Banca Generali: BGN IM

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Increasing assets under management and upward sloping yield curve: positive for Banca Generali

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Increasing Assets Under Management

Banca Generali's Assets under Management (AUM) are expected to grow at a 6.5% CAGR over the next 5 years. AUM will grow at a slower rate than before due to near term growth being overexaggerated by a change in Italian tax laws surrounding mutual funds.

Performance and management

We believe Performance and Management fees will grow in line with AUM at 6.5%.

Net interest Income

Upward sloping yield curve will increase net interest income over the next 5 years. Net interest income was 61 million in 2016, we forecast this figure to reach 100 million by 2021.

Strong competitive position

Despite the struggling Italian banking sector (14% of total loans are non-performing, Monte dei Paschi delisted in December and strong calls for government intervention in the banking sector), we believe Banca Generali's core franchise and market position are very strong, making it a stock to hold on to.

Stock Data

Price	€ 27.85
Projected Price	€ 28.15
Downside Potential	1.07%
Date	10-May-2017
Current Mkt Cap	3,269.5M
Shares Outstanding	116.604M
52-week Range	15.75 – 28.43
ROE	24.30%
P/B	5.06x
P/E	17.90x
EPS	1.64
Dividend / Share	1.07

Contents

1. Business Overview

Banca Generali is an Italian bank owned by Generali Group. The bank has 47 branches and 143 financial advisor offices throughout the Italian territory and provides three main services to its private and corporate clients: banking, asset management and insurance services.

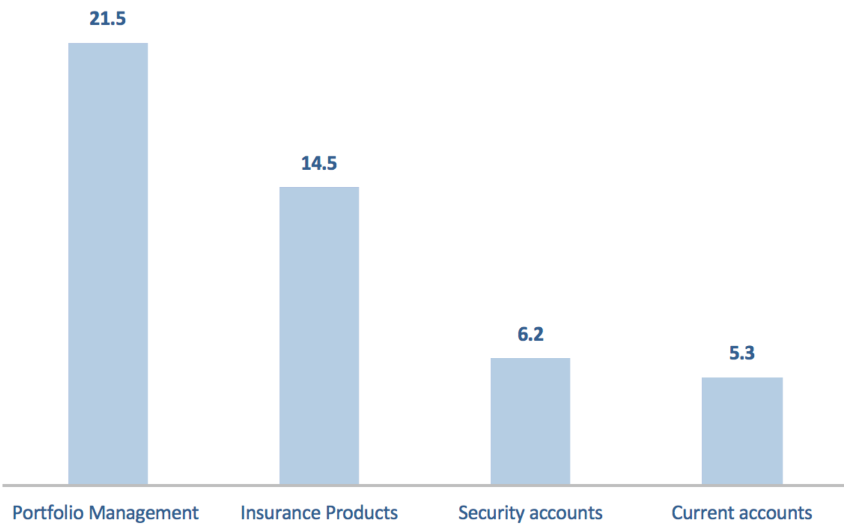
Banking services include current and deposit accounts, repos, counter guaranteed lending and security deposits. Banca Generali generates a small portion of its total revenue from traditional banking activities.

Asset management and insurance account for the majority of the income of Banca Generali and income is accrued to them from this in terms of commissions. Asset management products which the bank provide include SICAVS, mutual funds, funds of funds, portfolio management and trust services.

Insurance products include wrappers, which are unit linked(UL) policies. These UL life assurance policies are linked to the underlying investment in which the individual chooses. The individual can choose a certain level of risk from the provided funds and the returns from the investment are linked to the policy. These life assurance policies are essentially investments that are only paid out on the death of the investor.
This is an essential part of tax planning in Italy as life assurance proceeds are not taxable. This means that the individual's beneficiaries receive the amount from the life assurance premium along with the underlying returns tax free upon death. Due to the incentives to purchase these life assurance products in estate planning Banca Generali also earns commissions on these products and are treated as assets under management.

The majority of income is accruing from management fees and performance fees on the assets under management. Changes in Italian tax laws, which have reduced the tax expenses on mutual funds for Italian investors, have been a factor in the strong performance of the mutual fund industry , causing large inflows even in times of economic uncertainty in the rest of Italy due to high level of unemployment and low inflation.

Exhibit 1 – Breakdown of Assets Under Management as of 31 December 2016 (Billions of EUR)



Source: Banca Generali Annual Report

1.1 Italian Insurance Regulation Overview

The Italian insurance industry is regulated by IVASS (Istituto per la vigilanza sulle Assicurazioni). IVASS is an independent authority which aims to guarantee the protection of policyholders and persons entitled to insurance benefits. The institute also ensures the respect of insurance regulation and controls over accounting, financial and technical management of insurance companies.

IVASS took over all tasks competences and powers of ISVAP (Istituto per la vigilanza sulle assicurazioni private) in 2012. IVASS reports directly to the government and IVASS accounts are subject to the court of auditors. The biggest change brought in from this new authority is within the new form of governance which partially incorporates Banca d'Italia. This ensures a closer integration between insurance and banking supervision.

IVASS or its predecessor ISVAP have not indicated that they intend to change the regulation surrounding life assurance in any meaningful way. In our forecast period, we have not adjusted our forecasts to account for the risk of regulation changes in Italian life assurance. From analysing how long it takes new regulation to get through the Italian court system we deemed that it would not be an issue within our forecast range of five years.

2. Macroeconomic Context

The Eurozone is currently experiencing political uncertainty after the exit of the UK from the European Union. Prolonged low levels of inflation and high unemployment have led the ECB to carry out unconventional monetary policy in an attempt to increase the money supply and boost the general economy since 2014. Quantitative Easing (QE), a money printing program, has been underway since 2014 and has pushed interest rates in Europe to historic lows. Mario Draghi, the President of the ECB, revealed the intention of the European Central Bank to extend the QE programme until December 2017 by cutting the purchase of government bond from 80b to 60b of Euro a month. Therefore, the negative short term interest rates are likely to remain negative for the next few years and the long-term government bond yields will remain at all-time lows.

Under this uncertain political context, Banca Generali significantly performed better than the Italian market and the Italian Regional Banking Index. The stock price almost tripled from its 2012 April closing price of €9.26 to its current price of €26.39: an upside of nearly 185%.

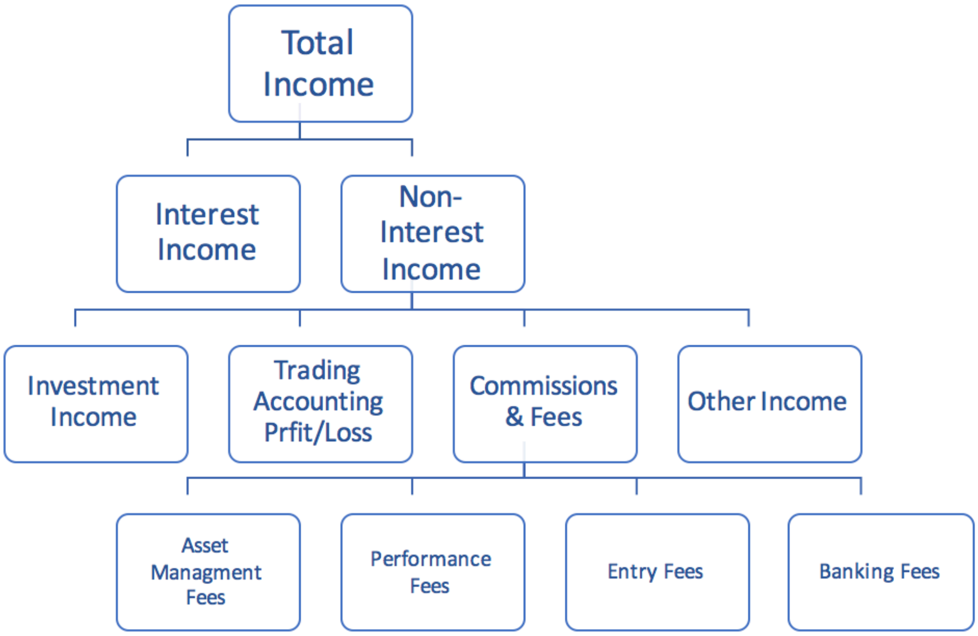
Exhibit 2 – Banca Generali cumulative returns vs FTSE MIB, Italian Regional Banking Index and EURO STOXX 50

Source: Bloomberg

3. Business Model

In Banca Generali, there are two main sources of income. These are Interest Income and Non-interest income. The Interest Income is the income the bank gains from the interest charged on the loans and the yield the bank receives from its portfolio of financial assets.

Exhibit 3 – Sources of Income



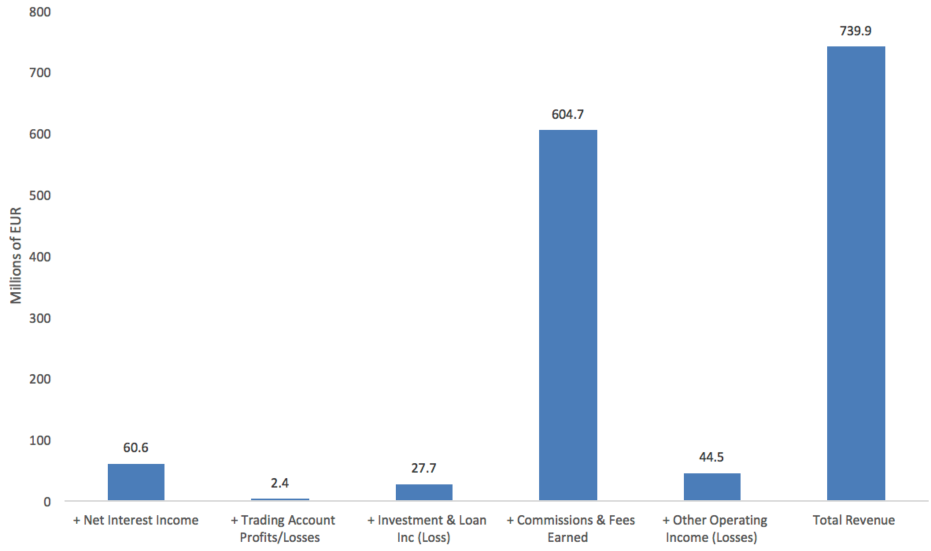
The non-interest income is mainly made of the fees the bank receives from its asset management activities and insurance services. It also receives revenue from the gains/losses the bank makes on its trading activities and the Investment Income, i.e. the capital gain/loss the bank receives from selling part of its portfolio of financial assets.

Over the last few years, the asset management and insurance sectors have considerably expanded in Italy, by a compounded annualised growth rate of 9% (Data: annual report). Banca Generali has consistently outperformed the market and its assets under management have grown by a CAGR of 14.7% over the same period. The AUM market share of the bank rose from 10.2% in 2011 to 12.5% in 2016.

On the other hand, the interest income, as of Dec 31 2016, accounts for 8.7% of the total revenue. Over the last two years, this has suffered a sharp decrease (-44% from 2014 to 2016) due to the Quantitative Easing monetary policy and the resulting decline in interest rates.

However, since most of the income the bank receives derives from commissions from asset management and insurance, the bank has experienced an increasing positive Net Income over the last 5 years.

Exhibit 4 – 2016 Total Revenue for each income source (Millions of EUR)

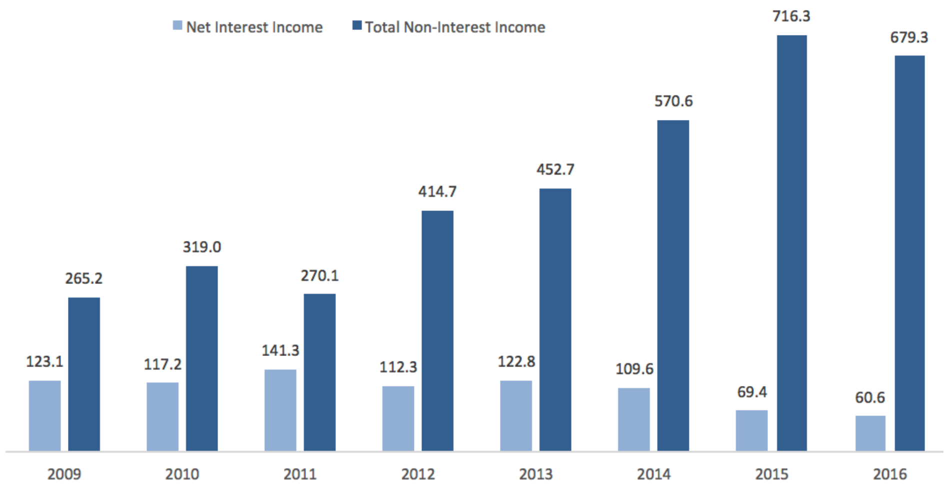


Source: Bloomberg

4. Net Interest Income

Net interest income figures have decreased since 2009 and have drastically decreased as a percentage of total revenue. We can see that in 2009 Net Interest Income made up 32% of total revenue, whereas in 2016 it only made up 8%. This is a clear illustration of how the decrease in interest rates have impacted the banking sectors interest income.

Exhibit 5 - Net Interest Income and Non-Interest Income revenue (Millions of EUR)



Source: Bloomberg

To see what drives the net interest income, we look to the financial statements and analyse the assets that are earning interest. Banca Generali earns interest in two ways, from interest on loans to customers and from interest earned on holding financial assets. We can see that financial assets make up most of the interest earning assets. Even though interest bearing assets and loans have grown over the past five years, the net interest income earned as a percentage of these assets has decreased.

Exhibit 6 – Interest Bearing Financial Assets and Net Interest Income (Millions of EUR)

Interest Bearing Assets (€M)	2012	2013	2014	2015	2016
+ Interest Bearing Financial Assets	4,956	4,508	3,668	3,390	5,179
% Of Interest Income	*79%*	*75%*	*67%*	*64%*	*73%*
+ Total Loans	1,325	1,519	1,819	1,938	1,882
% Of Interest Income	*21%*	*25%*	*33%*	*36%*	*27%*
Interest bearing Financial Assets and Loans	6,282	6,027	5,487	5,329	7,062
Net Interest Income	112	123	110	69	61
Interest Earned on Financial Assets and Loan	*1.8%*	*2.0%*	*2.0%*	*1.3%*	*0.9%*

Source: Bloomberg

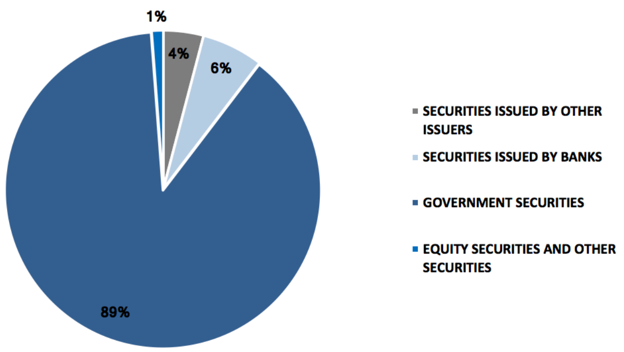
The portfolio of interest bearing financial assets and loans has experienced a 5 year CAGR increase of 3%. Despite this growth, the net interest income has a 5 year CAGR of -14%, and the interest earned on the financial assets and loans has significantly decreased.

In order to forecast the net interest income, we first look at the interest earning assets of Banca Generali and then forecast how they will grow going forward. We then examine how the changing interest rate environment will affect the net interest income.

4.1 Financial Assets

Looking through the annual report we found that the majority of the interest bearing financial assets are government securities. There is a high concentration of Italian securities with 94.4% of the portfolio made up from the region.

Exhibit 7 - Breakdown of Banca Generali's financial assets



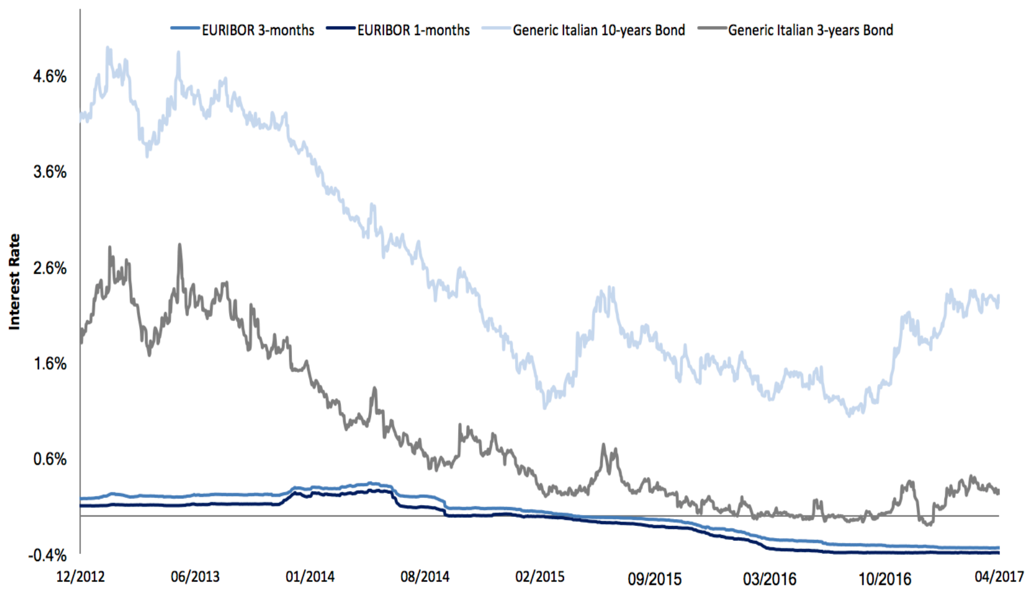
Source: Banca Generali Annual Report

We can see that there is a heavy concentration in Italian government bonds, the bank's net interest income is highly prone to changes in the Italian government bond yields. From the annual report we find that the average maturity of the portfolio as of 31/12/2016, was 4.5 years and 58% was made up of variable rate issues.

From 2012 to 2016 the 5 year yields fell over 80%, which explains the huge reduction in net interest income. It is apparent that in our net interest income forecast the yield of the Italian government bond is going to be a major indicator in the future revenues.
From the previous 5 years the bank has experienced a CAGR of 1% for its financial assets. We believe this to be a reasonable estimate going forward in line with deposits growth. From reading the annual report we found that the accounting treatment of available for sale financial assets is different in Italy. The Italian Central Bank in 2010 changed accounting laws for Italian banks surrounding mark to market practices on purchasing **Italian Government bonds**. This law is intended to protect the banks from short term changes in bond prices and reduce volatility. This was also a measure to increase domestic government bond buying by banks. However, it creates issues for investors as we cannot see the actual market value of their available for sale assets.

We can see that the majority of financial assets are Italian government bonds. Since the inception of the accounting rule change we can see that interest rates have greatly reduced. Due to this the price of the bonds will increase, meaning that the underlying value of the financial assets is higher than what is recorded on the balance sheet. This gives us some comfort for when interest rates rise, the impact of the loss in bond values will not be as substantial. However, we do not see major changes in Eurozone interest rates in the near term which means that the growth rate is appropriate. Available for sale assets make up the majority of the financial assets held by Banca Generali (85% of 2016's financial assets).

Exhibit 8 – Historical yields of EURIBOR 1-months, EURIBOR 3-months, Generic Italian 5-years Bond and Generic Italian 10-years Bond

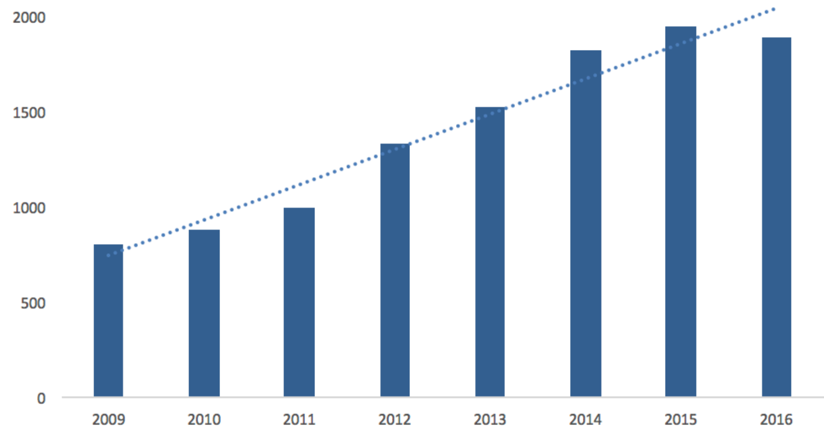


Source: Bloomberg

4.2 Total Loans

Total loans have increased steadily since 2006, even during the midst of the great financial crisis. We can see from 2015 to 2016 there has been in fact a slight decrease in total loans by Banca Generali, which is due to the reduction in current account overdraft facilities. Management have indicated in the earnings call however that they do not expect this to impede growth going forward.

Exhibit 9 – Historical Total Loans (Millions of EUR)



Source: Bloomberg

Banca Generali's Non-Performing Loans have been relatively low throughout the financial crisis which are a positive for net interest income figures. This strength has been significant considering the effect which NPL's have had on the rest of the sector (Industry wide NPL's are 14%). An extreme example of issues in the sector is of Banca Monte dei Paschi who had NPL's at greater than 30% of their total loan book and delisted in December due to these problems. The main reason for the strength of Banca Generali's loan book is they target high net worth clients who are less likely to default.

Exhibit 10 - Banca Generali Total Loans (Millions of EUR), Non-Performing Loans (Millions of EUR), and NPL/TL ratio

	Tot Loans	NPL	NPL/TL
2009	800.9	40.4	5.0%
2010	874.2	36.0	4.1%
2011	994.2	29.7	3.0%
2012	1325.3	25.5	1.9%
2013	1518.8	55.3	3.6%
2014	1819.2	57.8	3.2%
2015	1938.5	47.1	2.4%
2016	1881.9	47.3	2.5%

Source: Bloomberg

Banca Generali's Total Loans have a 5 year CAGR of 9% from 2012-2016 which we believe to be the most accurate assumption of the future loan growth. The anticipated future strengthening of the Italian economy and the commitment by management to increase their loan book support our finding. We looked at rolling windows of 5 year CAGR's since 2009 and found the average to be 16%. However, Banca Generali's management committed to maintaining quality in the loan book in their earnings call so we decided that the most recent 9% 5-year compounded growth rate to be our best estimate.

4.3 Interest Rates and their effect on net interest income

We looked at the net interest income as a percentage of interest bearing assets. In the past 5 years there has been a 50% reduction in this figure. This is a result of the huge reduction in interest rates causing the net interest income to drop correspondingly.

Exhibit 11 - Percentage of Net Interest from Interest Bearing assets

	2012	2013	2014	2015	2016
% Net Interest Income from Interest Bearing Assets	1.8%	2.0%	2.0%	1.3%	0.9%

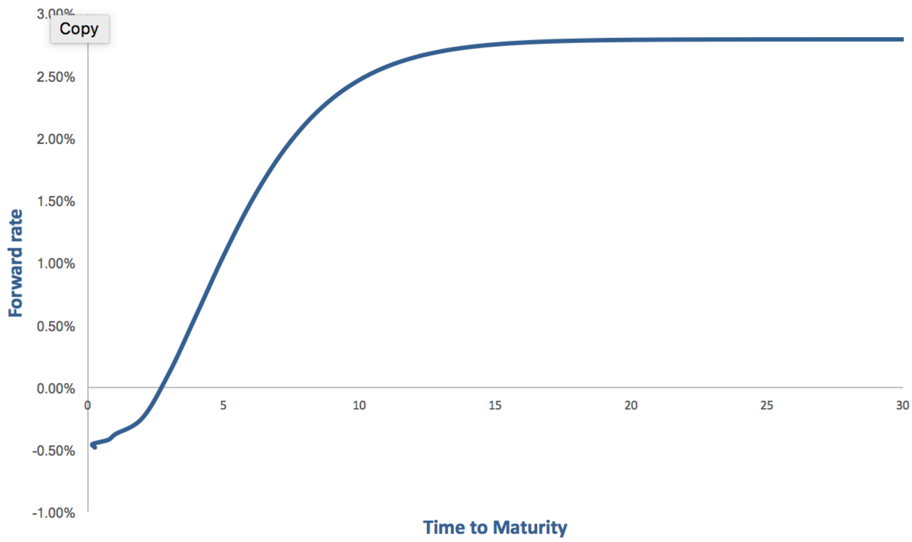
Source: Bloomberg

To forecast the interest received from our total interest bearing assets we must take a position in future interest rates. To do this we look at the yield curve. We calculated the one year forward rates from the yield curve. The forward rates we calculate for 2017 and 2018 are flat and they increase as we move towards 2021.

As there is a liquidity risk premium for longer maturity assets we adjusted this for 2020 and 2021 and deducted it from the future yield. We then used changes in forward rates to give us the change in the percentage of net interest income from interest bearing assets. Using the predicted change in the percentage of income from interest bearing assets multiplied by the change in total financial bearing assets we derived our net interest income figure.

We have assumed that the interest percentage **received** on the loan and financial assets will grow at the same rate for our forecasting purposes.

Exhibit 12 – Extracted Eurozone Forward Curve



Source: Bond Yields downloaded from the European Central Bank website. Accessed on 28 April 2017.

Exhibit 13 – Extracted Eurozone Forward Curve

	2017	2018	2019	2020	2021
Interest bearing Financial Assets and Loans	7282	7519	7773	8046	8339
% Net Interesting Income from Interest Bearing Assets	0.9%	0.9%	0.9%	1.1%	1.2%
Net Interest Income	65.5	67.7	70.0	88.5	100.1

5. Non-Interest Income

Non-interest income comprises of 4 main sub sectors:

- Trading Accounting Profits/Losses
- Investments & Loans Income (Loss)
- Commission & Fees earned
- Other Operating Income

5.1 Trading Account Profits

Looking at the previous 5 years of trading account profit and losses we found that the 5 year CAGR was -27%. We found from the financial statements that this consists of profits and losses due to hedging activities by Banca Generali in relation to interest rate and currency exposures.

Exhibit 14 – Historical Trading Account Profits/Losses (Millions of EUR)

	2012	2013	2014	2015	2016
+ Trading Account Profits/Losses	8.5	-2.5	4.6	4.5	2.4

Source: Bloomberg

We don't believe that there will be a continued decline in this sector and feel the average of the past five years gives the best estimate of future trading accounts P+L's so the figure we forecast is €3.5 million each year from 2017 to 2021.

Exhibit 15 – Forecasted Trading Account Profits/Losses (Millions of EUR)

	2017	2018	2019	2020	2021
+ Trading Account Profits/Losses	3.5	3.5	3.5	3.5	3.5

5.2 Investment and Loans Income P+L's

This line item relates to capital gains and losses made on the sale of financial assets and loans which have been forecast in the interest income section. This section has experienced a 69% CAGR over the past five years due to the decrease in interest rates and increase in the value of bonds. From our yield curve analysis, we believe that interest rates will be flat for the next number of years.

Exhibit 16 – Historical Investment & Loan Income (Loss) (Millions of EUR)

	2012	2013	2014	2015	2016
+ Investment & Loan Inc (Loss)	3.4	19.4	44.3	16.0	27.7

Source: Bloomberg

With the information we have on the underlying assets, we believe that the most accurate estimation for the next three years is that this will be relatively flat as interest rates are flat. When the interest rates creep up in 2020 and 2021 we forecast that the figure will decrease. To calculate how much they will decrease by we analysed how much the investment and loan income increased when interest rates rose by the same figure. We then forecast a parallel decline in line with the change when interest rates rise.

Exhibit 17 – Forecasted Investment & Loan Income (Loss) (Millions of EUR)

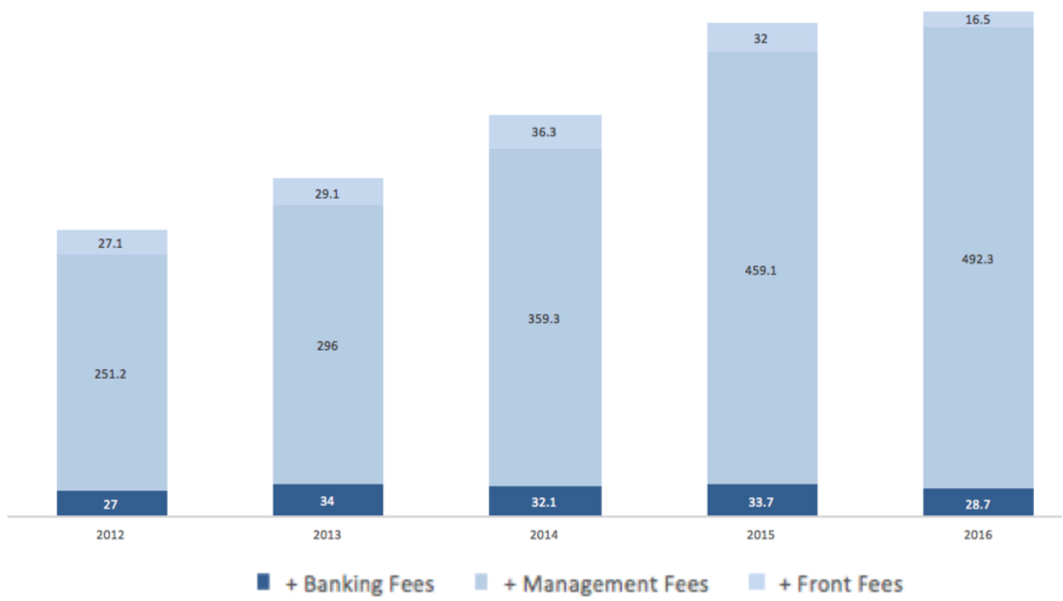
	2017	2018	2019	2020	2021
+ Investment & Loan Inc (Loss)	27.7	27.7	27.7	24.9	22.4

6. Commissions

Commissions are the most important aspect of Banca Generali's revenue stream. The Asset management and insurance segments make up the majority of the fee income. From analysis of the financial statements we find that the fee income from asset management and insurance is included together in the accounts, so we will forecast these together for our forecasting purposes.

The bank earns both recurring fees and variable fees. Recurring fees consist of Management Fees, Banking Fees and Front Fees, while variable fees consist of Performance Fees.

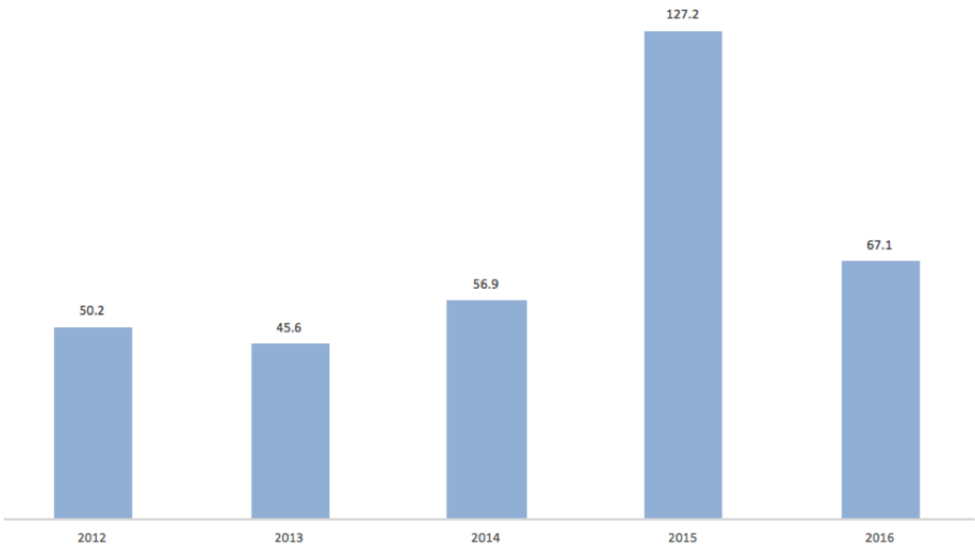
Exhibit 18 – (2016) Total Recurring Fees (Millions of EUR)



Source: Bloomberg

Management fees and performance fees are highly correlated with the total number of assets under management. Management fees have been quite constant as a percentage of total AUM and we believe this will be the case going forward in the next five years.

Exhibit 19 – 2016 Variable Fees (Millions of EUR)



Source: Bloomberg

We can see from below that the performance fees have a much higher standard deviation than the management fees. These are highly dependent on market returns and are tied to the performance of the underlying funds. The performance fees changes in fact have a higher correlation with the assets under management changes as the two are linked.

Performance fees obviously have a higher standard deviation than man fees, however we found for our forecasting purposes the average of the previous 5 year's performance fees as a percentage of total assets captured the uncertainty around performance fees and represented a period in which there were highs and lows. The last number of years have been particularly volatile for funds in Europe, however it is representative of a future 5 year sample.

Exhibit 20 – Historical Management and Performance Fees as a percentage of AUM

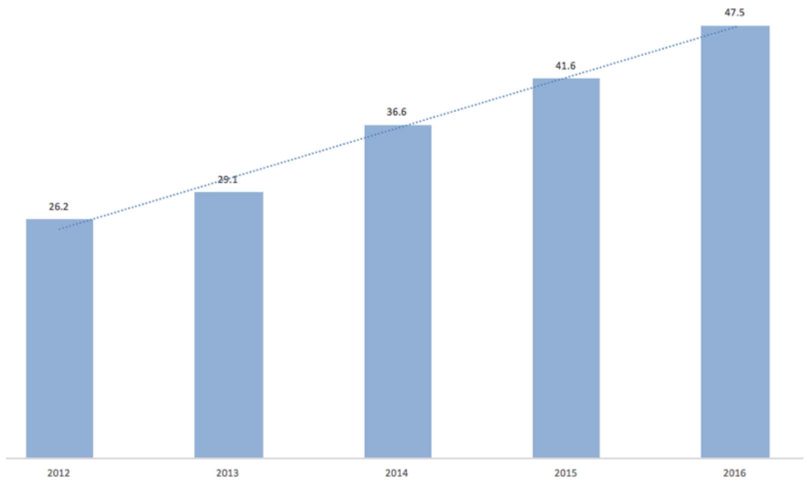
		2012	2013	2014	2015	2016	Avg
+ Management Fees	% Of AUM	0.96%	1.02%	0.98%	1.10%	1.04%	1.02%
+ Performance Fees	% Of AUM	0.19%	0.16%	0.16%	0.31%	0.14%	0.19%

Source: Bloomberg

7. Fees Forecasting

AUM have experienced a CAGR of 16% from 2012 to 2016. This is due to strong global market returns and large inflows of assets from Italian investors. Going forward we believe a CAGR of 16% to be unsustainable in the coming years. Near term growth has been overexaggerated by a change in tax laws surrounding mutual funds which has increased the number of Italians investing in them. From analysis of other banks within Italy and in Europe we found that a CAGR of 6.5% to be more appropriate as the fund grows in value.

Exhibit 21 – Historical AUM (Millions of EUR)



Source: Bloomberg

- Using the relationship between the management fees and the AUM we forecast management fees using the average ratio's we found before, multiplied by our forecast AUM.

Exhibit 22 – Forecasted Management Fees (Millions of EUR)

	2016	2017	2018	2019	2020	2021
+ Management Fees	492.3	515.8	549.3	585.0	623.0	663.5

- Performance fees obviously have a higher standard deviation than man fees, however we found for our forecasting purposes the average of the previous 5 year's performance fees as a percentage of total assets captured the uncertainty around performance fees and represented a period in which there were highs and lows. The last number of years have been particularly volatile for funds in Europe, however it is representative of a future 5 year sample.

Exhibit 23 – Forecasted Performance Fees (Millions of EUR)

	2016	2017	2018	2019	2020	2021
+ Performance Fees	67.1	96.2	102.5	109.1	116.2	123.8

- Entry fees have experienced a -12% CAGR decline over the past five years. This has been a result of investors looking to purchase funds with lower entry fees. Clients having fees waived also played a central role in this decline. We believe the decline has hit a bottom in 2016 and that there will not be a major change either way in entry fees over the next five years. For this reason we have maintained the entry fees as a constant figure from 2016's.

Exhibit 24 – Forecasted Entry Fees (Millions of EUR)

	2016	2017	2018	2019	2020	2021
+ Entry Fees	16.5	16.5	16.5	16.5	16.5	16.5

- Banking and other fees have experienced a 5 year CAGR of 1.5%. We expect this trend to continue over the next 5 years as Banca Generali increase their customer base. Banca Generali has invested significantly in developing online platforms and hope to increase the client base by providing an excellent online service. Low cost online banking will put pressure higher growth rates.

Exhibit 25 – Forecasted banking Fees (Millions of EUR)

	2016	2017	2018	2019	2020	2021
+ Banking Fees	28.7	29.1	29.6	30.0	30.5	31.0

- When looking at the commission expenses we found that it is a relatively constant amount of total commission income. It ranged from 43%-49% of commission income over the five years from 2012 to 2016.

Exhibit 26 – Historical Commission & Fees Earned vs Expenses (Millions of EUR)

Source: Bloomberg

We believe that the commission expense will be constant going forward and will use an average of the last five years to capture the best estimate of the next five. Going forward 46% of commission income will be related to commission expenses.

Exhibit 27 – Forecasted Commission & Fees Expenses (Millions of EUR)

	2016	2017	2018	2019	2020	2021
+ Commissions & Fess Expense	295.5	303.8	322.4	342.1	363.2	385.6

8. Other Operating Income and Expenses

- Other operating income has experienced a 5 year CAGR of 24%. We do not expect this trend to continue over the next 5 years. From looking at the financial statements we found that the majority of this is made up of an item called 'Recovery of Taxes from customers'. This is due to the increase in non-performing loans in 2013 and 2014 which are being recovered in 2105 and 2016. As the NPL's doubled in 2013, the recovery of taxes has increased in recent years to make up for that.
  As the NPL issue is now relatively flat we decided the most accurate way to look at this for the next five years is to keep it the same as 2016's figure.

Exhibit 28 – Forecasted Other Operating Income (Millions of EUR)

	2017	2018	2019	2020	2021
+ Other Operating Income	44.5	44.5	44.5	44.5	44.5

- Other operating expenses have experienced a 5 year CAGR of 5.5%. This is due to the recent business expansion and large increases in IT expenditure. As the bank has quickly expanded in recent years so has the operating expenses. Below we can see the breakdown of operating expenses from the financial statements for 2016.

Exhibit 29 – Breakdown of Operating Expenses (Millions of EUR)

Employee salaries	80.47
Administration	15.79
Operations	34.98
IT	37.37
Taxes and duties borne by customers	43.69
BRRD and FITD	8.28
Adjustments	-0.78
Provisions for staff incentive fees/disputes/redundancy	24.74
+ Total Operating Expenses	244.55

Source: Banca Generali Annual Report

As management have indicated in the earnings call that they intend to continue increasing business investment we anticipate that the CAGR for the other operating expenses will continue to be 5.5% in 2017. However, as we move to 2021 the growth rate of expenses will not continue to grow at this level. We anticipate that by 2021 the growth rate of operating expenses will fall in line with the ECB target long term inflation rate of 2% which is our best estimate of inflation, and operating expenses growth, in the future.

Exhibit 30 – Forecasted Other Expenses Income (Millions of EUR)

	2017	2018	2019	2020	2021
+ Other Operating Expenses	259.0	270.7	280.1	287.1	292.9

9. Valuation

We used a dividend discount model to value Mediobanca, forecasting 5 years of net income. Since the working capital, capital expenditure and debt are not clearly defined and difficult to estimate, we cannot calculate the free cash flows with certainty. A DDM is most appropriate for the following reasons.

Financial firms tend to use more debt in funding their activities than non-financial services firms and the level of debt constantly changes according to the amount of short term deposits. Moreover, the degree of financial leverage is higher for banks than for other firms since banks tend to finance their activities by using deposits and, consequently, debt can be view as raw material rather than a pure liability.

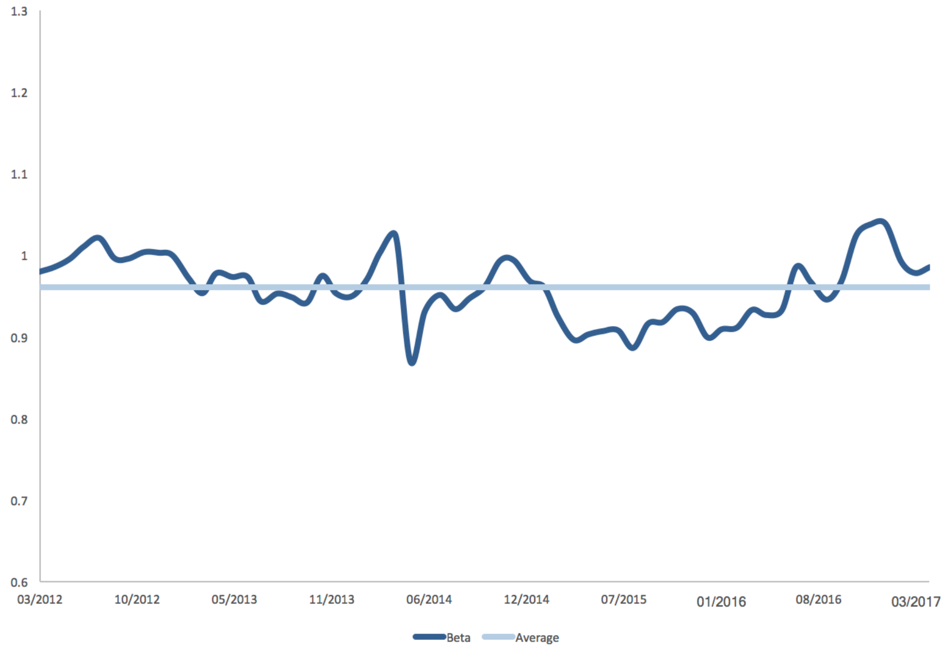
Defining the net working capital expenditures is problematic since banks do not have intangible assets such as plants and equipment and therefore corresponding low depreciation.

9.1 Cost of Equity

We calculated the cost of equity according to the CAPM:

- We estimated our **beta** by regressing the Banca Generali's monthly return against the FTSE Italia All-Share, the Italian index that comprises the FTSE MIB, FTSE Italia Mid Cap and FTSE Italia Small Cap, and captures approximately the 95% of the Italian total capitalisation. We created a 5-years window of beta and we noticed that it has oscillated around its mean value of 0.9602 during the past five years and therefore we decided to use this mean value in our analysis.
- Our **Market Risk Premium** of 7.62% has been computed as the average of annualised monthly Market Risk Premiums, from the start of 1930 to present, downloaded from the Fama and French online library.
- We used as **risk-free rate** the 3-months Italian Government Bond of -40 bps.
- Using the **CAPM** we estimated the cost of equity to be 7.30%.

Exhibit 31 – Rolling Beta



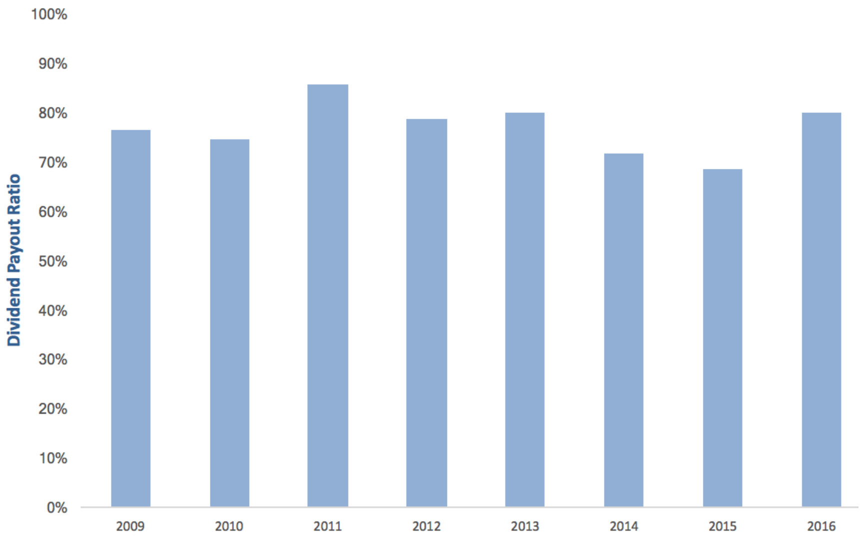
Source: Bloomberg

9.2 Assumptions

Our Dividend Discount Model calculates the sum of present values of future dividends and the present value of the Terminal Value. The Terminal Value is computed as follow.

- We assumed a constant dividend payout ratio of 76%. This is equal to the average of the last 8 years payout ratio. From listening to earnings call management have indicated that they plan on keeping the payout ratio within a 70%-80% range. The dividends are not a constant amount but a relatively constant percentage of net income.
- We assumed a terminal ROE of 26.4%
- We assumed a terminal growth rate of 1.5%.
- We have assumed a tax rate of 17.5%, which is equal to the average tax rate of the last 8 years.

Exhibit 32 – Historical Dividend Payout Ratio



Source: Bloomberg

Exhibit 33 – Projected Price

Dividend Payout Ratio	0.76
Last Dividend x Share	1.07
Diluted Shares Outstanding	116.60
COE	0.0730
Terminal ROE	26%
Terminal g	1.5%
Terminal (P/B) Multiple	4.30
Terminal Value	3865.62
PV Terminal	2717.72
PV Dividends	564.49
PV	3282.21
Projected Price	28.15
Current Share Price	27.85
Premium/Discount	1.07%

10. Sensitivity Analysis

We test the sensitivity of our model with respect to both changes in the growth rates and cost of equity. The growth rate ranges from 1% to 2%, while the cost of equity ranges from 7% to 8%.

Exhibit 34 – Sensitivity Analysis

	g = 1%	g = 1.2%	g = 1.4%	g = 1.6%	g = 1.8%	g = 2%
COE = 7.0%	26.79	27.36	27.96	28.62	29.32	30.08
COE = 7.2%	25.88	26.40	26.96	27.56	28.20	28.88
COE = 7.4%	25.04	25.51	26.02	26.57	27.15	27.78
COE = 7.6%	24.24	24.68	25.15	25.65	26.18	26.76
COE = 7.8%	23.50	23.90	24.33	24.79	25.28	25.80
COE = 8.0%	22.80	23.17	23.57	23.99	24.44	24.92

The price ranges from € 22.80 to € 30.08 per share, with an upside potential and a downside potential of 13.99% and -13.61%.

Exhibit 35 – Sensitivity Analysis. Relative changes

	g = 1%	g = 1.2%	g = 1.4%	g = 1.6%	g = 1.8%	g = 2%
COE = 7.0%	1.51%	3.66%	5.97%	8.44%	11.11%	13.99%
COE = 7.2%	-1.92%	0.05%	2.16%	4.42%	6.84%	9.45%
COE = 7.4%	-5.13%	-3.32%	-1.39%	0.68%	2.89%	5.26%
COE = 7.6%	-8.13%	-6.47%	-4.70%	-2.80%	-0.78%	1.38%
COE = 7.8%	-10.96%	-9.42%	-7.79%	-6.05%	-4.20%	-2.22%
COE = 8.0%	-13.61%	-12.19%	-10.69%	-9.09%	-7.39%	-5.58%

11. Recommendation: HOLD

Our recommendation is to hold Banca Generali. Banca Generali has enjoyed strong returns over the past few years due to its strong growth in market share and huge increase in AUM. Using our best estimates to forecast each section of revenue we found that the bank has been fairly priced by the market.

Banca Generali will experience strong growth over the next number of years and we find that the market has come to the same conclusion as we have about the net income figures.

Projected Net Income

	2016	F 2017	F 2018	F 2019	F 2020	F 2021
Net Revenue	739.9	754.3	796.7	841.8	895.1	952.4
+ Net Interest Income	60.6	65.5	67.7	70.0	80.5	91.7
+ Total Non-Interest Income	679.3	688.8	729.0	771.8	814.6	860.7
+ Trading Account Profits/Losses	2.4	3.5	3.5	3.5	3.5	3.5
+ Investment & Loan Inc (Loss)	27.7	27.7	27.7	27.7	24.9	22.4
+ Entry Fees	16.5	16.5	16.5	16.5	16.5	16.5
+ Man Fees	492.3	515.8	549.3	585.0	623.0	663.5
+ Performance Fees	67.2	96.2	102.5	109.1	116.2	123.8
+ Banking Service Fees	28.7	29.1	29.6	30.0	30.5	31.0
+ Other Operating Income	44.5	44.5	44.5	44.5	44.5	44.5
- Provision for Loan Losses	1.9	2.1	2.3	2.5	2.7	2.9
Net Revenue after Provisions	738.0	752.2	794.4	839.3	892.4	949.5
- Total Non-Interest Expense	541.2	562.8	593.0	622.3	650.3	678.5
+ Commissions & Fees Paid	295.7	303.8	322.4	342.1	363.2	385.6
+ Other Operating Expenses	245.5	259.0	270.7	280.1	287.1	292.9
Operating Income (Loss)	196.8	189.5	201.4	217.0	242.1	271.0
- Abnormal Loss	12.0	0.0	0.0	0.0	0.0	0.0
Pretax Income (Loss), Adjusted	184.8	189.5	201.4	217.0	242.1	271.0
- Income Tax Expense (Benefit)	28.9	33.2	35.2	38.0	42.4	47.4
Net Income	155.9	156.3	166.2	179.1	199.7	223.6

Dividend Discount Model

	2016	F 2017	F 2018	F 2019	F 2020	F 2021
Net Income	155.9	156.3	166.2	179.1	199.7	223.6
% Growth		*0.3%*	*6.3%*	*7.8%*	*11.5%*	*11.9%*
Dividends	124.8	118.8	126.3	136.1	151.8	169.9
Payout Ratio	80%	76%	76%	76%	76%	76%
Beginning Shareholder Equity	646.5	677.6	715.1	755.0	798.0	845.9
Plus: Net Income	155.9	156.3	166.2	179.1	199.7	223.6
Less: Dividends	-124.8	-118.8	-126.3	-136.1	-151.8	-169.9
Ending Shareholder Equity	677.6	715.1	755.0	798.0	845.9	899.5
ROE	24.1%	23.1%	23.2%	23.7%	25.0%	26.4%
Discounting period	*0*	*1*	*2*	*3*	*4*	*5*
PV of dividends		110.7	109.7	110.2	114.5	119.4

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