Unione Banche Italiane (UBI.MI)

Further Capital Strengthening, But Profitability Suffering

Equity ☑
Estimate change ☑

- **Strengthening Capital Further** — Over the past two weeks, UBI has announced three transactions (non life insurance JV, depositary bank, branch rationalisation), totaling c30bp core tier 1 benefit by 1H10. Proforma, these transactions raise our 2009 Core tier 1 to c7.7%, solid for a retail bank.
- **The Non Life Insurance Deal, +c10bp on Core Tier 1** — UBI sold 50%+1 share of its non life bancassurance activities (UBI Assicurazioni) to Fortis and BNP. UBI will immediately receive c€120m and then c€40m in the future as part of an earn-out agreement linked to volumes. UBI will have a capital gain of c€45m, and +c10bp benefit on core tier 1, likely in 2009.
- **The Depositary Bank Deal, +c10bp on Core Tier 1** — UBI has transferred its depositary bank activities to RBC Dexia (c€19bn of assets, mainly related to the AUC of UBI Pramerica). UBI should book a net capital gain of c€80m from the transaction and +c10bp benefit on core tier 1, likely to close in 1H2010.
- **Branch Rationalisation, +c10bp on Core Tier 1** — UBI franchise reorganisation will involve rebranding of branches to the key franchise bank in the area and should increase group efficiency. The reorganisation will result in c10bp additional core tier 1 and it is expected to complete in January 2010.
- **Only Italian Mid Cap Not Requesting Tremonti Bonds** — UBI is the only mid-cap bank in our Italian coverage not to have expressed interest for Government support (Tremonti) last March, as its capital position seems solid enough, and its asset quality is deteriorating but less than peers. This leaves the bank more independent in terms of business decisions (e.g. lending/dividend policy).
- **Stronger Capital to Face Challenging Environment and Sustain Dividend?** — We forecast core tier 1 at 7.5% in 2009, and 7.7% in 2010E. The group's stronger capital position relative to peers could leave scope for higher dividend payments, once market conditions stabilise and regulatory requirements are clarified.
- **A Retail Bank, Suffering the Current Macroeconomic Conditions** — UBI is a typical retail bank: mostly retail-funded, strong reliance on core revenues, low trading, high sensitivity to rates and provisions and solid capital. Given the current market conditions, the bank's profitability is suffering and this should only reverse with a recovering economy (higher rates, lower provisions, stronger GDP).
- **Update Estimates** — We update our estimates to account for the capital gains, but leave our adjusted EPS virtually unchanged.

See Appendix A-1 for Analyst Certification and important disclosures.

Hold/High Risk	**2H**
Price (02 Oct 09)	€10.08
Target price	€10.50
Expected share price return	4.2%
Expected dividend yield	2.8%
Expected total return	**6.9%**
Market Cap	€6,443M
	US$9,363M

Price Performance (RIC: UBI.MI, BB: UBI IM)

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Estimates Change

We have updated our reported EPS estimates to account for the capital gains originated by the disposals, but this has virtually no impact on our adjusted EPS.

Figure 1. UBI Banca – Adjusted EPS Estimates

	2009E	2010E	2011E
New EPS	0.45	0.74	0.97
Old EPS	0.45	0.74	0.96
% Chg	0%	0%	0%

Source: Citi Investment Research and Analysis

Figure 2. UBI Banca – Group P&L by Year

€ millions	2006	2007	2008	2009E	% chg	2010E	% chg	2011E	% chg	2012E	% chg
GROUP P&L											
Net Interest Income (NII)	2,513	2,778	3,060	2,649	-13%	2,731	+3%	2,890	+6%	3,062	+6%
Dividends and Other Income	51	84	71	11	nm	22	nm	25	+17%	30	+21%
Income (Loss) from Equity Investments	17	33	0	20	nm	21	+2%	21	+3%	22	+4%
Net Commission Income	1,326	1,345	1,188	1,076	-9%	1,163	+8%	1,215	+5%	1,274	+5%
Gain (Loss) from Financial Transactions	243	102	-242	102	nm	105	nm	109	+4%	114	+4%
Insurance Result	68	40	10	37	nm	37	+1%	38	+1%	38	+1%
Other Net Operating Income	148	150	81	85	nm	86	+2%	89	+3%	92	+3%
Total revenues	**4,366**	**4,530**	**4,168**	**3,979**	**-5%**	**4,165**	**+5%**	**4,387**	**+5%**	**4,633**	**+6%**
Staff costs	-1,532	-1,537	-1,583	-1,496	-5%	-1,500	+0%	-1,521	+1%	-1,546	+2%
Other expenses	-745	-768	-751	-758	+1%	-761	+1%	-771	+1%	-783	+2%
Depreciation	-184	-183	-197	-166	-15%	-167	+1%	-169	+1%	-172	+1%
Total operating expenses	**-2,461**	**-2,488**	**-2,530**	**-2,420**	**-4%**	**-2,429**	**+0%**	**-2,462**	**+1%**	**-2,500**	**+2%**
Operating profit pre provisions	**1,905**	**2,042**	**1,638**	**1,559**	**-5%**	**1,736**	**+11%**	**1,925**	**+11%**	**2,132**	**+11%**
Goodwill	0	0	0	0	nm	0	nm	0	nm	0	nm
Bad Debt Provisions	-239	-346	-567	-917	+62%	-792	-14%	-639	-19%	-551	-14%
Net Value Adj. to Fin. Assets	2	-29	-511	-35	nm	0	nm	0	nm	0	nm
Provisions for risks and charges	-51	-38	-34	-38	nm	-39	+2%	-39	+2%	-40	+2%
Gain (Loss) from Sale of Investments	63	23	85	54	nm	75	nm	20	nm	20	nm
Profit before tax	**1,680**	**1,652**	**610**	**623**	**+2%**	**981**	**+57%**	**1,267**	**+29%**	**1,561**	**+23%**
Taxes	-670	-654	-273	-259	-5%	-389	+50%	-531	+37%	-656	+24%
Integration Costs and PPA	0	-247	-156	-91	-42%	-65	-28%	-48	-26%	-38	-21%
Profit (Loss) from Discontinued Operations	12	309	-16	5	nm	0	nm	0	nm	0	nm
Net Profit	**1,021**	**1,059**	**166**	**279**	**nm**	**527**	**+89%**	**688**	**+31%**	**867**	**+26%**
Minority interests	-89	-118	-97	-38	-61%	-53	+39%	-69	+31%	-87	+26%
Attributable profit	**933**	**941**	**69**	**241**	**nm**	**474**	**+97%**	**619**	**+31%**	**780**	**+26%**
Adjusted attributable profit	883	954	848	289	-66%	472	+63%	649	+38%	801	+23%
PER SHARE FIGURES											
EPS - basic	1.46	1.47	0.11	0.38	nm	0.74	+97%	0.92	+24%	1.16	+26%
EPS - adjusted	**1.38**	**1.49**	**1.33**	**0.45**	**-66%**	**0.74**	**+63%**	**0.97**	**+31%**	**1.19**	**+23%**
Dividend per share (ordinary)	0.80	0.95	0.45	0.28	nm	0.45	+57%	0.55	+24%	0.70	+26%
Book value per share (reported)	18.12	18.45	17.43	17.50	+0%	17.96	+3%	18.19	+1%	18.8	+3%
Tangible Book Value per share	9.66	11.63	10.64	10.56	-1%	11.02	+4%	11.58	+5%	12.2	+5%
Tangible Book Value (all intangible) per share	**9.45**	**9.65**	**8.78**	**8.75**	**-0%**	**9.21**	**+5%**	**9.85**	**+7%**	**10.5**	**+6%**
OPERATING RATIOS											
Revenues on avg RWAs	5.11%	4.81%	4.44%	4.49%		4.70%		4.79%		4.86%	
Cost to Asset ratio	2.08%	2.05%	2.07%	1.99%		1.93%		1.89%		1.8%	
Cost / income ratio	56%	55%	61%	61%		58%		56%		54%	
Provision charge / customer loans	**0.29%**	**0.37%**	**0.59%**	**0.94%**		**0.78%**		**0.60%**		**0.50%**	
Tax rate	40%	40%	45%	42%		40%		42%		42%	
Return on Equity (Adjusted / Tangible , All)	**14.6%**	**15.5%**	**15.1%**	**5.2%**		**8.0%**		**9.8%**		**11.4%**	
SHARES OUTSTANDING											
Total shares outstanding (mn)	639	639	639	639	+0%	639	+0%	671	+5%	671	+0%
BALANCE SHEET ITEMS											
Total Assets	118,164	121,469	121,956	121,600	-0%	125,856	+4%	130,261	+4%	136,774	+5%
Net customer loans	**83,552**	**92,729**	**96,368**	**97,218**	**+1%**	**101,495**	**+4%**	**105,961**	**+4%**	**111,259**	**+5%**
Total Customer Deposits	86,253	90,514	97,591	96,928	-1%	101,019	+4%	105,284	+4%	110,429	+5%
Loan / deposit ratio	97%	102%	99%	100%		100%		101%		101%	
Shareholder Equity	11,582	11,790	11,140	11,184	+0%	11,477	+3%	12,205	+6%	12,613	+4%
REGULATORY CAPITAL											
Risk-Weighted Assets	**90,418**	**97,912**	**89,892**	**87,372**	**-3%**	**89,731**	**+3%**	**93,320**	**+4%**	**97,519**	**+5%**
Tier 1 ratio	6.9%	7.4%	7.7%	8.0%		8.2%		8.6%		8.6%	
'Core" Tier 1 ratio	6.3%	6.9%	7.1%	7.5%		7.7%		8.1%		8.2%	
Total ratio	10.3%	10.2%	11.1%	11.9%		12.1%		12.6%		12.6%	

Source: Company Reports and CIRA Estimates

Unione Banche Italiane

Company description

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

Investment strategy

We have a Hold/High Risk (2H) rating on UBI shares. UBI shares suit a defensive investment strategy. The main defensive characteristics of the UBI story are: solid balance sheet, a strong capital position and safer assets. The combination with Banca Lombarda should have a low integration risk and could generate more cost synergies. The stock trades broadly in line with Italian bank sector and in the short term profitability could suffer from deteriorating macroeconomic conditions (pressure on core revenues) and worsening of asset quality.

Valuation

We have a €10.50 target price for UBI shares, based on a DDM calculation. In valuing UBI, we focus primarily on a DDM valuation using a c10% cost of equity and a c12% sustainable tangible ROE, also taking into account the group's capital position. We cross-check this with a price-to-book methodology. At our target price, the stock would trade at c1.4x price to tangible book valuation, a premium to other Italian banks, reflecting UBI's defensive business mix and balance sheet characteristics.

Risks

We have a High Risk rating on UBI shares. Any revenue slippage would impact UBI's profits. Net interest income is the major revenue generator; NII margin and profitability are at risk in the event of movement of the ECB rate and movement in the credit market rates, or of more pricing pressure in Italy. Among the potential risks for the stock, we would highlight: a weaker-than-expected Italian economy, slowdown in dividend payments, deterioration in asset quality, rising provisions, and any speculation indicating UBI as a possible partner in case of a rescue merger of any of its peers. If the impact on the company from any of these factors proves to be more or less negative than we anticipate, the stock could deviate significantly from our target price. The recent management change should not represent a key risk for the stock.

Appendix A-1

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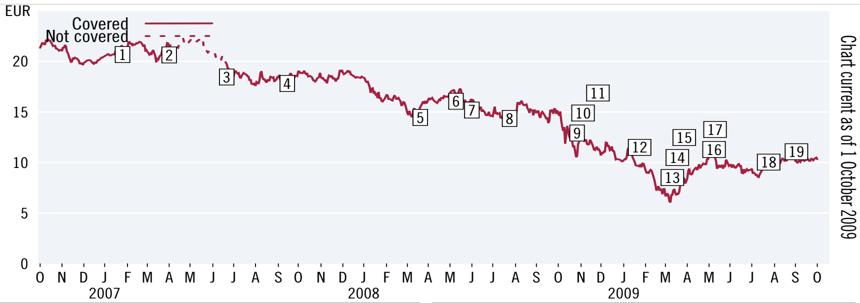
Unione Banche Italiane (UBI.MI)
Ratings and Target Price History
Fundamental Research
Analyst: Azzurra Guelfi
Covered since December 6 2007



	Date	Rating	Target Price	Closing Price
1	25-Jan-07	*2M	*23.11	21.46
2	2-Apr-07	Coverage suspended		
3	21-Jun-07	2M	*20.65	19.72
4	14-Sep-07	2M	*19.67	18.23
5	20-Mar-08	2M	*16.72	15.47
6	9-May-08	2M	*17.70	16.84
7	2-Jun-08	*1M	*18.49	16.14
8	24-Jul-08	1M	*17.70	14.86
9	28-Oct-08	1M	*13.77	10.64
10	5-Nov-08	1M	*15.24	12.79
11	26-Nov-08	1M	*13.77	11.22
12	23-Jan-09	1M	*11.31	9.57
13	11-Mar-09	1M	*8.85	6.81
14	18-Mar-09	*1H	8.85	6.93
15	27-Mar-09	1H	*10.03	8.39
16	8-May-09	1H	*13.28	11.29
17	11-May-09	1H	*12.59	10.48
18	24-Jul-09	*2H	*10.80	9.56
19	2-Sep-09	2H	*10.50	10.13

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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