

Change in recommendation

Banks

Banca Monte Paschi Siena

A strongly dilutive M&A commitment

Italy

Previously: Sell

Hold

This company note is an extract from European Banks: 2008 a challenging year (9/1/08) available from research.ing.com or your sales contact.

07/01/08

Maintained

Reuters: **BMPS.MI**

Price: €3.44

12-mth target: €3.73

- Strategically valid, Banca AntonVeneta's acquisition should dilute 2010F EPS by 11%, while partial restoration of solvency ratios will hang on a €5bn right issue and the success of €2bn in asset sales.
- Given the poor stock performance, we upgrade our rating from Sell to HOLD, with an unchanged TP of €3.73, though uncertainties on the final effects of the acquisition on both future profitability and solidity might continue to penalise the stock versus peers.

An industrially-valid but EPS-dilutive acquisition. Monte Paschi Siena announced the acquisition of AntonVeneta, the seventh-largest Italian bank with some 1,000 branches and a 3% market share (versus Monte Paschi Siena's current 6%), from Santander. The deal has a strong strategic rationale, as it allows Monte Paschi Siena to expand its branch network by almost 50% and gain a presence in areas where it is weak; namely, to add 8% market share in Veneto, 7% in Friuli, 6% in Sicily and 3% in both Lazio and Emilia Romagna. The price of €9.0bn values AntonVeneta at the top of the M&A valuation range in the sector, ie, a 2008F PER of 17.2x, 2008F PBV of 2.5x and €9m per branch, with a premium of >50% on Italian banks' secondary market multiples. Assuming: (1) a rights issue of €5.0bn at €3.5 per share (1.4bn new shares); (2) €4bn of bond issues and asset sales at a 6.0% cost; and (3) €598m of net profit at AntonVeneta in 2010F (below the €700m management target for 2009, due to a more cautious stance on the achievement of revenue synergies), from the deal we estimate adjusted EPS dilution in 2010F of 11% to €0.39.

A challenging restoration of solvency ratios. In reality, the most problematic aspect is the size of the deal's cash payment, since Monte Paschi Siena's core Tier 1 capital is estimated at €7.0bn in 2007F. That means that the bank will be forced to fund the acquisition predominantly via a rights issue, indicated by management of €5bn, a figure that nonetheless should be barely sufficient to set a 2008F core Tier 1 ratio of 4.3%, versus 6.8% expected for Monte Paschi Siena on a standalone basis. Thus, the restoration of solvency ratios close to a safer figure of 5.5% for that year will leverage chiefly on the success of €2bn asset sales, while the remaining €2bn for the payment should come from bond issues. We think that in these conditions a bank's credit rating downgrade is likely, with a consequent rise in its cost of funding in an already expensive market for the borrowers.

Upgrade to HOLD, but we favour other stocks. After a 31% collapse in the stock price since July and a 16% underperformance versus the European Banks index in the period, Monte Paschi is now trading below our unchanged LEFAC*-derived TP of €3.73, and therefore we upgrade our rating from Sell to **HOLD**. The stock is currently trading at a 2008F adjusted PER of 11.6x on our earnings estimates, inclusive of Banca AntonVeneta's acquisition, ie, with a 10% premium to the Italian banks' average 2008F adjusted PER of 10.6x. In the domestic banking sector, we therefore continue to favour stocks with either higher upside potential or with more visibly solid capital ratios than Monte Paschi Siena.

12-month forecast returns (%)	
Share price	8.4
Dividend	4.9
12m f'cst total return	13.3

Forecasts and ratios		
Yr to Dec (€m)	2006	2007F
Total income	4,756.7	4,783.5
Net operating income	1,849.8	1,908.1
Net income	909.8	1,156.6
Adj EPS (€)	0.29	0.30
DPS (€)	0.2	0.2
Adj PER (x)	12.0	11.6
Dividend yield (%)	0.0	0.0
P/BVPS (x)	0.0	0.0
ROE (%)	12.1	13.8

Share data	
No. of shares (m)	3,029.5
Daily turnover (shares)	10,308,700
Free float (%)	32.7
BVPS (€)	2.6
Market cap (€m)	10,409



Roberto Marchesi

Milan + 39 02 89629 3625

roberto.marchesi@ing.it

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SEE THE DISCLOSURES APPENDIX FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATION

Company profile

History

Monte Paschi Siena was founded in 1472 and is considered the oldest bank in the world. Up to the early 1990s, the bank acquired several retail banks based in Tuscany, including Banca Toscana, and thus became the market leader in the region. The acquisition of Banca Agricola Mantovana and Banca del Salento in 1999 added exposure to Northern and Southern Italy, respectively. More recently, the bank announced the acquisition of Banca AntonVeneta from Santander, expected to be finalised in early 2008.

Business profile

Monte Paschi Siena is the sixth-largest Italian bank in terms of network size, comprising c.2,000 branches, with a national market share of 6%, to serve 4.5m clients. It enjoys a particularly strong market position in Tuscany, with a 25% market share, where almost one-third of its network is concentrated. The bank's presence is instead decidedly modest in all of the Northern Italian regions, where its market share rarely exceeds 3%.

Banca AntonVeneta will add to the existing network some 1,000 branches and a 3% national market share, with a concentration especially in Veneto (291 branches, 8% market share) and in Friuli (66 branches, 7% market share), plus an interesting presence also in Lombardy, Lazio, Emilia Romagna and Sicily.

It has split its operations into four main divisions: Retail, Private, Corporate and Investment Banking, though the distribution model remains based on the group's three commercial banks, Banca Monte Paschi Siena, Banca Toscana and Banca Agricola Mantovana. Distribution also depends on 1,200 advisors of MPS Banca Personale. The retail banking business contributes c.45% of consolidated operating profit, private banking a mere 5%, corporate banking a sizeable 35% and investment banking c.20%, with the difference to 100% made up by the corporate centre and other minor businesses. As for manufacturing platforms, the group leverages on the corporate bank MPS Banca Impresa, on MPS Leasing&Factoring, while consumer credit is run by Consumit, asset management by MPS AM Sgr and life insurance by MPS Vita, in a JV with Axa. Support functions are concentrated in specialised companies MPS Gestione Crediti for credit recovery and Consorzio Operativo for IT systems.

Risks

Monte Paschi Siena incurs all the risks of the banking business, connected mainly to a possible downturn in the economic cycle, a deterioration in client solvency and to interest rate changes, in addition to operational risks. Moreover, the ongoing acquisition of Banca AntonVeneta for €9bn will require a right issue of €5bn to restore a core Tier 1 ratio just above 4%, whereas additional improvements in solvency indices remain linked to the success of assets sales and the issue of hybrid capital instruments. A downgrade in the bank's credit ranking seems thus plausible.

* LEFAC is ING's proprietary valuation methodology that is used primarily to calculate the company-specific risk premium. It is based on assigning scores for stock liquidity (L), earnings quality (E), franchise/strategy (F), asset quality (A) and capital adequacy (C).

Financials

Yr to Dec (€m)	2006	2007F	2008F	2009F
Net interest income	2,714.2	2,882.6	3,224.7	3,468.9
Net fees and commissions	1,490.6	1,542.3	1,651.1	1,747.5
Trading profit	523.4	325.0	240.0	240.0
Insurance profit	0.0	0.0	0.0	0.0
Other operating income	28.5	33.6	38.6	38.6
Total income	4,756.7	4,783.5	5,154.4	5,495.1
% of average total assets	3.0	2.9	2.9	3.0
Total operating costs	(2,906.9)	(2,875.4)	(2,920.5)	(2,956.8)
% of average total assets	1.9	1.8	1.7	1.6
% of total income	61.1	60.1	56.7	53.8
Net operating income	1,849.8	1,908.1	2,233.9	2,538.3
Provisions	(582.3)	(1,105.3)	(554.3)	(591.4)
Operating profit	1,267.5	802.8	1,679.6	1,946.9
Associates	15.3	55.8	89.3	93.9
Capital gains, etc	2.9	863.0	0.0	0.0
Pre-tax profit	1,285.7	1,721.5	1,768.9	2,040.8
Tax	(500.8)	(609.9)	(701.9)	(801.6)
% tax rate	39.0	35.4	39.7	39.3
Minorities	(19.9)	(15.0)	(35.0)	(40.0)
Extraordinary & other items	145.4	60.0	0.0	0.0
Earnings	910.4	1,156.6	1,032.0	1,199.3
Amortisation of goodwill	(0.6)	0.0	0.0	0.0
Net income after amortisation of goodwill	909.8	1,156.6	1,032.0	1,199.3
Total assets	158,556	169,452	180,396	189,459
Shareholders funds	7,775.1	9,016.7	9,382.1	9,914.9
Per share data (€)				
EPS before amortisation of goodwill	0.3	0.4	0.3	0.4
EPS after amortisation of goodwill	0.3	0.3	0.3	0.4
DPS	0.2	0.2	0.2	0.2
BVPS	2.6	3.0	3.1	3.3
Adj BVPS	1.7	2.1	2.2	2.4
Key ratios (%)				
Net interest margin	1.9	2.1	2.1	2.2
NPLs	5.1	4.8	4.5	4.3
Cost/income	61.1	60.1	56.7	53.8
ROA	0.6	0.7	0.6	0.6
Solvency and profitability ratios (%)				
Total BIS ratio	9.5	10.4	10.2	10.2
ROE	12.1	13.8	11.2	12.4
Credit quality (€m)				
Gross NPLs	6,831.4	7,036.4	7,036.4	7,036.4
Accumulated provisions	3,004.1	3,077.6	3,077.6	3,077.6
Coverage ratio (%)	44.0	43.7	43.7	43.7
Net NPLs	3,827.3	3,958.8	3,958.8	3,958.8
As % of shareholders funds	49.2	43.9	42.2	39.9
As % of net operating income	206.9	207.5	177.2	156.0

Source: Company data, ING estimates

Disclosures Appendix

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Buy	51%	31%
Hold	43%	26%
Sell	6%	27%
	100%	

* Percentage of companies in each rating category that are Investment Banking clients of ING Financial Markets LLC or an affiliate.

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Buy: Forecast 12-mth absolute total return greater than +15%

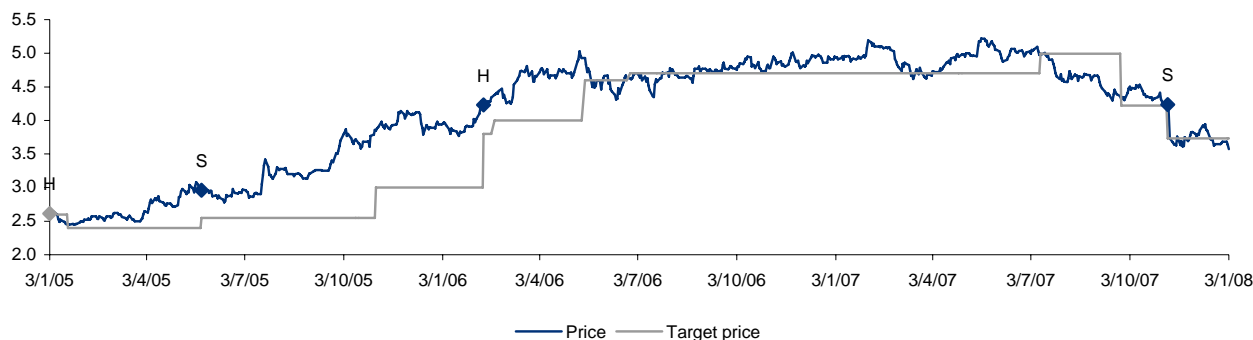
Hold: Forecast 12-mth absolute total return of +15% to -5%

Sell: Forecast 12-mth absolute total return less than -5%

Total return: forecast share price appreciation to target price plus forecast annual dividend. Price volatility and our preference for not changing recommendations too frequently means forecast returns may fall outside of the above ranges at times.

Research published prior to 15/12/05: EMEA equities' ratings were based on US dollar total returns; Western Europe's were based on: absolute return +25%, Strong Buy; greater than +10%, Buy; +10% to -10%, HOLD; lower than -10%, Sell.

PRICE & RATINGS HISTORY TO 03/01/08: BANCA MONTE PASCHI SIENA (BMPS.MI)



SB = Strong Buy; B = Buy; H = Hold; S = Sell; NR = Not Rated; R = Restricted

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Source: ING

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