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UBI Banca

27 April 2009 - COMPANY UPDATE

ITALY

BANKS

 Rating
Buy

 Previous
 Buy

**FLASH
NOTE**

Standing on its own two feet

With a 7.1% core Tier 1 ratio reported at the end of 2008, the bank is one of the few opting to forego Government support while delivering on dividend distribution. Still our top pick among domestic small banks. Buy.

Prudent available-for-sale portfolio impairment performed in 2008

We conservatively revised our 2009-10 estimates to factor in lower interest rates

One of the few players not asking for Government support

EUR11.4 target price confirmed on more favourable valuation assumptions. Buy.

Key points

Full-year 2008 bottom line absorbs severe AFS asset impairment

A severe EUR481m AFS asset impairment led the group to close FY 2008 with a EUR69m net profit (vs. our EUR546m estimate). On the other hand, operating results were in line with estimates, apart from the one-off negative items in the EUR242m net trading loss (vs. our estimate of a EUR150m loss): 1) net operating income down 7.9% YOY to EUR4.1bn, (vs. EUR4.2bn); 2) GOP down 21.8% YOY to EUR1.48n, (vs. EUR1.62bn); 3) net cost of credit was 59bp; 3) EURO.45 proposed dividend; 4) 7.1% Core Tier 1 ratio; 5) convertible bond issue, up to a maximum EUR640m, aiming to exploit a cheaper source of funding versus Tremonti bonds. UBI Banca's CEO denied any intention to employ this capital for acquisitions.

Low visibility on 2009, company guiding to prudence

During the FY08 results presentation, CEO Victor Massiah stated that the net interest income is seen decreasing YOY in 2009, with a higher pressure in the H109, whose unfavourable comparison YOY is due to approx. 3 pp reduction in interest rates. In terms of asset quality, he also stated that the first two months of 2009 confirmed a slowdown in new NPLs flows. Operating costs are seen down YOY (2009 should be the best year for synergy extraction, after a 2008 flat YOY, despite the inertial 3.6% increase in labour cost). Net cost of credit is seen below the 129bp annualised in Q4 2008, around 85bp, despite the bank aims to beat this target. Tax rate is seen at around 40%.

Target Price EUR11.40	Current Price EUR10.05
Market Cap EUR6.4bn	Free Float 93%

YTD Abs. Perf.	-2.3%
Shares Outstanding (m)	639
Daily Trade Vd.(sh 000)	2,457
52 Week Hgh/Low	EUR17.60/EUR6.15
NAV(EUR)	17.51
Cost Income	62.9%

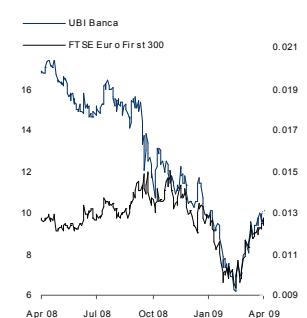
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FY End: 31/12 (EUR)	2008	2009E	2010E
Revenues	4,090	4,046	4,178
GOP	1,411	1,506	1,673
Current profit	385	672	910
Net profit (dcl)	69	337	448
Net profit (adj)	437	439	531
EPS (adj)	0.68	0.69	0.83
DPS	0.45	0.40	0.45
PE	21.9	14.6	12.1
P/OPBRP	6.8	4.3	3.8
P/Current profit	24.9	9.6	7.1
P/BOOK	0.85	0.57	0.56
Net dividend yield	3.0%	4.0%	4.5%

Source: Kepler Capital Markets

UBI Banca rel. FTSE EuroFirst 300



Source: Kepler Capital Markets

Published by:

Kepler Capital Markets

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Announcing an integration project between IWBanck and Twice Sim

At the beginning of March, UBI Banca announced a value-enhancing project on its on-line banking subsidiary IWBanck, which foresees: 1) the acquisition of a further 32.4% stake in IWBanck by UBI Banca (currently owning a 52.5% stake approximately), mainly held by IWBanck's management; 2) entry into IWBanck's capital of Medinvest International, a financial holding company, which currently owns a 59.3% stake in Twice SIM (ranked 5th for domestic equity brokerage in 2008, with a 4.5% market share approximately); 3) the integration between IWBanck and Twice SIM, through the acquisition of a control stake in Twice SIM by IWBanck (up to maximum 100% but with a minimum 50.1%). As a consequence, UBI Banca will consolidate IWBanck with a stake of approximately 74.7%, with a total maximum cash out of approximately EUR80m and a limited impact on core Tier 1 ratio (approximately 7bp).

The strategic rationale of the deal is to exploit the potential synergies between Twice SIM and IWBanck, with the extension of the banking products supply to Twice SIM customers and the reaching of significant economies of scale. The project also foresees the confirmation of IWBanck's current top management positions.

We see strong strategic rationale in the deal for UBI Banca, with a limited impact on core Tier 1 ratios while also confirming that Italy's better capitalised banks have a competitive edge in terms of strategic flexibility and the potential to strengthen market share.

We have revised our FY2009-10 estimates to factor in the recent cuts in interest rates

We have revised our 2009-10 estimates for UBI Banca to factor in:

- Higher pressure on net interest income, due to a deteriorated macro scenario and the more recent cut in interest rates (estimates cut by 1.9% and 0.5% in those two years, respectively) and a reduction in our net customer loans estimated YOY growth from 4% to 3% in 2009.
- Weaker net commissions, due to the still-dramatic trend in AUM outflows (at industry level) in the first months of 2009 and likely to continue at least over 2009 (estimates cut by 1.8% and -1.3% in 2009 and 2010 respectively).
- Operating costs estimates increased by 2.1% in both 2009, and 2010, to fully factor in the 3.6% YOY expected inertial contractual increase in salaries.
- Expected tax rate increased from 36% to 40% in these two years.

The above-mentioned revisions result in a 19.5% and a 15% cut in our bottom line estimates for 2009-10 respectively.

Q1 2009 expected to be weak to prudent loan-loss provisioning

We expect Q1 2009 to anticipate the operating trends expected for the full year: net interest income and net commissions are seen down 6.5% and 18.6% YOY, respectively, reflecting the recent cuts in interest rates the first and the constant AUM outflows the second (according to Assogestioni, from April 2008 to March 2009 UBI Banca registered EUR4.bn in net fund management outflows, representing 18% of its total funds under management).

Table 1: UBI Banca- Q1 2009 results previews

	1Q08A	2Q08A	3Q08A	4Q08A	1Q09E	Q109/Q108
Net interest income	731	732	741	779	684	-6.5%
Dividends	2	67	2	1	2	22.2%
Income from equity stakes	9	5	0	-15	1	-88.5%
Net commissions	318	303	277	289	259	-18.6%
Trading income	-27	38	-61	-193	20	-173.8%
Insurance income	4	10	3	-7	8	94.6%
Other net operating income	31	23	21	6	25	-19.7%
Net operating income	1,068	1,178	983	860	999	-6.5%
Personnel expenses	-395	-415	-379	-396	-386	-2.1%
Other administrative costs	-175	-199	-166	-210	-180	3.3%
D&A	-67	-67	-67	-77	-60	-9.8%
Integration costs	-14	-14	-17	-22	-5	-63.6%
<i>Operating costs</i>	<i>-650</i>	<i>-695</i>	<i>-629</i>	<i>-704</i>	<i>-632</i>	<i>-2.8%</i>
Gross operating profit	418	484	353	156	367	-12.2%
Loan loss Provisions	-60	-93	-103	-310	-185	209.6%
Other writedowns/ups	-0	4	2	-516	-	-100.0%
Risks and charges provisions	-8	-17	-13	5	-13	47.2%
Income from asset/investment disposal	57	22	1	5	-	-100.0%
Pretax profit from ordinary activities	407	398	241	-661	170	-58.3%
Taxes	-161	-66	-120	126	-68	-57.7%
Net income from non recurring activities	0	-11	-	-5	-	-
Minority income	-27	-21	-20	-11	-17	-38.6%
Net profit	219	300	101	-551	85	-61.1%

Source: Kepler Capital Markets, company figures.

Investment conclusion

Despite the cut in 2009 and 2010 estimates, we keep our EUR11.4 target price on the stock unchanged, as we have applied some more favourable valuation assumptions, in light of the particular defensiveness of the investment case. More specifically:

- Our beta assumption in the Discounted Shareholders' Profit is reduced from the previous 1.25 to 1.2.
- Our Dividend Discount Model benefited from our new assumption of a EURO.40 dividend distribution in 2009 (vs. our previous zero payout estimate), with the impact on core Tier 1 more than offset by the particularly virtuous trend in risk-weighted assets registered in 2008 (-8% YOY, also due to the adoption of the Lince external rating for the credit counterparty risk valuation).

We still see UBI Banca as the best play among smaller Italian banks for the current year, as the bank is delivering on capital adequacy (7.1% core Tier 1 ratio at the end of December 2008 without any Government support) and might decide to reimburse the announced convertible bonds issue by cash in 2013, should the next three years' organic core Tier 1 generation produce significant excess capital (which we currently consider a likely scenario).

This is why we do not factor into our estimates or valuation the convertible bonds issue, and we appreciate the bank's decision to take recourse to a much cheaper source of funding than the "Tremonti bonds", given the adequacy of its core Tier 1 ratio level.

Moreover, UBI Banca business model, purely domestic and mainly retail focused, represents in our view a valid play in the currently uncertain macro conditions.

Last but not least, we see the opportunity for investors to play a second round of consolidation among the Italian Popolari banks, as we do not rule out it becoming a realistic scenario as early as in H2 2010, and perhaps meeting with the favour of both the Bank of Italy and the Italian government.

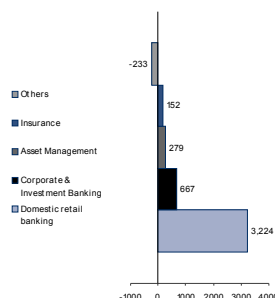
Key financials

Company profile

UBI Banca is the banking group originated from the recent merger between Banche Popolari Unite and Banca Lombarda. With approx. 1,960 branches network (the fourth largest in the domestic market), it is operating in the traditional (both retail and corporate) banking business, in the asset management and in the investment banking business.

Top shareholders		Events calendar	
Carlo Tassara SpA	2.3%	BoD on Q109	13/05/2009
CR Cuneo Foundation	2.3%	BoD on H109 results	25/08/2009
Banca M.te Lombardia Foundation	2.3%	BoD on Q309 results	12/11/2009

Sales split – Divisional



Income statement (EURm)	2008	2009E	2010E	2011E
Net interest income	2,982	2,700	2,837	2,991
Net fee & commission income	1,188	1,115	1,096	1,176
Trading income	-242	0	0	0
Total revenue	4,090	4,046	4,178	4,427
Total cost	-2,679	-2,540	-2,505	-2,556
Op. Profit before risk provisions	1,411	1,506	1,673	1,870
Risk provisions	-1,111	-844	-773	-592
Associates	0	10	11	11
Asset disposal	85	0	0	0
Pretax profit bef. exceptionals	385	672	910	1,289
Goodwill impairment	0	0	0	0
Other exceptionals	0	0	0	0
Reported profit before taxation	385	672	910	1,289
Tax	-222	-269	-364	-516
Tax rate	-57.6%	-40.6%	-40.5%	-40.3%
Reported net profit	163	403	546	774
Result on discontinued operations	-16	0	0	0
Minority interests	-79	-66	-98	-151
Reported attributable profit	69	337	448	622
Adj. attributable profit	437	439	531	711

Revenue and cost trends (%)	2008	2009E	2010E	2011E
Net interest income growth	11.0%	-9.5%	5.1%	5.4%
Net fee & commission income growth	-11.9%	-6.2%	-1.7%	7.3%
Cost growth	-1.4%	-5.2%	-1.4%	2.0%
Op. profit bef. risk provisions growth	-16.5%	6.7%	11.1%	11.8%
Risk provision growth	171.4%	-24.0%	-8.5%	-23.4%
Pretax profit bef. exceptionals growth	-71.2%	74.6%	35.5%	41.6%
Adj. attributable profit growth	-61.6%	0.5%	20.9%	33.9%

Ratios	2008	2009E	2010E	2011E
Cost/income ratio (banking)	-64.0%	-62.9%	-60.8%	-58.4%
Staff cost/revenues	38.7%	38.2%	36.6%	35.3%
Net interest/avg yielding assets	2.76%	2.43%	2.47%	2.49%
Net interest margin/total revenue	72.9%	66.7%	67.9%	67.6%
Customer deposits to loan ratio	56.2%	56.2%	56.7%	56.7%
NPL (gross) as % of customer loans	1.9%	1.9%	1.9%	1.9%
Risk provisions (stock) as % of NPL	-130.9%	-96.6%	-85.0%	-62.0%
Annual risk provisions as % of RWA	-1.24%	-0.93%	-0.83%	-0.62%
Annual risk provisions as % of OPBRP	-78.7%	-56.1%	-46.2%	-31.7%
ROE (adj.)	3.8%	3.9%	4.7%	6.1%
RORWA	0.47%	0.49%	0.58%	0.76%
Tier 1 + 2 ratio	11.1%	11.1%	11.0%	10.9%
Tier 1 ratio	7.7%	7.7%	7.8%	7.7%
Equity tier 1 ratio	7.1%	7.1%	7.1%	7.1%

Balance sheet (EURm)	2008	2009E	2010E	2011E
Loans to customers	96,368	99,260	103,230	108,391
Loans to banks	3,054	3,145	3,208	3,272
Trading assets	2,327	2,443	2,565	2,693
Insurance assets	88	106	108	110
Investments	6,689	7,157	7,437	7,730
Intangible assets	5,532	5,532	5,532	5,532
Fixed assets	2,171	2,025	2,065	2,106
Total assets	121,956	125,080	129,680	135,502
Deposits from customers	54,151	55,775	58,564	61,492
Deposits from banks	3,981	4,180	4,389	4,608
Trading liabilities	799	815	832	848
Debt securities	43,441	45,613	47,893	50,288
Insurance liabilities	408	449	494	543
Total liabilities	109,692	112,701	117,010	122,346
Shareholders' equity				
Before revaluation reserve	11,211	11,253	11,439	11,768
Revaluation reserve	-70	-63	-57	-51
After revaluation reserve	11,140	11,190	11,382	11,717
Net income	69	337	448	622
Minority interests	1,124	1,190	1,288	1,439
Liabilities & shareholders' equity	121,956	125,080	129,680	135,502

Per share (EUR)	2008	2009E	2010E	2011E
EPS (reported)	0.11	0.53	0.70	0.97
EPS (adjusted and diluted)	0.68	0.69	0.83	1.11
BV bef. rev. reserve (dil.)	17.54	17.61	17.90	18.41
NAV (diluted)	17.43	17.51	17.81	18.33
Dividend (net)	0.45	0.40	0.45	0.68

Valuation	2008	2009E	2010E	2011E
P/E (adjusted and diluted)	21.9	14.6	12.1	9.0
P/profit bef. exceptionals and taxes	24.88	9.56	7.06	4.98
P/BV bef. revaluation reserve	0.85	0.57	0.56	0.55
P/BV after revaluation reserve	0.86	0.57	0.56	0.55
P/NAV	0.86	0.57	0.56	0.55
Yield (net)	3.0%	4.0%	4.5%	6.8%
Dividend cover (on adjusted EPS)	1.5	1.7	1.8	1.6
Pay-out ratio (on adjusted EPS)	416.93%	75.82%	64.23%	70.00%

Source : Kepler Capital Markets

Disclosures

Disclosure checklist – Potential conflict of interests

Stock	ISIN	Disclosure (see below)	Currency	Price
IW Bank S.p.A.	IT0003477673	nothing to disclose	EUR	1.91
UBI Banca	IT0003487029	nothing to disclose	EUR	10.05

Source: Factset closing prices of 24/04/2009

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Kepler Capital Markets' current rating for UBI Banca is "Buy" and was issued on 10 October 2008 (re-initiation of coverage).

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Rating ratio Kepler Capital Markets Q1 2009

Rating breakdown	A	B
Buy	50.0%	0.0%
Hold	9.9%	0.0%
Reduce	37.1%	0.0%
Not Rated/Under Review/Accept Offer	3.0%	0.0%
Total	100.0%	0.0%

Source: Kepler Capital Markets

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