Bankia
Solid B/S translating into sound ROEs soon

Equities

Spain
Banks, Ex-S&L

12-month rating	Neutral
12m price target	€1.40
Price	€1.29

RIC: BKIA.MC BBG: BKIA SM

Trading data and key metrics

52-wk range	€6.50-0.55
Market cap.	€14.8bn/US$20.0bn
Shares o/s	11,517m (ORD)
Free float	48%
Avg. daily volume ('000)	49,436
Avg. daily value (m)	€56.0
Common s/h equity (12/13E)	€11.8bn
P/BV (12/13E)	1.3x
Tier 1 ratio	12%

EPS (UBS, diluted) (€)

	UBS	Cons.
12/13E	0.03	0.05
12/14E	0.07	0.12
12/15E	0.11	0.16

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4Q results: in line with UBSe both at the bottom line and pre provision level

NII at €2.425m (-21% YoY) vs €2428m UBSe, pre provision profit at €1.725m vs €1761m UBSe and net profit at €512m vs €515m UBSe. Encouraging trends or the NII (+8% QoQ) driven by lower cost of deposits leading the customer spread improvement (+16bp QoQ to 95bp). Also good news that deposits remained stable in 4Q, despite branch closures. The loan book still dropped by 3% taking the LDR to 120%, more in line with its domestic peers. P&L remains supported by cost cutting, total cost -16% YoY as expected with branch network down 35% YoY. Credit quality showed NPL ratio increasing to +14.7% (+110bp QoQ) exclusively driven by the reclassification of restructured loans as expected. Coverage at 56% (-6 PP QoQ) still well above peers at 45%. Capital wise, CT1 EBA at 11.7% (+48bp QoQ) and we estimate fully loaded BIII at 8.8% by 4Q2013 although not disclosed.

Sound credit quality and capital to start translating into profitability soon

We estimate a fully loaded BIII ratio at 10% post DTAs by 2014, the debate will be left behind if Bankia continues to use them (c€700m reduction in DTAs as of 9M) and might move forward to unrecognized DTAs at some stage. Bankia has best in class coverage over restructured loans at 22%, minimum legacy RE assets and the best coverage ratio in the sector. Cost of retail funding continues to improve, we estimate total cost of retail funding at 1.2% in 2014 and 1% by 2015, the main game changer for potential EPS upgrades, while deposit volumes have remained quite resilient despite the ongoing restructuring in the branch network.

Regulatory headwinds still ahead for the sector not that much for Bankia

Main challenges are: (1) deleveraging toward a 100% LDR by 2017 will make difficult an improvement in the asset mix, (2) strong contribution from ECB-funded ALCO not recurrent in the long run. On the other hand Bankia has a very strong management team & solid credit quality. We estimate its sustainable ROE at 11% 2016 UBSe.

Valuation: Neutral ratings remain unchanged. Our PT is P/BV-based

Stock trades on 1.1x NAV14e, in line with its listed peers.

Highlights (€m)	12/10	12/11	12/12	12/13E	12/14E	12/15E	12/16E	12/17E
Revenues	4,625	3,855	4,468	3,816	4,013	4,341	4,574	4,535
Profit before tax	(552)	(4,485)	(22,188)	708	1,218	1,872	2,150	2,086
Net earnings (local GAAP)	(555)	(3,145)	(19,191)	515	839	1,235	1,428	1,387
Net earnings (UBS)	(657)	(3,145)	(16,830)	330	839	1,235	1,428	1,387
Tier 1 ratio %	7.5	7.5	9.6	12.1	13.3	14.7	15.9	17.9
EPS (UBS, diluted) (€)	(4.61)	(22.13)	(98.65)	0.03	0.07	0.11	0.12	0.12

Profitability/valuation	12/10	12/11	12/12	12/13E	12/14E	12/15E	12/16E	12/17E
ROE (UBS) %	(5.0)	(25.4)	NM	11.5	7.0	9.8	10.6	9.7
P/PPOP (diluted)	-	3.7	1.7	7.8	6.6	5.4	5.0	5.1
P/BV x	-	0.5	(0.6)	1.3	1.2	1.1	1.1	1.0
P/BV (UBS) x	-	0.6	(0.6)	1.3	1.2	1.2	1.1	1.0
P/E (UBS, diluted)	-	(2.0)	(0.2)	44.8	17.7	12.0	10.4	10.7
Net dividend yield %	-	0.0	0.0	0.0	1.4	3.3	4.8	4.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of €1.29 on 31 Jan 2014 21:45 GMT

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Diversified Banks
Western Europe | Spain

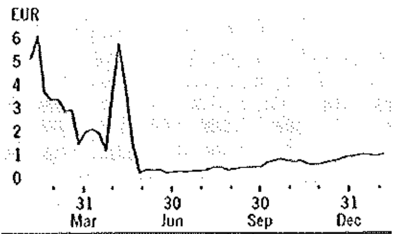
Bankia SA (BKIA.MC)

Spanish Recovery Poster Child: Initiating with Neutral, TP €1.45

- **Initiation of Coverage**

Neutral	**2**
Price (05 Feb 14)	€1.34
Target price	€1.45
Expected share price return	8.5%
Expected dividend yield	0.0%
Expected total return	**8.5%**
Market Cap	€15,387M
	US$20,803M

Price Performance
(RIC: BKIA.MC, BB: BKIA SM)



- **Restructuring Story** — Bankia was born in 2011 in tumultuous circumstances. But the bank has since recovered and, in our opinion, is the restructuring story par excellence in Spain. It offers investors exposure to key themes: 1) declining term deposit costs; 2) asset quality normalisation; 3) cost optimisation; and 4) organic capital rebuild. *However, we believe most of the upside is currently priced in and we initiate coverage with a Neutral rating and €1.45 target price. In a bull scenario we see +32% upside; in a downside scenario we see -15% downside (see Valuation).*
- **Opportunity 1: NIM Improvement** — Falling term deposit costs has been the most important driver of NII growth in Spain. While larger banks (e.g. SAN) reported improving deposit costs earlier on, Bankia was a late beneficiary but has started catching up. We estimate Bankia could enjoy an NII benefit of €420m from repricing term deposits closer to peers over 2014-15, or 15% of 4Q13 annualised NII.
- **Opportunity 2: Provisions Normalisation** — We expect Bankia to report a relatively normalised cost of risk in 2016 at c 50 bps of gross loans – in the middle of the pack among peers (Figure 16). But Bankia should be the first to report a more normal cost of risk starting this year, i.e. 1-2 years ahead of peers. This positive development, we believe, is a function of the meaningful legacy asset 'clean-up' the bank undertook in 2011-13.
- **Opportunity 3: Cost Optimisation** — Bankia's restructuring plan runs on two fronts: 1) asset disposals (€1.9bn of cash proceeds to-date); and 2) cost optimisation. The second part focuses on employee count reduction and branch optimisation. As a result, we expect Bankia's cost/income ratio to fall to c 47% by end 2014 and stabilise around 40-41% by the end of 2016, one of the best in Spain.
- **Neutral Rating, TP €1.45** — Our 2014-16E EPS are €0.07, €0.11 and €0.12 (net profit -9%, +5% and +17% vs cons). We use a Dividend Discount Model to value Bankia with 9.5% sustainable ROE and 12.0% Cost of Equity assumption, adjusted for any shortfalls in capital/coverage. This results in a target price of €1.45. With an 8.5% expected total return we rate Bankia Neutral. The shares trade on 1.2x P/'14E TBV for 9.5% sustainable ROTE, in-line with Neutral-rated CABK (9.2% ROTE).

Bankia SA (EUR)

Year to 31 Dec	2012A	2013A	2014E	2015E	2016E
Net Income (€M)	-19,056.0	517.0	853.3	1,226.0	1,361.0
Diluted EPS (€)	-9.88	0.06	0.07	0.11	0.12
Diluted EPS (Old) (€)	-9.88	0.06	0.07	0.11	0.12
PE (x)	-0.1	23.7	18.1	12.6	11.3
P/BV (x)	-0.5	1.4	1.3	1.2	1.1
DPS (€)	0.00	0.00	0.02	0.03	0.03
Net Div Yield (%)	0.0	0.0	1.4	2.0	2.2
ROE (%)	-484.7	18.2	7.5	9.9	10.0

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Stock Rating
Overweight

Industry View
In-Line

Initiation

Bankia SA

Initiating at Overweight on write-backs potential

Bankia will be the most efficient bank in Spain post its restructuring, we believe. Together with higher coverage levels, this should translate into higher ROEs and open the door to provision write-backs – we estimate an 11% ROTE in 2016, >20% ahead of consensus. We initiate with an OW, PT €1.6.

Higher provisions open the door for write-backs. Post clean-up, Bankia holds the highest provisioning levels of the listed banks, with its corporate loan book written down by 16%, >3x higher than its peers. With no meaningful real estate exposure left, we estimate it will have the lowest provision charge in 2013-2016 (60bp) and could have €3bn excess provisions.

Lower cost base is worth 2.5% of ROE, we estimate. Bankia ended 2013 with 2,000 retail branches, half of the number in 2008 (pro forma), and its network is now the most productive in Spain, alongside BKT's. Its lower cost base represents 20-90bp of RWAs advantage, or 2.5% of ROE for Bankia, on our estimates.

Lower carry trade is a risk, but should be offset by lower deposit costs. We estimate Bankia's carry trade contribution is high versus peers, at 55-60% of NII 2013, and is the main risk to earnings growth. We assume it falls to 20% by 2016, but that this will be offset by a 150bp improvement in time deposit costs.

Change in business mix needed to drive NII higher. We believe Bankia needs to reduce its dependence on mortgages, currently 60% of its book, if loan yields are to go up and provide upside to NII. Loan growth in 2015 and beyond will gradually achieve this, we think.

We initiate with an Overweight, €1.6 PT. We value the bank at 1.2x PTBV 2014e, and factor in €3bn of excess provisions and €1.4bn of excess capital. With a 13.5% 2016e B3 CT1, we believe it will be able to pay dividends in 2014 with a 4.2% yield in 2015E. The Spanish government's 68% stake is an overhang risk.

Key Ratios and Statistics

Reuters: BKIA.MC Bloomberg: BKIA SM
Banks / Spain

Price target	**€1.60**
Shr price, close (Feb 4, 2014)	€1.33
52-Week Range	€11.80-0.48
Mkt cap, curr (mn)	€15,308

Fiscal Year ending	12/13	12/14e	12/15e	12/16e
ModelWare EPS (€)#	0.03	0.09	0.11	0.13
Consensus EPS (€)§	-	0.06	0.09	0.10
P/E**	35.8	15.3	12.0	10.2
Tang BVPS (€)	1.00	1.10	1.15	1.21
P/tang BV	1.23	1.21	1.16	1.10
Div per shr (€)	-	0.02	0.06	0.07
Div yld (%)	-	1.6	4.2	4.9

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
= Our pension accounting has changed in ModelWare, which will affect ModelWare EPS figures for some stocks under coverage. Visit www.ms.com/mw.pdf for details
** = Based on consensus methodology
§ = Consensus data is provided by Thomson Reuters Estimates.
e = Morgan Stanley Research estimates