

Q1 2010 PREVIEW: TRENDS EXPECTED TO WEAKEN FURTHER

BBVA reports its Q1 2010 earnings next Wednesday 28 April (at about 7am GMT). We believe the key items to look at for BBVA will be the NIM, development of asset quality (specifically LLC, coverage ratio and NPL growth), and also loan growth. We expect all the trends in these to show deterioration (or, in the case of LLC, to remain at elevated levels, given that in Q3 and Q4 2009 they were already at exceptionally high levels).

We have a SELL rating and target price of €9.60 per share on BBVA, indicating 12% downside. We do not think any positive earnings surprises in the Mexican operations (which account for only 17% of operating profit) will be sufficient to offset the significant deterioration that we expect for Iberia, which accounts for 61%.

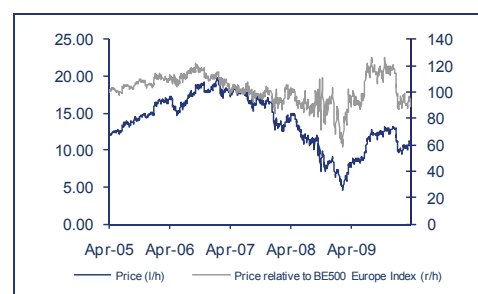
- We expect LLC to remain at elevated levels. Note that loan losses in Q3 and Q4 2009 were already relatively high, at €1.7bn and €1.8bn, respectively. We are far more pessimistic than consensus with respect to our forecast for Q1 2010, believing that the LLC will fall only slightly to €1.6bn (due to the fact that there may have been some conservative provisioning made in the last quarter). This is the main source of delta between us and consensus, in our opinion. Our reasons for believing that loan losses will continue to be significant are because NPLs continue to increase at a rapid pace (+29% in Q4 2009) and the coverage ratio continues to fall (to 57% in Q4 2009 from 67% in Q3 2009), putting more pressure on management to write off loans, and use earnings to supplement provisions.
- We expect the NIM and NII to start seeing pressure from declining asset spreads. We anticipate a NIM for Q1 2010 of 4.08%, down from 4.15% in Q4 2009, with NII falling 2.3% QoQ. The main component of asset pricing comes from retail mortgages, which are largely priced off 12-month EURIBOR. 12-month EURIBOR only started falling in October 2009, so we believe the negative impact will only now start to impact on margins in earnest. Our expectation is supported by the 6bps deterioration in Q1 2010 NIM seen at Bankinter. The negative impact on liability margins arising from the aggressive price war for deposits should only be felt from Q2 2010 onwards, in our view.
- We believe BBVA will also continue to experience loan book contraction, in keeping with the 1.4% contraction in the Spanish economy forecast by consensus in Q1 2010. This will have a direct impact on the amount of NII generated. We expect customer loans to contract some 1% QoQ in Q1 2010, rather than grow as some bullish analysts will have forecast.

Research

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Rating	SELL
Target price (€)	9.60
Yesterday's closing price	10.89
Upside / Downside	-12%
Sector	Pan-Euro Banks
Market cap (€bn)	39.4

(€/€m)	2009A	2010E	2011E
Net interest income	13,881	13,376	11,943
Net fees & commissions	4,430	4,468	4,680
Trading profits/losses	1,544	1,453	1,482
Other revenue	811	887	902
Total op. revenues	20,666	20,184	19,007
Operating costs	-8,359	-8,224	-8,266
Operating profit	12,308	11,960	10,741
Total provisions	-5,931	-7,109	-5,643
Pre-tax profit	5,735	4,051	4,799
ROA	0.78%	0.52%	0.57%
ROE	15.32%	9.57%	10.56%
ROTNNAV	21.44%	12.76%	14.12%
Cost/Income	-40.45%	-40.74%	-43.49%
Net interest margin	3.88%	3.96%	3.66%
LLC % gross loans	-1.63%	-2.11%	-1.71%
NPL ratio	4.70%	7.00%	6.90%
NPL coverage ratio	57.32%	35.00%	25.00%
Loans % deposits	127%	112%	101%
Core tier 1 ratio (Basel II)	7.97%	8.04%	8.29%
Est. Core tier 1 ratio (Basel III)	5.75%	5.82%	6.07%
EPS	1.13	0.78	0.92
DPS	0.27	0.19	0.23
Payout ratio	23.76%	25.00%	25.00%
P/E	9.61	13.98	11.80
P/TNAV	1.85	1.75	1.62
Div yield	2.45%	1.77%	2.10%



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Figure 1: BBVA Earnings Table

BBVA	Q4 2009	FY 2009	Q1 2010E	Q1 2010E Cons.	FY 2010E	FY 2011E	FY 2012E
INCOME STATEMENT (€m)							
Net interest income	3,589	13,881	3,507		13,376	11,943	11,506
Net fees & commissions	1,163	4,430	1,106		4,468	4,680	4,903
Trading profits/losses	420	1,544	371		1,453	1,482	1,511
Other revenue	116	811	222		887	902	918
Total operating revenues	5,288	20,666	5,205		20,184	19,007	18,838
Operating costs	-2,254	-8,359	-2,110		-8,224	-8,266	-8,409
Operating profit	3,034	12,308	3,095	2,900	11,960	10,741	10,428
Total provisions	-2,011	-5,931	-1,674		-7,109	-5,643	-3,460
Investment income	-1,238	-641	-200		-800	-300	0
Impairments on other assets	0	0	0		0	0	0
Goodwill impairment	0	0	0		0	0	0
Pre-tax profit	-215	5,735	1,222	1,592	4,051	4,799	6,969
Taxes	277	-1,141	-293		-972	-1,152	-1,672
Minorities	-31	-384	-56		-185	-219	-318
Other non-operating items	-1	0	1		0	0	0
Net profit	30	4,210	874	1,176	2,894	3,428	4,978
ASSETS (€m)							
Loans to customers	323,878	323,878	319,194		309,507	305,543	300,394
Interbank loans	22,239	22,239	21,572		19,891	18,347	17,980
Total securities	141,027	141,027	143,848		152,652	165,236	178,856
Intangible assets	7,248	7,248	7,393		7,845	8,492	8,492
Total assets	535,065	535,065	545,530		578,622	632,204	685,270
Net interest-earning assets	346,117	346,117	340,766		329,398	323,889	318,374
LIABILITIES (€m)							
Interbank borrowings	70,312	70,312	71,718		76,108	82,382	89,173
Customer deposits	377,624	377,624	385,176		408,752	448,329	485,286
Total shareholders' equity	29,300	29,300	29,650		31,166	33,737	37,471
Tangible net asset value	22,052	22,052	22,257		23,320	25,245	28,978
IMPORTANT FINANCIAL RATIOS							
ROA	0.02%	0.78%	0.65%		0.52%	0.57%	0.76%
ROE	0.42%	15.32%	11.84%		9.57%	10.56%	13.98%
ROTNAV	0.57%	21.44%	15.76%		12.76%	14.12%	18.36%
Cost/income	-42.62%	-40.45%	-40.54%		-40.74%	-43.49%	-44.64%
Tax rate	-128.84%	-19.90%	-24.00%		-24.00%	-24.00%	-24.00%
Payout ratio	1083.87%	23.76%	25.00%		25.00%	25.00%	25.00%
Net interest margin	4.15%	3.88%	4.08%		3.96%	3.66%	3.58%
LLC % gross loans	-2.16%	-1.63%	-2.10%		-2.11%	-1.71%	-1.03%
Non-performing loans % gross loans	4.70%	4.70%	5.50%		7.00%	6.90%	5.60%
NPL coverage ratio	57.32%	57.32%	52.00%		35.00%	25.00%	60.00%
Loans % deposits	127.42%	127.42%	123.11%		112.49%	100.61%	91.38%
Tier 1 ratio	9.36%	9.36%	9.13%		9.21%	9.41%	10.12%
Core tier 1 ratio (Basel II)	7.97%	7.97%	7.92%		8.04%	8.29%	9.05%
Est. Core tier 1 ratio (Basel III)	5.75%	5.75%	5.70%		5.82%	6.07%	6.83%
RWA % total assets	54.39%	54.39%	54.15%		52.59%	50.34%	48.56%

Source: Matrix Research

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