terms of share of wallet and cross selling.

Figure 32: Optimized 'cost to serve' and service model



Source: Company report

Table 26: Sharpened branch network and increased in the number of relationship managers

	Number of branches	Number of relationship managers serving the core segment
2014	654	736
2015	579	784
Target	~500	~1120
Target vs. 15	-14%	+43%

Source: Company report

More focused distribution model specialized by customer segment

Banca Popolare di Vicenza is seeking to evolve its distribution model **from** undifferentiated regional areas coordinating retail, corporate and private banking, **to two distinct commercial networks specialized by customer segment** as shown in Table 27. The bank has already implemented this new customer service model with the setting up of two new divisions in Jan-16.

- **Community Banking** (focused on mass, affluent and small business customers with revenues ≤ €10m). This will be composed of six regional districts including the branches (which support all other segments of clients).
- **Corporate/SME & Private Banking** (focused on SMEs, corporate and private banking). This network will be composed of 15 business offices focused on private clients (total funding > €1m) & corporate (revenues > €10m). The bank sees high synergy potential from consolidation of the corporate relationship managers and private banker functions. The large corporate segment, which includes companies generating revenues > €250m (and the private clients connected to them), will be organized separately in a dedicated and centralized structure.

Table 27: BPVi – new customer segmentation effective from Jan-2016

				Service model	Clients	Revenues (€mn)	Revenues (€)/clients
Community Banking	Retail	Mass	Total deposits*< €75,000	Branch	~983,000	130	132
		Affluent	Total deposits* €75,000-1m	Relationship manager	~219,000	124	561
	Small Businesses	Small businesses	Annual turnover < €10m	Relationship manager	~118,000	265	2,243
Corporate and Private Banking	Private Banking	Private	Total deposits≥ €1m	Relationship manager	~12,000	35	2,565
	Corporates	Mid corporate	Ann.turnover €10m-250m	Relationship manager	~9,000	173	19,819
		Large corporate	> €250m	Relationship manager	~1,000	71	42,275
Total					1,342,000	798	

Source: Company report. Note * direct funding and indirect funding; segmentation of individual customers is based on the amount of deposits and on behavioral rules (i.e. annual spending)

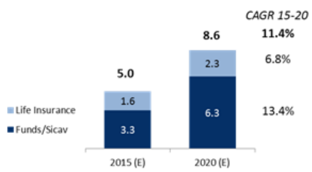
Overall, the group is focusing on core revenues – particularly on net fees & commissions driven by AUM growth. The group expects net commissions to grow at a 7.1% CAGR from €322m in 2015 to €453m in 2020 and AuM to grow from €7.0bn at end-15 to €12.5bn at end-2020 (15-20 CAGR of 12.1%).

Community banking commercial strategy – enhance cross-selling and increase client coverage for core segments

- **Enhance cross selling and re-build wealth advisory services:** BPVi seeks to exploit cross selling to community banking clients, by offering advisory through client relationship managers, open platform (investments) and product partnerships. Currently only 7% of small banking revenues are from fee-based services (payments, trade & export finance, leasing, factoring, insurance products). In the mass segment, 46% of clients use three products or fewer, according to the company presentation. Hence, the bank believes there are major opportunities to enhance cross-selling in community banking. BVPi expects its AuM stock volume related to affluent clients to increase to €8.6bn by 2020 (from €5bn in 2015) and small business loan stock to increase to €5.8bn (from €4.9bn). Overall, BVPi expects AuM to grow from €7.0bn at end-15 to €12.5bn at end-20 (15-20e CAGR of 12.1%).

- **Increase client coverage for affluent and small business banking**: Currently the commercial coverage is low in both affluent and small banking business (24% of clients without dedicated relationship managers in affluent segment and 45% of clients without dedicated relationship managers in small banking). The bank is planning to increase number of relationship managers dedicated to these segments and thereby enable wider and more effective client coverage. Overall, the bank plans to increase the number of relationship managers (serving its core segments) to 1,120 by 2018 from 784 at end-15.

Figure 33: BPVi – targeted affluent AuM stock volume (€bn)



Source: Company report

Corporate and private banking strategy – reshape client service model to create 'one stop' service platform for corporate SMEs & entrepreneurs

Banca Popolare di Vicenza sees high synergy potential from consolidation of corporate relationship managers and private banker functions. The group is seeking to enforce and further strengthen its value added services offer and delivery for corporate/SME & private banking (e.g. ECM, minibond, export/trade finance, structured finance & MT lending).

Private banking strategy:

- Focusing on setting up advisory services unit and strengthening its wealth management unit to better serve private banking client's needs.

- Working on product offering enhancement by broadening asset manager and life insurance houses open architecture framework and developing in-house wealth portfolio management services.

- Looking to acquire new private bankers to increase geographical coverage, customer base and AUM. Overall, the bank plans to increase its dedicated private banking relationship managers to 120 by 2018 from 77 at end-15.

Corporates and SMEs:

- **Specialized corporate vs private coverage with integrated service teams** – The commercial coverage for SMEs and corporates is not focused currently with inefficient geographical presence. The group indicated in its company

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presentation that it is planning to form "local integrated centers" for corporate and private bankers providing specialized support in trade/export finance and ECM/DCM/advisory to clients.

- **Enforce and further strengthen value added services** – Currently only 8.1% of revenues come from 'value added' services (trade & export finance, derivatives, DCM/ECM). The group is seeking to enforce and further strengthen its value-added services offer and delivery for corporate/SME (e.g. ECM, minibond, export/trade finance, structured finance & MT lending). As a result, the group expects net commissions from its SME platform to grow from €25.2m to €48m in 2020 with commissions from ECM, minibond and structuring increasing to €19.8m in 2020 (from €5.3m in 2015) and commissions trade/export increasing to €28.2m in 2020 (from €19.8m in 2015)

Table 28: BPVi – net commissions target (€m)

	2015	2020 target
Total net commissions	322	453
o/w SME platform	25.2	48.0
o/w ECM, minibond, structuring	5.3	19.8
o/w Trade export	19.9	28.2

Source: Company reports.

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Financial forecasts

JPMe vs management targets

We expect BPVi to return to positive profits from 2017 onwards after further restructuring in 2016. Net profits should be supported by a) more "normal" cost of risk levels after two years of clean-ups, b) top-line progression with NII growth returning with the reversal of part of the lost funding and ongoing fees & commission growth, and c) cost reduction as per the business plan.

- **Net Interest Income to increase at a 3.9% CAGR 2015-20e**, driven by 1) lending volumes increasing at a 2.4% CAGR (ex CCG), 2) lower funding costs (down 56bp to 88bp in 2020e) more than offsetting ongoing margin pressure from lower Euribor rates with increased pressure on lending spreads (down 29bp over the period to 285bp in 2020e), and 3) relatively resilient NII on the securities portfolio due to the €2bn increase in government bonds and increased volumes from minibonds that are partly retained.
- **Cost of risk (on average net loans) to decline to 83bp in 2020e** from 500bp on average loans in 2015, as NPL/bad loans continue to grow despite NPL disposals of €1.5bn. We expect the group to continue to improve impaired loan coverage from 40.6% in 2015 to 46.3% in 2020e.

Table 29: BPVi – summary P&L 2015-2020e

€ million

	2015	2016e	2017e	2018e	2019e	2020e	2016e	2017e	2018e	2019e	2020e
Net Interest Income	504	494	534	561	578	609	-2%	7.9%	5.1%	3.1%	5.3%
Net commissions	322	326	339	354	373	394	1.2%	3.9%	4.5%	5.2%	5.8%
Trading income	163	120	100	80	80	80	-26%	-17%	-20%	0%	0%
Other	63	80	80	80	80	80	27%				
Total revenues	1,053	1,021	1,052	1,075	1,111	1,163	-3.0%	3.1%	2.1%	3.3%	4.7%
Operating expenses	-754	-732	-638	-619	-632	-610	-3%	-13%	-3%	2%	-3%
Pre-provision profits	298	288	415	456	479	553	-3%	44%	10%	5%	15%
Loan loss provisions	-1,333	-300	-325	-250	-300	-230	-78%	8%	-23%	20%	-23%
Other provisions & other	-858	-100	0	0	0	0					
Pretax	-1,893	-112	90	206	179	323					
Tax	486	33	-27	-64	-57	-107					
Minorities	-1	-1	-1	-1	-1	1					
Net income	-1,407	-79	62	141	121	218					
Net Loans*	25,178	25,647	25,764	26,473	27,243	28,277	1.9%	0.5%	2.8%	2.9%	3.8%
Direct Funding	21,943	23,970	24,112	24,772	25,449	26,147	9.2%	0.6%	2.7%	2.7%	2.7%
Indirect Funding	14,550	15,141	15,779	16,468	17,213	18,018	4%	4%	4%	5%	5%
Tangible equity	2,523	3,944	3,975	4,046	4,106	4,215	56%	1%	2%	1%	3%
NIM	1.52%	1.54%	1.62%	1.69%	1.71%	1.78%					
Cost/Income	71.6%	71.7%	60.6%	57.6%	56.9%	52.4%					
Cost of risk on av. loans	5.00%	1.18%	1.26%	0.96%	1.12%	0.83%					
ROTE	-36.2%	-1.0%	1.6%	3.5%	3.2%	5.2%					

Source: J.P. Morgan estimates, Company data. *including CCG.

Our estimates are 30% below company targets, with net profit of €141m in 2018e vs. targeted profit of €202m, and net profits of €218m in 2020e vs. targeted €309m, mainly due to lower Net Interest Income and Fees & Commissions.

- **Net Interest Income growing at a 3.9% CAGR 2015-20e vs. targeted growth of 5.8%**: We expect a lending volumes CAGR of 2.4% vs. targeted 3.7%, and see more margin pressure with: 1) commercial spreads increasing 27bp to 197bp in

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2020e from ~170bp in 2015 vs. targeted improvement of ~50bp by 2020; and 2) lower market rates with Euribor at ~30bp only in 2020e vs. 59bp assumed by management in the business plan.

- **Cost of risk 81bp in 2020e vs. targeted 70bp on end-period loans:** We expect slower improvement in provisions from 529bp to 81bp in 2020e vs. targeted 70bp, as we see impaired loan coverage increasing from 40.6% at end-2015 to 46.3% at end-2020e vs. targeted 45.4% in 2020.

- **Net fees and commission CAGR of ~4% 2015-20e vs. targeted 7.1%:** We forecast a solid net fees & commissions CAGR of ~4%, with indirect funding progressing at a 4.4% CAGR and AuM at a 6.7% CAGR. This is, however, lower than the targeted 7.1% CAGR in fees and 7.2% CAGR in indirect funding, including a 12.1% CAGR in AuM.

- **Cost reduction in line with management:** We expect group expenses to decrease at a ~4% CAGR 2015-20, broadly in line with management's target, supported by a branch reduction of 79 and staff cut of ~485 by 2020. Our cost/income ratio is, however, higher at 57.6% in 2018e and 52.4% in 2020e vs. the targeted 54.4% and 47.6% respectively, due to lower revenues.

We note that the company's business plan and our estimates do not include the benefit from ACE ("allowance for corporate equity") in terms of lower tax, for the period 2016-2020 stemming from the planned €1.5bn IPO, equivalent to €8.9m in 2016 and €14.6m per year starting from 2017.

Table 30: BPVi – Summary P&L 2015-2020e – JPMe estimates vs. company targets

€ million

	2015 Actual	2018e JPMe	2020e JPMe	2018 Target	2020 Target	2015-2018e CAGR JPMe	2015-2020e CAGR JPMe	2015-2018 CAGR Target	2015-2020 CAGR Target
Net Interest Income	504	561	609	579	669	3.6%	3.9%	4.7%	5.8%
Net commissions	322	354	394	401	453	3.2%	4.1%	7.5%	7.0%
Trading income	163	80	80	84	85	-21%	-13%	-20%	-12%
Other	63	80	80	79	82	8%	5%	8%	5%
Total revenues	1,053	1,075	1,163	1,143	1,289	0.7%	2.0%	2.8%	4.1%
Operating expenses	-754	-619	-610	-622	-613	-6.4%	-4.2%	-6.2%	-4.1%
Pre-provision profits	298	456	553	521	676	15.2%	13.1%	20%	18%
Loan loss provisions	-1,333	-250	-230	-220	-214	-43%	-30%	-45%	-31%
Other provisions & other	-858	0	0	-	-	-	-	-	-
Pretax	-1,893	206	323	-	-	-	-	-	-
Net income	-1,407	141	218	202	309	-	-	-	-
Net Loans*	25,051	26,346	28,150	28,174	30,073	1.7%	2.4%	4.0%	3.7%
Direct Funding	21,943	24,772	26,147	26,439	28,231	4.1%	3.6%	6.4%	5.2%
Indirect Funding**	14,550	16,468	18,018	18,628	20,584	4.2%	4.4%	8.6%	7.2%
Tangible equity***	2,523	4,046	4,215	3,607	3,768	17.0%	10.8%	12.7%	8.4%
NIM	1.52%	1.69%	1.78%	-	-				
Cost/Income	71.6%	57.6%	52.4%	54.4%	47.6%				
Cost of risk****	5.29%	0.94%	0.81%	0.77%	0.70%				
ROTE	-36.2%	3.5%	5.2%	5.6%	8.2%				

Source: J.P. Morgan estimates, Company data. * Net loans outstandings excluding repurchase agreements with Cassa Compensazione e Garanzia. ** Indirect funding excludes own shares held by customers. *** Tangible equity in 2015 excluding the €1.5bn IPO. **** cost of risk on end period net loans.

Net Interest Income

Net Interest Income declined 3.3% in 2014 and 1.4% in 2015, mainly driven by the lower contribution from the securities portfolio, which saw its average yield decrease from ~350bp in 2013 to ~140bp in 2015, on our estimates. NII on client margin activities has been relatively resilient, with customer spreads improving from ~121bp to ~170bp on lower funding cost, more than offsetting weaker lending volumes (net loans down ~10% CAGR 2013-15).

However, we expect Net Interest Income to decline -2% in 2016e, driven by lower client margin contribution due to lower lending volumes (lag effect from the H2 15 deleveraging), ongoing margin pressure from lower Euribor rates (down >30bp on average), more than offsetting lower funding costs on both deposits and wholesale funding (~131bp vs. 144bp in 2015).

On the other hand, we see NII growing at a ~5% CAGR 2016e-20e, driven by a) improved lending volumes (2.5% CAGR 2016-20e) as the bank recovers on part of the lost funding; and b) repricing of funding cost to more "normal" levels (from 131bp in 2016e to 88bp in 2020e), more than offsetting the pressure on the contribution from the securities portfolio.

Table 31: BPVi – Total Net Interest Income trends (2013-2020e)

€ million

	2013	2014	2015	2016e	2017e	2018e	2019e	2020e	2016e	2017e	2018e	2019e	2020e
NII on client margin	379	420	416	409	441	465	487	528	-2%	7.9%	5.4%	4.8%	8.3%
o/w Customer activities	336	451	475	468	483	507	529	569	-1%	3.2%	4.9%	4.4%	7.7%
Loans	932	975	836	762	758	757	765	791	-9%	-0.5%	-0.1%	1.1%	3.4%
Deposits & Securities	-596	-524	-362	-294	-275	-251	-237	-222	-19%	-6.4%	-8.9%	-5.6%	-6.3%
ow Deposits	-327	-265	-150	-122	-112	-95	-88	-80	-19%	-8.4%	-15%	-7.3%	-8.4%
ow Securities issued	-269	-259	-212	-172	-164	-156	-149	-142	-19%	-5.0%	-4.6%	-4.6%	-5.0%
o/w Interbank	-68	-56	-36	-39	-22	-22	-22	-22					
ow Hedging derivatives	111	26	-23	-20	-20	-20	-20	-20					
NII on securities portfolio	150	91	87	86	92	96	91	81	-2%	8%	4%	-5%	-11%
Total Net Interest Income	528	511	504	494	534	561	578	609	-1.9%	7.9%	5.1%	3.1%	5.3%
NIM on client margin	1.30%	1.42%	1.56%	1.61%	1.72%	1.78%	1.81%	1.90%					
o/w NIM Customer activities	1.21%	1.52%	1.70%	1.69%	1.78%	1.85%	1.89%	1.97%					
Loan spread	3.20%	3.30%	3.14%	3.00%	2.95%	2.90%	2.85%	2.85%					
Deposits & Securities	-1.99%	-1.78%	-1.44%	-1.31%	-1.17%	-1.05%	-0.96%	-0.88%					
ow Deposit spread	-1.53%	-1.18%	-0.78%	-0.70%	-0.60%	-0.50%	-0.45%	-0.40%					
ow Cost securities issued	-3.71%	-3.80%	-3.56%	-3.40%	-3.30%	-3.10%	-2.90%	-2.70%					
o/w Interbank cost	2.06%	1.67%	0.69%	0.56%	0.35%	0.35%	0.35%	0.35%					
Yield on financial assets	3.52%	1.68%	1.40%	1.30%	1.32%	1.40%	1.35%	1.30%					
NIM on Int. Earnings Assets	1.62%	1.41%	1.52%	1.54%	1.62%	1.69%	1.71%	1.78%					

Source: J.P. Morgan estimates, Company data.

We see client margin contribution increasing, supported by lower funding cost, with NIM on client margin increasing from 156bp in 2015 to 178bp in 2018e and 190bp in 2020e supported by increased lending volumes as the bank recovers part of the lost funding, with funding cost repricing to more "normal" levels, more than offsetting further pressure on lending spreads.

We expect commercial spreads (NIM on customer activities) to grow from 170bp in 2015 to 185bp in 2018e and 197bp in 2020e. We see ongoing pressure on lending spreads to 285bp in 2020e, down from 300bp in 2016e, due to the repricing of the higher yielding back book with lower front book spreads, combined with lower Euribor rates. However, this should be more than offset by further deposit & wholesale funding cost repricing from ~131bp in 2016e to 88bp in 2020e.

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Note that we have also included the estimated ~€20m benefits from TLTRO in our cost for interbank borrowing.

Table 32: BPVi – Net Interest Income from customer activities (2013-2020e)

€ million

	2013	2014	2015	2016e	2017e	2018e	2019e	2020e	2016e	2017e	2018e	2019e	2020e
NII on client margin	379	420	416	409	441	465	487	528	-2%	7.9%	5.4%	4.8%	8.3%
o/w Customer activities	336	451	475	468	483	507	529	569	-1%	3.2%	4.9%	4.4%	7.7%
Loans	932	975	836	762	758	757	765	791	-9%	-0.5%	-0.1%	1.1%	3.4%
Deposits & Securities	-596	-524	-362	-294	-275	-251	-237	-222	-19%	-6.4%	-8.9%	-5.6%	-6.3%
ow Deposits	-327	-265	-150	-122	-112	-95	-88	-80	-19%	-8.4%	-15%	-7.3%	-8.4%
ow Securities issued	-269	-259	-212	-172	-164	-156	-149	-142	-19%	-5.0%	-4.6%	-4.6%	-5.0%
o/w Interbank	-68	-56	-36	-39	-22	-22	-22	-22					
ow Hedging derivatives	111	26	-23	-20	-20	-20	-20	-20					
Customer loans	30,893	28,111	25,178	25,647	25,764	26,473	27,243	28,277	1.9%	0.5%	2.8%	2.9%	3.8%
Financial Assets	4,263	6,559	5,872	7,300	6,700	7,000	6,500	6,000	24.3%	-8.2%	4.5%	-7.1%	-7.7%
Cash	2,389	193	174	174	174	174	174	174					
Interest Earning Assets	37,545	34,862	31,224	33,120	32,638	33,646	33,916	34,451	6.1%	-1.5%	3.1%	0.8%	1.6%
Customer deposits	22,993	22,158	16,272	18,550	18,643	19,202	19,778	20,372	14.0%	0.5%	3.0%	3.0%	3.0%
Securities issued	6,958	6,668	5,199	4,939	4,989	5,088	5,190	5,294	-5.0%	1.0%	2.0%	2.0%	2.0%
Net interbank borrowing	4,259	2,503	7,823	6,228	6,228	6,228	6,211	6,211	-20%	0.0%	0.0%	-0.3%	0.0%
NIM on client margin	1.30%	1.42%	1.56%	1.61%	1.72%	1.78%	1.81%	1.90%					
o/w NIM Customer activities	1.21%	1.52%	1.70%	1.69%	1.78%	1.85%	1.89%	1.97%					
Loan spread	3.20%	3.30%	3.14%	3.00%	2.95%	2.90%	2.85%	2.85%					
Deposits & Securities	-1.99%	-1.78%	-1.44%	-1.31%	-1.17%	-1.05%	-0.96%	-0.88%					
ow Deposit spread	-1.53%	-1.18%	-0.78%	-0.70%	-0.60%	-0.50%	-0.45%	-0.40%					
ow Cost securities issued	-3.71%	-3.80%	-3.56%	-3.40%	-3.30%	-3.10%	-2.90%	-2.70%					
o/w Interbank cost	2.06%	1.67%	0.69%	0.56%	0.35%	0.35%	0.35%	0.35%					

Source: J.P. Morgan estimates, Company data.

We see the contribution from the securities portfolio increasing initially on the increased size of the portfolio, but declining from 2018e with the run-off. Initially, contribution is inflated by the significant increase in the government bond portfolio and issuances of minibonds, which are retained (+24% to €7.3bn in 2016e), and helped by the relatively long duration (average maturity of 5.8 years for the €5.2bn government bond portfolio), partly offsetting the lower yields. However, with the portfolio progressively running off, we expect yields to come down slightly from ~140bp in 2018e to ~130bp in 2020e.

Table 33: BPVi – Net Interest Income from the securities portfolio (2013-2020e)

€ million

	2013	2014	2015	2016e	2017e	2018e	2019e	2020e	2016e	2017e	2018e	2019e	2020e
NII on securities portfolio	150	91	87	86	92	96	91	81	-2%	8%	4%	-5%	-11%
Securities portfolio	4,263	6,559	5,872	7,300	6,700	7,000	6,500	6,000	24%	-8.2%	4.5%	-7.1%	-7.7%
Government bond maturity	-	-	-	-	605	808	586	116					
Yield on financial assets (av.)	3.52%	1.68%	1.40%	1.30%	1.32%	1.40%	1.35%	1.30%					

Source: J.P. Morgan estimates, Company data.

Note that government bonds account for 90% of the securities portfolio and 13% of total assets. The current business plan seems to assume no change in capital requirements for sovereign holdings. The ECB is reviewing the treatment of sovereign exposures, and could consider some additional constraints – cap on sovereign holdings as percentage of total assets or capital, potentially higher risk weightings. Any big changes would put the NII growth at risk, in our view.

Overall, our Net Interest Income forecasts are ~9% below company targets in 2020, as we forecast more modest lending volumes with more margin pressure and lower rates with NII growing ~4% CAGR 2015-20e vs. targeted +5.8%. We see:

- **Lower deposit and funding growth**, with a ~3.6% CAGR for 2015-20e vs. target 5.2%. While we expect the bank to recover part of the lost funding in 2016, we expect a lower progression in deposit growth and wholesale funding issuances.
- **Lower lending volumes with a 2.4% CAGR in 2015-20e**, compared to management's target of a ~3.7% CAGR (ex CCG). We estimate a net lending volume increase of just €3bn vs. target €5bn cumulative over 2015-2020. On a gross loan basis, we forecast a 2.1% CAGR 2015-20e, below the target 3.3% CAGR.
- **Lower market rates assumption** with Euribor still ~30bp in 2020e more in line with the forward curve vs. management +59bp.
- **More margin pressure with commercial spreads improving 27bp only from ~170bp in 2015 to ~197bp in 2020e**, with less deposit and wholesale repricing (~88bp in 2020e vs. target 63bp) than anticipated by management and more pressure on lending spreads (~285bp in 2020e vs. target 305bp). BPVi on the other hand guides to margin expansion to ~240bp, driven by lower cost of funding.

Table 34: BPVi – Net Interest Income – JPM estimates vs. company targets 2018 and 2020

€ million

	2015	2018e JPMe	2020e JPMe	2018 Target	2020 Target	2015-2018e CAGR JPMe	2015-2020e CAGR JPMe	2015-2018 CAGR Target	2015-2020 CAGR Target
Net Interest Income	504	561	609	579	669	3.6%	3.9%	4.7%	5.8%
ow Client margin	416	465	528	465	594	3.8%	4.9%	3.8%	7.4%
ow Securities portfolio	87	96	81	114	75	3.3%	-1.4%	9.4%	-3.1%
Net loans (€bn)	25.1	26.5	28.3	28.2	30.1	1.8%	2.4%	4.0%	3.7%
Direct funding (€bn)	21.9	24.8	26.1	26.4	28.2	4.1%	3.6%	6.4%	5.2%
Securities portfolio (€bn)	25.2	26.5	28.3	-	-	-	-	-	-
Lending spreads (av.)	3.14%	2.90%	2.85%	3.14%*	3.05%*	-0.24%	-0.29%	0.00%	-0.09%
Deposit spreads (av.)	1.44%	1.05%	0.88%	1.09%*	0.63%*	-0.39%	-0.56%	-0.35%	-0.81%
Commercial spreads (av.)	1.70%	1.85%	1.97%	2.05%*	2.41%*	0.15%	0.27%	0.35%	0.71%
Investment Yield	-1.44%	-1.05%	-0.88%	-	-	-	-	-	-
Euribor rate	-0.13%	-0.20%	0.10%	0.07%	0.59%				

Source: J.P. Morgan estimates, Company data. * based on end period rates. Note: For spreads, JPM estimates are not comparable to BPVi targets as the targets are based on end period rates and JPM estimates on average spreads.

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Fees and commissions

We expect growth in fees & commissions to offset the weakness in Net Interest Income, with a ~4% CAGR in 2015-2020e, supported mainly by growth in AuM and AuC as well as financing & transaction banking.

- **Net fees and commission CAGR of ~4% 2015-20e vs. targeted 7.1%:** We forecast a solid net fees & commissions CAGR of ~4%, with indirect funding progressing at a 4.4% CAGR and AuM at a 6.7% CAGR. This is, however, lower than the targeted 7.1% CAGR in fees and 7.2% CAGR in indirect funding, including a 12.1% CAGR in AuM.
- **We expect asset management to expand at a 6% CAGR 2015-20**, supported by AUM +5% CAGR, AuC +2% and insurance +10%, as the group rebuilds its wealth advisory services for affluent and private customers. Note that we have assumed stable margins on AuM and AuC, which could prove challenging in this environment.
- **We expect fees from financing & transaction banking to achieve a 3% CAGR 2015-20,** driven by better cross selling to corporate clients with the increased number of relationship managers and expansion in P&C.

Table 35: BPVi – Fees & commissions 2015-2020e

€ million

	2015	2016e	2017e	2018e	2019e	2020e	2015	2016e	2017e	2018e	2019e	2020e
Asset Management Fees	73	76	81	86	92	98	7%	4%	6%	6%	7%	6%
Commissions on AuM	54	58	61	64	67	70	10%	7%	5%	5%	5%	5%
Commissions on AuC	10	8	8	9	9	9	-9%	-17%	2%	2%	2%	2%
Insurance products	16	17	18	20	22	25	14%	5%	10%	10%	10%	10%
Financial promoters commissions	-7	-7	-7	-7	-6	-6	17%	0%	0%	0%	-14%	0%
Fees from financing, transaction & other	196	199	203	209	216	227	8%	2%	2%	3%	4%	5%
Consumer Finance	28	24	25	26	28	29	4%	-15%	5%	5%	5%	5%
SME platform	25	28	30	33	37	40	0%	10%	10%	10%	10%	10%
Total net commission income	322	326	339	354	373	394	7.0%	1.3%	3.9%	4.5%	5.2%	5.8%
AuC	7,507	7,640	7,786	7,947	8,123	8,318	-10%	2%	2%	2%	2%	2%
Stocks	6,179	6,179	6,179	6,179	6,179	6,179	-14%	0%	0%	0%	0%	0%
Other financial assets	1,328	1,461	1,607	1,768	1,944	2,139	16%	10%	10%	10%	10%	10%
AuM and Insurance Products	7,043	7,502	7,994	8,522	9,090	9,700	7%	7%	7%	7%	7%	7%
AuM	4,916	5,162	5,420	5,691	5,975	6,274	10%	5%	5%	5%	5%	5%
Insurance products	2,127	2,340	2,574	2,831	3,114	3,426	-1%	10%	10%	10%	10%	10%
% on AuC	0.13%	0.11%	0.11%	0.11%	0.11%	0.11%						
% on AuM	1.15%	1.15%	1.15%	1.15%	1.15%	1.15%						
% on insurance products	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%						

Source: J.P. Morgan estimates, Company data.

While we expect fee progression to offset weakness in NII, our growth forecasts for net commissions are ~13% below company targets, with a ~4% CAGR 2015-2020 vs target of ~7%, mainly due to a lower AuM CAGR of ~7% 2015-20e vs a target of 12%.

Table 36: BPVi – net fees & commissions – JPM estimates vs. company targets 2018 and 2020

€ million

	2015	2018e JPMe	2020e JPMe	2018 Target	2020 Target	2015-2018e CAGR JPMe	2015-2020e CAGR JPMe	2015-2018 CAGR Target	2015-2020 CAGR Target
Net fees & commissions	322	354	394	401	453	3.2%	4.1%	7.6%	7.1%
ow Financing & transaction	196	209	227	225	245	2.2%	3.0%	4.7%	4.6%
ow AuM and AuC	73	86	98	104	128	5.5%	6.1%	12.5%	11.9%
ow SME platform	25	26	29	44	49	1.6%	3.0%	20.7%	14.4%
ow Consumer Finance	28	33	40	28	31	5.9%	7.5%	0.0%	2.1%
AuM	7.0	8.5	9.7	10.8	12.5	6.8%	6.7%	15.6%	12.3%
AuC	7.5	7.9	8.3	7.9	8.1	1.9%	2.1%	1.7%	1.6%
Total Indirect Funding	14.5	16.5	18.0	18.7	20.6	4.3%	4.4%	8.8%	7.3%

Source: J.P. Morgan estimates, Company data.

Other revenues

Other revenues are mainly derived from gains on government bonds – in 2015, gains on government bonds accounted for €102m or 50% of total other revenues (clean numbers excluding gains on disposals of stakes).

We expect other revenues to decline by 12% in 2016, mainly due to lower gains on disposals of financial assets, as well as lower dividends/profits from equity investments, as we do not expect the 2015 exceptional gains from disposals of Pittarosso (€11.3m) and Metafin (€10.5m) to be repeated.

Table 37: BPVi – Total other revenues 2015-2020e

€ million

	2015	2016e	2017e	2018e	2019e	2020e	2016e	2017e	2018e	2019e	2020e
Trading income & gains/losses on proprietary portfolio	163	120	100	80	80	80	-26%	-17%	-20%	0%	0%
Dividends/profits from equity investments	48	30	30	30	30	30	-37%	0%	0%	0%	0%
Other income/charges	15	50	50	50	50	50	227%	0%	0%	0%	0%
Total other revenues	226	200	180	160	160	160	-12%	-10%	-11%	0%	0%

Source: J.P. Morgan estimates, Company data. Note: Dividends and profits from equity investments in 2015 included exceptional gains from disposals of stakes in Pittarosso (€11.3m) and Metafin (€10.5m)

Cost management

We expect total operating cost to decline at a ~3.5% CAGR over 2015-2018 and a -2.3% CAGR over 2015-2020 on a normalized basis, broadly in line with management targets, driven by a reduction in both personnel costs and other operating expenses. The group is targeting a potential net headcount reduction of ~620 (~11% of total 5,473) by 2020 and closure of a further 79 branches (~14% of total 579) by Q2 16.

- **Personnel cost:** The group is targeting ~625 potential net headcount reductions by 2020 (~575 reductions, ~90 new hires and ~150 potential outsourcing). We only take in cost savings related to net headcount reduction of 485 and do not account for any cost savings from ~150 potential outsourcing in our estimates, in line with management cost targets. Some 425 or most of the total 485 headcount reduction would be done over 2016-17, and we expect -3.7% underlying CAGR over 2015-18e and only -0.4% over 2019-20e. Note that we include one-off impact of €65m in 2016 and €16m in 2019 for redundancy costs related to headcount reduction and, hence, we have costs going up in both these years.

- **Other administrative costs:** The group is targeting closures of ~79 branches by Q2 16, and we expect -3.2% CAGR over 2015-18e and only -0.7% over 2019-20e. Note that other operating expenses in 2015 were impacted by a total €52m in one-off charges including: 1) €41m of extraordinary contribution to the national resolution fund, and 2) €11m in extraordinary expenses for the transformation to a joint stock company.

Table 38: BPVi – Total Operating Costs 2014-2020e

€ million

	2014	2015*	2016E	2017E	2018E	2019E	2020E	2015	2016E	2017E	2018E	2019E	2020E
Administrative costs:	-634	-718	-698	-606	-589	-603	-583	13%	-3%	-13%	-3%	2%	-3%
- payroll	-402	-410	-456	-372	-357	-373	-354	2%	11%	-18%	-4%	5%	-5%
- other admin costs	-232	-308	-242	-234	-231	-230	-228	33%	-21%	-4%	-1%	-1%	-1%
Depreciation	-36	-36	-34	-32	-30	-29	-27	0%	-5%	-5%	-5%	-5%	-5%
Net Operating costs	-669	-754	-732	-638	-619	-632	-610	13%	-3%	-13%	-3%	2%	-3%

Source: .P. Morgan estimates, Company data. *2015 was impacted by several one-offs 1) €41m of extraordinary contribution to the National Resolution Fund 2) €11m the extraordinary expenses for the transformation to Joint Stock Company and 3) €10mn related to top management turnaround 4) Note that we include one-off impact related to redundancy funds €65m in 2016 and €16m in 2019.

Our costs estimates are broadly in line with management targets. We expect total costs of €619m (target €622m) in 2018e and €610m (target €613m) in 2020e. However, our cost to income ratio is higher at 57.6% in 2018 (target 54.4%) and 52.4% in 2020 (target 47.6%) due to our lower revenue forecast than management targets.

We expect both the personnel costs and other administrative expenses to decline at a ~3.5% CAGR over 2015-2018e and a ~2% CAGR over 2015-2020e on an underlying basis and broadly in line with management targets shown in Table 39.

Table 39: BPVi – Total Operating cost – JPM estimates vs. company targets 2018 and 2020

€ million

	Stated 2015	Underlying* 2015	2018e JPMe	2020e JPMe	2018 Target	2020 Target	Underlying 2015-2018e CAGR JPMe	Underlying 2015-2020e CAGR JPMe	Underlying 2015-2018e CAGR Target	Underlying 2015-2020e CAGR Target
Administrative costs:	-718	-655	-589	-583	-592	-586	-3.5%	-2.3%	-3.3%	-2.2%
- payroll	-410	-400	-357	-354	-364	-361	-3.7%	-2.4%	-3.1%	-2.0%
- other administrative costs	-308	-255	-231	-228	-228	-225	-3.2%	-2.2%	-3.7%	-2.5%
Depreciation	-36	-36	-30	-27	-30	-27	-5.5%	-5.5%	-5.9%	-5.6%
Net Operating costs	-754	-691	-619	-610	-622	-613	-3.6%	-2.5%	-3.4%	-2.4%
C/I ratio	72%	66%	58%	52%	54%	48%				

Source: J.P. Morgan estimates, Company data. *Note that underlying 2015 is adjusted for 1) €41m of extraordinary contribution to the National Resolution Fund 2) €11m the extraordinary expenses for the transformation to Joint Stock Company and 3) €10m related to top management turnaround.

Management strategy on costs savings

BPVi targets net **cost savings of €63m by 2018,** of which €36m is in personnel costs, mainly driven by headcount reduction, and €27m in other admin expenses, mainly driven by branch closures. Over 2019-2020, it expects additional cost savings of €6m (€3m in personnel costs and €3m in other admin expense), resulting in **net cost savings of €69m by 2020** of which €39m is in personnel costs and €30m in other admin expenses.

We discuss the two key drivers of the cost savings: 1) headcount reductions and 2) branch closures, in detail below.

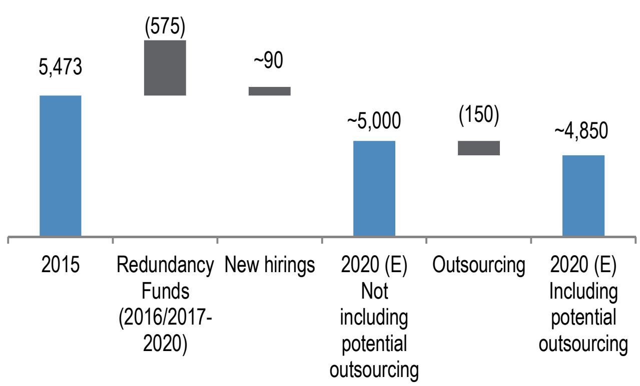
#1 Headcount reduction of ~620 FTEs by 2020

BPVi employed 5,473 personnel at end-2015. It is targeting a net headcount reduction of ~620 by 2020 (~575 reductions, ~90 new hires and ~150 potential outsourcing). Of the 575 targeted reduction, ~200 are planned in 2016, ~225 in 2017 and ~150 reductions in 2020. The group expects an additional reduction of 150 FTEs from externalization of volume driven activities. The 90 or so new hires are to be mainly focused on relationship managers to enhance core segments coverage and also include internal auditors and other internal control functions. As a result, the group expects savings of €39m of personnel net cost by 2020 (€36m by 2018).

The €39mn targeted net cost saving consists of : €38mn related to the ~425-employee reduction in 2016/2017 and €12m is related to the ~150-employee reduction in 2020, partially offset by an €8m increase in cost, due to the ~90 new hires, and €3m, due to other net effects.

We list the details on the personnel cost savings from the various actions taken by the management in Table 40 below.

Figure 34: BPVi: Personnel headcount reduction target



Source: Company reports.

Table 40: €36mn of targeted cost savings by 2018 in personnel costs

€ million

2015 underlying personnel costs	-400
Cost savings by 2018	
o/w 1st staff redundancy fund (-425 Employees)	+38
o/w labor cost reduction	+7
o/w legal entities rationalisation/disposal,	+17
Cost increases by 2018	
o/w ~ 90 new hirings	-8
o/w incentives for the employees	-6
o/w economic effect of new labor agreement	-12
Net personnel cost savings by 2018	+36
2018 personnel cost target	-364
Impact from 2nd staff redundancy fund (-150 employees)	+12
Impact from Economic effect of (Italian national banking labor agreement) and incentives for the staff	-9
Net cost savings over 2019-2020	+3
2020 personnel cost target	-361

Source: Company reports.

#2 Simplification and branch efficiency – closure of further 79 branches by the end of 2016

Some 70% of the group's branches generate ~93% of its revenues as shown in Figure 35. Given the revenues are highly concentrated in some branches, the group is now optimizing its branches to improve efficiency and productivity

BPVi has already closed 75 branches in 2015 bringing the total number down to 579 in FY15 from 654 in FY14. It further aims to close 79 branches by end-2016 (~11% of the 579). In addition, it is also working on the rationalization of back office, legal entities and procurement activities. As a result, overall, the group expects €30mn of net cost savings in other admin expense by 2020 (€27m by 2018).

Out of the €30m targeted net cost saving 1) €20m is related to logistics & real estate, i.e. closure of branches, legal entities rationalization, facility management

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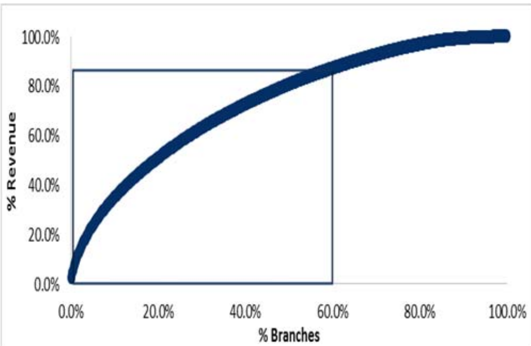
optimization; 2) €8m is related to IT/back office activities; and 3) €8m is related to savings in advisory, marketing sponsorship, corporate communication and closure of foreign representative offices, partially offset by €5m expected increase in BRRD/ DGS contributions.

Figure 35: Revenue concentration – concentrated in some branches



Source: Company reports.

Table 41: BPVi: €27mn of targeted savings in other admin expense by 2018

€ million

2015 underlying other admin costs	-255
Cost savings by 2018	
o/w related to IT / back office	+8
o/w logistics & real estate– closure of branches, legal entities rationalization etc.	+20
o/w savings in advisory, marketing sponsorship, corporate communication etc.	+5
Cost increases by 2018 due to BRRD/DGS contributions	-5
Net other admin cost savings by 2018	+27
2018 other admin costs target	-228
Net cost savings over 2019-2020	+3
2020 other admin costs target	-225

Source: J.P. Morgan estimates

Loan loss provisions

We expect active credit and risk management with better NPL trends to translate into lower cost of risk in the next few years. We expect cost of risk (on average net loans) to decline to 96bp in 2018e and 83bp in 2020e from ~500bps in 2015. Note that loan loss provisions of €1,333m or ~500bp in 2015 were impacted by the significant loan book clean-up done by the new management and also include €460m impact related to the financed capital.

Note that we take into account company estimated impact of €50m in 2017 related to NPL disposal of €1.0bn and an estimated impact of €25m by the company related to NPL disposal of €500m in 2019.

Overall, our cost of risk estimates are higher than management expectations of pre-crisis level cost of risk of 70bp (JPMe 81bp) in 2020 and 77bp (JPMe 94bp) in 2018, as we assume higher NPL/sofferenze coverage levels.

Table 42: BVPi – Cost of risk on net loans (incl. CCG) 2012-2020e

€ million	2012	2013	2014*	2015**	2016e	2017e	2018e	2019e	2020e	2018 Target	2020 Target
Loan Loss Provisions	-216	-432	-868	-1,333	-300	-325	-250	-300	-230	-220	-214
Cost of risk (on average net loans)	-0.80%	-1.48%	-2.94%	-5.00%	-1.18%	-1.26%	-0.96%	-1.12%	-0.83%	-0.79%	-0.72%
Cost of risk (on year end net loans)	-0.79%	-1.40%	-3.09%	-5.30%	-1.17%	-1.26%	-0.94%	-1.10%	-0.81%	-0.77%	-0.70%
Net customer loans (average)	26,881	29,119	29,502	26,644	25,413	25,706	26,119	26,858	27,760	27,691	29,690
Net customer loans (year end)	27,345	30,893	28,111	25,178	25,647	25,764	26,473	27,243	28,277	28,200	30,100

Source: J.P. Morgan estimates, Company data. * including €155m of AQR related provisioning ** including €460m related to the effect of the financed capital. Note: 2017e and 2019e estimates include the impact of NPL disposals.

Taxes & DTA Usage

The group had €1,355m of DTAs at FY15 of which €706mn related to DTA Law 214/2011 (fully recoverable) and €220m DTAs are related to tax losses carry forward. BPVi expects DTA to decline over time and expects to recover about 50% of loss tax carry forward within 2020.

We forecast a tax rate of 30-33% during 2016-2020 and do not assume any DTA usage in our estimates currently.

We note that the company has confirmed that there will be an additional benefit expected from ACE ("allowance for corporate equity") in terms of lower tax, for the period 2016-2020 stemming from the €1.5bn IPO, equivalent to €8.9m in 2016 and €14.6m per year starting from 2017. This benefit is currently not included in the business plan targets and not included in our estimates.

Allowance for corporate equity

In 2011, Italy introduced a law that incentivizes companies to raise new equity, by introducing tax benefits on amounts raised.

- From 2011, Italian companies may deduct from their net tax base a notional interest computed on the increase in their net equity (the "allowance for corporate equity"). The notional interest rate was fixed at 3% for 2011-2013, 4% for 2014, 4.5% for 2015 and 4.75% for 2017. From 2017, the notional rate will be determined by decree, depending on the Italian treasury bonds yield.
- The increase in net equity is subject to certain upward and downward adjustments: 1) increased by cash contributions and allocation of profits to capital reserves (except allocation to specific reserves that cannot be used for distribution, increasing share capital or covering losses); and 2) decreased by distributions of equity to shareholders, acquisitions of new interests in participated companies etc.

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Table 43: BPVi: P&L summary P&L 2014-2020e

€ million

	2014	2015	2016E	2017E	2018E	2019E	2020E	2015	2016E	2017E	2018E	2019E	2020E
Net interest income	511	504	494	534	561	578	609	-1.9%	7.9%	5.1%	3.1%	5.3%	-1.9%
Divi from equity investments	29	48	30	30	30	30	30						
Net fees and commissions	301	322	326	339	354	373	394	1%	4%	5%	5%	6%	1%
Net profit for property portfolios	187	163	120	100	80	80	80	-26%	-17%	-20%	0%	0%	-26%
Other	49	15	50	50	50	50	50						
Net Operating income	1,077	1,053	1,021	1,052	1,075	1,111	1,163	-3.0%	3.1%	2.1%	3.3%	4.7%	-3.0%
Administrative costs:	-634	-718	-698	-606	-589	-603	-583	-3%	-13%	-3%	2%	-3%	-3%
- payroll	-402	-410	-456	-372	-357	-373	-354	11%	-18%	-4%	5%	-5%	11%
- other administrative costs	-232	-308	-242	-234	-231	-230	-228	-21%	-4%	-1%	-1%	-1%	-21%
Depreciation	-36	-36	-34	-32	-30	-29	-27	-5%	-5%	-5%	-5%	-5%	-5%
Net Operating costs	-669	-754	-732	-638	-619	-632	-610	-3%	-13%	-3%	2%	-3%	-3%
Net Operating profit	408	299	288	415	456	479	553	-3%	44%	10%	5%	15%	-3%
Net impairment adjustments	-1,521	-1,827	-350	-325	-250	-300	-230	-81%	-7%	-23%	20%	-23%	-81%
- o/w on loans and advances	-868	-1,333	-300	-325	-250	-300	-230	-78%	8%	-23%	20%	-23%	-78%
- o/w on AFS & equity invest.	-36	-171	-50	0	0	0	0						
- o/w impairment on goodwill	-600	-335	0	0	0	0	0						
- others	-17	12	0	0	0	0	0						
Net provisions for risks/charges	-18	-513	-50	0	0	0	0						
Gains (losses) on disposal/	-3	149	0	0	0	0	0						
Net income before tax	-1,134	-1,893	-112	90	206	179	323	-94%	-180%	130%	-13%	81%	-94%
Income tax	377	486	33	-27	-64	-57	-107						
Minority interests	-1	-1	-1	-1	-1	-1	1						
Net income	-759	-1,407	-79	62	141	121	218	-94%	-178%	129%	-15%	80%	-94%
Adjusted net earnings	-358	-160	-34	62	141	132	218	-79%	-284%	129%	-7%	65%	-79%

Source: J.P. Morgan estimates, Company data.

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Table 44: BPVi: Summary Balance Sheet 2014-2020e

€ million

BALANCE SHEET	2014	2015	2016E	2017E	2018E	2019E	2020E	2015	2016E	2017E	2018E	2019E	2020E
ASSETS													
Cash and cash equivalent	193	174	174	174	174	174	174	-10%	0%	0%	0%	0%	0%
Financial assets HFT	7,579	3,409	3,409	3,409	3,409	3,409	3,409	-55%	0%	0%	0%	0%	0%
Financial assets at fair value	4	8	8	8	8	8	8	84%	0%	0%	0%	0%	0%
Financial assets AFS	5,321	5,726	7,157	7,300	7,446	7,297	7,152	8%	25%	2%	2%	-2%	-2%
Financial assets HTM	43	0	0	0	0	0	0	-100%	0%	0%	0%	0%	0%
Interbank loans	2,255	2,150	2,150	2,150	2,150	2,150	2,150	-5%	0%	0%	0%	0%	0%
Customer loans (net)	28,111	25,178	25,647	25,764	26,473	27,243	28,277	-10.4%	1.9%	0.5%	2.8%	2.9%	3.8%
Hedging derivatives	98	33	33	33	33	33	33	-66%	0%	0%	0%	0%	0%
Macro hedges	87	46	46	46	46	46	46	-47%	0%	0%	0%	0%	0%
Equity Investments	495	493	493	493	493	493	493	0%	0%	0%	0%	0%	0%
PPE	626	598	598	598	598	598	598	-4%	0%	0%	0%	0%	0%
Intangible fixed assets	348	11	11	11	11	11	11	-97%	0%	0%	0%	0%	0%
o.w. Goodwill	330	6	6	6	6	6	6	-98%	0%	0%	0%	0%	0%
Tax assets	949	1,457	1,457	1,457	1,457	1,457	1,457	0%	0%	0%	0%	0%	0%
current assets	81	102	102	102	102	102	102	0%	0%	0%	0%	0%	0%
deferred assets	867	1,355	1,355	1,355	1,355	1,355	1,355	0%	0%	0%	0%	0%	0%
Other assets	366	502	502	502	502	502	502	37%	0%	0%	0%	0%	0%
Total assets	46,475	39,783	41,684	41,944	42,799	43,420	44,308	-14%	2%	2%	2%	2%	2%
Net interbank borrowing	-2,503	-7,823	-6,228	-6,228	-6,228	-6,211	-6,211	213%	-20%	0%	0%	0%	0%
LIABILITIES													
Due to banks	4,758	9,973	8,378	8,378	8,378	8,361	8,361	110%	-16%	0%	0%	0%	0%
Due to customers	22,158	16,272	18,550	18,643	19,202	19,778	20,372	-27%	14%	1%	3%	3%	3%
Debt securities in issue	6,668	5,199	4,939	4,989	5,088	5,190	5,294	-22%	-5%	1%	2%	2%	2%
Financial liabilities HFT	5,957	2,772	2,772	2,772	2,772	2,772	2,772	-53%	0%	0%	0%	0%	0%
Financial liabilit. at fair value	1,547	472	481	481	481	481	481	-70%	2%	0%	0%	0%	0%
Hedging derivatives	525	888	888	888	888	888	888	69%	0%	0%	0%	0%	0%
Tax liabilities	182	317	317	317	317	317	317	0%	0%	0%	0%	0%	0%
a) current	2	3	3	3	3	3	3	0%	0%	0%	0%	0%	0%
b) deferred	180	314	314	314	314	314	314	0%	0%	0%	0%	0%	0%
Other liabilities	791	718	765	853	978	877	960	-9%	7%	11%	15%	-10%	9%
Provision for severance	80	73	73	73	73	73	73	0%	0%	0%	0%	0%	0%
Provisions for risks/charges:	58	548	548	548	548	548	548	0%	0%	0%	0%	0%	0%
Total liabilities	42,725	37,231	37,711	37,940	38,724	39,285	40,064	-13%	1%	1%	2%	1%	2%
Valuation reserves	187	157	157	157	157	157	157	-16%	0%	0%	0%	0%	0%
Equity instruments	3	1	1	1	1	1	1	-56%	0%	0%	0%	0%	0%
Reserves	609	224	224	224	224	224	224	-63%	0%	0%	0%	0%	0%
Additional paid-in capital	3,365	3,207	3,300	3,220	3,251	3,322	3,382	-5%	3%	-2%	0%	1%	1%
Capital stock	352	377	377	377	377	377	377	7%	0%	0%	0%	0%	0%
Treasury shares (-)	-26	-25	-25	-25	-25	-25	-25	-2%	0%	0%	0%	0%	0%
Minority interests (+/-)	18	18	18	18	18	18	18	-2%	0%	0%	0%	0%	0%
Net income (loss) (+/-)	-759	-1,407	-79	31	71	60	109						
Total equity	3,750	2,552	3,973	4,004	4,075	4,135	4,244	-32%	56%	1%	2%	1%	3%
Total liabilities and shareholders' equity	46,475	39,783	41,684	41,944	42,799	43,420	44,308	-14%	5%	1%	2%	1%	2%

Source: J.P. Morgan estimates, Company data.

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Table 45: BPVi: Asset Quality

€ million

ASSET QUALITY	2014	2015	2016E	2017E	2018E	2019E	2020E
Gross NPL ratio	21.2%	30.9%	30.9%	28.3%	27.5%	25.3%	24.3%
NPL	11.1%	15.1%	16.9%	15.3%	15.9%	14.8%	15.0%
Unlikely to Pay - Substandard	7.3%	15.3%	13.4%	12.2%	10.6%	9.4%	8.2%
Past due/overdue	2.7%	0.5%	0.6%	0.8%	1.0%	1.1%	1.1%
Coverage ratio (incl generic provision)	37.8%	42.3%	45.3%	45.7%	47.5%	48.1%	49.4%
Coverage ratio (exc-generic provision)	34.4%	40.6%	43.5%	43.4%	44.9%	45.2%	46.3%
Coverage on sofferenze (ex writeoffs)	50.1%	56.8%	57.0%	56.5%	57.0%	56.5%	56.5%
Coverage on unlikely to pay	19.5%	25.8%	28.0%	29.0%	30.0%	31.0%	32.0%
Coverage on past due/overdue	10.5%	12.2%	12.0%	12.0%	12.0%	12.0%	12.0%
Generic as a % of gross loans	0.7%	0.7%	0.8%	0.9%	1.0%	1.0%	1.0%
Total Gross NPLs	6,474	8,963	9,213	8,359	8,388	7,839	7,794
change	*1,094*	*2,489*	*250*	*-854*	*29*	*-550*	*-45*
NPL	3,402	4,369	5,024	4,522	4,838	4,597	4,826
Unlikely to Pay - Substandard	2,238	4,439	3,995	3,596	3,236	2,913	2,621
Past due/overdue	834	154	193	241	314	329	346
Total Gross Performing Loans	24,083	20,005	20,605	21,223	22,072	23,175	24,334
Total Gross loans	30,557	28,967	29,818	29,582	30,460	31,014	32,128
Net loans	28,111	25,178	25,647	25,764	26,473	27,243	28,277
Total BS provisions	2,446	3,789	4,171	3,818	3,987	3,771	3,851
BS Provisions on Impaired	2,229	3,642	4,006	3,627	3,766	3,539	3,607
Provisions on sofferenze	1,705	2,480	2,864	2,555	2,758	2,597	2,727
Provisions on unlikely to pay	436	1,144	1,119	1,043	971	903	839
Provisions on past due/overdue	88	19	23	29	38	40	41
Generic provisions	217	147	165	191	221	232	243
LLP specific provisions P&L	-868	-1,333	-300	-325	-250	-300	-230
LLP/ Gross loans	2.76%	4.48%	1.02%	1.09%	0.83%	0.98%	0.73%
LLP/ av. Net loans	2.94%	5.00%	1.18%	1.26%	0.96%	1.12%	0.83%

Source: J.P. Morgan estimates, Company data.

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