

22 March 2011

# Portuguese Banks: to reach an 8% CT ratio by YE11

(Price Target and Recommendation maintained)

## 8% CT1 ratio for all...

According to the update of the Portuguese Growth and Stability Pact (GSP) presented yesterday, Portuguese banks must have an 8% CT1 ratio by YE11. According to the document, bank will have to present a until the end of May a reorganization plan. Such plan should define target and timeframe for the size and composition of the B/S, capital ratios and efficiency levels.

## Restore confidence in Portuguese banks seems to be the goal...

Earlier this month, in the Finance Ministry presentation of the revised GSP, it was mentioned that banks would have to prepare reorganization plans. The purpose of such plans is to reinforce Portuguese banks capital, considering the required deleverage of the financial system and the need to regain access to funding markets. Such plans will be evaluated by the BoS until the end of May.

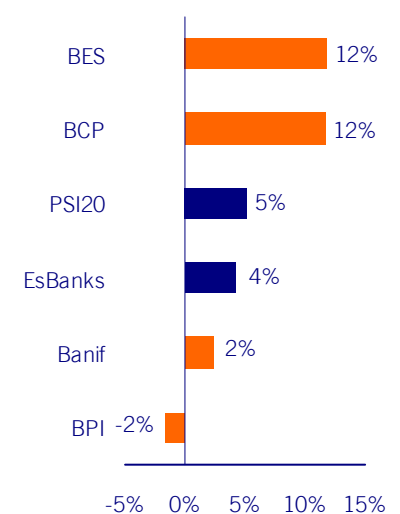
## Will these measures go through?

These capital requirements are part of the updated SGP. The leaders of the major opposition parties have stated that their parties will vote against the SGP in the Parliament in what may be the trigger for a political crisis and early elections in the country. That said the reason behind the opposition veto is not related with the higher capital ratios demanded to banks, but with the new austerity measures foreseen in the document, which makes us believe that these measures will be eventually imposed to banks.

## BCP and BNF as the most penalized

Looking at the listed Portuguese banks capital position as of Dec10, BCP and Banif should face the most challenging task to fit to the 8% CT1 threshold: (1) BCP posted a CT1 ratio of 6.7% at YE10, implying a gap of Eur 800mn (26% of current mkt cap); (2) Banif faces a gap of Eur 85mn (17% of mkt cap), from a CT1 of 7.3% at YE10; (3) BES is also slightly below the 8% threshold, but the 10bps gap (or Eur 100mn, 3% of mkt cap) should be manageable in the short-term thought retained earnings

Portuguese Banks - Market performance (YTD)



Source: Bloomberg

## Summary of Recommendations

Bank	Last price	Mkt Cap (Eur bn)	Price Target	Upside	Recom.	Adj.	Adj.	DY11F
	21-Mar					PE11F	PBV11F	
BES	3.22	3.8	3.15	-2%	Accu.	9.6	0.7	5.5%
BCP	0.65	3.1	0.60	-8%	Hold	14.8	1.1	0.0%
BNF	0.89	0.5	0.90	1%	Hold	12.9	0.6	2.6%
BPI	1.36	1.2	N.R.		N.R.	7.4	n.a.	n.a

Source: BPI Equity Research.

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**Portuguese Banks - Potential capital Needs**

Eur mn	BCP	BES	BPI	BNF
Core Capital	3 966	5 407	2 267	934
Tier 1	5 455	6 031	2 379	1 079
RWA	59 564	68 839	26 031	12 736
Core capital Ratio	6.7%	7.9%	8.7%	7.3%
Tier 1 ratio	9.2%	8.8%	9.1%	8.5%
<b>Capital required to reach a 8% CT1</b>	<b>799</b>	<b>100</b>	<b>0</b>	<b>85</b>
<b>% of mkt cap</b>	<b>26%</b>	<b>3%</b>	<b>0%</b>	<b>17%</b>
Pension fund Corridor	532	218	234	14
post tax	391	160	172	6
Other actuarial losses not recognised in capital	267	269	0	0
post tax	196	198	0	0
CT1 after deduction all PF losses	3 379	5 049	2 095	927
CT1 ratio	5.7%	7.3%	8.0%	7.3%
<b>Capital required to reach a 8% CT1</b>	<b>1 386</b>	<b>458</b>	<b>0</b>	<b>92</b>
<b>% of mkt cap</b>	<b>45%</b>	<b>12%</b>	<b>0%</b>	<b>18%</b>
<b>Per each 100bps k increase</b>				
<b>EPS dilution</b>				
	2011	-18%	-13%	-14%
	2012	-18%	-13%	-18%
	2013	-18%	-14%	-19%

Source: BPI Equity Research

**BCP: an equity-per-debt operation as a possibility**

BCP posted a CT1 ratio of 6.7% at YE10, implying a gap to the 8% CT1 threshold of Eur 800mn (26% of current mkt cap). In the earnings presentation, management mentioned an equity-per-debt operation as a possibility to enhance mentioned an equity-per-debt operation as a possibility to enhance capital ratios. We believe it would likely be the optimal solution both for the bank and the holders of the prefs. For the bank this would allow minimizing the EPS dilution and the discount at which the new shares are issued vs. a rights issue, given that this debt is trading significantly below its nominal value. For the holders of this debt issues, it could be the way of cutting losses.

For illustration purposes, **we estimate a 12% EPS dilution in a medium-term for a swap of Eur 750bn of prefs shares (25% of current # shares).**

To go through, such operation would have to be approved in BCP's GSM and the bank would then launch a tender offer over those securities.

**BCP: impact from the conversion of T1 perpetual debt into Equity**

Eur mn	2011	2012	2013
<b>Prior debt per Equity</b>			
# shares	4 695	4 695	4 695
NP estimate (as reported)	305	412	513
Cost o prefs	49	49	49
cost of T1 perpetual debt	50	50	63
<b>Adj. NP</b>	<b>206</b>	<b>313</b>	<b>401</b>
Adj. EPS	0.044	0.067	0.086
After debt swap			
# shares	5 848	5 848	5 848
NP estimate (as reported)	305	412	513
Cost o prefs	12	12	12
cost of T1 perpetual debt	50	50	63
<b>Adj. NP</b>	<b>242</b>	<b>350</b>	<b>438</b>
Adj. EPS	0.041	0.060	0.075
EPS accretion (/dilution)	-5%	-10%	-12%

Source: BPI Equity Research

**BCP: impact from the conversion of T1 perpetual debt into Equity**

Eur mn	Dec10
<b>Prior debt per Equity</b>	
CT1	3966
Tier 1	5455
RWA	59564
CT1	6.7%
Tier 1	9.2%
Debt converted	750
<b>Prior debt per Equity</b>	
CT1	4716
Tier 1	6205
CT1	7.9%
Tier 1	10.4%

Source: BPI Equity Research

**BCP: Relative valuation before and after the operation**

	2011F	2012F	2013F
<b>Prior to the operation</b>			
EPS	0.044	0.067	0.086
Adj. BV	2808	3047	3187
Adj. BVPS	0.60	0.65	0.68
Adj PBV	1.09	1.00	0.96
PE	14.83	9.73	7.60
<b>Adjusted for the K increase and MCB issue</b>			
EPS	0.041	0.060	0.075
Adj. BV	3558	3797	3937
Adj. BVPS	0.61	0.65	0.67
Adj PBV	1.07	1.00	0.97
PE	15.7	10.9	8.7

Source: BPI Equity Research

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"Banco BPI has celebrated two "Equity Swap" contracts with Sonae Investments with strictly financial settlements (Cash Settled Share Swap Transaction), the first of which was celebrated in November 2007 to cover the inherent risk in the acquisition of 6.64% of Sonae's share capital, at a price of €2.06 per share, and the second of which was celebrated in January 2008, involving Sonae Capital shares at a reference price of €1.92 per share. In both contracts, the periodic repercussion over Sonae Investments of the amounts corresponding to Sonae share price changes relative to the above-mentioned prices was agreed as well as the amounts equivalent to the proceeds to be received by Banco BPI under the exercise of rights inherent to these shares. These contracts have both a maximum maturity of 3 years. In October 2010, the maximum maturity of the referred first "Equity Swap" (covering at such date the inherent risk in respect of 6.52% of Sonae's share capital) was extended up to 3 years, until November 2013. In December 2008, Banco BPI participated in the financing of "Grupo Soares da Costa", through a project finance, by leading the bank syndicate which financed "Auto-Estradas XXI - Subconcessionária Transmontana, S.A.", the sub-concessionaire of the Transmontana Highway (in which "Soares da Costa Concessões SGPS, S.A." and "Soares da Costa Construções, S.A." hold a stake). BPI entered into a liquidity provider agreement with Euronext Lisbon for the Banco Popular Español shares, being such agreement effective from February 2008. In October 2009, Banco BPI, among with BNP Paribas, acted as Global Coordinator, Joint Lead Manager and Joint Bookrunner, on the share capital increase with pre-emptive right for cash value of €100.577.162,40 through the issuance of 6,447,254 New Shares of Pescanova, S.A. BPI and BNP Paribas entered into an underwriting agreement under which terms and conditions they assisted Pescanova in maximizing the subscription of the underwritten shares (70% of the new shares, in a split of 50% for each bank), and further undertook to subscribe, in their own name, for the underwritten shares whose subscription fell to them in discharge of their respective underwriting commitment. The underwriting commitment of each underwriter in proportion to its committed shares was reduced by the number of new shares subscribed in the public offer. The 6,447,254 New Shares of Pescanova, S.A. were entirely subscribed in the public offer. Pursuant to a subscription agreement dated 21 January 2010 between Pescanova, S.A., BNP Paribas and Banco BPI, S.A., as Joint Lead Managers (the "Joint Lead Managers"), each of them severally (but not jointly) agreed, subject to certain customary closing conditions, to procure subscribers and, failing which, to subscribe for the aggregate principal amount of the €110,000,000 - 6.75 per cent, Senior Unsecured Convertible Notes due 2015 of Pescanova, S.A. (in a split of 70% to BNP Paribas and 30% to Banco BPI). The Senior Unsecured Convertible Notes were entirely subscribed by qualified investors. Banco BPI is one of the major banks that finance Pescanova's business.. BPI Group may provide corporate finance and other investment banking services to the companies referred to in this report."

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	Low Risk	Medium Risk	High Risk	As of 28 <sup>th</sup> February BPI Equity Research investment ratings were as follows:	
Buy	> 15%	>20%	>25%	Buy	36%
Accumulate	>10% and < 15%	>10% and < 20%	>15% and < 25%	Accumulate	24%
Hold	>0% and < 10%	>0% and < 10%	>0% and < 15%	Hold	22%
Reduce	>-15% and < 0%	>-20% and < 0%	>-25% and < 0%	Reduce	13%
Sell	< -15%	< -20%	< -25%	Sell/Accept Bid	4%
These investment ratings are not strict and should be taken as a general rule.				Under Revision	1%
				Total	100%

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