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The dash for cash begins

05 SEPTEMBER 2012

Daniel Davies
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WHY YOU SHOULD READ THIS REPORT

After five years of global financial crisis, it is easy to forget that not so long ago, the Banks sector used to be the biggest dividend payers in the European market. Some European banks have structurally impaired business models, but some of them are quickly reaching the point at which significant cash distribution could become possible once more. In this report, we identify which banks are in each category.

The key metric going forward is the 'distributability date' - the day on which we project each bank to reach its regulatory capital target and therefore to regain control of its free cash flow. We find that the banks where you have to wait the least time for free cash flow are being generally undervalued by the market.

As a result of this analysis, we upgrade our price target for UBS to CHF14.70 and our recommendation to Outperform.

BANKS (+)

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EXANE BNP PARIBAS

Investment summary

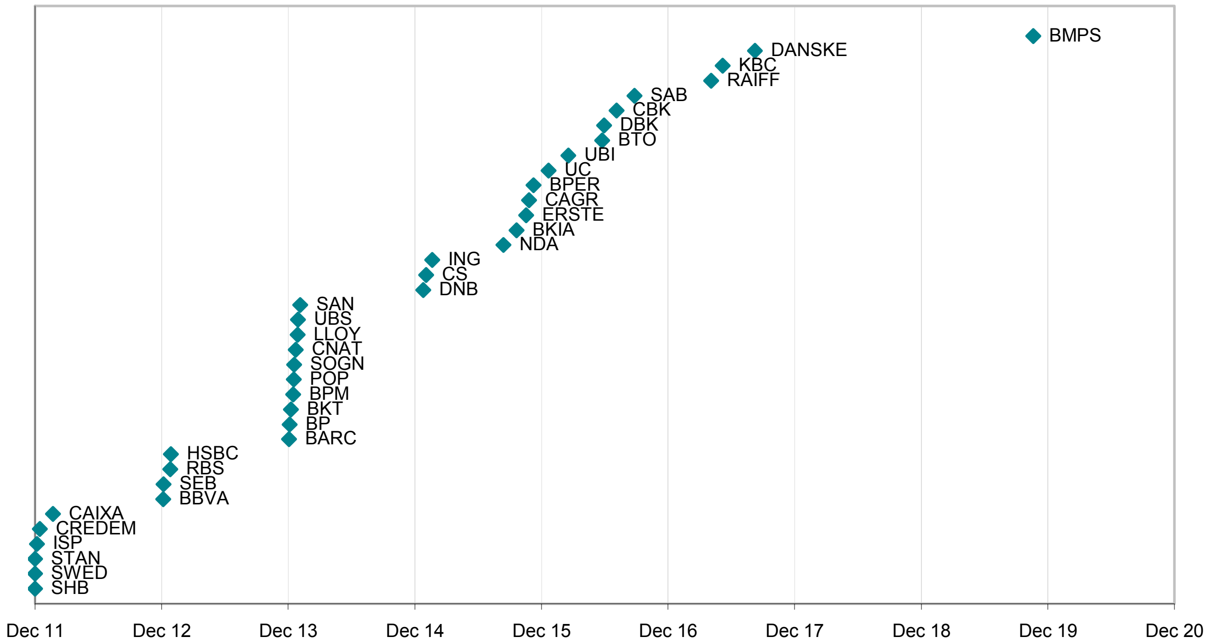
In this report, we return to a theme which used to be one of the most important drivers of share performance in the European banking sector – the banks' ability to generate distributable cash flow for shareholders. It is almost difficult to remember the idea of banks as cash generating companies, but once upon a time, before the global financial crisis, that is what they were. The business model of a bank – particularly in a low loan growth environment – is intrinsically cash generative and in steady states, very high payout ratios (usually combining a progressive dividend with share buybacks) can be sustained. Alternatively, the banks could retain surplus cash flow for the benefit of the fixed income markets, allowing potentially faster reduction in funding spreads – another key driver, as discussed in "Funding revisited", (Tiberghien, 29th August).

Time to cash flow

The obstacle to regarding the banks' earnings as free cash flow, of course, is that it is not free. During the period when the sector suffered from chronic undercapitalisation, the banks had to retain all their earnings, and in many cases to supplement them with new issuance of dilutive equity. However, the period during which regulatory minimum requirements were being constantly raised (the "Basel 3 implementation cycle") is now drawing to a close, meaning that for the first time in a long time, we have some degree of visibility as to when the cash flow of the sector will become distributable again (on a sector level we forecast the banks reaching a B3 FL ET1 ratio of 9.8% by end-2013E). We use our earnings and balance sheet forecasts (plus conservative assumptions about the long term) to derive a "distributability date" for each bank in our coverage universe.

Figure 1: The "dash to cash" – timeline to generation of distributable cash flow

Vertical scale only for readability



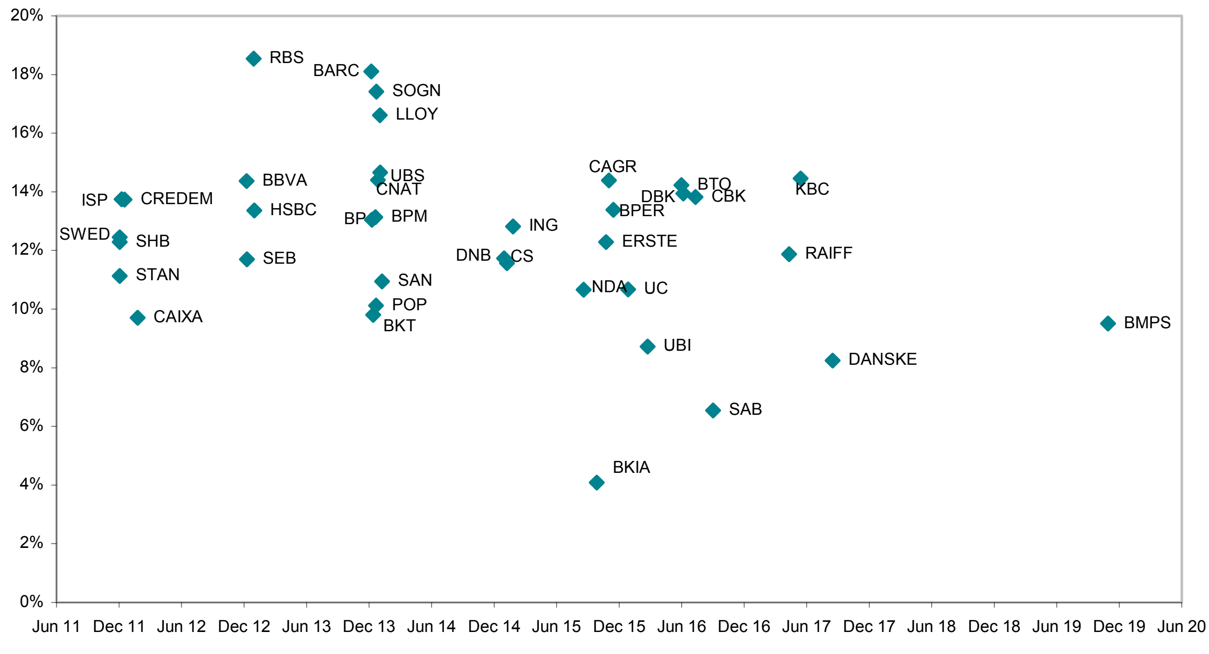
Source: Exane BNP Paribas estimates.

Implied cost of equity

In crude terms, the "dash to cash" chart, by measuring the time taken to reach target CET1 standards, shows the extent to which there is visibility of the banks' ability to generate cash, and the likely time frame over which the uncertainty is likely to be resolved. Furthermore, on our analysis, this important quality differentiator is not necessarily being priced correctly by the market – when valuations are analysed in terms of the implied cost of equity from a fully specified DCF model (based on current TPs), it actually appears that in many cases, the stocks with the best visibility of distributable cash flows are potentially being relatively undervalued by the market rather than overvalued. We show this in the figure below, plotting the distributability date against the implied cost of equity.

In particular, it appears that the UK and French banks are not being given sufficient credit for the fact that they are comparatively close to meeting their regulatory target Common Equity Tier One ratios, while UBS in particular is not being given sufficient credit for the extremely high intrinsic cash generation of its business model. Meanwhile, stocks like Nordea and Danske do not appear to have been penalised sufficiently for their more draconian regulatory environment, while the market is still underpricing the risk in stocks like BMPS and the small Spanish banks, where even in a relatively benign earnings environment, the development of truly distributable cash flow is several years in the future, in our opinion. In the current valuation environment there is no need to make a trade-off between time to distributability (how long you have to wait) and implied cost of equity (how well you get paid for waiting).

Figure 2: Implied cost of equity versus time to distributability



Source: Exane BNP Paribas estimates

DCF valuation

We have made DCF models of all the stocks under our coverage. We are not using them to set target prices in most cases – DCF approaches tend to be excessively sensitive to assumptions, and particularly so in cases when a very large percentage of the DCF value is attributable to cash flows well outside the forecast period. However, the DCF framework allows us to set bounds on the range of valuations that are consistent with our near term earnings forecasts and longer term operating assumptions. We have calculated valuations under two different sets of assumptions about the cost of equity, using company specific betas from Bloomberg.

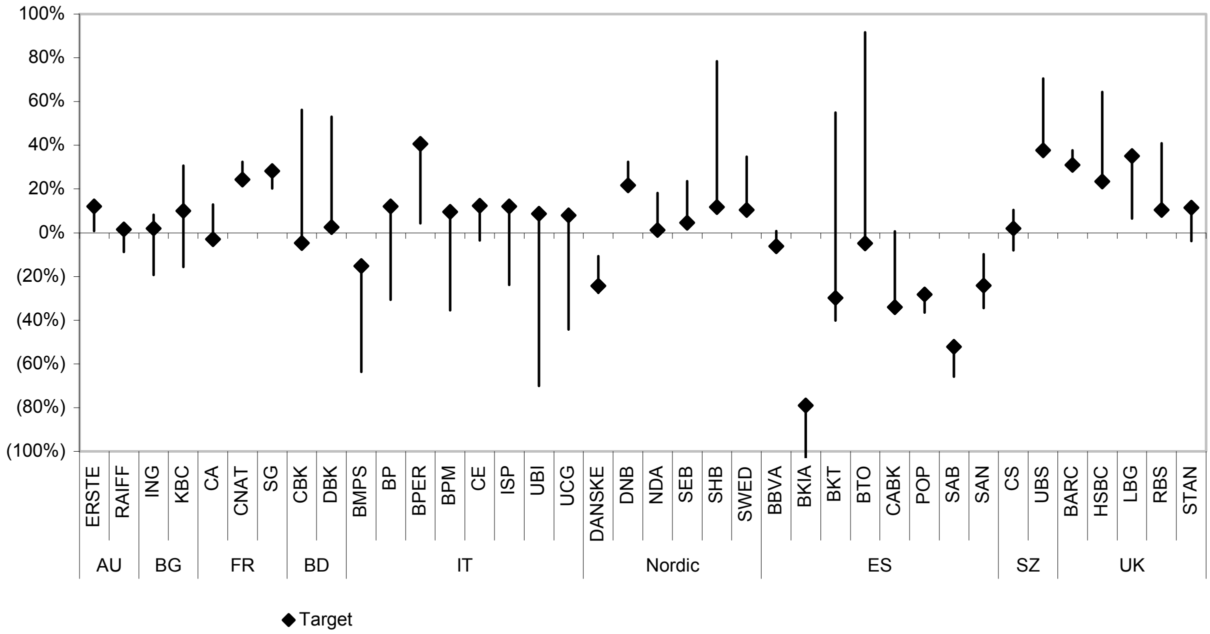
– First, an approach based on current sovereign bond yields and our strategists estimate of the current ERP of 7%. This tends to give higher price targets to banks in Nordic countries and Germany (as the cost of equity is pulled down by the low sovereign yield) and much lower valuations in Italy and Spain.

– Second, a long term approach based on our strategists' working assumption that long term equilibrium bond yields will tend toward nominal GDP growth plus a term premium (around 3.5%) in all markets, plus a normalised ERP estimate of 6%. This tends to drag down price targets for Nordic, German and Swiss banks while raising them for peripheral Europe. In this scenario, we also applied a schedule of haircuts on peripheral European sovereign debt, reflecting the likelihood that any such convergence of bond yields in our space would most likely be driven by some debt mutualisation scheme such as Eurobonds, and that such a scheme would be unlikely to come in without a degree of private sector involvement in its financing.

Neither approach to the cost of equity is perfect – in our view it is nearly always a mistake to take DCF models too seriously. However, putting the two assumptions together allows us to see what the implicit assumptions about costs of equity in our price targets derived from P/TNAV or sum-of-parts models might be.

Figure 3: Current target prices with DCF error bars

% Upside/downside from current price. Error bars represent range between EBNPP target price, and DCF models based on "Current" and "Normalised" cost of equity.



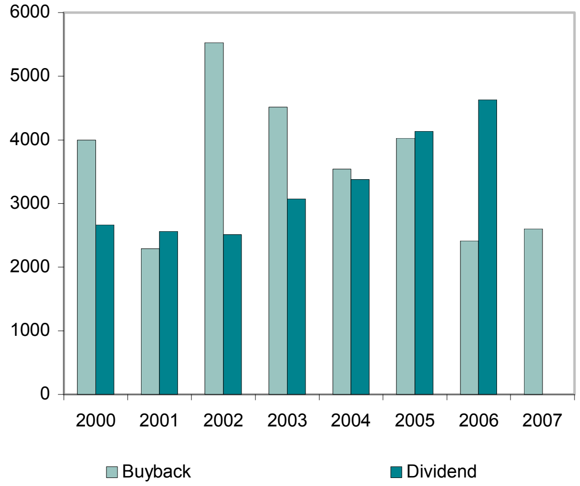
Note: In order to reflect the execution risk of the Emporiki disposal, and despite the fact that CA has received three binding offers, we only give half of the benefit of the removal of Emporiki losses. Removing them fully would have increased upside to 30% and 32% respectively for the normalised and current DCF models, to EUR2.85 and EUR2.88. Source: Exane BNP Paribas estimates.

Upgrading UBS to Outperform – target price CHF14.70

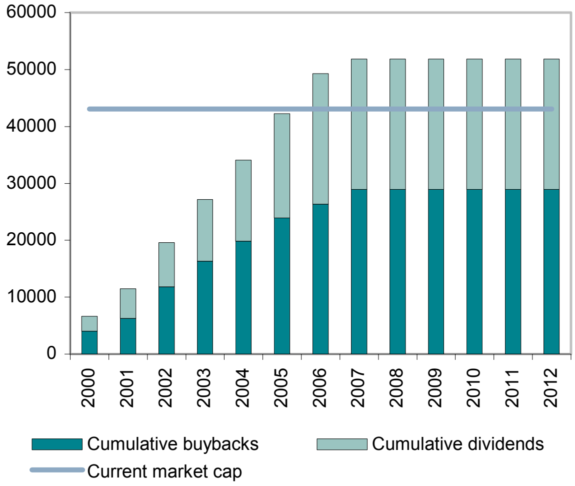
Our main investment conclusion from the DCF analysis is that previous focus on accounting earnings and RoTE/TNAV approaches has caused us to underappreciate the potential for cash generation at UBS. Although we have been sceptical in the recent past about the Swiss banks' RWA divestment strategies, they can potentially generate large amounts of cash by doing so. Furthermore, the Swiss banking model has always been highly cash generative, since as much as half the earnings come from business lines with little or no marginal regulatory capital requirement. UBS has significantly better visibility than Credit Suisse in its path to reaching its capital target within the forecast period, and we believe that the valuation is now cheap enough to get over our concerns about the near term operating environment. We are therefore raising our price target to CHF14.70 and our recommendation to Outperform. We note that on our 2013e dividend forecast, the stock currently has a prospective dividend yield of nearly 5%, and that before the crisis (between 2000 and 2007), UBS distributed CHF52bn of cash to shareholders – a sum nearly 20% greater than its current market capitalisation.

Figure 4: Back in the "good old days", UBS generated and distributed significant cash

UBS dividends and buybacks 2000-2007



UBS cumulative cash distribution since 2000



Source: Exane BNP Paribas. For the purposes of this chart, we have treated each separate buyback program as if all the cash was distributed on the first day of the program, and treated par value reductions as dividends.

Cash is king

In normal conditions, banks should be highly-cash-generative companies. The business is itself based on cash payment for cash invested, and the only material requirement for "working capital" has historically been the need to ensure that the regulatory capital base grows at least roughly in proportion to the loan book. Historically this has indeed tended to be the case.

However, of course, the last five years have been abnormal for the banks sector in a variety of ways. The banks have been hit by several factors at once, all of which tend to reduce their ability to generate distributable cash earnings. Among these are:

– Large losses on credit and on securities trading, reducing the accounting earnings. Writedowns and losses relating to this amounted to c.EUR543bn for the period H2 2007- H1 2011 (according to Bloomberg data).

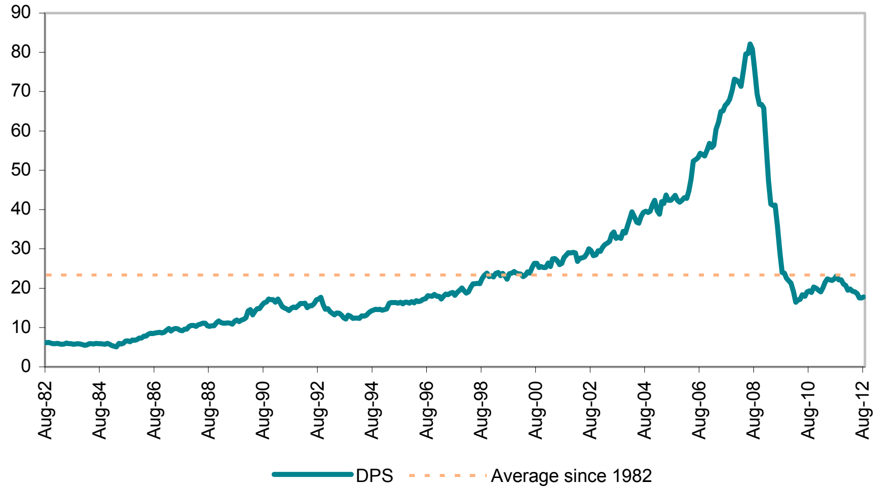
– Historically low interest rates and a flat yield curve, reducing the intrinsic profitability of the banking franchise

– A step-change in regulatory capital ratio requirements, requiring earnings to be retained in order to deleverage the balance sheet

– New regulatory requirements for liquidity and funding (namely the NSFR and LCR ratios), which require banks to build up large liquid asset balances on balance sheet, acting as a further drag on profitability.

As can be seen in the chart below, the cash generation of the European sector has fallen precipitously; about half the banks in our coverage universe are either paying zero or only a token dividend. When one takes into account the significant equity issuance over the crisis period, we can see that one of the drivers of the underperformance of the European bank stocks has been the gradual move of cash generation from positive to negative territory.

Figure 5: DPS for the European banks sector since 1982



Note: DPS is implied using banks price index and dividend yield data. Source: Datastream

European banks are not generating cash

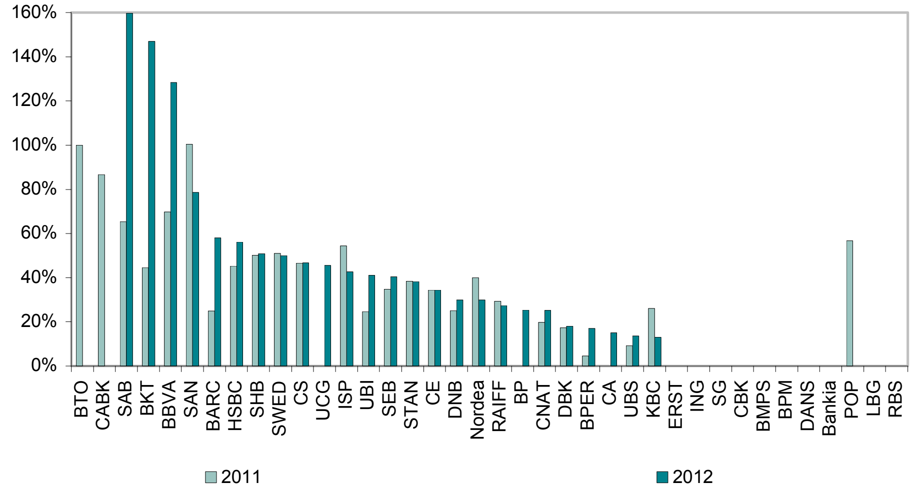
In our opinion, it is not fully appreciated how the change in the European banks' status from cash-generative to cash-negative has contributed to the volatility and opacity of the sector's equity prices. In normal conditions, both price/earnings and RoTE/TNAV valuation methodologies should be quite easy to reconcile to a full discounted cash-flow framework. However, when the earnings do not represent distributable cash and the RoTE is not a cash return, valuation becomes more difficult. Similarly, sum-of-parts models can tend to overstate the true valuation if the cash flow generated by the profitable operating businesses needs to be retained in order to restore capitalization levels at the group centre.

How this affects valuation

Furthermore, DCF models themselves can be tricky to use when analyzing companies that are not generating cash (in our opinion, this property was a major reason why DCF models fell out of fashion; their use in the dot com era generated price targets on unprofitable companies which looked unfortunate in retrospect). When a large proportion of the DCF value is based on perpetuity growth beyond the forecast period, the models can be sensitive to the long-term parameters chosen, which by their nature are difficult to check.

The European banks are currently in exactly this situation. Of the 38 banks in our coverage universe, 13 paid no 2011 dividend at all, and 5 had a 2011 payout ratio below 25% (another three had a payout ratio above 100%, which is itself not a stable situation, while Santander and Credit Suisse are paying this year's dividend entirely in scrip). As a result, they are vulnerable to changes in sentiment as the valuation is not "held down" by actual forecast cashflows. When this is combined with the unusually high degree of uncertainty attached to earnings and to regulatory capital requirements, it is unsurprising, in our view, that the sector has been so volatile.

Figure 6: Dividend payout ratios 2011-2012E

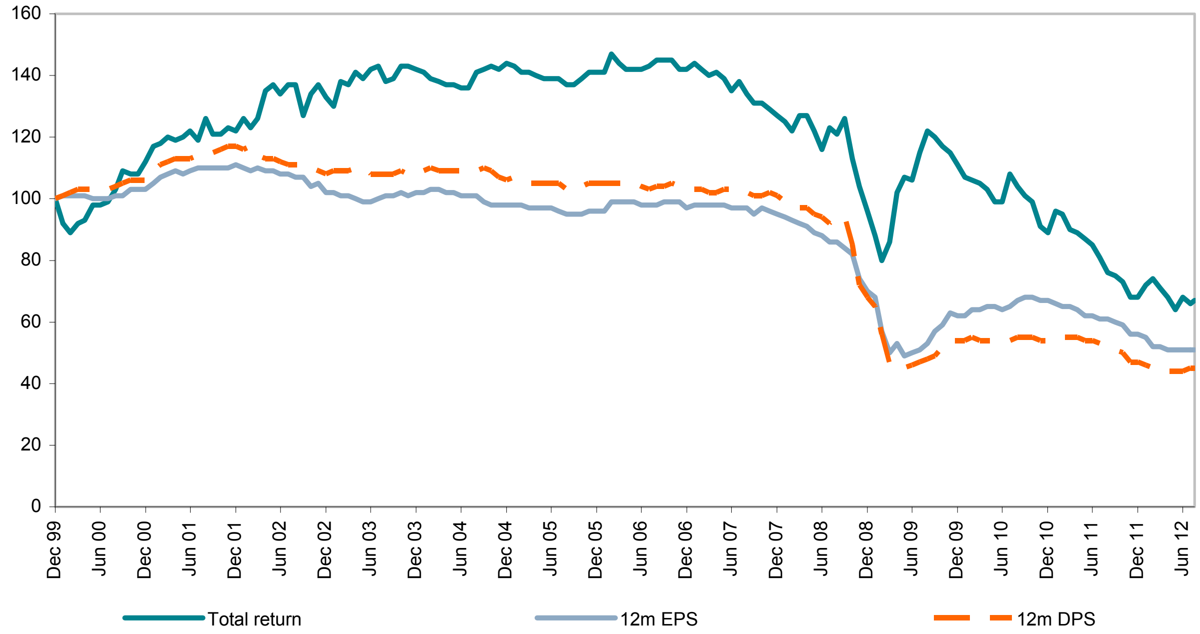


Note: payout refers to total dividend including scrip. Source: Exane BNP Paribas estimates

Using dividends as a proxy for distributable cash flow, we can see how the relative performance of the banks has historically been driven by its relative cash generation. Particularly, for most of 2009/10 in the immediate recovery from the Lehman crisis, the sector continued to underperform despite the fact that forecast earnings were recovering more quickly for the banks than for the market as a whole. In our opinion, a large part of the reason for this was that the earnings in question were not cash; in this case, the dividend forecasts were more important to the relative performance than the EPS.

Figure 7: Where EPS and DPS expectations have diverged, relative performance has followed dividends

MCSI Banks Europe vs MSCI Europe – price, 12m EPS consensus and 12m DPS consensus, rebased to Dec 99 = 100

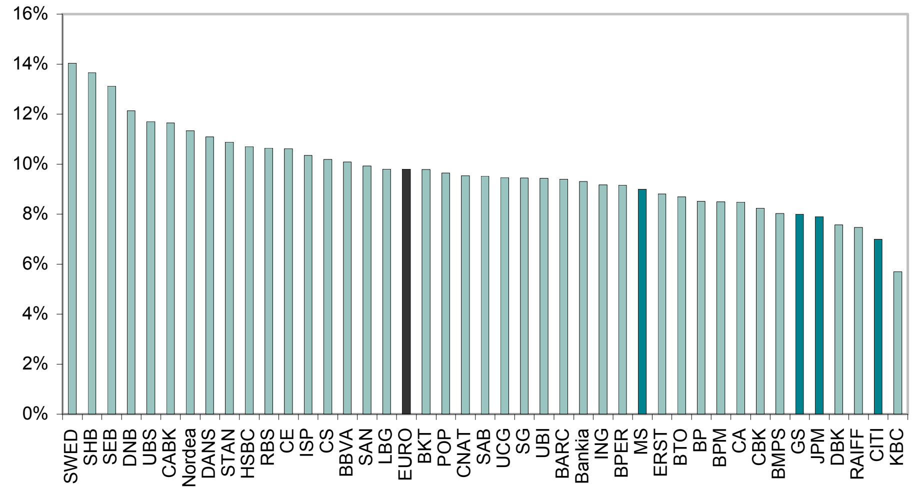


Source:Factset, Exane BNP Paribas analysis

Regulatory capital as a driver of cash flow

The lack of cash generation in the European banks is not wholly or even mainly a result of business conditions. If regulatory standards had been held constant, the sector would have for the most part been considered to have recovered from the crisis in early 2010, and would have been generating cash and potentially buying back shares for the last two years (as the US banks in fact have, despite having Basel 3 FL ratios which are no better than European banks currently considered "undercapitalized").

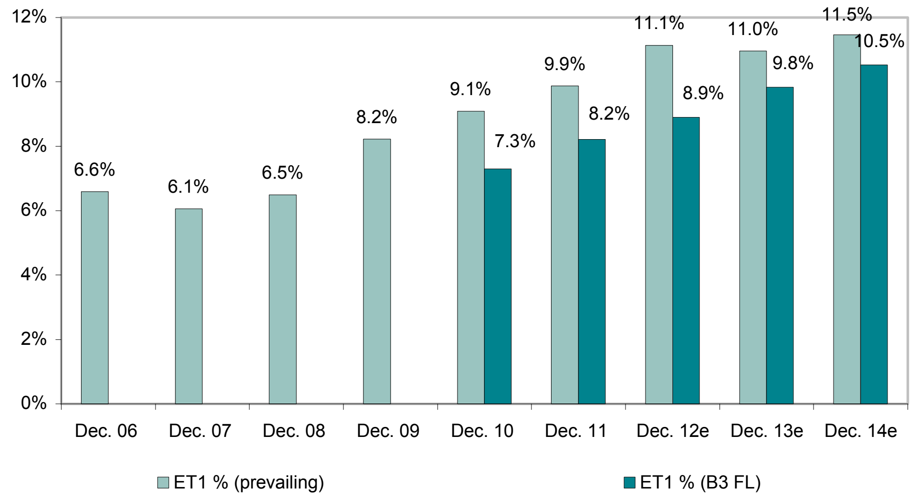
Figure 8: European and US ET1 ratios (2013E, Basel 3 fully loaded)*



**US banks data based on Q2 12 B3 FL figures from company presentations. Source: Exane BNP Paribas estimates*

The deleveraging of the European sector has been driven by the decision taken to raise equity capital requirements to levels well above those considered normal before the crisis. This regulatory decision has been exacerbated by the tendency to focus on "fully loaded" Basel 3 capital and to effectively ignore the phasing-in period, and most recently, by the EBA's decision to impose an entirely arbitrary 9% minimum standard unrelated to the Basel minima plus buffers including unrealised losses on sovereign bonds.

Figure 9: Annual development in sector ET1 ratios (prevailing and B3 FL basis)



Source: Exane BNP Paribas estimates

The regulatory capital process is, however, coming toward the end of its current cycle. With CRD4/CRR all but finalized (only now needing to be passed by the European Parliament), the important factors going into the definition of risk-weighted assets and the deductions from capital are now more or less stable, and the only remaining risks relate to the comparatively smaller set of issues on which there is national regulatory discretion. We would divide these into three main categories:

1) Flexibility in the standards

Although the purpose of the CRR was to standardise capital treatments across Europe, the eventual compromise text allowed for a small amount of national variation in the application of some of the standards (typically relating to issues of substantial local importance to one Member State). This was seen most clearly with respect to insurance capital, where the "Danish Compromise" allowed local regulators to depart from the Basel treatment on insurance subsidiaries by treating them as a 370% risk-weighted item rather than a deduction. In our opinion, the only regulator likely to use this treatment is France (and potentially the Netherlands); the UK is unlikely to give the benefit of the choice to Lloyds Banking Group. Meanwhile, the Sveriges Riksbank is taking a significantly more cautious approach than other European regulators to the removal of the transitional "floors", particularly with respect to retail mortgage exposure.

2) Use of buffers

The various buffers incorporated into the Basel regulations imposed such significant restrictions on the distributability of earnings that we regard them as *de facto* additional capital requirements. Although, as the table below shows, it would in principle be possible for a bank to structurally operate with less than the total buffer amount as long as its payout ratio was not too high, we do not regard this as a realistic possibility for a major quoted bank, particularly as discretionary compensation is counted as being part of potentially retainable earnings for the purposes of determining the maximum payout.

Figure 10: Individual bank minimum capital conservation standards

Common ET1 ratio	Minimum capital conservation ratios (% of earnings)
4.5% – 5.125%	100%
>5.125% – 5.75%	80%
>5.75% – 6.375%	60%
>6.375% – 7.0%	40%
>7.0%	0%

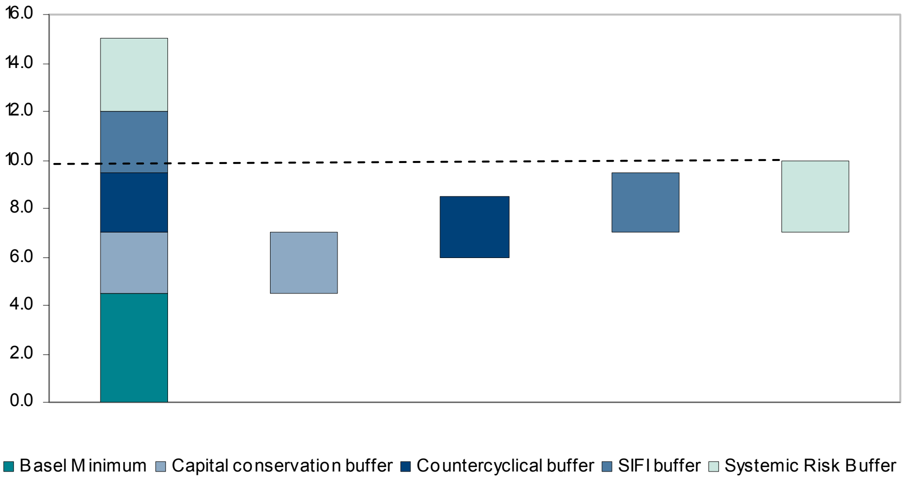
Note: this assumes countercyclical buffer = 0. Source: BIS

In principle, if every possible buffer was used to its maximum extent, a large European bank operating in credit markets which were in an expansionary phase could face a Common Equity Tier One requirement of 14.5% (4.5% Basel minimum, 2.5% Capital Conservation Buffer, 2.5% Countercyclical Buffer, 2.5% SIFI and 3% Systemic Risk Buffer). Although this is not completely out of the question – the Swiss Experts' Committee on Too-Big-To-Fail was prepared to recommend requirements as high as 16% in the event of a market for CoCo failing to develop – in our opinion it is materially higher than most European regulators would really wish to require.

It is not clear from either the Basel rules or their European interpretation in CRD4/CRR whether the various buffers are meant to be wholly additive. Some comments from the Bank of England's Financial Stability Committee suggest that at the very least, the Systemic Buffer is not intended to be. The extent to which the buffers are additive is likely, in our opinion, to be a major source of national flexibility with respect to the overall de facto capital requirement (despite the fact that ostensibly the purpose of CRR was to standardise capital requirements across Europe), and means that, in our DCF exercise, we will need to set target capitalisation requirements on a case by case basis, consistent with our understanding of the stance of the different national regulators.

Figure 11: Capital buffers are not necessarily wholly additive …

(%). Buffers may overlap, giving a lower total capital requirement



Source: Exane BNP Paribas estimates

3) Moral suasion and timing

Finally, we need to consider the reality of the way in which regulations are introduced in practice. Although the Basel and CRD4 standards allow for a long phasing-in period, we have never regarded it as a realistic option for banks to take full advantage of this. The phase-in period, in truth, is largely there to benefit the regulators (by reducing legal complexities and the potential for sharp dislocations requiring immediate regulatory action), not the banks. Most European regulators have made it clear in a more or less explicit manner that the true phasing-in period is "as soon as possible", and have used quite heavy moral suasion to achieve this goal. Even in cases where the direct regulatory authorities appeared to be happy with progress, other political and market entities have also been able to exercise significant pressure. This was most obvious in the case of Switzerland, where the Swiss National Bank took an independent view from FINRA and, by publishing an opinion about the adequacy of Credit Suisse's capital base in its annual financial stability report, effectively forced the company into a capital issue. We would expect that, if all else fails, the gap between the capital requirement and buffers delivered by the rules, and the requirement which the domestic regulators want to see will be made up by moral suasion, backed up if necessary by Pillar 2 powers.

Outlook for regulation

Different regulators, in our opinion, will not arrive at the same balance of flexibility on standards, use of buffers and moral suasion. Some regulators in Europe appear to be tougher than others with respect to minimum ratios (although this does not necessarily mean that any national regulator can be described as "tough" or "soft" tout court; regulators can take a hard line toward the recognition of hedges or other items which go into the denominator of the ratio which offsets a lower level of the ratio itself). For this reason, we have set slightly different Common Equity Tier One targets for some of the banks in this report, although in the majority of cases we have taken 10% as the target on a Basel 3 FL basis.

Figure 12: Common Equity Tier One ratio "target" assumptions

	ET1 target (B3 FL)	Comments
Austria		
ERSTE	10.0%	
RAIFF	10.0%	
Belgium		
ING	10.0%	
KBC	10.0%	
France		
CA	9.5%	Strong parent structure (drives regulators/rating agency assessment)
CNAT	10.0%	Strong parent structure (drives regulators/rating agency assessment), however we put a higher target than CA given the higher weighting of CIB
SG	10.0%	
Germany		
CBK	10.0%	
DBK	10.0%	
Italy		
BMPS	10.0%	
BP	10.0%	
BPER	10.0%	
BPM	8.5%	Impact of migration to IRB (not already in estimates) – c.150bp
CE	10.0%	
ISP	10.0%	
UBI	10.0%	
UCG	10.0%	
Nordics		
DANSKE	13.0%	Regulatory uncertainty, but we expect similar rules as for Sweden
DNB	13.0%	Regulatory uncertainty, but we expect similar rules as for Sweden
NDA	13.0%	Regulator requires a higher level of ET1
SEB	13.0%	Regulator requires a higher level of ET1
SHB	13.0%	Regulator requires a higher level of ET1
SWED	13.0%	Regulator requires a higher level of ET1
Spain		
BBVA	10.0%	
BKIA	10.0%	
BKT	10.0%	
BTO	10.0%	
CABK	10.0%	
POP	10.0%	
SAB	10.0%	
SAN	10.0%	
Switzerland		
CS	12.0%	CS has agreed 1% of eligible non-equity T1 for Swiss regulatory purposes
UBS	13.0%	Regulator requires a higher level of ET1
UK		
BARC	10.0%	
HSBC	10.0%	
LBG	10.0%	
RBS	10.0%	
STAN	10.0%	

Source: Exane BNP Paribas estimates

Longer term outlook

With the passage of the Basel 3/CRD4/CRR complex, Europe will finally have reached a degree of regulatory stability with respect to capital regulation at least. However, this is a temporary equilibrium at best. The liquidity regulations (NSFR and LCR) are still under development, although at present it seems unlikely to us that they will pose additional risks above and beyond those captured in our existing forecasts (this issue is discussed in detail in "Funding revisited", Tiberghien, 29th August). However, for the investment banks in particular, the Basel Committee's Fundamental Review Of The Trading Book (summarised in our note "Fundamental Review of the Trading Book - it's more complicated than that", 4 May) could lead to materially higher capital requirements.

The fundamental review is at its early stages at present; across the US and European earnings season, no bank was able to provide guidance on potential impact and the first Quantitative Impact Study has not been commissioned yet. However, in our view, the intention appears to be to make the market risk capital requirement more responsive to changing conditions and to have it more pro-actively managed by regulators. The key points of the FRTB in its current draft are:

– Use of the "Expected Shortfall" measure to replace "Value at Risk". This will tend to have the effect of increasing the impact on capital measures of extreme values.

– Integration of credit risk, counterparty risk and CVA into the overall Expected Shortfall framework. At present these distinct sources of risk are dealt with by separate capital requirements.

– Smaller "granularity" of model approvals. Regulators under this model would give trading book treatment approvals on a product by product or even desk by desk basis, and there would be no necessary presumption that even the largest banks would necessarily be using internal models rather than standardised treatment for at least some of their activities.

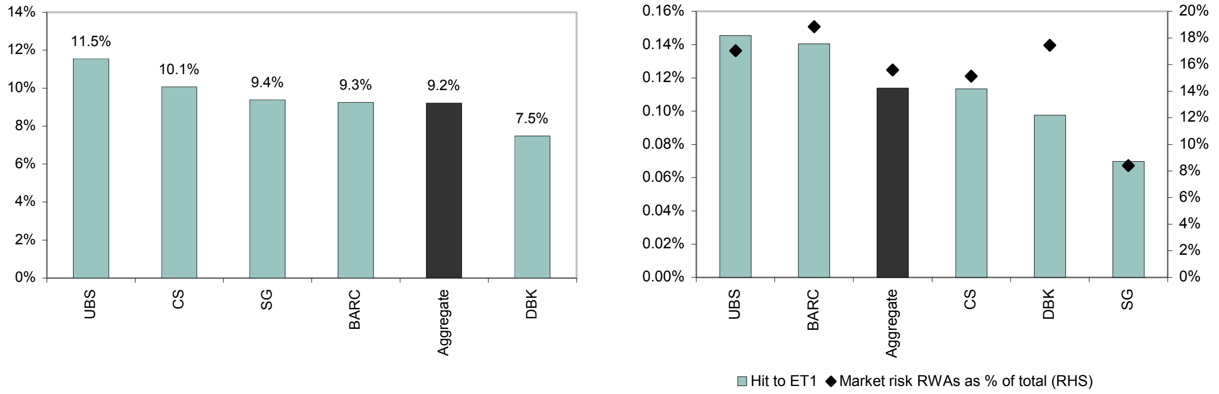
– A smaller gap between standardised and internal-models treatments. It is not clear from the consultation document whether this would be achieved by reducing the standardised or increasing the internal model requirements, but the intention is to make the regulators' implicit threat to de-recognise internal models more credible.

In our opinion, it may be a mistake to assume that the FRTB will necessarily involve a further large increase in overall trading book capital – after all, the capital requirement on securities trading business has nearly tripled since Basel 2, and the move to a stricter regime with respect to trading book risk will come with a rationalisation of the numerous "add-ons" for counterparty risk, CVA and similar quantities which have proliferated since the crisis. We are not currently modelling any impact of FRTB in our DCF valuations for the investment banks – there is no basis on which to do so, and in any case, it seems unlikely to us that speculation on possible regulatory change five years out will drive share prices.

However for reference we show for the banks with material investment banking businesses what the impact would be on our current 2013 ET1 forecasts (Basel 3 basis) from a 10% increase in current market risk RWAs – the chart below shows an average reduction in solvency of c.11bps, with a range of 7-14bps. SG sees the least impact on ET1, with UBS the most (albeit the latter still has a higher ET1 post the solvency hit). We have calculated the increase in total B3 CET1 based on the Basel 2.5 market risk RWAs, as to use Basel 3 market risk as the basis for extrapolation would double-count some of the treatments added on in Basel 3 which are to be replaced by the new Fundamental Review regime.

Figure 13: Hit to ET1 (B3 FL 2013) for the investment banks from a 10% increase in market risk RWAs

Adjusted ET1 B3 FL 2013E post increase in market risk | Hit to ET1 ratio and market risk RWA % of total



Note: base for increase is Q2 12 market risk RWAs. Source: Exane BNP Paribas estimates

The "years-to-cashflow" metric

With our assessment of the target CET1 in place, and with a forecast of the remaining "regulatory drag" on capital, we are now in a position where our forecasts of retained earnings and underlying balance sheet growth are sufficiently transparent to be used as the basis for cashflow forecasting. This allows us to calculate what we regard as a key metric – the "distributability date". This is the day on which, on the basis of our forecasts and assumptions, each bank reaches its target regulatory capital ratio, and is, at least in principle, capable of making a decision as to whether to distribute the marginal dollar of earnings to shareholders or to retain it to fund future growth.

For those banks where the target capital ratio is reached within our forecast period, calculating the date is a relatively simple affair; we presume that earnings are accrued evenly across each quarter or year for which we have forecasts, and that risk-weighted assets change similarly according to our forecasts. Where our forecasts still imply CET1 ratios below target at the end of 2014, we assume a terminal growth rate for earnings and RWA and calculate the remaining time using the formula:

Figure 14: Our 'years to cashflow' formula

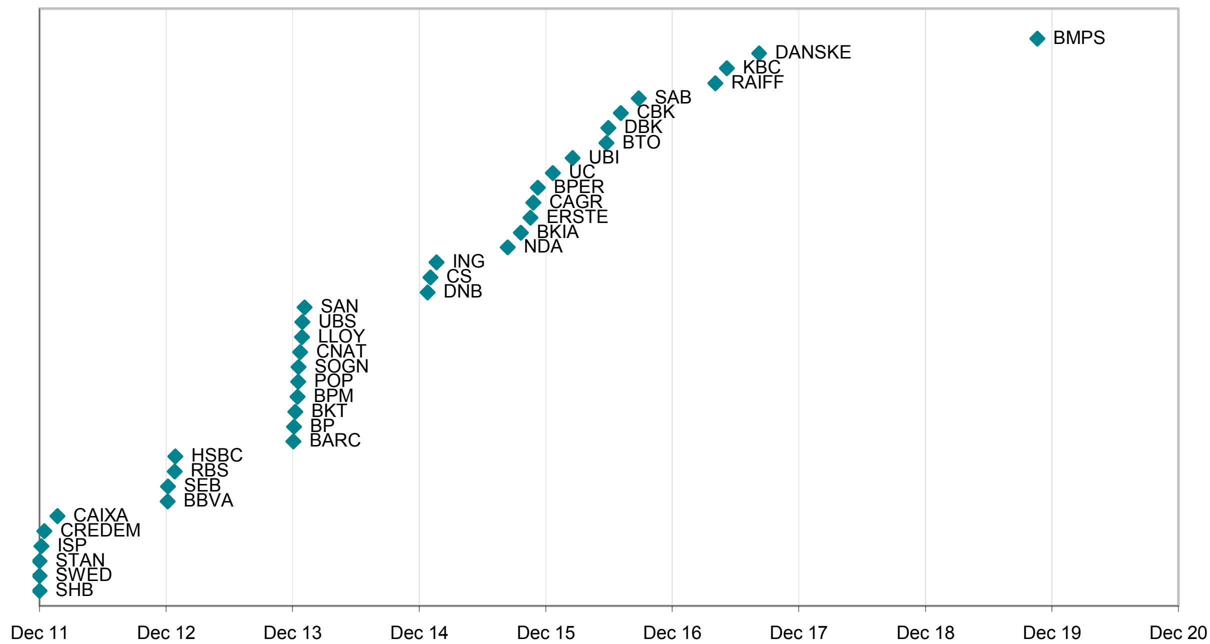
$$\text{Years to cashflow} = \frac{\text{RWA * (target ET1 - current ET1)}}{\text{Projected retained earnings - (RWA* terminal RWA growth * target ET1)}}$$

Source: Exane BNP Paribas estimates

The date of distributability which arises out of this calculation should not necessarily be taken as the first day on which a bank could in principle apply to its regulators for permission to buy back shares – for most regulators, accrued earnings are only counted in Common Equity Tier 1 capital when they have been audited – but in our opinion, it marks the day on which the usage of internally generated capital becomes a live rather than a theoretical debate. In our opinion, the rank ordering of banks by distributability date should match up reasonably well to the order in which the uncertainty with respect to the true underlying ability of each bank to generate distributable cashflow will be resolved.

Figure 15: Timeline for distributability

Vertical scale is only for readability

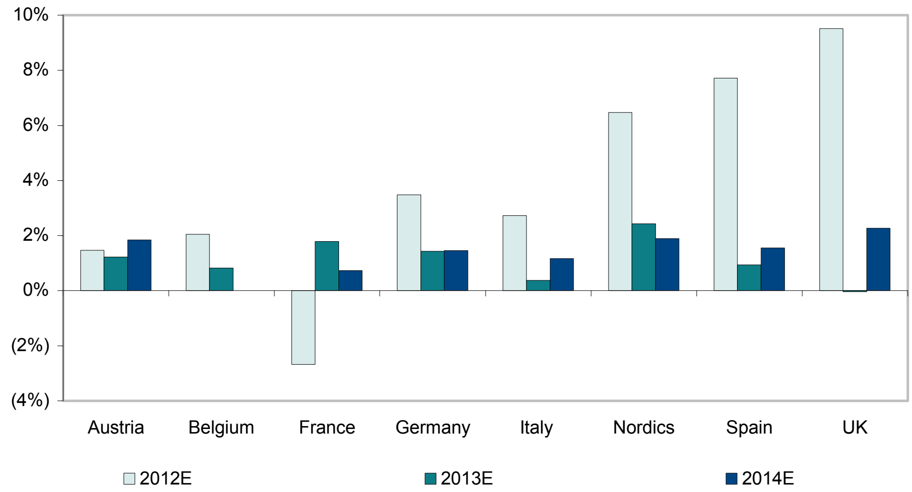


Source: Exane BNP Paribas estimates

Prospects for balance sheet growth

With customer loans representing c.40% of the bank's asset base and deposits amounting to the same proportion of banks' liabilities we believe the key to building earnings is the ability to maintain both loan and deposit growth. Banks need to be able to lend but also have the means to fund this business, especially at a time where the regulator wants to focus on long term and stable financing (hence the introduction of the NSFR). Our sector aggregate balance sheet forecasts (shown in the chart below) imply only 75bps yoy growth in assets in 2013 and c.140bps yoy in 2014.

Figure 16: Forecasts of total asset growth – only 75bps for the sector in 2013E…



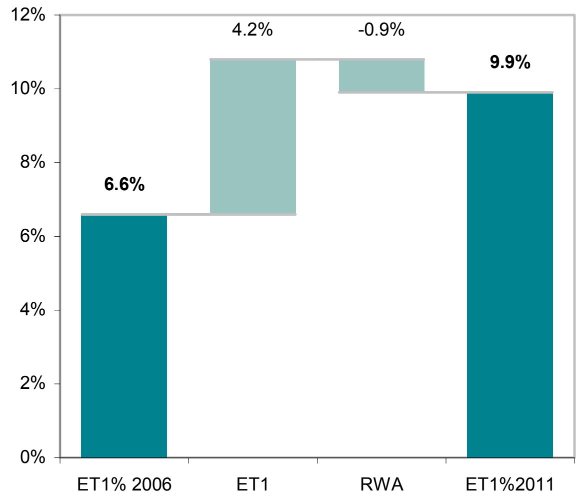
Source: Exane BNP Paribas estimates

Despite our forecasts implying minimal balance sheet growth in the coming years, this bodes well for capital generation through limited RWA growth. During the period Dec 2006 – Dec 2011 the sector's ET1 ratio (B2 basis) increased by 330bp from 6.6% to 9.9% – the ET1 growth of 64% over the 5 years contributed to a 420bp increase to the ET1 ratio but was reduced by 90bps reflecting the c.10% RWA growth over the period.

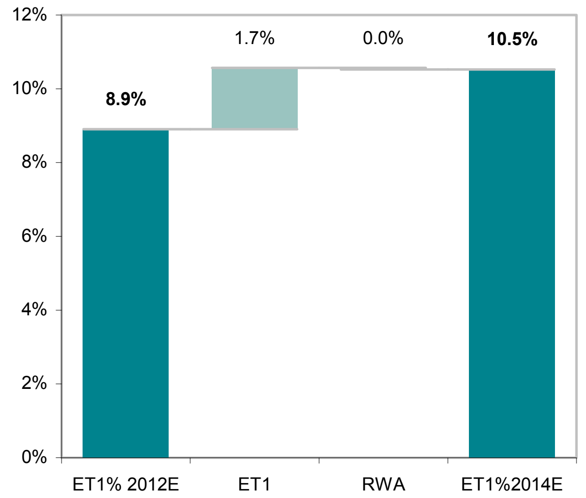
For the period Dec 2012- Dec 2014 on a Basel 3 basis however, we expect the build of ET1 capital to dominate – we forecast the ratio to improve by 160bp from 8.9% to 10.5%, solely led by the c.20% ET1 growth over the period and zero RWA growth.

Figure 17: …however RWA inflation will be limited going forward allowing better annual ET1% generation

ET1 ratio development 2006-2011 (B2 basis)



ET1 ratio forecasts 2012E-2014E (B3 FL basis)



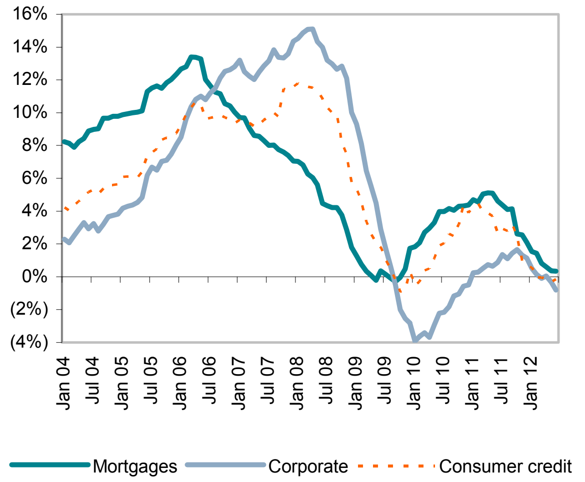
Source: Exane BNP Paribas estimates

Current GDP and loan growth subdued in Europe, with additional deleveraging consequences

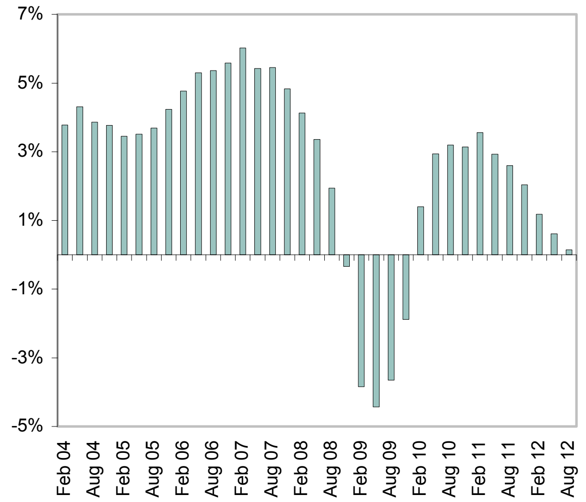
Current loan growth is most subdued in consumer credit where June lending was down 150bps yoy, followed by an 80bp yoy decline in corporate lending. The most positive trend remains in mortgage lending with 35bp yoy growth in June. With a similar trend, GDP growth is at a mere 0.14% for the 3 months to August vs. a peak of 3.6% in early 2011.

Figure 18: Loan and GDP growth development in Europe since 2004

European loan growth development (% yoy)



European nominal GDP growth (% yoy)*



** refers to the yoy % change for the 3 months ending at the reference period.*
Source: ECB, Exane BNP Paribas estimates

The table below shows our loan growth forecasts on a bank nationality basis. Loan growth in 2012 will still be affected unusually by discrepancies such as one-off deleveraging by the French banks in particular and mergers within the Spanish banking sector. However we currently forecast 1% sector loan growth for 2013E, and is focused largely in the Nordic region.

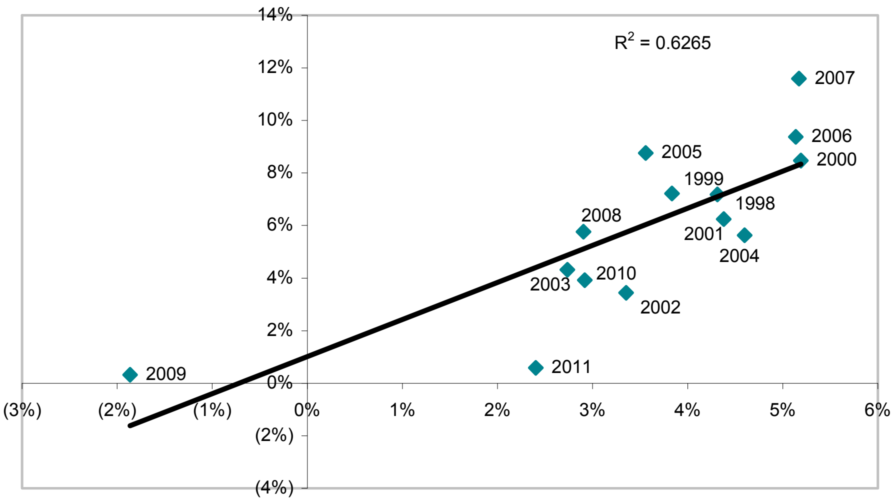
Figure 19: European banks' loan growth forecasts by nationality

	2011	2012E	2013E
Sector	**0%**	**4%**	**1%**
Austria	4%	0%	2%
Benelux	-3%	2%	2%
France	0%	-7%	1%
Germany	-4%	-1%	2%
Italy	-1%	0%	1%
Nordics	8%	9%	3%
Spain	2%	5%	1%
Switzerland	16%	6%	0%
UK (domestics) *	-5%	-4%	-4%
UK (Asians) *	0%	6%	6%

** in local currency. Source: Exane BNP Paribas estimates*

So how much will future GDP growth tell us about likely bank loan growth? The relationship between loan growth and GDP is not straightforward, although there is some correlation as shown below. Since 1998, banks have typically grown lending at a faster rate than GDP. It seems unlikely to us that the lending market will return to this trend in any short time, however, as there has been a fundamental change in regulation, risk attitudes and funding markets.

Figure 20: Euro area Loan growth vs. nominal GDP growth correlation since 1998



Source: ECB

We assume a long term growth rate of 2.5% for European banks

Below we show the 2012 and 2017 IMF forecasts for nominal GDP growth by country – the European estimate is 4.1% for 2017 (likely reflecting c.2% of real growth and c.2% of inflation). This can be used as a proxy for a long term growth rate, however we are inclined to remain more conservative – from experience having a more attractive g priced into a Gordon Growth model tends to lead to a much too early signal to buy the sector during times of crisis. We therefore assume a g equal to 2.5%, which reflects 0-1% of real growth and 1-2% of inflation. In a later section we use this figure to calculate individual bank DCF-based valuations.

Figure 21: IMF nominal GDP growth forecasts, 2012E and 2017E

	2012 E	2017 E
Austria	0.9	1.8
Netherlands	1.0	3.3
Belgium	2.4	3.9
France	3.3	4.1
Germany	2.9	2.6
Italy	-0.6	2.6
Sweden	5.6	4.4
Denmark	2.1	3.8
Norway	6.2	4.5
Finland	2.3	4.1
Spain	-1.0	3.5
Switzerland	1.0	3.0
UK	3.3	5.4
Euro zone	**1.5**	**3.5**
EU	**2.1**	**4.1**
US	**3.4**	**5.3**

Source: WEO April 2012, IMF

ECB lending survey shows risk on the demand side

Adequate loan growth not only requires supply side factors to be positive (i.e. the banks need to be in a position where they have the capital and the funding to offer loans), but the lending products also need to be in demand. The latest ECB lending survey is showing worse trends:

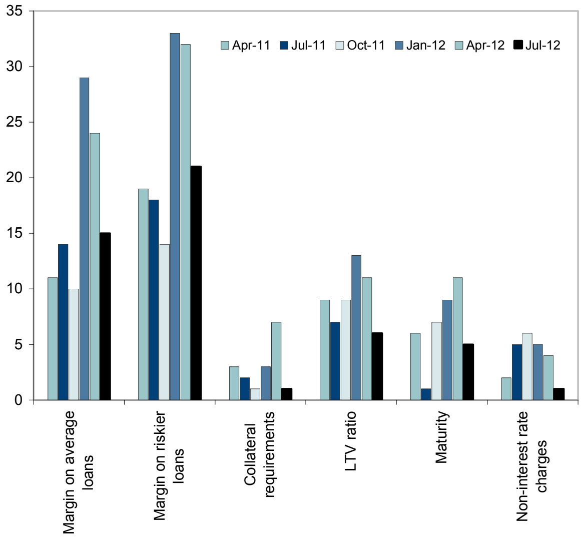
– The Q2 survey showed that not only is corporate demand for long-term credit close to 2008-2009 levels but also that the outcome was worse than expected for Q2. This was largely due to a reduction in fixed investments and more internal financing. A net 8% of banks expect a decline in demand in Q3.

– Q2 saw a higher than expected proportion of banks showing a contraction in demand from retail clients, particularly for consumer credit. Mortgage demand is still a net negative, driven most strongly by poor housing market prospects and consumer confidence. For Q3 only 10% of Euro area banks (in net terms) are expecting demand for mortgages to decline further (8% for consumer credit) but we see this as optimistic.

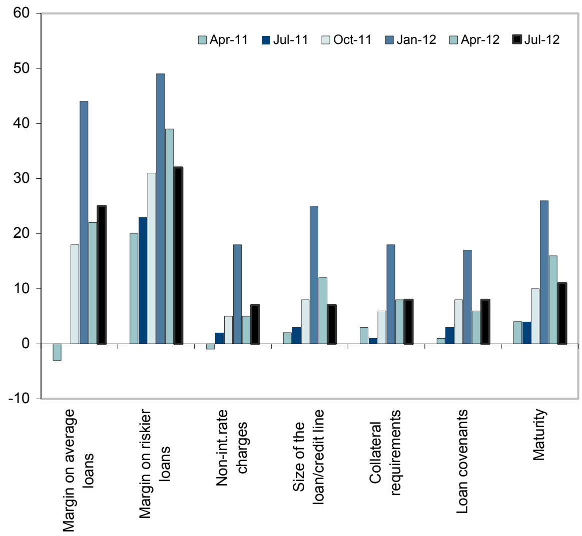
Demand is likely to be largely driven by country growth dynamics over the coming quarters, but also the higher rates charged to customers (currently increasing as banks try to pass on higher funding costs to customers) may lead to a reduction in demand if raised too severely.

Figure 22: Declining net share of banks seeing higher margins on some loans, lower than expected demand

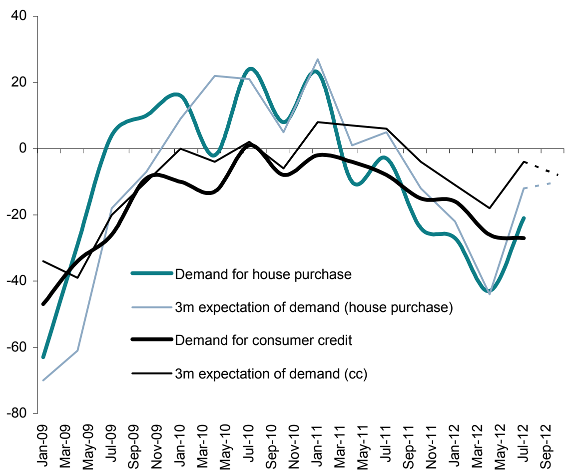
Net percentage of banks reporting tightening terms and conditions – mortgage loans



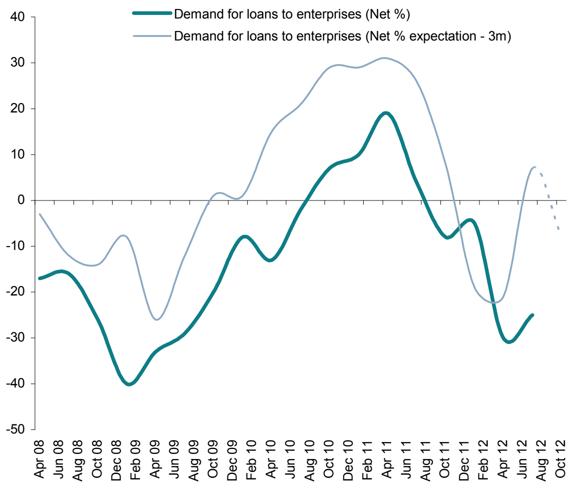
Net percentage of banks reporting tightening terms and conditions – corporate loans



Loans to households – development/ expectations in demand



Loans to enterprises – development/ expectations in demand



Source: Central bank data

Low growth equals high distributability

Stronger loan demand would, of course, be better for the banking industry – other things being equal, demand for the product is always a good thing. And the overall weak economic backdrop is a clear negative. However, from the point of view of distributable cash flow, the fact that RWA growth is likely to be in the low single digits means that the corresponding "new business strain" and the requirement for earnings to be retained in order to support balance sheet growth will also be low. At an RWA growth rate of 1-2%, in equilibrium the majority of a bank's earnings are distributable and payout ratios of well above 50% could be supported.

Historically in Europe, periods of low balance sheet growth have tended to result in surplus capital piling up and eventually being used up in acquisitions or destructive competition. In the current case, however, it seems to us that this is less likely; the fact that many key competitors in a number of key European markets will still not have reached their "distributability date" by the end of our forecast period suggests that the industry as a whole will be less likely to chase market share and that some hope of pricing discipline may be possible for the first time in recent history. As regards acquisitions, we would guess that (apart from distressed or state-organised consolidations) most European regulators would be reluctant to approve transformational deals that had a major effect on the capital base. We therefore conclude that the low growth environment makes it more likely that the distributable cash flow that the industry is capable of generating will actually be distributed.

DCF and valuation

Having surveyed the regulatory and business drivers of the sector's cash generation, it is now time to use this information for valuation purposes, allowing us to identify opportunities. Discounted cashflow models are not unproblematic in the financial sector, but used carefully, in our opinion they can provide us with useful insights, particularly when the distinction between accounting earnings and returns on equity and cash is as important as it is now.

We have prepared a template DCF model which links our earnings and balance sheet forecasts to a set of distributable cash flow projections, as shown below for Standard Chartered. This is for illustrative purposes only as this standardised template is slightly different from – and delivers a slightly lower valuation than – the company-specific model which we use to drive our current target price of GBP15.50.

Figure 23: Our template DCF model for European banks

Standard Chartered, modelled using current bond yields for cost of equity

Standard Chartered (USD, unless otherwise stated)	2011	2012	2013	2014	Perpetuity*	Total
Accounting earnings	5,013	5,311	5,613	5,967	5,967	
Tangible Equity	32,260	35,724	39,516	43,909	32,260	
ET1 B3FL	30,486	33,696	37,555	42,009	30,486	
RWA B3FL	289,331	320,468	350,682	382,801		
Marginal RWA		31,137	30,214	32,119	9,570	
ET1 ratio (B3 FL)	10.5%	10.5%	10.7%	11.0%		
ET1 capital needed to support balance sheet	28,933	32,047	35,068	38,280		
Cash created (required) by balance sheet		-3,114	-3,021	-3,212	-957	
Free cash flow		2,197	2,592	2,755	5,010	
Value of perpetuity					66,047	
Dividend adjustment	1,051	1,469	1,312	1,428		
Discount factor to 12m target		0.937	1.032	1.136	1.250	
Present value		2,344	2,512	2,425	52,820	**60,101**
No of shares 2013E						2,424
Per share (pence)						**1,588**
**Time beyond forecast period to reach target ET1 (yrs)*		*0.00*				

Source: Exane BNP Paribas estimates

The model requires a number of assumptions to be made, many of which are at least as important to the final answer as the earnings forecasts themselves. In establishing a sensible and objective basis for these assumptions, we can see in what ways current market prices are and are not consistent with our views; in many ways this process is more important than simply reaching a number in the bottom right-hand cell.

The definition of cash

Obviously, given the nature of the banking industry, the accounting definitions of cash and cash flow cannot be used straightforwardly (the Exane BNPP banks team have approximately 70 years of experience between us, and not only have none of us ever found the published cashflow statements useful, we have never met anyone else who has either). For the purposes of this note, we define cash flow for a period as:

Figure 24: Our definition of cashflow

Cash flow = Accounting earnings - (RWA growth) * (Target ET1)

Source: Exane BNP Paribas estimates

This represents, in our opinion, the truly distributable earnings for a bank for a given period; in a steady state, a bank which distributed this full amount every year would tend to see its Common Equity Tier One ratio converge toward the target. This model might not be quite conservative enough for states of the world in which organic RWA growth was rapid, as it assumes that RWA growth can be "post-funded" for capital (ie, one year's RWA increase can be funded out of the same year's retained earnings, rather than needing to make an allowance every year for the next year's expected RWA growth). However, in current conditions we see little reason to expect rapid organic RWA growth and we therefore regard this as an acceptable approximation.

Dividend adjustment

Earlier on in this publication we estimated the target levels of CET1 and have used these for the purposes of our DCF models. Most of the banks analysed in this report are currently below their target levels, and so for some (or all) of the forecast period, our estimate of the "true" cash earnings is zero until the target level has been reached. We then make an adjustment in those cases where a bank, despite being below its target, is nevertheless paying a dividend. In our analysis, such a dividend would be classed as an over-distribution, however it is real cash and needs to be analysed consistently.

Time to distributability adjustment

Many banks do not reach their target CET1 ratios in our forecast by 2014e, the last year for which we have explicit forecasts. In these cases, the "time to distributability" calculated earlier based on target capital ratios needs to be incorporated into the DCF framework. In cases where a bank is not at its target CET1 ratio in our 2014e regulatory balance sheet projections (and therefore has no distributable cash flow in the forecast period), we adjust the discount factor applied to the present value of perpetuity cash flows to reflect the additional wait before earnings are distributable.

Cost of equity and unrealised losses

In order to ensure consistency, we have decided not to have any element of subjectivity in our cost of equity estimates. We have simply used a CAPM framework, taking estimated betas from Bloomberg. We calculate the models twice for each bank; once using the current domestic bond yield as the risk free rate (and therefore incorporating current market perceptions of country risk) and an equity risk premium of 7%, and once using an equilibrium approach suggested by our Strategy team. In this second approach, we take a uniform long term risk free rate assumption of 3.5% (long term nominal GDP growth plus a term structure premium), and add a 6% equilibrium equity risk premium. This approach simulates a case in which the sovereign risk is resolved, implicitly by some form of mutualisation or Eurobonds. The implications of this approach are discussed at length in the Cost of Equity section further on.

As a counterpart to this, we have presumed that there would be a further round of private sector involvement or other cost to the banking sector as part of the roadmap to a solution. There is, of course, very little real basis upon which to estimate the size of such a measure – as a very crude adjustment, and one which seems to give the right qualitative pattern of exposures, we have haircut the most recent holdings of Greek sovereign debt by 75%, Portuguese by 30% and Irish, Spanish and Italian debt by 20%. This should not be seen as a prediction of default or any indication that debt is not correctly marked as present – simply a recognition that any normalisation of costs of equity has to have some cost of implementation.

Terminal returns and perpetuity cash flows

For the most part, we have used our modelled 2014e RoTE as the basis for perpetuity earnings, with modifications in cases where we do not believe that 2014e is necessarily a steady state.

Our annotated long term RoTE assumptions are listed below:

Figure 25: Long term RoTE assumptions

Bank	Estimated ROTE 14E	Long term RoTE (relevered/ delivered)	Long term ROTE vs. 14E	Comments
Austria				
ERSTE	12.3%	11.2%	-1.1%	
RAIFF	12.2%	9.7%	-2.5%	
Belgium				
ING	7.3%	7.2%	-0.1%	
KBC	16.1%	11.8%	-4.3%	
France				
CA	8.0%	8.8%	0.8%	Add 140bp to terminal ROTE – 10bp due to halving of losses on legacy assets, 130bp due to halving of Emporiki losses
CNAT	7.6%	7.6%	0.1%	
SG	7.6%	8.7%	1.1%	Add 80bp to terminal ROTE for halving of legacy assets losses. Also deduction for “rogue losses”
Germany				
CBK	7.6%	6.8%	-0.7%	Additional earnings for 100bp higher rates
DBK	11.7%	10.1%	-1.6%	Deduction for “rogue losses”
Italy				
BMPS	6.3%	5.1%	-1.2%	Additional earnings for 100bp higher rates
BP	5.2%	5.2%	0.0%	Additional earnings for 100bp higher rates
BPER	7.3%	6.9%	-0.4%	Additional earnings for 100bp higher rates
BPM	6.1%	6.3%	0.2%	Additional earnings for 100bp higher rates
CE	9.4%	10.0%	0.6%	Additional earnings for 100bp higher rates
ISP	7.8%	8.2%	0.4%	Additional earnings for 100bp higher rates
UBI	4.6%	4.4%	-0.2%	Additional earnings for 100bp higher rates
UCG	5.8%	5.5%	-0.3%	Additional earnings for 100bp higher rates
Nordics				
DANSKE	9.9%	8.0%	-1.9%	Additional earnings for 100bp higher rates
DNB	11.1%	11.0%	-0.1%	Additional earnings for 100bp higher rates
NDA	13.2%	12.3%	-0.9%	Additional earnings for 100bp higher rates
SEB	11.8%	12.3%	0.5%	Additional earnings for 100bp higher rates
SHB	16.1%	17.4%	1.3%	Additional earnings for 100bp higher rates
SWED	14.8%	16.5%	1.6%	Additional earnings for 100bp higher rates
Spain				
BBVA	13.6%	14.9%	1.3%	
BKIA	6.1%	6.0%	-0.1%	
BKT	6.6%	6.7%	0.1%	
BTO	7.9%	7.2%	-0.7%	
CABK	7.0%	8.4%	1.4%	
POP	7.8%	8.3%	0.4%	
SAB	7.0%	6.3%	-0.7%	
SAN	12.6%	13.8%	1.3%	
Switzerland				
CS	10.1%	10.0%	-0.1%	Adjustment for deficit capital in 2014e forecast and 100bp deduction for "missing rogues"
UBS	12.4%	13.0%	0.7%	Rebalancing of business mix toward private banking and adjustment for excess capital in 2014e model, net of 100bp deduction for "missing rogues”
UK				
BARC	9.6%	10.1%	0.4%	Small deduction for “rogue losses”. Added 40bp to reflect further normalisation of loan impairment losses in Corporate Banking and Europe RBB post 2014E
HSBC	13.4%	15.1%	1.7%	
LBG	11.6%	12.1%	0.6%	Based on core business only
RBS	8.9%	10.3%	1.4%	Based on core business only
STAN	13.6%	14.8%	1.3%	

Source: Exane BNP Paribas estimates

The major modifications we have made to long term return assumptions fall into four categories:

– Adjustments to delever or relever returns to adjust for differences between 2014e capital ratios and the long term target ET1. We do not want to give a valuation benefit for having too little capital (or a penalty for having too much), and so we adjust the RoTE in the long term to take account of regulatory capital gearing where it differs from the target.

– Adjustments to the RoTE for banks with significant deposit franchises (mainly in Italy and the Nordics) to reflect the impact of the current low interest rate environment. We are not forecasting any improvement in deposit spreads by 2014e in our models but expect that a more normalised level of deposit profitability should be built into long term valuations.

– Adjustments to investment banking RoTEs to reflect the "missing rogues" issue described in our initiation note of January 2012; the fact that our forecasts for 2014e do not include any allowance for large surprise losses despite the fact that these are a completely normal part of the cost of doing business in trading franchises.

– Adjustments made to remove non-core businesses in run-off at Lloyds, RBS and HSBC.

Terminal growth

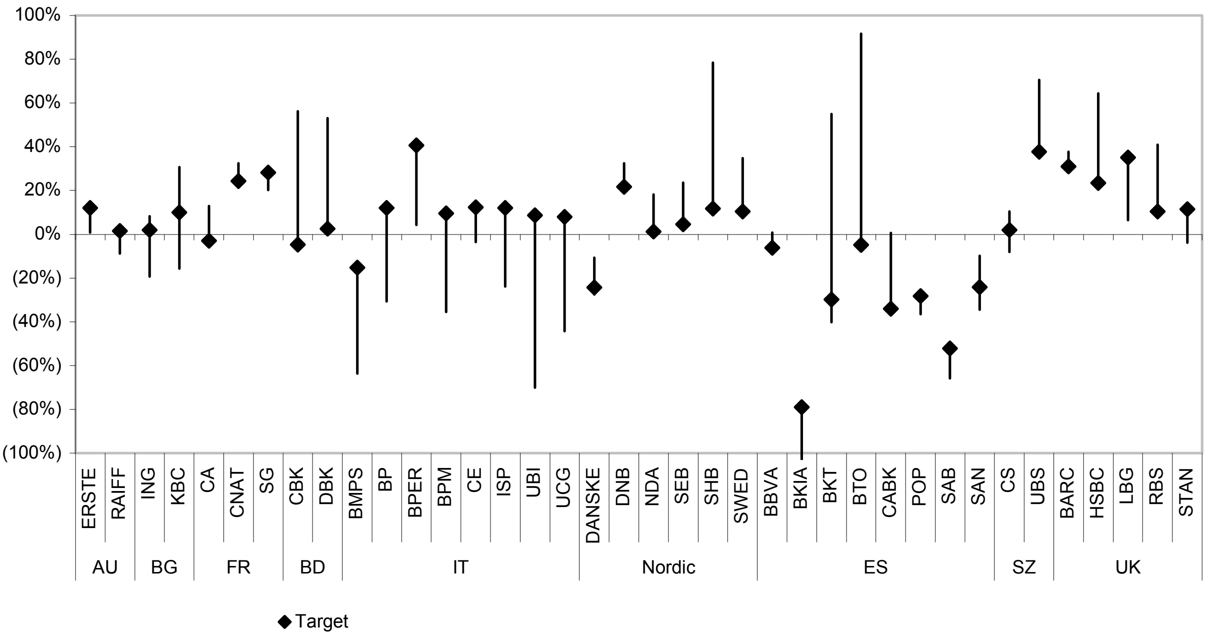
In general for modelling purposes, and in line with our assessment of the visibility of loan growth in Europe as discussed earlier, we have assumed terminal growth of 2.5%, in line with nominal GDP. In cases where the terminal RoTE is below the cost of capital, however, we have shaded this downward to 1%, to reflect the lesser likelihood of managements' continuing to grow a value-destroying business. We have not shaded the growth rate all the way down to zero in these cases, however; as discussed above, there is considerable uncertainty about discount rates, and therefore considerable scope for management to have a different assessment of the required return. Furthermore, there are plenty of cases in history when banks have continued to grow while earning below-par RoTEs; there is always room for misplaced optimism about the future, or belief in a change in the competitive environment.

Cost of equity

The key issue with respect to DCF models for banks, however, in our opinion is that they are highly sensitive to the choice of discount rate. As the figure below (summarising our DCF valuations listed in full in the Appendix) shows, it makes a very large difference in a number of cases whether we use current sovereign bond yields and a 6% equity risk premium or "normalised" long term returns on equity from our Strategy team as a basis for calculating the cost of equity. This introduces an unavoidable compromise into the methodology. If we adjust the cost of equity to a figure which looks "reasonable" to us as analysts, then subjectivity has been brought into the process, while if we use a figure mechanically based on market rates, the target price will be volatile.

Figure 26: Current target prices vs 'current' and 'normalised' DCF target prices

% Upside/downside from current price. Error bars represent range between DCF model based on "Current" and "Normalised" cost of equity.



Note: In order to reflect the execution risk of the Emporiki disposal, and despite the fact that CA has received three binding offers, we only give half of the benefit of the removal of Emporiki losses. Removing them fully would have increased upside to 30% and 32% respectively for the normalised and current DCF models, to EUR2.85 and EUR2.88. Source: Exane BNP Paribas estimates.

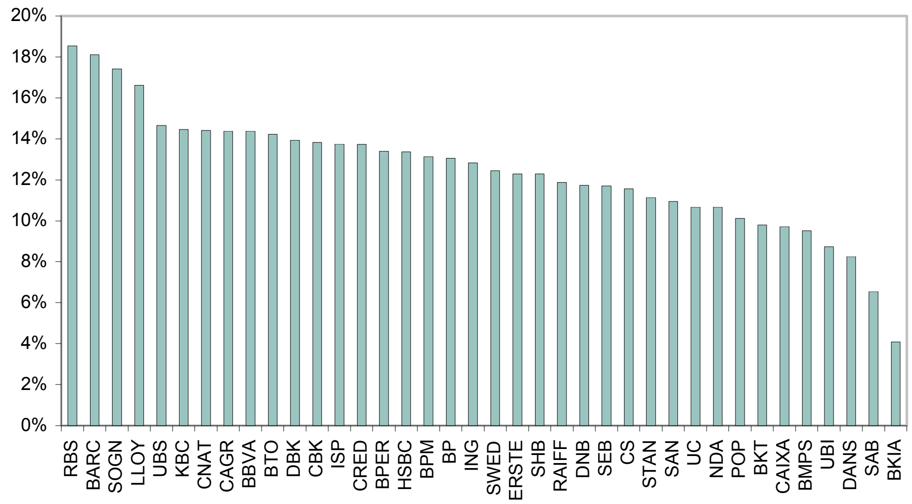
This is not necessarily a bad thing about DCF models – in our opinion, target prices *should* be at least somewhat sensitive to market discount rates. If there is one thing we have learned over the last three years after all, it is that banks' share prices are sensitive to domestic government bond yields and risk premia. However, the government bond yield curves cannot be taken completely at face value – the current safe-haven status of the Bund and Swiss franc have delivered extremely low government bond yields in Germany and Switzerland, but we do not necessarily want to translate these into very low costs of equity for the highly levered and volatile investment banks which happen to be headquartered there.

There is no real solution to this problem and, in our opinion, nor should there be. The "true" cost of equity for any stock is not an observable parameter and so some element of subjectivity and uncertainty is inevitable. The advantages of using a DCF framework are that a) it focuses on distributable cash rather than accounting earnings, b) the "bracketing" of our target prices by the valuations generated by standardised models works as a consistency check, and c) that it models long term sustainable returns as well as current trading. It does not give a silver-bullet solution to generate a single target price which can be guaranteed to be correct – if it did, we would have adopted it much earlier. For this reason, we have not, in the majority of cases, changed our target prices based on the DCF models; the DCF values give more clarity on upside and downside, however, while the "time to cash flow" ranking helps us get a clearer idea of the visibility and proximity of the valuations.

Implied cost of equity

Another way of looking at this question is to solve the model backwards – to see what cost of equity would need to be used to make the DCF valuation consistent with the current share price (and with our long term RoTE and growth assumptions), or target price. This creates another rank ordering of the banks which can be checked for consistency and reasonableness. We show this below.

Figure 27: Implied cost of equity from DCF models (current price)

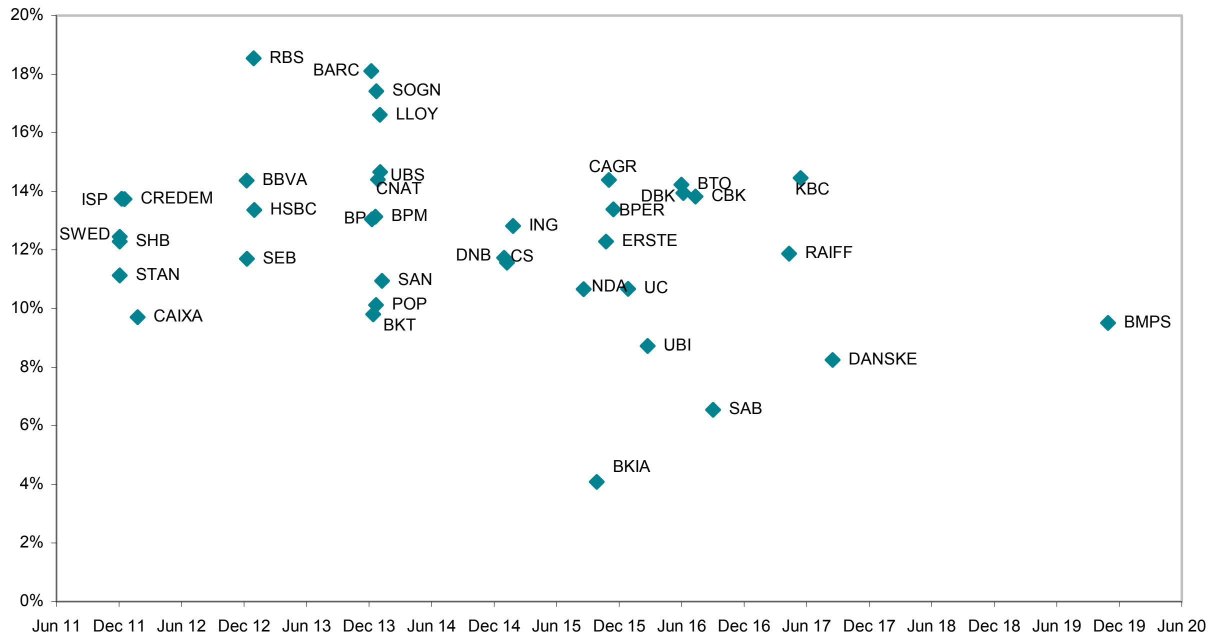


Source: Exane BNP Paribas estimates

It is even possible to plot valuation and capitalisation in two dimensions, showing the time-to-distributability (how long it takes to get paid) on the horizontal axis and the implied cost of equity (how much you get paid for waiting) on the vertical axis. This gives a dynamic version of our scatter chart analysis, as shown below.

An interesting characteristic of the chart shown below is that, in so far as the scatter plot has any shape at all, the slope of the implied trendline is opposite to what we might have expected to see. Rather than rewarding risk at a higher rate in those banks which are further away from achieving their capital targets, the market seems to be relatively undervaluing near-term distributable returns. In our opinion, this may represent a genuine opportunity for a rerating over the next year, as the cashflow becomes more visible for banks toward the upper left-hand side of the plot.

Figure 28: Implied cost of equity versus time to distributability



Source: Exane BNP Paribas estimates

The banks in the upper left hand quadrant include a substantial selection of our favoured calls in the sector; this is not wholly surprising as we have emphasised low valuation and higher visibility on capital as a key theme all year. The two surprises are:

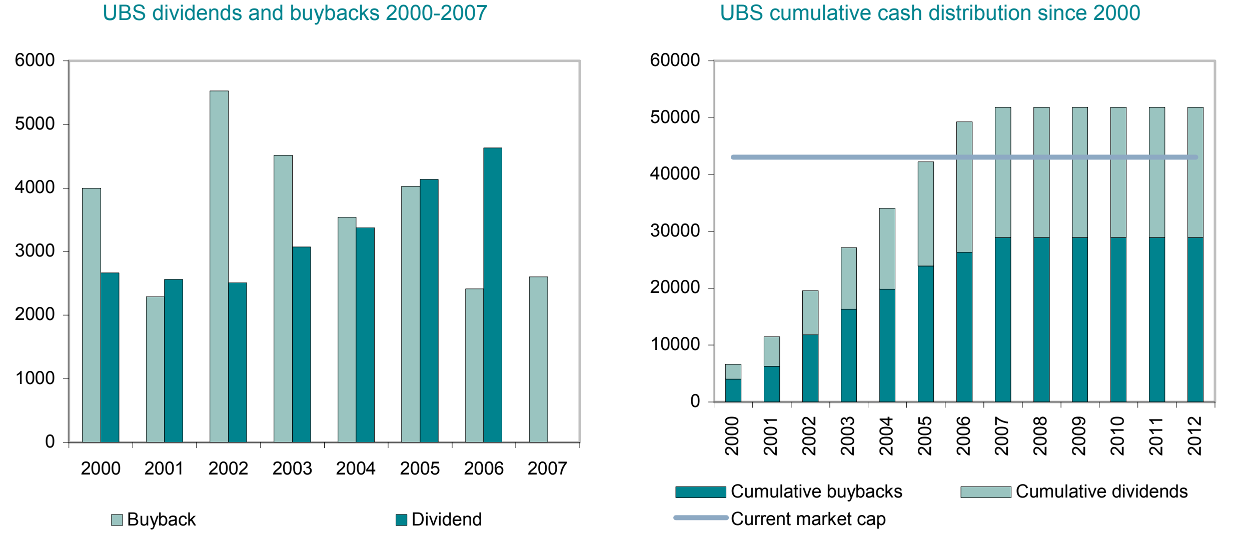
– **RBS**, which has one of the earliest distributability dates in the sector, and which has a very high implied CoE when we use an explicit DCF framework. Looking back at the model, however, reveals that both of these things are driven by the same underlying business reality – our core forecasts assume that the divestments will take place according to schedule. The realisation of these transactions creates a very large reduction in RWA, which not only greatly accelerates the distributability date but shows up in the model as a very significant free cash flow. This is technically correct from a modelling point of view, but clearly we need to take into account the execution risk, and to be realistic about whether the cash freed up would genuinely be immediately distributable – cash distributions take place only on the permission of the regulator, and the cGBP120bn of RWA involved is a considerable fraction of RBS' capital base. For the time being, therefore, we regard the DCF value of RBS as somewhat theoretical and retain our Neutral recommendation and preference for Lloyds.

– **UBS**, where we believe that the model has genuinely shown up an opportunity. Although we have been sceptical in the recent past about the Swiss banks' RWA diverstment strategies, they do generate cash by doing so. Furthermore, the Swiss banking model has always been highly cash generative, since as much as half the earnings come from business lines with little or no marginal regulatory capital requirement. As UBS has decent visibility in its path to reaching its capital target within the forecast period, we believe that the valuation is now cheap enough to get over our concerns about the near term operating environment. We are therefore raising our price target to CHF14.7 and our recommendation to Outperform.

UBS – upgrade to Outperform

The main conclusion that we draw from the analysis above is that we have possibly been underestimating the virtues of UBS as an investment going forward. For most of this year, we have been concentrating on the negative effects on the business of the RWA reduction plan (in such notes as "You can't grow by shrinking", 14 February, summarising our view that reducing the size of the investment banking operations was likely to have negative rather than positive effects on profitability). The analysis of this note suggests, however, that even though the RWA reductions may have the effects we expect on underlying profitability, they have the significant advantage of bringing forward in time the date on which those earnings are distributable as cash. This matters because UBS is, historically and intrinsically, a high cashflow company, which used to have one of the largest buyback programs in the European market. Between 2000 and 2007, it distributed just under CHF52bn of cash flow in dividends and buybacks, somewhat more than the total current market capitalisation.

Figure 29: Back in the "good old days", UBS generated and distributed significant cash



Source: Exane BNP Paribas. For the purposes of this chart, we have treated each separate buyback program as if all the cash was distributed on the first day of the program, and treated par value reductions as dividends.

The buyback program was cancelled in 2007 and will not, in our opinion, be reinstated in 2012 or 2013. The company has suggested (at the Q2 results presentation) that building the regulatory capital base will remain the favoured use of retained earnings until a level of 13% fully-loaded Basel 3 fully loaded is achieved. This would correspond to the Swiss Finish 10% common equity requirement, plus 3% representing that part of the Swiss Finish which could, in principle, be satisfied by low-trigger contingent convertible capital. So far, low-trigger CoCo remains an instrument which has never been successfully issued; UBS issued USD2bnbn of high-trigger loss-absorbing notes (which are equivalent to CoCo in our opinion although issued with a writedown rather than conversion structure) earlier this year. On our current estimates, UBS's forward "capital roll" to this target is made comfortably.

There is clearly significant uncertainty in forecasting the Common Equity Tier One ratio three years out; it is a ratio of a large number to a comparatively small number, so the uncertainty in forecasting risk-weighted assets is magnified. Our current forecasts implicitly assume that the Investment Banking division is put on a fixed capital budget in absolute terms from 2013 onward; given the headcount reductions taking place under the current expense reduction program, we believe this assumption makes sense. Our previous assumption had incorporated 2-3% yearly business as usual growth in Investment Banking RWA; the capital roll associated with that assumption had UBS making the 13% target almost precisely at the end of the forecast period in 2014.

In our opinion, the uncertainty surrounding our central estimates is material enough to make it important to concentrate on the big picture rather than point estimates. We do not believe that the company is being given credit for its intrinsically cash-generative business model; even on the basis of the current, token dividend for 2012e, the stock currently trades on a dividend yield greater than the Swiss 10 year government bond yield (0.9% versus 0.55%). In our view, investors also ought to consider the possibility of:

– Increases in the dividend from its current token level to something closer to the historic payout ratio of 40%

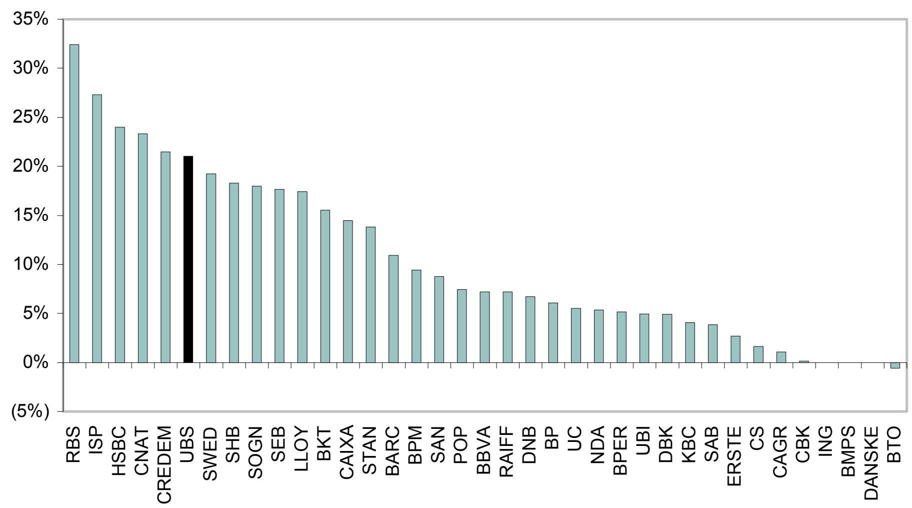
– Capital return through buybacks after 2014, by which time it is highly likely that the 13% threshold will have been passed (as was projected by our previous set of earnings and balance sheet forecasts)

– Potentially accelerated capital return if the 13% threshold is achieved within the forecast period (as is projected by our current earnings and balance sheet forecasts).

The discounted value of the potential cash flows over the next few years are not, in our opinion, reflected in the valuation in UBS. As the chart below shows, if we take the forecast period cashflows alone from our DCF model (using current bond yields for cost of equity), we have already accounted for 21% of the market value of UBS. On our current dividend forecasts, the stock is trading on a yield of c.5% based on 2013e.

Figure 30: The market value of UBS is not sufficiently reflecting long term value

Forecast period cashflows in DCF value as % of current market capitalisation



Source: Exane BNP Paribas estimates

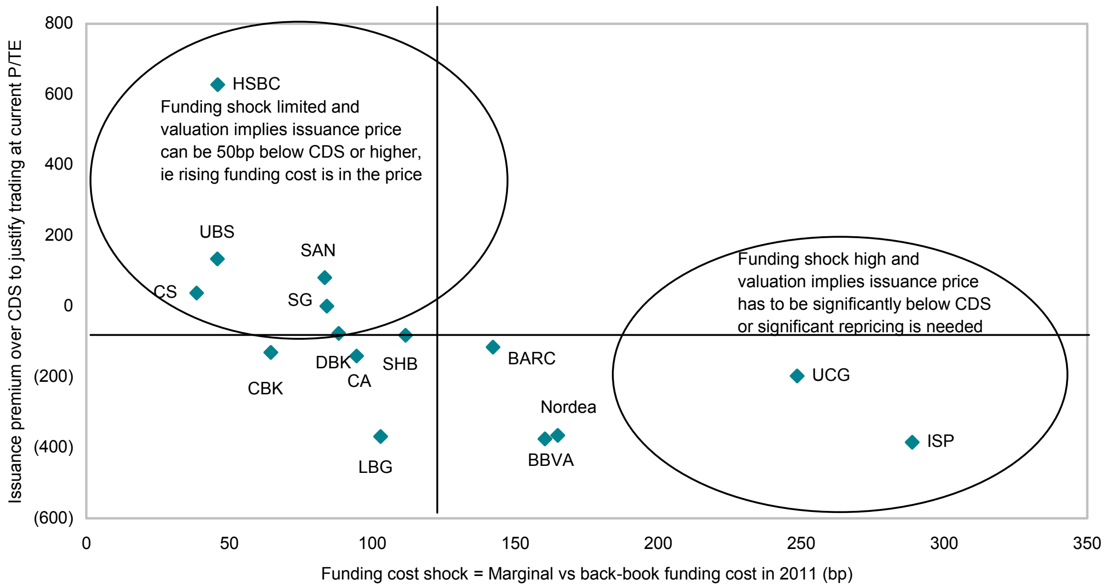
In our opinion, it is something of an anomaly for a bank like UBS (where our belief would usually be that the value was in the competitive franchise, the brand and in long term intangible assets) to have such a proportion of its valuation accounted for by near term forecast period cash flows. It is not completely incomprehensible – over the last five years, UBS has generated substantial negative cash flow, from operating losses and from recapitalisations. It could even be convincingly argued that some of the developments over the crisis period have permanently impaired the brand. However, given the current market environment and the progressive changes in UBS' business model, in our opinion it seems unlikely that any such impairment, or any reasonable forecast negative cashflows, could account for the valuation. We believe it is simply an anomaly – the cyclically depressed conditions in both investment banking and wealth management, combined with a lack of visibility on the direction of the business, have combined to help people to forget how much of a cash machine UBS really is.

Funding strength may come to fore

We would also draw attention to an attribute of the Swiss banks which is not necessarily currently reflected in equity valuations, but which remains a key operational source of strength. This is that, as noted in "Funding revisited" (Tiberghien, 29th August), the Swiss banks have less to worry about from conditions in funding markets than nearly any other subsector in Europe. This is partly because they have already made substantial changes in their liability structure (building up large surplus liquidity portfolios and increasing stable funding, in response to Swiss domestic regulations which effectively anticipated the LCR and NSFR). It is also because the Swiss banks still have some of the cheapest borrowing spreads in the European sector.

This means that, unlike many other banks in our coverage universe, the Swiss banks can continue to issue at spreads near to current secondary market yields without having a destructive effect on their returns and profitability. On our estimates from our proprietary funding model, if UBS were to continue to issue at current spreads and with its target liability structure, it would have a marginal cost of funds somewhere close to 50bp more expensive than the average "back book" cost of funding its book in 2011. Taking the current cost of capital and the long term RoTE implied by the PTNAV multiple at which the stock is trading, UBS could in fact issue as much as 200bp wider than its current CDS spread and still maintain a double digit RoTE

Figure 31: How banks' valuations withstand the liability repricing in our target liability structure (bp)



Source: Exane BNP Paribas estimates

EXANE BNP PARIBAS

Profitability at a multi-year cyclical low

Finally, we note that across UBS's divisional structure, there are practically no businesses which are not at multi-year or extreme cyclical low points. The investment banking business (although it also has structural problems and is being scaled back) is suffering from extremely low levels of securities issuance and trading activity. The private bank has well-known issues with the gross margin, resulting from the combination of unusually high client risk aversion combined with low interest rates. We would therefore suggest that if the valuation case works for UBS at the current point in time, the upside in any improved market conditions could be considerable. The stock has fallen 3% in absolute terms since the beginning of the year, underperforming the sector by 10%.

Minor earnings and capital revisions underlying cash generation

We have made small changes to our earnings model which do not affect current year EPS, but which bring our RWA projections closer in line with company guidance. UBS most recently announced targets for RWA on a B3 FL basis were CHF270bn for 2013e and less than CHF240bn by 2016e. Consistently with the approach we have taken across the investment banking space (where we believe that RWA guidance in general and Basel 3 mitigation plans in particular may be too aggressive), we are forecasting RWA of CHF283bn for 2013e, the difference from management targets roughly being accounted for by CHF12bn of operational risk assets to reflect litigation exposure. However, we had previously assumed positive RWA growth in 2014e and beyond, presuming that targets four years out were subject to revision, and that the natural tendency of investment banking businesses was to expand rather than contracting. After our analysis of the value generated by releasing capital, however, we are inclined to believe that this was excessively cynical – the plan to reduce RWA by a further CHF30bn between 2013 and 2016 (freeing up regulatory capital of CHF1bn per year, or close to CHF0.25 per UBS share) is a good one and the incentive for top management to execute on it are considerable. We have also made downward adjustments to the cost base of the investment bank (and similar adjustments in Credit Suisse) reflecting the P&L counterpart of the balance sheet downsizing. These adjustments are summarised below:

Figure 32: RWA forecast changes and earnings revisions drive cashflow

CHF in millions

UBS model Group P&L	Old FY 12e	Old FY 13e	Old FY 14e	Revision FY 12e	Revision FY 13e	Revision FY 14e	New FY 12e	New FY 13e	New FY 14e
Total revenues	26,610	31,034	33,142	0%	0%	0%	26,610	31,034	33,142
Credit loss expense (recovery)	(53)	(180)	(182)	0%	0%	0%	(53)	(180)	(182)
Noninterest expense	22,256	23,930	24,896	0%	-1%	-1%	22,256	23,626	24,580
PBT	4,300	6,925	8,064	0%	4%	4%	4,300	7,229	8,379
Tax expense (benefit)	1,231	1,523	1,774	0%	4%	4%	1,231	1,590	1,843
Minorities/prefs	274	206	154	0%	0%	0%	274	206	154
Attributable profit	2,795	5,196	6,136	0%	5%	4%	2,795	5,433	6,382
Dividend per share	0.10	0.50	0.50	0%	0%	0%	0.10	0.50	0.50
EPS	0.73	1.36	1.61	0%	5%	4%	0.73	1.42	1.67
RWAs	330,908	290,152	294,378	0%	-2%	-6%	**330,908**	**283,222**	**276,978**
CET1 B3 FL	9.1%	11.7%	13.0%	+0.0pp	+0.4pp	+1.0pp	9.1%	12.1%	14.0%

Source: Exane BNP Paribas estimates

Valuation

The standardised DCF models we have used across the sector give valuations of CHF18.20 and CHF14.70 per share using cost of equity based on current bond yields and normalised bond yields respectively. Given the uncertainty inherent in the current environment, and the international nature of UBS' business, we are reluctant to use a valuation which is heavily driven by the effect on the cost of equity of an extremely low domestic Swiss government bond yield. We therefore set our price target equal to the "normalised" DCF valuation of CHF14.70.

Figure 33: UBS discounted cash flow valuation based on "normalised" cost of equity

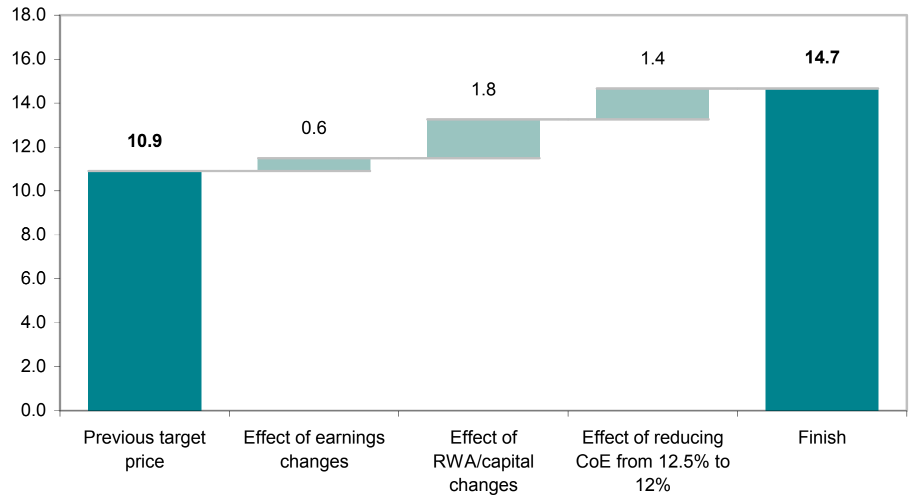
CHF in millions, except per share figures

UBS	2011	2012	2013	2014	Perpetuity	Total
Accounting earnings	4,233	2,795	5,433	6,382	6,382	
Other adjustments to earnings				0		
Tangible Equity	43,856	46,738	47,501	51,601		
ET1 B3FL	25,583	30,111	34,167	38,675		
Assume haircut on sovereign exposure	-134	-134	-134	-134		
RWA B3FL	367,200	330,908	283,222	276,978		
Other adjustments to RWA						
Marginal RWA		-36,292	-47,687	-6,243	6,924	
ET1 ratio	6.9%	9.1%	12.0%	13.9%		
ET1 capital needed to support balance sheet	47,736	43,018	36,819	36,007		
Cash created (required) by balance sheet		0	0	812	-900	
Free cash flow		0	0	7,193	5,482	
Value of perpetuity					60,436	
Cash dividend bill	383	383	1,916	1,916		
Dividend adjustment			383	1,916		
Discount factor to 12m target		0.929	1.036	1.156	1.290	
Present value		0	370	7,878	46,849	**55,097**
No of shares 2013E						3,747
Per share						**14.70**

Source: Exane BNP Paribas estimates

Figure 34: Drivers of UBS target price change

CHF per share



Source: Exane BNP Paribas estimates

Relative to Credit Suisse

Many of the favourable business drivers described above also apply to Credit Suisse, in particular, CS has just as many of its business lines suffering at cyclical lows as UBS does. We have made similar earnings and RWA forecast adjustments, as detailed below. The problem is, however, that in our DCF analysis these changes simply do not help anything like as much at Credit Suisse as they do at UBS, because CS is still, even after its capital raising exercise, significantly further from its Swiss basis capital targets than UBS is. As Credit Suisse grows toward its target CET1 ratio (which we have set at 12%, one percentage point lower than UBS to reflect the non-equity capital which CS has agreed with the Swiss regulators is eligible against Swiss Finish regulations.

Figure 35: Credit Suisse forecast revisions

CHF in millions (underlying basis)

Credit Suisse	Old FY 12e	Old FY 13e	Old FY 14e	Revision FY 12e	Revision FY 13e	Revision FY 14e	New FY 12e	New FY 13e	New FY 14e
Net revenues	24,274	27,020	28,936	0%	0%	0%	24,274	27,020	28,936
Provision for credit losses	171	228	235	0%	0%	0%	171	228	235
Total expenses	20,989	21,310	22,058	0%	-2%	-1%	20,989	20,922	21,783
PBT	3,114	5,481	6,643	0%	7%	4%	3,114	5,869	6,918
Earnings basis for EPS	1,871	3,483	4,261	0%	8%	4%	1,871	3,751	4,451
DPS	0.75	0.75	0.75	0%	0%	0%	0.75	0.75	0.75
EPS	1.33	2.16	2.57	0%	8%	4%	1.33	2.33	2.69
RWAs	309,001	314,199	327,048	0%	0%	-3%	309,001	314,199	318,278
CET1 B3 FL	8.5%	10.2%	11.4%	+0.0pp	+0.1pp	+0.5pp	8.5%	10.3%	11.9%

Source: Exane BNP Paribas estimates

Our two DCF models give a valuation of CHF20.35 using current bond yields and CHF16.94 on normalised bond yields. On this basis, we see little reason to change our current price target of CHF18.8.

Conclusion

With 38% upside to our new UBS price target, versus c.7% for the sector as a whole, UBS now has enough valuation upside to justify an Outperform recommendation. We therefore raise our recommendation, in the anticipation of improving visibility of cashflow and earnings. We will continue to monitor progress; we would regard the thesis as proved by progress toward the capital targets in line with our forecasts and disproved by any failure to make incremental improvements toward this goal.

Appendix: the DCF valuations

The following table summarises the DCF valuation exercises for all stocks in our current coverage universe.

Figure 36: Assumptions and valuations

Key assumptions and DCF value per share under current and normalised cost of equity

		Common assumptions				Using current bond yields			Using normalised CoE		
		Target CET1	Long term delevered/ relevered RoTE	Growth rate	Beta	Cost of Equity	DCF value (LC per share)	Perpetuity value as % of total	Cost of Equity	DCF value (LC per share)	Perpetuity value as % of total
Austria	ERSTE	10.0%	11.2%	1.0%	1.45	12.0%	16.69	97%	12.2%	16.19	97%
	RAIFF	10.0%	9.7%	1.0%	1.52	12.4%	24.77	92%	12.6%	24.22	96%
Belgium	ING	10.0%	7.2%	1.0%	1.78	15.0%	4.91	100%	12.0%	6.58	100%
	KBC	10.0%	11.8%	1.0%	1.93	16.0%	14.58	95%	12.0%	22.59	97%
	CAGR*	9.5%	8.8%	1.0%	1.59	13.2%	5.23	99%	13.0%	5.15	99%
	NATI	10.0%	7.6%	1.0%	1.30	11.2%	2.88	82%	11.3%	2.85	82%
	SOGN	10.0%	8.7%	1.0%	1.83	14.9%	25.28	85%	14.5%	26.20	85%
Germany	CBK	10.0%	6.8%	1.0%	1.26	10.2%	1.93	100%	11.1%	1.53	100%
	DBK	10.0%	10.1%	1.0%	1.29	10.4%	43.26	97%	11.2%	38.35	96%
Italy	BMPS	10.0%	5.1%	1.0%	1.16	14.1%	0.11	100%	10.4%	0.08	100%
	BP	10.0%	5.2%	1.0%	1.23	14.6%	1.00	93%	10.9%	0.80	91%
	BPER	10.0%	6.9%	1.0%	1.00	13.0%	4.47	95%	9.5%	5.52	96%
	BPM	8.5%	6.3%	1.0%	1.30	15.1%	0.34	89%	11.3%	0.26	97%
	CREDEM	10.0%	10.0%	1.0%	1.16	14.1%	3.29	78%	10.5%	3.26	92%
	ISP	10.0%	8.2%	1.0%	1.43	16.0%	1.08	68%	12.1%	0.95	90%
	UBI	10.0%	4.4%	1.0%	1.16	14.1%	1.38	90%	10.5%	0.80	83%
	UC	10.0%	5.5%	1.0%	1.48	16.3%	1.76	90%	12.4%	1.94	91%
Nordics	DANSKE	13.0%	8.0%	1.0%	1.10	8.9%	91.88	100%	10.1%	74.71	100%
	DNB	13.0%	11.0%	2.5%	1.12	9.7%	88.15	95%	10.2%	81.37	95%
	NDA	13.0%	12.3%	2.5%	1.16	9.6%	72.39	95%	10.4%	63.34	95%
	SEB	13.0%	12.3%	2.5%	1.22	9.9%	62.68	86%	10.8%	56.12	84%
	SHB	13.0%	17.4%	2.5%	0.94	8.0%	411.97	90%	9.1%	340.30	88%
	SWED	13.0%	16.5%	2.5%	1.21	9.9%	156.11	86%	10.7%	139.51	84%
Spain	BBVA	10.0%	14.9%	1.0%	1.27	15.6%	5.52	92%	11.1%	6.12	94%
	BKIA	10.0%	6.0%	1.0%	0.88	12.9%	-0.05	-601%	8.8%	-0.03	-961%
	BKT	10.0%	6.7%	1.0%	1.27	15.7%	1.79	74%	11.1%	4.64	87%
	BTO	10.0%	7.2%	1.0%	0.91	13.1%	2.75	101%	8.9%	4.64	100%
	CAIXA	10.0%	8.4%	1.0%	0.94	13.4%	2.12	79%	9.2%	3.05	92%
	POP	10.0%	8.3%	1.0%	1.12	14.6%	1.15	88%	10.2%	1.26	106%
	SAB	10.0%	6.3%	1.0%	1.07	14.2%	0.79	89%	9.9%	1.10	92%
	SAN	10.0%	13.8%	1.0%	1.21	15.3%	3.71	87%	10.8%	5.11	100%
Switz	CS	12.0%	10.0%	1.0%	1.47	10.7%	20.35	99%	12.3%	16.94	98%
	UBS	13.0%	13.0%	2.5%	1.35	9.9%	18.20	88%	11.6%	14.70	85%
UK	BARC	10.0%	10.1%	1.0%	1.80	14.1%	252.28	92%	14.3%	235.76	95%
	HSBC	10.0%	15.1%	2.5%	1.07	9.0%	899.31	85%	9.9%	699.46	94%
	LLOY	10.0%	12.1%	1.0%	1.74	13.7%	41.84	86%	14.0%	35.44	99%
	RBS	10.0%	10.3%	1.0%	1.69	13.3%	318.74	77%	13.6%	245.66	97%
	STAN	10.0%	14.8%	2.5%	1.23	10.1%	1587.75	88%	10.9%	1336.44	93%

Note: In order to reflect the execution risk of the Emporiki disposal, and despite the fact that CA has received three binding offers, we only give half of the benefit of the removal of Emporiki losses. Removing them fully would have increased upside to 30% and 32% respectively for the normalised and current DCF models, to EUR2.85 and EUR2.88Source: Exane BNP Paribas estimates

European banks sector aggregate

Figure 37: European banks sector aggregate 2006-2014E

P & L HIGHLIGHTS (EURm)	Dec. 06	Dec. 07	Dec. 08	Dec. 09	Dec. 10	Dec. 11	Dec. 12e	Dec. 13e	Dec. 14e
Net interest income	192,759	210,182	257,844	263,691	275,526	276,233	280,110	284,892	293,248
Net fees and commissions	142,328	158,290	139,604	130,138	139,603	138,627	143,673	150,062	154,029
Trading profit	77,262	58,874	(37,643)	58,972	63,221	49,117	64,075	63,877	65,979
Other income	24,927	36,985	27,128	18,036	21,681	24,480	14,551	17,853	19,995
Total Revenues	**437,276**	**464,330**	**386,932**	**470,838**	**500,031**	**488,457**	**502,409**	**516,685**	**533,250**
Personnel costs	(153,806)	(167,167)	(156,038)	(159,502)	(169,111)	(175,733)	(179,945)	(183,627)	(186,744)
Other operating costs	(93,517)	(93,972)	(99,879)	(97,623)	(104,749)	(104,208)	(105,191)	(104,213)	(105,816)
Depreciation and amortisation (excl. goodwill)	(15,255)	(16,142)	(19,192)	(19,177)	(20,679)	(20,307)	(19,988)	(19,439)	(19,498)
Total costs	**(262,579)**	**(277,280)**	**(275,108)**	**(276,302)**	**(294,539)**	**(300,248)**	**(305,124)**	**(307,279)**	**(312,057)**
Operating profit before provisions	**174,697**	**187,050**	**111,824**	**194,536**	**205,492**	**188,208**	**197,284**	**209,406**	**221,194**
Bad debt charge	(30,322)	(41,013)	(94,044)	(145,103)	(97,381)	(90,572)	(92,749)	(78,932)	(70,234)
Other provisions	(1,410)	(2,000)	(3,533)	(2,760)	(2,358)	(3,469)	(1,635)	(1,507)	(1,408)
Associates	3,152	3,201	1,307	1,762	2,577	3,113	4,817	5,052	5,278
Others	5,458	5,934	(2,748)	(77)	(900)	(1,098)	492	691	687
Profit before tax, gdw and exceptionals	**151,576**	**153,172**	**12,806**	**48,358**	**107,430**	**96,181**	**108,208**	**134,709**	**155,518**
Amt of goodwill	(147)	(20)	(23)	0	0	0	0	0	0
Exceptional items	9,169	7,293	(16,432)	11,365	(4,355)	(45,513)	(23,345)	(14,251)	(10,408)
Profit before tax	**160,598**	**160,446**	**(3,650)**	**59,723**	**103,075**	**50,668**	**84,864**	**120,458**	**145,110**
Tax	(42,720)	(35,162)	(851)	(10,969)	(26,261)	(21,605)	(25,555)	(33,143)	(39,489)
Minorities	(9,268)	(10,563)	(5,207)	(6,341)	(6,565)	(6,528)	(6,327)	(7,810)	(8,212)
Net attributable profit (NAP) reported	**108,609**	**114,721**	**(9,708)**	**42,413**	**70,248**	**22,535**	**52,981**	**79,505**	**97,408**
Net attributable profit adjusted	**100,244**	**103,558**	**15,600**	**29,112**	**73,076**	**61,714**	**65,781**	**86,290**	**101,574**
BALANCE SHEET HIGHLIGHTS (EURm)	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Customer Loans	7,335,774	8,336,314	9,519,127	8,988,974	9,466,781	9,441,825	9,782,285	9,893,479	10,119,838
Securities	3,834,422	4,394,930	4,871,880	4,908,327	5,171,189	5,254,993	5,542,952	5,564,915	5,614,634
Intangibles	235,613	267,125	266,294	252,962	262,323	226,253	234,814	234,895	235,555
Other assets	7,091,265	8,970,115	10,350,839	7,021,949	7,665,965	8,761,519	9,751,760	9,807,775	9,883,555
Total assets	18,497,073	21,968,484	25,008,139	21,172,212	22,566,257	23,684,590	25,311,810	25,501,064	25,853,583
Customer Deposits	6,620,929	7,501,713	7,600,437	7,535,518	8,255,890	8,435,524	9,020,746	9,275,241	9,525,581
Shareholder's funds (excl treasury shares)	747,527	792,697	754,466	889,856	993,080	1,017,048	1,123,800	1,182,024	1,257,631
Tangible Book Value	511,914	525,572	488,172	636,893	730,757	790,795	888,986	947,129	1,022,076
KEY DATA (EURm)	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Risk weighted assets (Prevailing regulatory regime)	7,219,144	8,107,416	8,361,419	7,733,147	8,005,966	7,897,843	7,940,642	8,602,055	8,793,077
Risk weighted assets (Basel 3 fully loaded)					7,180,728	8,329,760	8,901,290	8,729,156	8,944,285
Tier one capital	586,060	616,447	723,684	815,056	904,733	910,505	1,017,568	1,070,272	1,142,265
Equity tier 1 capital (Prevailing regulatory regime)	475,830	491,348	542,754	636,041	727,991	780,300	884,123	939,330	1,008,691
Equity tier 1 capital (Basel 3 fully loaded)					524,170	684,398	792,269	856,873	939,813
NPL (Non Performing Loans)	179,245	192,085	310,380	479,130	548,154	556,201			
Funds under management	9,145,022	9,962,156	8,681,702	7,927,222	8,385,755	7,545,140	8,187,510	8,597,851	9,045,600
YOY GROWTH (%)	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Net interest income	11%	9%	23%	2%	4%	0%	1%	2%	3%
Revenues	15%	6%	(17%)	22%	6%	(2%)	3%	3%	3%
Costs	14%	6%	(1%)	0%	7%	2%	2%	1%	2%
Operating profit bef prov.	16%	7%	(40%)	74%	6%	(8%)	5%	6%	6%
Adjusted net attributable profit	8%	3%	(85%)	87%	151%	(16%)	7%	31%	18%
Customer Loans	20%	14%	14%	(6%)	5%	(0%)	4%	1%	2%
Customer Deposits	15%	13%	1%	(1%)	10%	2%	7%	3%	3%
RWA (***)	17%	12%	3%	(8%)	4%	(1%)	1%	8%	2%
FINANCIAL RATIOS (%)	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Net interest margin (avg. tang. assets)	1.13%	1.05%	1.11%	1.15%	1.27%	1.21%	1.15%	1.13%	1.15%
Cost / Income ratio	60.0%	59.7%	71.1%	58.7%	58.9%	61.5%	60.7%	59.5%	58.5%
Costs / avg. tang. Assets	1.53%	1.39%	1.18%	1.21%	1.36%	1.31%	1.26%	1.22%	1.23%
Bad debt charge / average outstanding loans	0.45%	0.52%	1.05%	1.57%	1.06%	0.96%	0.96%	0.80%	0.70%
Bad debt charge / RWA (***)	0.45%	0.54%	1.14%	1.80%	1.24%	1.14%	1.17%	0.95%	0.81%
Tax rate	26.6%	21.9%	23.5%	18.4%	25.5%	42.6%	30.1%	27.5%	27.2%
ROE adjusted	15.3%	13.6%	2.0%	3.6%	7.9%	6.2%	6.2%	7.5%	8.4%
ROTE adjusted	21.4%	20.0%	3.1%	5.2%	10.7%	8.1%	7.8%	9.4%	10.3%
RORWA adjusted (***)	1.50%	1.35%	0.19%	0.36%	0.93%	0.78%	0.83%	1.04%	1.17%
ROTA	0.59%	0.52%	0.07%	0.13%	0.34%	0.27%	0.27%	0.34%	0.40%
Tier one Ratio	8.1%	7.6%	8.7%	10.5%	11.3%	11.5%	12.8%	12.4%	13.0%
Equity tier 1 ratio (Prevailing regulatory regime)	6.6%	6.1%	6.5%	8.2%	9.1%	9.9%	11.1%	10.9%	11.5%
Equity tier 1 ratio (Basel 3 fully loaded)					7.3%	8.2%	8.9%	9.8%	10.5%
Loans / Deposits	111%	111%	125%	119%	115%	112%	108%	107%	106%
RWA (***) / Loans	98%	97%	88%	86%	85%	84%	81%	87%	87%
Loans / Assets	40%	38%	38%	42%	42%	40%	39%	39%	39%
Deposits / Assets	36%	34%	30%	36%	37%	36%	36%	36%	37%
NPL / Outstanding loans (Gross)	2.40%	2.27%	3.20%	5.18%	5.62%	5.72%			
NPL coverage Ratio	74%	72%	60%	53%	52%	52%			

(*) In listing currency, with div. reinvested, (**) also adjusted for am. of intangibles from M&A, or for am. of gwill for pre IFRS years, (***) Based on stated RWA

Data as of 31st August. Source: Exane BNP Paribas estimates

European banks valuation summary

Figure 38: Current European banks valuation

	Market cap						Acc.	P/E		P/TE		ROTE			Div. yield		ET1 % (B3 FL)
	(EURm)	Rec.		Price	12m TP	Upside	Curr.	12E	13E	12E	13E	12E	13E	14E	12E	13E	13E
Austria																	
ERST	6,337	=	€	16.06	18.00	12%	EUR	11.1x	8.1x	0.82x	0.75x	7.8%	9.6%	11.2%	0%	3%	8.8%
RAIFF	5,198	-	€	26.59	27.00	2%	EUR	6.3x	7.5x	0.75x	0.70x	12.4%	9.6%	9.9%	4%	4%	7.5%
Benelux																	
ING	22,979	=	€	6.08	6.20	2%	EUR	7.3x	6.2x	0.47x	0.45x	6.8%	7.4%	7.6%	0%	0%	9.2%
KBC	5,555	=	€	17.29	19.00	10%	EUR	4.1x	4.0x	0.74x	0.69x	18.2%	18.1%	17.1%	1%	4%	5.7%
France																	
BNPP**	43,322		€	34.56	-	-	EUR	6.3x	6.2x	0.71x	0.66x	11.9%	11.0%	11.0%	4%	5%	-
CAGR	11,586	=	€	4.64	4.50	-3%	EUR	17.7x	6.1x	0.46x	0.44x	2.7%	7.4%	8.2%	1%	2%	8.4%
CNAT	6,698	+	€	2.17	2.70	24%	EUR	6.6x	6.4x	0.49x	0.47x	7.9%	7.6%	7.8%	4%	4%	9.5%
SOGN	15,495	+	€	21.05	27.00	28%	EUR	7.5x	5.7x	0.45x	0.41x	6.3%	7.5%	7.9%	0%	4%	9.5%
Germany																	
CBK	7,345	-	€	1.26	1.20	-5%	EUR	10.7x	7.3x	0.35x	0.34x	3.3%	4.7%	7.3%	0%	3%	8.2%
DBK	26,070	=	€	28.28	29.00	3%	EUR	6.8x	5.1x	0.65x	0.59x	10.2%	12.5%	12.3%	3%	3%	7.6%
Italy																	
BMPS	2,620	-	€	0.22	0.19	-15%	EUR	23.0x	8.2x	0.34x	0.33x	1.7%	4.1%	5.4%	0%	0%	8.0%
BP	2,046	+	€	1.16	1.30	12%	EUR	9.8x	8.8x	0.30x	0.29x	3.2%	3.4%	4.7%	3%	4%	8.5%
BPER	1,443	+	€	4.34	6.10	41%	EUR	7.6x	7.5x	0.39x	0.37x	5.3%	5.1%	6.5%	2%	3%	9.2%
BPM	1,327	=	€	0.41	0.45	10%	EUR	14.8x	10.2x	0.40x	0.38x	2.8%	3.8%	5.2%	0%	2%	8.5%
CE	1,124	+	€	3.38	3.80	12%	EUR	11.0x	9.4x	0.68x	0.66x	7.0%	7.2%	7.7%	4%	4%	10.6%
ISP	20,542	+	€	1.25	1.40	12%	EUR	12.7x	10.0x	0.60x	0.58x	4.9%	5.9%	7.4%	4%	4%	10.4%
UBI	2,406	=	€	2.67	2.90	9%	EUR	12.6x	9.7x	0.37x	0.36x	3.1%	3.8%	4.9%	2%	4%	9.4%
UCG	18,225	=	€	3.15	3.40	8%	EUR	16.8x	10.6x	0.39x	0.38x	2.6%	3.7%	5.7%	3%	3%	9.5%
Nordics																	
DANSKE	12,880	-	DKK	103.00	78.00	-24%	DKK	21.2x	15.0x	0.90x	0.85x	4.3%	5.8%	8.1%	0%	0%	10.4%
DnB	14,870	+	NOK	66.60	81.00	22%	NOK	8.5x	8.0x	0.91x	0.84x	11.0%	10.9%	10.8%	4%	4%	12.1%
NDA	29,733	-	SEK	61.25	62.00	1%	EUR	10.7x	10.1x	1.21x	1.11x	11.8%	11.4%	12.4%	3%	3%	11.3%
SEB	13,344	=	SEK	50.70	53.00	5%	SEK	10.3x	9.8x	1.13x	1.06x	11.4%	11.2%	11.3%	4%	4%	13.2%
SHB	17,269	=	SEK	230.90	258.00	12%	SEK	10.8x	10.1x	1.54x	1.43x	15.0%	14.9%	14.9%	5%	5%	13.7%
SWED	15,316	=	SEK	115.90	128.00	10%	SEK	9.6x	9.3x	1.41x	1.31x	15.2%	14.6%	14.4%	5%	5%	14.0%
Spain																	
BBVA	32,686	=	€	6.07	5.70	-6%	EUR	18.7x	8.7x	1.09x	1.02x	6.0%	12.1%	14.3%	7%	7%	10.1%
BKIA	2,843	-	€	1.43	0.30	-79%	EUR	NC	41.0x	1.54x	1.48x	-30.8%	3.7%	6.3%	0%	0%	9.3%
BKT	1,606	-	€	2.99	2.10	-30%	EUR	25.4x	8.9x	0.66x	0.64x	2.5%	7.3%	6.7%	5%	5%	9.8%
BTO	1,663	-	€	2.42	2.30	-5%	EUR	NC	6.5x	0.34x	0.33x	-3.9%	5.2%	8.1%	6%	8%	8.7%
CABK	12,394	-	€	3.03	2.00	-34%	EUR	NS	65.4x	0.68x	0.74x	0.4%	1.2%	7.2%	8%	8%	11.6%
POP	3,712	-	€	1.81	1.30	-28%	EUR	NC	50.3x	0.69x	0.69x	-2.8%	1.4%	8.2%	0%	1%	9.7%
SAB	5,103	-	€	2.30	1.10	-52%	EUR	82.7x	17.8x	0.94x	0.91x	1.3%	5.2%	7.1%	2%	3%	9.5%
SAN	56,045	-	€	5.67	4.30	-24%	EUR	14.3x	9.8x	1.25x	1.17x	8.7%	12.7%	13.4%	5%	5%	9.9%
Switz.																	
CS	24,003	-	CHF	18.44	18.80	2%	CHF	13.9x	7.9x	0.86x	0.77x	5.6%	9.6%	10.1%	4%	4%	10.3%
UBS	32,571	-	CHF	10.68	14.77	38%	CHF	14.6x	7.5x	0.86x	0.84x	5.6%	10.7%	12.2%	1%	5%	12.1%
UK																	
BARC	28,198	+	p	183	240	31%	GBP	5.0x	4.5x	0.47x	0.44x	9.7%	10.4%	10.0%	4%	4%	9.4%
HSBC	125,855	+	p	547	675	23%	USD	9.4x	8.7x	1.19x	1.12x	13.2%	13.4%	14.0%	5%	6%	10.7%
LLOY	28,849	+	p	33	45	35%	GBP	12.9x	6.8x	0.56x	0.54x	4.4%	8.1%	9.2%	0%	3%	9.8%
RBS	31,437	=	p	226	250	10%	GBP	10.0x	8.1x	0.46x	0.44x	4.4%	5.5%	6.8%	0%	0%	10.6%
STAN	42,154	=	p	1392	1550	11%	USD	10.0x	9.6x	1.49x	1.35x	15.6%	14.9%	14.3%	4%	4%	10.7%
Sector	**689,526**					**7%**		**10.4x**	**8.0x**	**0.77x**	**0.73x**	**7.8%**	**9.4%**	**10.3%**	**4%**	**5%**	**9.8%**

*Data as of 31st August. *** BNPP figures based on consensus estimates (not under coverage). Source: Exane BNP Paribas estimates*

Analyst location

As per contact details, analysts are based in the following locations: London, UK for telephone numbers commencing +44; Paris, France +33; Brussels, Belgium +32; Frankfurt, Germany +49; Geneva, Switzerland +41; Madrid, Spain +34; Milan, Italy +39; New York, USA +1; Singapore +65; Stockholm, Sweden +46

Rating definitions

Stock Rating (vs Sector)
Outperform: The stock is expected to outperform the industry large-cap coverage universe over a 12-month investment horizon.
Neutral: The stock is expected to perform in line with the industry large-cap coverage universe over a 12-month investment horizon.
Underperform: The stock is expected to underperform the industry large-cap coverage universe over a 12-month investment horizon.
Under review: The rating of the stock has been placed under review for following important news. Any possible change will be confirmed as soon as possible.
Sector Rating (vs Market)
Outperform: The sector is expected to outperform the STOXX Europe 50 over a 12-month investment horizon.
Neutral: The sector is expected to perform in line with the STOXX Europe 50 over a 12-month investment horizon.
Underperform: The sector is expected to underperform the STOXX Europe 50 over a 12-month investment horizon.
Key ideas
BUY: The stock is expected to deliver an absolute return in excess of 30% over the next two years. Exane BNP Paribas' Key Ideas Buy List comprises selected stocks that meet this criterion.

Distribution of Exane BNP Paribas' equity recommendations

As at 02/07/2012 Exane BNP Paribas covered 606 stocks. The stocks that, for regulatory reasons, are not accorded a rating by Exane BNP Paribas are excluded from these statistics. For regulatory reasons, our ratings of Outperform, Neutral and Underperform correspond respectively to Buy, Hold and Sell; the underlying signification is, however, different as our ratings are relative to the sector.
41% of stocks covered by Exane BNP Paribas were rated Outperform. During the last 12 months, Exane acted as distributor for BNP Paribas on the 1% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering. BNP Paribas provided investment banking services to 6% of the companies accorded this rating*.
38% of stocks covered by Exane BNP Paribas were rated Neutral. During the last 12 months, Exane acted as distributor for BNP Paribas on the 0% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering. BNP Paribas provided investment banking services to 4% of the companies accorded this rating*.
21% of stocks covered by Exane BNP Paribas were rated Underperform. During the last 12 months, Exane acted as distributor for BNP Paribas on the 1% of stocks with this rating for which BNP Paribas acted as manager or co-manager on a public offering. BNP Paribas provided investment banking services to 4% of the companies accorded this rating*.
** Exane is independent from BNP Paribas. Nevertheless, in order to maintain absolute transparency, we include in this category transactions carried out by BNP Paribas independently from Exane. For the purpose of clarity, we have excluded fixed income transactions carried out by BNP Paribas.*

Commitment of transparency on potential conflicts of interest

Complete disclosures, please see www.exane.com/compliance

Exane

Pursuant to Directive 2003/125/CE and NASD Rule 2711(h)

Unless specified, Exane is unaware of significant conflicts of interest with companies mentioned in this report.

Company	Investment banking	Distributor	Liquidity provider	Corporate links	Analyst's personal interest	Equity stake US Law	Equity stake French Law	Amended after disclosure to company	Additional material conflicts
Banca Popolare di Milano	NO	NO	NO	NO	NO	NO	NO	NO	YES
Unicredit	NO	NO	NO	NO	NO	NO	NO	NO	YES

Additional material conflicts
Banca Popolare di Milano: Exane was indirectly interested in the success of Eurosic rights issue (10/2011).
Unicredit: Exane was indirectly interested in the success of Unicredit rights issue announced (11/2011).

Source: Exane

See www.exane.com/disclosureequitiesuk for details

BNP Paribas

Exane is independent of BNP Paribas (BNPP) and the agreement between the two companies is structured to guarantee the independence of Exane's research, published under the brand name "Exane BNP Paribas". Nevertheless, to respect a principle of transparency, we separately identify potential conflicts of interest with BNPP regarding the company/(ies) covered by this research document.

Potential conflicts of interest:
Credit Suisse: As of 31/07/2012 BNPP owns 1,08% of CREDIT SUISSE GROUP AG-REG
Banca Popolare di Milano: BNP acted as Joint-bookrunner for the rights issue (10/2011)
Unicredit: BNP acted as Joint-bookrunner for the rights issue (01/2012)

Source: BNP Paribas

Price at 31 Aug. 12 / 12m Target Price

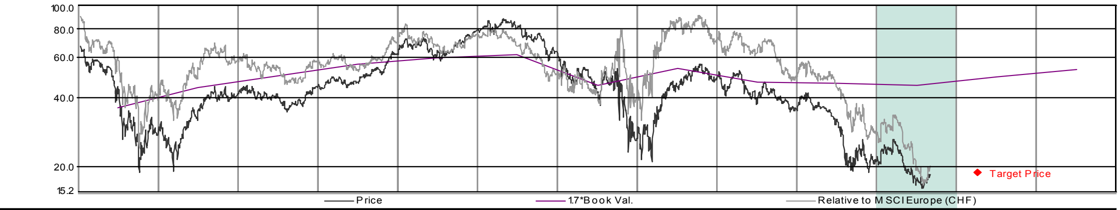
CHF18.4 / CHF18.8 +2%

CREDIT SUISSE (Underperform)

Reuters / Bloomberg: CSGN.VX / CSGN VX Davies (+44) 203 430 8451 & Tiberghien (+44) 203 430 8425

Banks (Outperform) - Switzerland

Company Highlights		CHFm / EURm	
Market capitalisation		28,824 / 24,003	
Free float		28,824 / 24,003	
3m average volume		152 / 127	
Performance (*)	**1m**	**3m**	**12m**
Absolute	11%	0%	(15%)
Rel. Sector	4%	(17%)	(22%)
Rel. MSCI Europe	9%	(10%)	(29%)
12m Hi/Lo (CHF) : 26.2 -30% / 16.0 +15%			
CAGR	**2000/2012**		**2012/2014**
EPS restated (**)	(13%)		42%
Book value	(2%)		8%



Price (yearly avg from Dec. 01 to Dec. 11)	*66.0*	*42.2*	*34.1*	*40.5*	*50.2*	*67.7*	*77.1*	*45.5*	*42.5*	*42.8*	*29.9*	*18.4*	*18.4*	*18.4*
PER SHARE DATA (CHF)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
No of shares year end, basic, (m)	1,188.89	1,230.31	1,195.01	1,213.90	1,247.80	1,214.90	1,162.40	1,184.60	1,169.20	1,186.10	1,220.30	1,563.10	1,630.09	1,665.02
No of shares (avg), diluted, restated for treasury stoc	1,203.45	1,190.21	1,178.60	1,209.40	1,185.70	1,152.30	1,169.05	1,132.30	1,209.85	1,201.15	1,211.05	1,408.38	1,613.24	1,656.18
EPS, company definition	1.32	(2.78)	5.10	3.83	4.93	9.84	6.64	(7.18)	5.56	4.24	1.61	1.61	2.68	3.08
Adjusted EPS, fully diluted	2.15	(2.83)	4.08	3.35	3.90	7.35	6.66	(6.76)	5.13	3.89	1.27	1.33	2.33	2.69
% change	*(69.0%)*	*NS*	*NS*	*(17.9%)*	*16.4%*	*88.6%*	*(9.4%)*	*NS*	*NS*	*(24.2%)*	*(67.3%)*	*4.4%*	*75.0%*	*15.6%*
Book value (BVPS)	30.11	21.59	26.56	29.88	33.75	35.88	37.16	27.27	32.09	28.06	27.59	27.27	29.53	31.79
Tangible BVPS	10.89	6.67	15.29	17.32	20.91	26.41	27.42	19.04	23.88	20.56	20.32	21.55	24.04	26.42
Net dividend	2.00	0.10	0.50	1.50	2.00	2.70	2.50	0.10	2.00	1.30	0.75	0.75	0.75	0.75
STOCKMARKET RATIOS (x)						**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
P / E adjusted	30.7	NC	8.4	12.1	12.9	9.2	11.6	NC	8.3	11.0	23.5	13.9	7.9	6.9
P / E relative to MSCI Europe (%)	123%	NC	60%	92%	104%	72%	82%	NC	61%	96%	197%	121%	78%	74%
P / GOP	16.11	1,433.99	7.07	7.52	8.10	5.43	6.43	NC	6.00	6.95	9.92	7.41	4.82	4.22
P / BVPS	2.19	1.95	1.28	1.35	1.49	1.89	2.08	1.67	1.33	1.53	1.08	0.68	0.62	0.58
P / Tangible BVPS	6.06	6.32	2.23	2.34	2.40	2.56	2.81	2.39	1.78	2.08	1.47	0.86	0.77	0.70
High (x)	7.32	10.11	2.92	2.62	3.04	3.00	3.23	3.28	2.36	2.56	2.06	1.22		
Low (x)	3.77	2.83	1.24	2.00	2.08	2.20	2.10	1.22	0.88	1.68	0.93	0.74		
Net yield (%)	3.0%	0.2%	1.5%	3.7%	4.0%	4.0%	3.2%	0.2%	4.7%	3.0%	2.5%	4.1%	4.1%	4.1%
Payout (%)	93.1%	NC	12.2%	44.8%	51.3%	36.7%	37.5%	NC	39.0%	33.4%	58.9%	56.4%	32.3%	27.9%
Payout on NAP reported (%)	151.7%	NC	9.8%	39.2%	40.5%	27.4%	37.7%	NC	36.0%	30.6%	46.5%	46.7%	28.0%	24.3%
P & L HIGHLIGHTS (CHFm)					**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Net interest income	6,751	8,036	7,434	7,516	6,918	6,566	8,442	8,536	6,891	6,496	6,124	6,241	6,525	6,525
Net fees and commissions	17,845	15,334	12,940	13,323	14,323	17,647	18,929	14,812	13,750	12,961	10,762	10,273	11,435	12,246
Trading profit	9,183	2,254	2,515	3,675	5,634	9,428	6,147	(9,880)	12,151	11,454	8,113	10,132	10,355	10,873
Other income	6,300	3,312	4,621	2,519	3,614	4,962	5,805	(4,113)	502	475	1,226	(2,102)	(1,160)	(572)
Total Revenues	**40,079**	**28,936**	**27,510**	**27,033**	**30,489**	**38,603**	**39,323**	**9,355**	**33,294**	**31,386**	**26,225**	**24,545**	**27,156**	**29,072**
Personnel costs	(21,890)	(16,910)	(13,630)	(12,951)	(13,974)	(15,697)	(16,098)	(13,254)	(15,013)	(14,568)	(13,213)	(12,681)	(12,622)	(13,242)
Other operating costs	(13,256)	(9,818)	(6,312)	(6,548)	(8,292)	(7,703)	(8,356)	(9,195)	(8,679)	(8,295)	(8,365)	(7,362)	(7,357)	(7,598)
Depreciation and amortisation (excl. goodwill)	0	(2,173)	(1,887)	(1,026)	(869)	(831)	(856)	(871)	(1,019)	(1,115)	(999)	(999)	(999)	(999)
Total costs	**(35,146)**	**(28,901)**	**(21,829)**	**(20,525)**	**(23,135)**	**(24,231)**	**(25,310)**	**(23,320)**	**(24,711)**	**(23,978)**	**(22,577)**	**(21,042)**	**(20,978)**	**(21,839)**
Operating profit before provisions	**4,933**	**35**	**5,681**	**6,508**	**7,354**	**14,372**	**14,013**	**(13,965)**	**8,583**	**7,408**	**3,648**	**3,503**	**6,177**	**7,233**
Bad debt charge	(1,634)	(2,822)	(592)	(83)	144	121	(240)	(813)	(506)	79	(187)	(171)	(228)	(235)
Other provisions	0	0	0	0	0	0	0	0	0	0				
Associates	0	0	0	0	0	0	0	0	0	0				
Others	0	0	0	0	0	0	0	0	0	0				
Profit before tax, gdw and exceptionals	**3,299**	**(2,787)**	**5,089**	**6,425**	**7,498**	**14,493**	**13,773**	**(14,778)**	**8,077**	**7,487**	**3,461**	**3,332**	**5,949**	**6,998**
Amt of goodwill	(770)	(806)	(593)	(56)	(97)	(183)	(32)	(37)	0	0	0	0	0	0
Exceptional items	(229)	863	1,791	632	1,324	3,046	6	(531)	169	(19)	0	0	0	0
Profit before tax	**2,300**	**(2,730)**	**6,287**	**7,001**	**8,725**	**17,356**	**13,747**	**(15,346)**	**8,246**	**7,468**	**3,461**	**3,332**	**5,949**	**6,998**
Tax	(486)	(596)	(154)	(1,293)	(927)	(2,389)	(1,248)	4,596	(1,835)	(1,548)	(671)	(786)	(1,467)	(1,729)
Minorities	(227)	17	(124)	(1,080)	(1,948)	(3,630)	(4,738)	2,619	313	(822)	(837)	(284)	(164)	(164)
Net attributable profit (NAP) reported	**1,587**	**(3,309)**	**6,009**	**4,628**	**5,850**	**11,337**	**7,761**	**(8,131)**	**6,724**	**5,098**	**1,953**	**2,262**	**4,318**	**5,104**
Net attributable profit adjusted	**2,586**	**(3,366)**	**4,811**	**4,052**	**4,623**	**8,474**	**7,786**	**(7,650)**	**6,204**	**4,670**	**1,542**	**1,871**	**3,751**	**4,451**
BALANCE SHEET HIGHLIGHTS (CHFm)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Customer Loans	278,806	277,039	268,700	184,399	205,671	208,127	240,534	235,797	237,180	218,842	233,413	239,164	239,164	239,164
Securities	168,597	161,844	171,536	100,365	121,565	21,394	15,731	13,823	11,232	8,397	8,397	8,397	8,397	8,397
Intangibles	22,850	18,359	13,467	15,253	16,023	11,499	11,326	9,753	9,595	8,897	8,879	8,943	8,943	8,943
Other assets	552,260	496,464	635,782	789,468	995,793	1,014,936	1,093,089	910,997	773,420	795,869	798,476	1,632,375	1,631,788	1,631,097
Total assets	1,022,513	953,706	1,089,485	1,089,485	1,339,052	1,255,956	1,360,680	1,170,370	1,031,427	1,032,005	1,049,165	1,888,879	1,888,292	1,887,601
Customer Deposits	636,231	585,867	592,789	299,341	364,238	388,378	426,369	355,169	322,908	325,057	313,401	312,683	312,683	312,683
Shareholder's funds (excl treasury shares)	35,800	26,566	31,736	36,273	42,118	43,586	43,199	32,302	37,517	33,282	33,674	42,620	48,138	52,930
Tangible Book Value	12,950	8,207	18,269	21,020	26,095	32,087	31,873	22,549	27,922	24,385	24,795	33,677	39,195	43,987
KEY DATA (CHFm)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Risk weighted assets (Prevailing regulatory regime)	222,874	196,486	190,761	199,249	232,891	253,676	312,068	257,467	221,609	218,702	241,753	229,001	314,199	318,278
Risk weighted assets (Basel 3 fully loaded)									311609	308702	339000	309,001	314,199	318,278
Tier one capital	21,155	17,613	22,287	24,596	26,348	35,147	34,737	34,208	36,207	37,725	36,844	45,439	51,259	56,051
Equity tier 1 capital (Prevailing regulatory regime)	19,079	15,451	20,118	22,478	24,178	32,980	30,601	22,068	24,009	26,627	25,956	36,959	44,352	43,987
Equity tier 1 capital (Basel 3 fully loaded)									19441	21919	17647	26,249	32,353	37,837
NPL (Non Performing Loans)	13,868	12,369	7,207	4,672	3,319	2,131	1,946	2,725	3,134	2,507	2,406	2,302	2,254	2,217
Funds under management	1,425,000	1,295,300	1,260,000	1,068,000	1,319,400	1,485,100	1,462,800	1,069,400	1,229,000	1,253,000	1,223,300	1,287,142	1,394,532	1,516,075
Employees (year end)	79,699	78,457	60,837	41,200	44,600	44,900	48,100	47,800	47,600	50,100	49,700	49,700	49,700	49,700
YOY GROWTH (%)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Net interest income	27%	19%	(7%)	1%	(8%)	(5%)	29%	1%	(19%)	(6%)	(6%)	2%	5%	0%
Revenues	9%	(28%)	(5%)	(2%)	13%	27%	2%	(76%)	256%	(6%)	(16%)	(6%)	11%	7%
Costs	32%	(18%)	(24%)	(6%)	13%	5%	4%	(8%)	6%	(3%)	(6%)	(7%)	(0%)	4%
Operating profit bef prov.	(52%)	(99%)	16131%	15%	13%	95%	(2%)	NC	NC	(14%)	(51%)	(4%)	76%	17%
Adjusted net attributable profit	(67%)	NC	NC	(16%)	14%	83%	(8%)	NC	NC	(25%)	(67%)	21%	100%	19%
Customer Loans	17%	(1%)	(3%)	(31%)	12%	1%	16%	(2%)	1%	(8%)	7%	2%	0%	0%
Customer Deposits	4%	(8%)	1%	(50%)	22%	7%	10%	(17%)	(9%)	1%	(4%)	(0%)	0%	0%
RWA (***)	(7%)	(12%)	(3%)	4%	17%	9%	23%	(17%)	(14%)	(1%)	11%	(5%)	37%	1%
FINANCIAL RATIOS (%)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Net interest margin (avg. tang. assets)	0.69%	0.83%	0.74%	0.70%	0.58%	0.51%	0.65%	0.68%	0.63%	0.64%	0.59%	0.43%	0.35%	0.35%
Cost / Income ratio	87.7%	99.9%	79.3%	75.9%	75.9%	62.8%	64.4%	249.3%	74.2%	76.4%	86.1%	85.7%	77.3%	75.1%
Costs / avg. tang. Assets	3.58%	2.99%	2.17%	1.91%	1.93%	1.89%	1.95%	1.86%	2.26%	2.35%	2.19%	1.44%	1.12%	1.16%
Bad debt charge / average outstanding loans	0.63%	1.02%	0.22%	0.04%	0.07%	0.06%	0.11%	0.34%	0.21%	0.03%	0.08%	0.07%	0.10%	0.10%
Bad debt charge / RWA (***)	0.71%	1.35%	0.31%	0.04%	(0.07%)	(0.05%)	0.08%	0.29%	0.21%	(0.04%)	0.08%	0.07%	0.08%	0.07%
Tax rate	15.8%	31.0%	2.2%	18.3%	10.5%	13.6%	9.1%	30.0%	22.3%	20.7%	19.4%	23.6%	24.7%	24.7%
ROE adjusted	6.7%	(10.8%)	16.5%	11.9%	11.8%	19.8%	17.9%	(20.3%)	17.8%	13.2%	4.6%	4.9%	8.3%	8.8%
ROTE adjusted	16.9%	(31.8%)	36.3%	20.6%	19.6%	29.1%	24.3%	(28.1%)	24.6%	17.9%	6.3%	6.4%	10.3%	10.7%
RORWA adjusted (***)	1.12%	(1.61%)	2.48%	2.08%	2.14%	3.48%	2.75%	(2.69%)	2.59%	2.12%	0.67%	0.80%	1.38%	1.41%
ROTA	0.26%	(0.35%)	0.48%	0.38%	0.39%	0.66%	0.60%	(0.61%)	0.57%	0.46%	0.15%	0.13%	0.20%	0.24%
Tier one Ratio	9.5%	9.0%	11.7%	12.3%	11.3%	13.9%	11.1%	13.3%	16.3%	17.2%	15.2%	19.8%	16.3%	17.6%
Equity tier 1 ratio (Prevailing regulatory regime)	8.6%	7.9%	10.5%	11.3%	10.4%	13.0%	9.8%	8.6%	10.8%	12.2%	10.7%	16.1%	14.1%	13.8%
Equity tier 1 ratio (Basel 3 fully loaded)									6.2%	7.1%	5.2%	8.5%	10.3%	11.9%
Loans / Deposits	44%	47%	45%	62%	56%	54%	56%	66%	73%	67%	74%	76%	76%	76%
RWA (***) / Loans	80%	71%	71%	108%	113%	122%	130%	109%	93%	100%	104%	96%	131%	133%
Loans / Assets	27%	29%	25%	17%	15%	17%	18%	20%	23%	21%	22%	13%	13%	13%
Deposits / Assets	62%	61%	54%	27%	27%	31%	31%	30%	31%	31%	30%	17%	17%	17%
NPL / Outstanding loans (Gross)	5%	4%	3%	3%	2%	1%	1%	1%	1%	1%	1%	1%	1%	1%
NPL coverage Ratio	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	NC	NC	NC	NC

Latest Model update: 21 Aug. 12

(*) In listing currency, with div. reinvested, (**) also adjusted for am. of intangibles from M&A, or for am. of gwill for pre IFRS years, (***) Based on stated RWA

EXANE BNP PARIBAS

Price at 31 Aug. 12 / 12m Target Price
CHF10.7 / CHF14.7 +38%

UBS AG (Outperform)

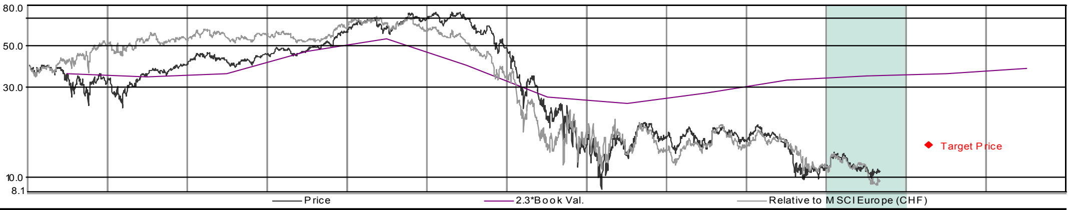
Reuters / Bloomberg: UBSN.VX / UBSN VX   Davies (+44) 203 430 8451 & Tiberghien (+44) 203 430 8425   Banks (Outperform) - Switzerland

Company Highlights	CHFm / EURm	
Market capitalisation	39,112 / 32,567	
Free float	39,112 / 32,567	
3m average volume	112 / 93	

Performance (*)	1m	3m	12m
Absolute	4%	(2%)	(8%)
Rel. Sector	(3%)	(19%)	(16%)
Rel. MSCI Europe	2%	(13%)	(23%)

12m Hi/Lo (CHF) : 13.5 -21% / 9.7 +11%

CAGR	2000/2012	2012/2014
EPS restated (**)	(11%)	51%
Book value	(1%)	5%



Price (yearly avg from Dec. 01 to Dec. 11)	38.8	34.3	33.9	42.3	49.2	65.8	64.3	25.5	15.3	16.3	14.1	10.7	10.7	10.7
PER SHARE DATA (CHF)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
No of shares year end, basic, (m)	2,563.43	2,512.60	2,366.09	2,253.72	2,177.27	2,105.27	2,073.55	2,932.57	3,830.10	3,830.84	3,747.17	3,747.17	3,747.17	3,747.17
No of shares (avg), diluted, restated for treasury stoc	2,577.15	2,446.77	2,277.60	2,163.92	2,097.19	2,058.83	1,929.52	2,770.83	3,821.24	3,838.33	3,815.00	3,815.00	3,815.00	3,815.00
EPS, company definition	1.93	1.44	2.80	4.15	6.69	5.60	(2.72)	(7.48)	(0.37)	1.96	1.09	0.73	1.42	1.67
Adjusted EPS, fully diluted	2.44	2.06	3.22	4.14	4.85	5.28	(2.78)	(7.66)	(0.71)	1.87	1.11	0.73	1.42	1.67
% change	*(20.8%)*	*(15.6%)*	*56.1%*	*28.6%*	*17.3%*	*8.9%*	*NS*	*(175.2%)*	*90.7%*	*NS*	*(40.5%)*	*(34.0%)*	*94.4%*	*17.5%*
Book value (BVPS)	16.98	15.52	14.92	15.52	20.36	23.60	17.16	11.63	10.71	12.21	14.29	15.08	15.36	16.56
Tangible BVPS	9.54	10.07	10.05	10.13	14.16	16.58	10.15	7.22	7.83	9.64	11.70	12.47	12.68	13.77
Net dividend	1.60	1.00	1.30	1.50	1.60	2.20	2.20	0.00	0.00	0.00	0.10	0.10	0.50	0.50
STOCKMARKET RATIOS (x)						**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
P / E adjusted	15.9	16.6	10.5	10.2	10.1	12.5	NC	NC	NC	8.7	12.7	14.6	7.5	6.4
P / E relative to MSCI Europe (%)	63%	78%	75%	78%	82%	97%	NC	NC	NC	76%	106%	127%	74%	69%
P / GOP	11.71	13.62	9.12	8.81	8.14	9.71	NC	NC	98.12	8.30	9.87	9.36	5.50	4.76
P / BVPS	2.29	2.21	2.27	2.73	2.42	2.79	3.75	2.19	1.42	1.33	0.98	0.71	0.70	0.64
P / Tangible BVPS	4.07	3.41	3.37	4.18	3.47	3.97	6.34	3.53	1.95	1.69	1.20	0.86	0.84	0.78
High (x)	4.74	3.91	3.97	4.53	4.19	4.49	7.36	6.60	2.49	1.92	1.62	1.08		
Low (x)	3.04	2.37	2.31	3.76	3.08	3.43	4.43	1.56	1.09	1.39	0.83	0.79		
Net yield (%)	4.1%	2.9%	3.8%	3.5%	3.3%	3.3%	3.4%	0.0%	0.0%	0.0%	0.7%	0.9%	4.7%	4.7%
Payout (%)	65.5%	48.5%	40.4%	36.3%	33.0%	41.6%	NC				9.0%	13.6%	35.1%	29.9%
Payout on NAP reported (%)	82.9%	69.3%	46.4%	36.1%	23.9%	39.3%	NC	(0.0%)	(0.0%)		9.2%	13.6%	35.1%	29.9%
P & L HIGHLIGHTS (CHFm)					**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Net interest income	8,041	10,545	12,299	11,860	9,528	6,521	5,337	5,992	6,446	8,454	7,729	7,782	7,582	7,471
Net fees and commissions	20,211	18,221	17,345	19,416	21,436	25,456	30,634	22,929	17,711	17,160	17,288	20,267	21,924	23,710
Trading profit	8,802	5,451	3,883	4,972	7,996	13,743	(8,353)	(25,820)	(324)	(425)	4,572	5,680	6,431	6,684
Other income	558	4	561	4,545	11,640	1,608	4,341	692	600	6,872	(1,716)	(7,119)	(4,904)	(4,723)
Total Revenues	**37,612**	**34,221**	**34,088**	**40,793**	**50,600**	**47,328**	**31,959**	**3,793**	**24,433**	**32,061**	**27,872**	**26,610**	**31,034**	**33,142**
Personnel costs	(19,828)	(18,524)	(17,231)	(18,515)	(21,049)	(24,031)	(25,515)	(16,261)	(16,920)	(16,920)	(15,591)	(15,289)	(16,438)	(17,296)
Other operating costs	(7,631)	(9,532)	(6,086)	(9,564)	(15,050)	(7,942)	(8,429)	(10,498)	(5,871)	(6,585)	(5,813)	(5,932)	(6,152)	(6,249)
Depreciation and amortisation (excl. goodwill)	(1,614)	0	(2,307)	(2,316)	(1,827)	(1,392)	(1,519)	(1,241)	(1,048)	(1,035)	(1,035)	(1,035)	(1,035)	(1,035)
Total costs	**(29,073)**	**(28,056)**	**(25,624)**	**(30,395)**	**(37,926)**	**(33,365)**	**(35,463)**	**(28,000)**	**(23,839)**	**(24,540)**	**(22,439)**	**(22,256)**	**(23,626)**	**(24,580)**
Operating profit before provisions	**8,539**	**6,165**	**8,464**	**10,398**	**12,674**	**13,963**	**(3,504)**	**(24,207)**	**594**	**7,521**	**5,433**	**4,354**	**7,408**	**8,562**
Bad debt charge	(498)	(115)	(116)	276	375	156	(236)	(2,996)	(1,832)	(66)	(84)	(53)	(180)	(182)
Other provisions	0	0	0	0	0	0	0	0	0	0				
Associates	0	0	0	0	0	0	0	0	0	0				
Others	0	0	0	0	0	0	0	0	0	0				
Profit before tax, gdw and exceptionals	**8,041**	**6,050**	**8,348**	**10,674**	**13,049**	**14,119**	**(3,740)**	**(27,203)**	**(1,238)**	**7,455**	**5,349**	**4,300**	**7,229**	**8,379**
Amt of goodwill	(1,323)	(1,514)	0	0	0	-	-	-	-	-	-	-	-	-
Exceptional items	0	0	0	0	4,688	888	145	198	(7)	2	0	0	0	0
Profit before tax	**6,718**	**4,536**	**8,348**	**10,674**	**17,737**	**15,007**	**(3,595)**	**(27,005)**	**(1,245)**	**7,457**	**5,349**	**4,300**	**7,229**	**8,379**
Tax	(1,401)	(676)	(1,618)	(2,135)	(3,047)	(2,987)	(1,111)	6,836	443	380	(923)	(1,231)	(1,590)	(1,843)
Minorities	(344)	(331)	(345)	450	(661)	(493)	(539)	(569)	(610)	(304)	(268)	(274)	(206)	(154)
Net attributable profit (NAP) reported	**4,973**	**3,529**	**6,385**	**8,989**	**14,029**	**11,527**	**(5,245)**	**(20,738)**	**(1,412)**	**7,533**	**4,158**	**2,795**	**5,433**	**6,382**
Net attributable profit adjusted	**6,296**	**5,043**	**7,328**	**8,953**	**10,178**	**10,879**	**(5,372)**	**(21,228)**	**(2,720)**	**7,161**	**4,233**	**2,795**	**5,433**	**6,382**
BALANCE SHEET HIGHLIGHTS (CHFm)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Customer Loans	226,545	211,647	212,679	232,387	269,969	312,521	335,864	340,308	306,828	262,877	266,604	274,489	274,489	285,634
Securities	29,500	9,096	6,755	7,476	9,507	10,460	6,945	6,140	82,627	75,558	53,174	54,161	55,249	57,493
Intangibles	19,085	13,696	11,529	12,149	13,486	14,773	14,538	12,935	11,008	9,822	9,695	9,754	10,050	10,458
Other assets	978,167	946,679	1,319,093	1,482,772	1,767,288	2,058,757	1,915,232	1,656,166	940,074	968,964	1,089,840	966,972	951,421	938,380
Total assets	1,253,297	1,181,118	1,550,056	1,734,784	2,060,250	2,396,511	2,272,579	2,015,549	1,340,537	1,317,221	1,419,313	1,305,376	1,291,209	1,291,965
Customer Deposits	333,781	306,876	346,633	376,083	451,533	570,565	641,892	474,774	410,475	332,301	342,409	361,783	361,783	361,783
Shareholder's funds (excl treasury shares)	43,530	38,991	35,310	34,978	44,324	49,686	35,585	34,114	41,014	46,759	53,551	56,492	57,551	62,059
Tangible Book Value	24,445	25,295	23,781	22,829	30,838	34,913	21,047	21,179	30,006	36,937	43,856	46,738	47,501	51,601
KEY DATA (CHFm)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Risk weighted assets (Prevailing regulatory regime)	253,735	238,790	251,901	264,125	310,409	341,892	372,298	302,273	206,525	198,875	227,200	195,908	298,222	276,978
Risk weighted assets (Basel 3 fully loaded)									206500	415900	367200	330,908	283,222	276,978
Tier one capital	29,322	27,047	29,765	31,051	39,943	40,528	32,811	33,371	31,795	35,272	38,449	43,253	45,599	49,785
Equity tier 1 capital (Prevailing regulatory regime)	25,474	23,865	26,541	28,088	36,980	34,895	26,424	25,978	24,538	30,369	34,093	38,811	41,071	45,171
Equity tier 1 capital (Basel 3 fully loaded)									15706	20899	25583	30,111	34,167	38,675
NPL (Non Performing Loans)	8,639	6,029	4,901	3,696	2,363	1,918	2,163	9,145	3,799	4,495	3,941	3,480	2,908	2,389
Funds under management	2,448,000	2,037,000	2,209,000	2,250,000	2,652,000	2,123,000	3,189,000	2,174,000	2,233,000	2,151,000	2,167,000	2,540,436	2,748,213	2,971,988
Employees (year end)	69,985	69,985	69,985	69,985	69,569	78,140	83,560	77,783	65,233	64,617	64,821	81,176	81,819	82,724
YOY GROWTH (%)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Net interest income	(2%)	31%	17%	(4%)	(20%)	(32%)	(18%)	12%	8%	31%	(9%)	1%	(3%)	(1%)
Revenues	3%	(9%)	(0%)	20%	24%	(6%)	(32%)	(88%)	544%	31%	(13%)	(5%)	17%	7%
Costs	10%	(3%)	(9%)	19%	25%	(12%)	6%	(21%)	(15%)	3%	(9%)	(1%)	6%	4%
Operating profit bef prov.	(13%)	(28%)	37%	23%	22%	10%	NC	(591%)	NC	1166%	(28%)	(20%)	70%	16%
Adjusted net attributable profit	(17%)	(20%)	45%	22%	14%	7%	NC	(295%)	87%	NC	(41%)	(34%)	94%	17%
Customer Loans	(7%)	(7%)	0%	9%	16%	16%	7%	1%	(10%)	(14%)	1%	3%	0%	4%
Customer Deposits	7%	(8%)	13%	8%	20%	26%	13%	(26%)	(14%)	(19%)	3%	6%	0%	0%
RWA (***)	(7%)	(6%)	5%	5%	18%	10%	9%	(19%)	(32%)	(4%)	14%	(14%)	52%	(7%)
FINANCIAL RATIOS (%)	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**Dec. 06**	**Dec. 07**	**Dec. 08**	**Dec. 09**	**Dec. 10**	**Dec. 11**	**Dec. 12e**	**Dec. 13e**	**Dec. 14e**
Net interest margin (avg. tang. assets)	0.70%	0.88%	0.91%	0.73%	0.51%	0.29%	0.23%	0.28%	0.39%	0.64%	0.57%	0.58%	0.59%	0.58%
Cost / Income ratio	77.3%	82.0%	75.2%	74.5%	75.0%	70.5%	111.0%	738.2%	97.6%	76.5%	80.5%	83.6%	76.1%	74.2%
Costs / avg. tang. Assets	2.53%	2.34%	1.89%	1.86%	2.01%	1.51%	1.53%	1.31%	1.43%	1.86%	1.65%	1.65%	1.83%	1.92%
Bad debt charge / average outstanding loans	0.21%	0.05%	0.05%	0.12%	0.15%	0.05%	0.07%	0.89%	0.57%	0.02%	0.03%	0.02%	0.07%	0.07%
Bad debt charge / RWA (***)	0.19%	0.05%	0.05%	(0.11%)	(0.13%)	(0.05%)	0.07%	0.89%	0.72%	0.03%	0.04%	0.03%	0.07%	0.06%
Tax rate	17.4%	11.2%	19.4%	20.0%	17.2%	19.9%	30.9%	25.3%	35.6%	5.1%	17.3%	28.6%	22.0%	22.0%
ROE adjusted	15.0%	11.8%	18.7%	24.8%	27.2%	25.1%	(12.0%)	(54.8%)	(7.5%)	17.6%	8.3%	4.7%	9.0%	10.2%
ROTE adjusted	25.3%	20.3%	29.9%	38.4%	37.9%	33.1%	(19.2%)	(100.5%)	(10.6%)	21.4%	10.5%	6.2%	11.5%	12.9%
RORWA adjusted (***)	2.39%	2.05%	2.99%	3.47%	3.54%	3.34%	(1.50%)	(6.29%)	(1.07%)	3.53%	1.99%	1.32%	2.20%	2.22%
ROTA	0.55%	0.42%	0.54%	0.55%	0.54%	0.49%	(0.23%)	(1.00%)	(0.16%)	0.54%	0.31%	0.21%	0.42%	0.50%
Tier one Ratio	11.6%	11.3%	11.8%	11.8%	12.9%	11.9%	8.8%	11.0%	15.4%	17.7%	16.9%	22.1%	15.3%	18.0%
Equity tier 1 ratio (Prevailing regulatory regime)	10.0%	10.0%	10.5%	10.6%	11.9%	10.2%	7.1%	8.6%	11.9%	15.3%	15.0%	19.8%	13.8%	16.3%
Equity tier 1 ratio (Basel 3 fully loaded)									7.6%	5.0%	7.0%	9.1%	12.1%	14.0%
Loans / Deposits	68%	69%	61%	62%	60%	55%	52%	72%	75%	79%	78%	76%	76%	79%
RWA (***) / Loans	112%	113%	118%	114%	115%	109%	111%	89%	67%	76%	85%	71%	109%	97%
Loans / Assets	18%	18%	14%	13%	13%	13%	15%	17%	23%	20%	19%	21%	21%	22%
Deposits / Assets	27%	26%	22%	22%	22%	24%	28%	24%	31%	25%	24%	28%	28%	28%
NPL / Outstanding loans (Gross)	4%	3%	2%	2%	1%	1%	1%	3%	1%	2%	1%	1%	1%	1%
NPL coverage Ratio	92%	87%	81%	78%	75%	69%	56%	42%	140%	111%	127%	144%	172%	210%

Latest Model update: 04 Sep. 12

(*) In listing currency, with div. reinvested, (**) also adjusted for am. of intangibles from M&A, or for am. of gwill for pre IFRS years, (***) Based on stated RWA

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