

Banking Sector

1Q24 previews

It's not the EPS, It's the Cost of Equity (...and strong 1Q24E)

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Italian Equity Market

Approaching the 1Q24 report season, we are revising UP banks' valuations, factoring in a lower CoE, on average 1% less, leaving our EPS estimates broadly unchanged. 1Q24 is expected to be a good quarter, mainly on the basis of *high-for-longer* Euribor rates and their impact on NII, despite *weakish* volumes. Meanwhile, CoR remains under control with low demand and banks' risk-averse strategy on new lending. 1Q24 positive results may give more visibility on 2024 projections. That said, the greenlight by the ECB on payout policies suggests banks' balance sheets are safer than before: in our view, this means that valuations may find further upside potential, not because of EPS upgrades but via a decreasing Market Premium leading to a lower Cost of Equity. All the banks are at their 5-y Market Cap highs; however, we maintain a NEUTRAL bias also on the back of a rich payout season. Looking forward, we still prefer banks that show higher exposure on WM, namely ISP, MB and Credem, in line with our 1H24 strategy. 1Q24 should likely see small/mid-cap banks benefitting more from NII exposure, while big caps may provide some guidance on hedging facilities set up to "contain" weakening NII on decreasing market rates.

- **What to expect in 1Q24.** We expect a sound quarter with NII still up Y/Y (down low-single digit Q/Q, also on a day-count effect) and low cost of risk on a healthy asset quality situation. The NII Y/Y comparison is still favourable given the trends in Euribor rates but will lose "power" going forward in the next quarters; incidentally, the stock of loans is still decreasing on lack of demand for new lending, especially corporate, on excessively high market rates. OpEx are seen up, mainly due to renewal of the national employment contract for banking employees, partially offset by early redundancies. To sum up: a good quarter is expected for all the banks.
- **Pay date is now.** In 1 month, we have all banks going ex-DPS (BAMI/UCG are already ex-date); that said, after the 1Q24 release, a few buybacks should be in the pipeline (UCG €3.1bn and ISP €1.7bn, MB to follow for up to €0.8bn but to be split over 2 years).
- **Resilient macro trend.** Latest BoI data (Feb. 2024) suggest that Italian banks again improved their commercial spread, with the rise in funding costs more than offset by higher yields on NNM. The other side of the coin is that volumes are clearly suffering. NPLs are steady, coverage flattish. Govies still down.
- **M&A.** A few BoDs have been renewed and the dividend season is now on. With UCG trading at around 1x 2023 t-NAV and €10bn of free capital in their pocket, we wonder if their M&A appetite may suddenly change...
- **Valuations.** We do not see much room for earnings upgrades apart from possible fine-tuning after the release of numbers, especially considering that 1) the "rolling" NII Y/Y comparison is going to lose "power" in 2H24; 2) if rates go down, banks will try to switch clients' money from AuC (i.e. IT Govies) towards AuM, but this takes time; this, together with a sluggish trend in volumes (due to high rates and banks' risk-averse strategy), may imply a weakening of 2H24 NII, which is in our estimates. Banks may count on support from dividends and SBBs that could stabilize their valuations together with an incoming good 1Q24. We are reducing Cost of Equity right now by 1% on average, thus improving banks' valuation. The view is that there has been a turning point in investors' risk-aversion on Italian banks, a situation greenlighted by the regulator, which allowed higher-than expected payout policies. Price target changes in the table overleaf. We remain positive on WM exposed stocks (ISP, MB, Credem) as we were in the 1H24 strategy, and to banks exposed to M&A (BAMI, BMPS, BPSO). We remain NEUTRAL on UCG, BPER since we believe they are possible natural bidders.

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- For the utilities sector comparisons are made between expected returns and the return on the regulatory asset base (RAB)

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