Company

Global Markets Research

Deutsche Bank

6 March 2009

Credem

Reuters: **EMBI.MI** Bloomberg: **CE IM** Exchange: **MIL** Ticker: **EMBI**

Q4-08 results preview: Upgrade to Hold

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Estimates revision; target price reduced to Euro 2.3 – upgrade to Hold
After downgrading Credem to Sell on 13 January, Credem lost some 53% of its market value and is now trading at 2009E P/TE of 0.5x – no longer with an unjustified premium towards peers. Therefore, we upgrade our recommendation to Hold from Sell after lowering our estimates. In particular, for 2009E we factor in a strong reduction of net interest income (-9% YoY) and an increase in provisions on loan losses (82bps).

Q4-08 results preview: losses due to mark-to-market and higher provisions
Credem should report Q4-08 on 30 March after the market close. We expect a Q4-08 net loss of Euro 48m, due to increasing provisions on loan losses (71bps, annualized) and the mark-to-market of some "plain vanilla" securities held by Abax. As far as the latter is concerned, we believe the rationale behind the recent change of management was to limit its expansion for cost reasons, rather than for risk reasons (i.e. Abax's has more than 160 employees and they are more expensive than average).

Core Tier 1 ratio at 6.6% in 2008E, up to 7% with Euro ~100m Tremonti-bonds
Credem should close 2008E with a Core Tier 1 ratio of 6.6%. This includes the payment of Euro 0.20 DPS, which corresponds to a 50% payout on our new 2008 earnings estimates. Management considers the current capital position suitable for Credem's risk profile; but based on the eventual "moral suasion" from authorities or the level of solvency ratios that its peers decide to keep in 2009. Credem may look into issuing Tremonti-bonds (hybrids to be underwritten by the Italian government). We assume Credem could aim to reach Core Tier 1 ratio of 7% in 2009 via Euro ~100m of Tremonti-bonds (H2-09), maintaining a 50% dividend payout. Note also that Credem may have different options to strengthen its ratios (i.e. the already approved second leg of the Euro 250m capital increase or the issue of other forms of hybrid capital).

Valuation and risks
We reduce our target price to Euro 2.3 from Euro 3.3 due to an EPS cut of 31%, 72% and 17% in 2008E, 2009E and 2010E, respectively. We value Credem via a Gordon model (cost of equity: 9.7%, perpetual growth rate: 2.5%). A generic risk for the bank and its peers is a downturn in the economic environment, which would affect our revenues and loan loss provisions assumptions (*for further details on valuation and risks, please refer to page 6*).

Forecasts and ratios

Year End Dec 31	2006A	2007A	2008E	2009E
EPS Adjusted (EUR)	0.81	0.92	**0.40**	0.07
DPS(EUR)	0.35	0.36	**0.20**	0.04
Dividend Yield (%)	3.3	3.4	**10.9**	2.4
P/B Tangible (x)	2.2	1.7	**0.4**	0.4

Source: Deutsche Bank estimates, company data

Forecast change

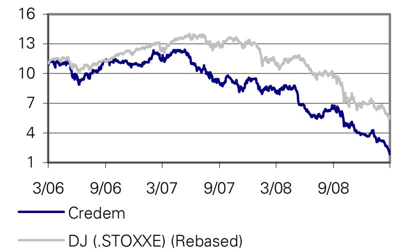
Hold

Price at 6 Mar 2009 (EUR)	**1.84**
Price Target (EUR)	**2.30**
52-week range (EUR)	**8.82 - 1.84**

Key changes

Rating	Sell to Hold ↑		
Target Price	3.30 to 2.30 ↓		**-30.3%**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*-42.9*	*-52.7*	*-77.5*
DJ (.STOXXE)	*-19.9*	*-16.2*	*-50.2*

Stock & option liquidity data

Price Target (EUR)	2.30
Market cap (EUR)	605
Shares outstanding (m)	304
Free float (%)	1
Option volume (und. shrs., 1M avg.)	–

Deutsche Bank AG/London

Model updated:17 July 2008

Running the numbers

Europe

Italy

Banks

Credem

Reuters: EMBI.MI Bloomberg: CE IM

Hold

Price (6 Mar 09)	EUR 1.84
Target price	EUR 2.30
52-week Range	EUR 1.84 - 8.82
Market Cap (m)	EURm 605 USDm 759

Company Profile

Credem is a banking group, with some 20 subsidiaries. It is based in Emilia Romagna, a region in the Centre of Italy, but it operates through a nationwide retail network (more then 450 branches). It is also active in brokerage and in Investment banking.

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Fiscal year end 31-Dec	2005	2006	2007	2008E	2009E	2010E
Data Per Share						
EPS (stated)(EUR)	0.91	0.84	0.90	0.40	0.09	0.31
EPS (DB) (EUR)	0.86	0.81	0.92	0.40	0.07	0.31
Growth Rate - EPS (DB) (%)	68.1	-6.0	13.8	-56.7	-82.1	334.3
DPS (EUR)	0.50	0.35	0.36	0.20	0.04	0.15
BVPS (stated) (EUR)	4.62	5.08	5.62	5.59	5.37	5.61
Tang. NAV p. sh. (EUR)	4.50	4.97	5.51	4.37	4.15	4.38
Market Capitalisation	2,586	2,991	2,630	605	605	605
Shares in issue	274	276	279	304	329	329
Valuation Ratios & Profitability Measures						
P/E (stated)	10.4	12.8	10.5	4.6	20.7	6.0
P/E (DB)	11.0	13.3	10.3	4.6	25.9	6.0
P/B (stated)	2.0	2.1	1.7	0.3	0.3	0.3
P/Tangible equity (DB)	2.1	2.2	1.7	0.4	0.4	0.4
ROE(stated)(%)	19.3	17.3	16.7	7.1	1.6	5.6
ROTE (tangible equity) (%)	21.2	17.0	17.5	8.1	1.7	7.2
ROIC (invested capital) (%)	18.1	16.7	17.2	7.1	1.3	5.5
Dividend yield(%)	5.8	3.3	3.4	10.9	2.4	8.4
Dividend cover(x)	1.8	2.4	2.5	2.0	2.0	2.0
Profit & Loss (EURm)						
Net interest revenue	366	419	491	554	503	532
Non interest income	582	640	579	362	372	429
Commissions	406	414	377	288	277	282
Trading Revenue	-80	-123	-171	-300	-200	-200
Other revenue	257	349	372	374	295	347
Total revenue	949	1,060	1,070	916	875	961
Total Operating Costs	608	653	682	677	689	702
Employee Costs	370	388	394	397	405	413
Other costs	238	265	288	280	284	288
Pre-Provision profit/(loss)	337	415	408	249	196	269
Bad debt expense	23	26	54	80	146	101
Operating Profit	318	381	334	159	40	159
Pre-tax associates	0	0	0	0	0	0
Pre-tax profit	318	381	334	159	40	159
Tax	63	148	78	38	19	57
Other post tax items	-5	-1	-7	0	8	0
Stated net profit	250	232	249	121	29	101
Goodwill	0	0	0	0	0	0
Extraordinary & Other items	-14	-9	7	0	-6	0
Bad Debt Provisioning	0	0	0	0	0	0
Investment reval, cap gains / losses	0	0	0	0	0	0
DB adj. core earnings	236	223	256	121	23	101
Key Balance Sheet Items (EURm) & Capital Ratios						
Risk-weighted assets	13,879	14,960	16,221	18,522	19,166	20,105
Interest-earning assets	17,957	20,795	22,611	24,725	25,525	26,642
Customer Loans	12,718	14,385	15,763	17,319	17,921	18,799
Total Deposits	9,521	10,917	11,240	12,252	12,864	13,507
Stated Shareholder Equity	1,266	1,415	1,567	1,837	1,764	1,842
Equals: Tangible Equity	1,235	1,384	1,535	1,435	1,362	1,440
Tier 1 capital	1,056	1,175	1,306	1,228	1,342	1,384
Tier 1 ratio (%)	8	8	8	7	7	7
o/w core tier 1 capital ratio (%)	7.6	7.9	8.0	6.6	7.0	6.9
Credit Quality						
Gross NPLs/Total Loans(%)	1.30	1.29	1.74	1.62	1.59	1.55
Risk Provisions/NPLs(%)	60	58	58	59	60	60
Bad debt / Avg loans (%)	0.19	0.19	0.36	0.49	0.82	0.54
Bad debt/Pre-Provision Profit(%)	6.8	6.2	13.1	32.3	74.5	37.4
Growth Rates & Key Ratios						
Growth in revenues (%)	14	12	1	-14	-4	10
Growth in costs (%)	-2	7	4	-1	2	2
Growth in bad debts (%)	184	12	109	50	82	-31
Growth in RWA (%)	8	8	8	14	3	5
Net int. margin (%)	2.13	2.16	2.26	2.34	1.97	2.00
Cap.-market rev. / Total revs (%)	21	nm	nm	nm	nm	nm
Total loans / Total deposits (%)	134	132	140	141	139	139
ROTE Decomposition						
Revenue % ARWAs	7.11	7.35	6.86	5.28	4.65	4.89
Net interest revenue % ARWA	2.75	2.91	3.15	3.19	2.67	2.71
Non interest revenue % ARWA	4.37	4.44	3.71	2.08	1.98	2.18
Costs/income ratio (%)	64.5	60.8	61.9	72.8	77.6	72.0
Bad debts % ARWAs	0.17	0.18	0.34	0.46	0.78	0.51
Tax rate (%)	19.8	38.8	23.3	23.9	47.0	36.1
Adj. Attr. earnings % ARWA	1.77	1.55	1.64	0.70	0.12	0.52
Capital leverage (ARWA/Equity)	12.0	11.0	10.7	11.7	13.5	14.0
ROTE (Adj. earnings/Ave. equity)	21.2	17.0	17.5	8.1	1.7	7.2

Source: Company data, Deutsche Bank estimates

Q4-08 results preview

Results due on 30 March

Credem should report Q4-08 results on 30 March after the market close.

We expect a Q4-08 net loss of Euro 48m due to higher trading losses (mark-to-market of Abax's portfolio) and high provisions on loan losses (71bps, annualized).

Figure 1: Credem: Q4-07 results preview

	Q1-07	Q2-07	Q3-07	Q4-09	Q1-08	Q2-08	Q3-08	Q4-08E	QoQ	YoY
	PF	PF	PF	PF					% ch.	% ch.
Net interest income	116	115	129	140	143	138	139	134	-4	-4
Dividends & associates	2	277	1	35	0	287	52	4	nm	nm
Trading income	46	-219	8	-5	8	-217	-33	-58	nm	nm
Net commissions & other income	94	105	104	101	86	86	64	82	27	-19
Total net income	258	277	242	270	237	295	223	162	-27	-40
Total costs	159	162	162	146	169	170	157	172	10	17
Gross operating result	99	115	80	124	69	124	66	-10	nm	nm
Total net provisions	6	11	8	49	6	15	34	35	2	-28
Goodwill amortization	0	0	0	0	0	0	0	0		
Net operating result	92	104	72	75	63	109	32	-45	nm	nm
Extraordinary items	0	0	0	-6	0	0	0	0	nm	nm
Pre-tax profit	92	104	72	68	63	109	32	-45	nm	nm
Taxes	37	40	20	-30	16	7	12	3	nm	nm
Minorities	0	0	-2	-13	0	0	0	0	nm	nm
Net Profit	55	64	54	112	47	102	19	-48	nm	nm

Source: Deutsche Bank Estimates; Company Data

Overall, revenues should be down both YoY and QoQ: the YoY performance should relate to the poor trends of commissions and trading income, which were only partially offset by some resilience of the net interest income.

In particular, net interest income (Euro 134m) should be 4% down QoQ and YoY due to margin compression coming from the interest rate cut. Also, net commission and other income should be down 19% YoY due to the outflows from AUM; the QoQ movement (+27%) is because Credem's insurance activities recorded very poor performance in Q3-08 (negative for Euro 24m), which we do not forecast for Q4-08; net of this effect, commissions and other income would be down 7% QoQ. For trading income, we expect a loss of Euro 58m, mostly related to the negative impact of the mark-to-market of some "plain vanilla" securities in Abax's portfolio.

Operating cost should increase 17% YoY (due to the new branches, mainly) and 10% QoQ (due to seasonality).

Total provisions should be Euro 35m, up 2% QoQ. The YoY comparison is odd, as they were particularly high in Q4-07 due to the preceding "under-provisioned" quarters and also due to the record of exceptional provisions on risk and charges. The provisioning level on loan losses should be 71bps, annualized.

Estimates revision

Lower net interest income and higher provisions in 2009E

We revise our estimates, cutting EPS by 31%, 72% and 17% in 2008E, 2009E and 2010E, respectively.

Figure 2: Credem: estimates revision

Consolidated data	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
(Euro million)	old	old	old	Estimates revision (%)			new	new	new
Net interest income	554	531	557	0	-5	-4	554	503	532
Dividends & associates	344	284	314	0	-11	-3	344	254	304
Trading income	-250	-200	-200	20	0	0	-300	-200	-200
Net commissions & other income	328	318	324	-3	0	0	318	318	324
Total net income	976	933	995	-6	-6	-3	916	875	961
Total costs	672	672	687	-1	1	1	667	679	692
Gross operating result	304	261	308	-18	-25	-13	249	196	269
Total net provisions	93	113	110	-3	38	1	90	156	111
Goodwill amortization									
Net operating result	211	148	198	-25	-73	-20	159	40	159
Extraordinary items	0	8	0				0	8	0
Pre-tax profit	211	156	198	-25	-69	-20	159	48	159
Taxes	35	52	75	7	-64	-24	38	19	57
Minorities	0	0	0				0	0	0
Net Profit	176	104	123	-31	-72	-17	121	29	101

Source: Deutsche Bank Estimates

The changes in our 2009 and 2010 forecasts relate to net interest income and, above all, provisions on loan losses.

In particular, for 2009E we assume a 9% YoY decline in net interest income, due to limited growth in customer loans (+3.5% YoY) and relevant compression of spreads. A potential increase of the mark up should not be enough to offset the decline of the mark down, because only part of the assets could be effectively re-priced, in our view (large corporate exposures, mainly; more difficultly for SMEs and retail loans), while the majority of the funding (except the wholesale funding, which is linked to Euribor) has no compressible costs.

For 2009E, we also expect higher cost of credit (82bps), which is somewhat above the annualized provisioning that we expect for Q4-08 (71bps). This level is slightly better than what we expect for its peers (partly due to the geography and sector mix of Credem's exposures, but also due to a certain time lag, as normally the real economy deterioration is visible in Lombardy first), and also because Credem's starting point was materially below average.

Figure 3: Credem: main P&L trends

	2006	2007	2008E	2009E	2010E	07E/06E Ch. (%)	08E/07E Ch. (%)	09E/08E Ch. (%)	10E/09E Ch. (%)
Net interest income	419	491	554	503	532	17%	13%	-9%	6%
Dividends & associates	280	315	344	254	304	12%	9%	-26%	20%
Trading income	-123	-171	-300	-200	-200	38%	76%	-33%	0%
Net commissions & other income	484	435	318	318	324	-10%	-27%	0%	2%
Total net income	1060	1070	916	875	961	1%	-14%	-4%	10%
Total costs	645	662	667	679	692	3%	1%	2%	2%
Gross operating result	415	408	249	196	269	-2%	-39%	-21%	37%
Total net provisions	34	74	90	156	111	117%	22%	73%	-29%
Goodwill amortization									
Net operating result	381	334	159	40	159	-12%	-52%	-75%	297%
Extraordinary items	9	-7	0	8	0				
Pre-tax profit	390	327	159	48	159	-16%	-51%	-70%	230%
Taxes	148	78	38	19	57	-48%	-51%	-50%	204%
Minorities	10	0	0	0	0	-100%	-51%	-70%	230%
Net Profit	232	249	121	29	101	7%	-52%	-76%	247%

Source: Deutsche Bank Estimates; Company Data

Abax: what's going on?

Credem should progressively downsize Abax, its investment banking arm. The company says that it would be more for "cost" reasons, rather than because of "risk". The rationale behind the change of management in Abax should be to limit its expansion from and to re-orient its strategy. A disposal is unlikely in this market environment; so, as of now, the only feasible project could be a gradual reduction of Credem's commitment, starting from the merger of the sum of its funds and to the reduction of the number of its employees (more than 160 people and more expensive than average).

Capital ratios

Credem should close 2008E with a Core Tier 1 ratio of 6.6%. This includes the payment of Euro 0.20 DPS, which corresponds to a 50% payout on our new 2008 earnings estimates.

Management considers the current capital position suitable for Credem's risk profile; however, based on the eventual "moral suasion" from authorities or on the level of solvency ratios that its peers decide to keep over the course of 2009, Credem may decide to issue Tremonti-bonds (hybrids to be underwritten by the Italian Government).

We assume that Credem might aim to reach Core Tier 1 ratio of 7% in 2009 via Euro ~100m of Tremonti-bonds (H2-09), maintaining a 50% dividend payout. We account for the costs of these instruments (8.5% yield) as a capital expenditure, like a dividend payment.

It might be worth mentioning that Credem may have different options to strengthen its ratios (i.e. the already approved second leg of the Euro 250m capital increase or the issue of other forms of hybrid capital).

Valuation

Target price

We reduce our target price to Euro 2.3 from Euro 3.3 and we upgrade the stock to Hold.

Figure 4: Valuation

	2009E	2010E
Equity	1764	1842
Goodwill	402	402
Tangible equity	1362	1440
Average Tangible equity		1401
Adjusted net profit	23	101
Average ROTE (%)		7.2
Shares (#)		329
Average Tangible equity per share		4.3
Free risk rate		5.0
Beta		1.18
Market premium		4.0
Discount factor		9.7
G		2.5
Fair value		2.8
Target price		2.3

Source: Deutsche Bank Estimates

Risks

As far as generic risks are concerned, we think that Credem, like its peers, remains exposed to a potential downturn in the economic environment, which could affect our revenues and loan loss provisions assumptions. Moreover, the new and constant attention that a number of authorities (customer associations, Bank of Italy and Antitrust, European Union) are paying on the costs of banking services in Italy (in comparison with the lower European average) could increase competition and margin pressure on the whole system.

As far as company-specific risks are concerned, we believe that due to its exposure to asset management and brokerage businesses, Credem would be negatively affected by any unexpected worsening of trends in equity markets. Credem is also exposed to export-oriented areas and industrial districts and could be negatively affected by changes in the Euro-USD exchange rate. Finally, the lack of free float could be another specific risk for the bank. Specific upside risks: our estimates on the cost of credit for Credem might reveal too conservative for the traditionally prudent risk profile of the bank.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist			
Company	**Ticker**	**Recent price***	**Disclosure**
Credem	EMBI.MI	1.84 (EUR) 6 Mar 09	8

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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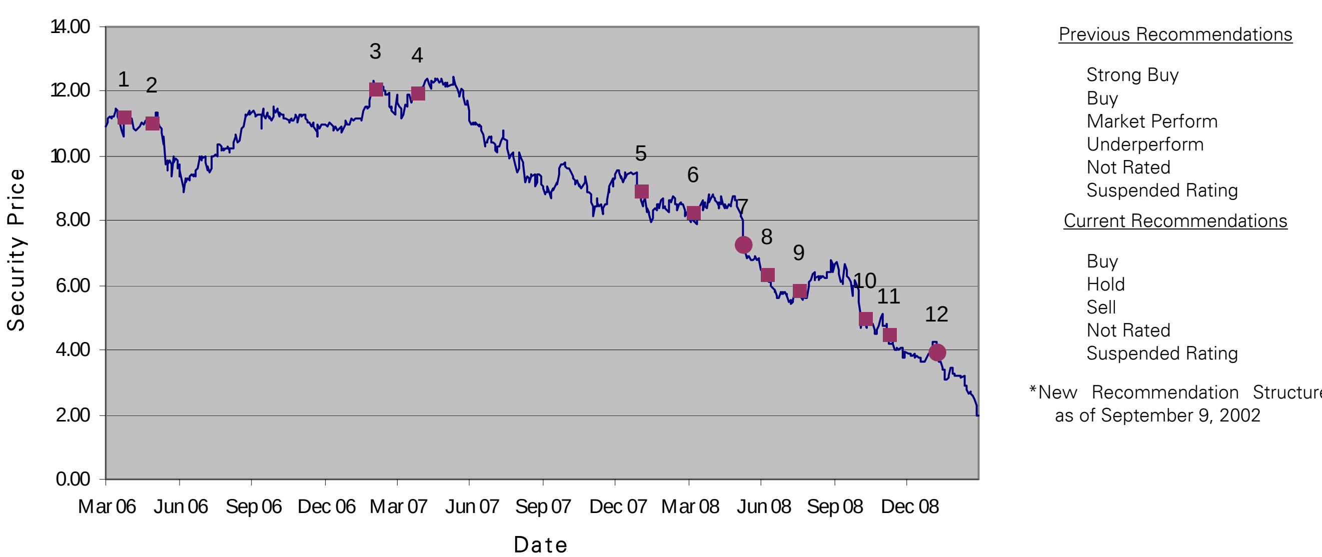
Historical recommendations and target price: Credem (EMBI.MI)

(as of 3/6/2009)



1.	30/3/2006:	Buy, Target Price Change EUR13.00	7.	16/5/2008:	Downgrade to Hold, Target Price Change EUR8.90
2.	4/5/2006:	Buy, Target Price Change EUR13.40	8.	13/6/2008:	Hold, Target Price Change EUR8.60
3.	8/2/2007:	Buy, Target Price Change EUR14.00	9.	23/7/2008:	Hold, Target Price Change EUR6.60
4.	3/4/2007:	Buy, Target Price Change EUR14.30	10.	14/10/2008:	Hold, Target Price Change EUR5.70
5.	8/1/2008:	Buy, Target Price Change EUR11.20	11.	13/11/2008:	Hold, Target Price Change EUR5.00
6.	12/3/2008:	Buy, Target Price Change EUR10.40	12.	13/1/2009:	Downgrade to Sell, Target Price Change EUR3.30

Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
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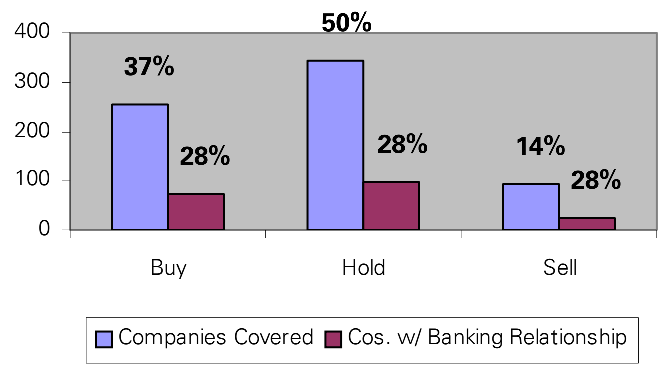
   Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



European Universe

Regulatory Disclosures

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