KBC Group SA/NV KBC (XBRU) | ★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
52.73 EUR	69.00 EUR	Medium	Narrow	Stable	Standard	Banks

Lower Bank Taxes and Organic Volume Growth Help Boost KBC's Second-Quarter Results

See Page 2 for the full Analyst Note from 11 Aug 2016

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The primary analyst covering this company does not own its stock.

Research as of 11 Aug 2016
Estimates as of 24 Jun 2016
Pricing data through 30 Aug 2016
Rating updated as of 30 Aug 2016

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

Contents

Investment Thesis 27 Jun 2016

KBC has now fully righted itself, more so than most banks nearly toppled by the financial crisis. The bank has sold off multiple businesses, which has boosted its capital ratios, while increasing its focus on its attractive and profitable Belgium and Czech Republic banking operations. Finally, in what we think is a major accomplishment, the bank repaid the final EUR 2 billion of government aid plus a 50% penalty at the end of 2015, well ahead of its original 2017 schedule and the government's 2020 requirement.

We're fans of KBC's Belgium business, which accounts for more than half of allocated equity and is the biggest source of the bank's narrow economic moat. In Belgium, KBC is one of the top financial services groups, enjoying an estimated 20%-25% share in banking and a 35% share in investment products, with more than EUR 200 billion in AUM and EUR 29 billion in life reserves. Underlying returns on equity are typically above 20% and sometimes more than 30%, and we expect these levels of returns to persist going forward. However, domestic growth is limited, and KBC has historically sought growth abroad.

KBC's position in the Czech Republic is profitable, and is as attractive as the core Belgian market, in our view. Loan growth is in the high-single-digit range, NIMs are above 3% (as opposed to below 2% in the core Belgian market), and the bank is seeing double-digit AUM growth (at EUR 8.5 billion). Further, cross-selling levels for insurance have generally improved over time, while the combined ratio has remained below 95%. With a cost ratio in the low 40s, the Czech Republic is currently generating returns well above 30%, and we expect this to continue for the foreseeable future.

KBC's other international markets are more mixed, and have been hurt by an outsize exposure to Ireland in recent years. After several challenging years, the bank has whittled down its loan book to EUR 11 billion and currently holds an interesting option on the improvement of the Irish economy. With strong GDP growth expected for Ireland in the coming years, KBC could see a rapid improvement in the health of its Irish loan book.

Vital Statistics

Market Cap (EUR Mil)	22,046
52-Week High (EUR)	59.89
52-Week Low (EUR)	39.35
52-Week Total Return %	-10.6
YTD Total Return %	-8.6
Last Fiscal Year End	30 Dec 2015
5-Yr Forward Revenue CAGR %	3.3
5-Yr Forward EPS CAGR %	2.0
Price/Fair Value	0.76

Valuation Summary and Forecasts

Fiscal Year:	2014	2015	*2016(E)*	*2017(E)*
Price/Earnings	13.3	9.1	*9.3*	*9.2*
Price/Book	1.7	1.4	*1.7*	*1.7*
Price/Tangible Book	1.9	1.5	*1.8*	*1.7*
Dividend Yield %	—	3.5	—	—

Financial Summary and Forecasts (EUR Mil)

Fiscal Year:	2014	2015	*2016(E)*	*2017(E)*
Net Revenue	6,720	7,146	*7,682*	*7,895*
Net Revenue YoY %	-10.6	6.3	*7.5*	*2.8*
Net Interest Income	4,308	4,311	*4,626*	*4,782*
Net Interest Margin %	1.9	1.8	*1.9*	*1.9*
Pre-Tax Pre-Provision Earnings	2,983	3,280	*3,534*	*3,632*
Pre-Tax Pre-Provision Earnings YoY %	-13.1	10.0	*7.7*	*2.8*
Net Income	1,458	2,637	*2,380*	*2,391*
Net Income YoY %	288.8	80.9	*-9.7*	*0.4*
Diluted EPS	3.50	6.31	*5.69*	*5.72*
Diluted EPS YoY %	288.8	80.4	*-9.7*	*0.4*

Source for forecasts in the data tables above: Morningstar Estimates

Profile

KBC is the second-largest bank in Belgium and offers bancassurance services primarily to retail customers and small to midsize businesses. KBC has a 20%-plus market share in Belgium and a strong franchise in the Czech Republic. It also houses an international markets business with operations primarily in Ireland, Bulgaria, Hungary, and Slovakia.

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Morningstar Analysis

Lower Bank Taxes and Organic Volume Growth Help Boost KBC's Second-Quarter Results 11 Aug 2016

KBC posted strong second-quarter results compared with the first quarter as loan and deposit volumes grew across many of its core European markets, bank taxes declined drastically, and it benefited from the one-off sale of its stake in Visa Europe. With these outcomes in mind within Europe's difficult low interest-rate environment, we plan to maintain our EUR 69 fair value estimate and narrow moat rating for the bank.

KBC reported a net result of EUR 721 million for the quarter, representing an increase of 8% year over year and 84% quarter over quarter. While the bank's net interest income remained relatively flat at EUR 1 billion, operating expenses plummeted by 24% from the prior quarter and 4% year over year to EUR 904 million as a result of diminished bank taxes. The positive trend in loan and deposit growth from the first quarter of 2016 continued across many of KBC's primary markets. While Belgium saw year-over-year loan volume growth of about 4%, the bank's Slovakian, Bulgarian, and Hungarian markets saw organic growth increases of 15%, 12%, and 10%, respectively. Deposit growth was also strong on a year over year basis as the Belgium business unit saw customer deposit increases of 6% and most of KBC's other key markets experienced growth of over 10%.

KBC saw more mixed results across some of its other businesses. Life insurance premium income rose 51% year over year to EUR 402 million due to higher sales of guaranteed interest and unit-linked products in Belgium and the Czech Republic. KBC's sale of its stake in Visa Europe for the pretax price of EUR 99 million also bolstered the bank's bottom line. Net fee and commission income, however, declined by 23% year over year primarily as a result of lower product and transaction fees in the Belgium Business Unit. Overall, at the end of the first half of 2016, KBC reported an improved adjusted cost/income ratio of 56% and an even stronger common equity Tier 1 ratio of 14.9%.

Valuation, Growth and Profitability 27 Jun 2016

We are maintaining our fair value estimate at EUR 69 after updating our model to reflect recent results. Our fair value estimate is about 2 times book value as of March 31, and and 12 times projected 2016 earnings per share.

We project that KBC will earn a medium-term return on equity of around 16%. We expect net interest margin to increase to 1.9% by 2020, compared with 1.8% in 2015. We anticipate that KBC's efficiency ratio, currently in the mid 50s, will improve to 50% in 2020, thanks to continued cost-cutting and improved net interest margins; however, we expect that it will be slightly offset by ongoing bank levies. We assume a cost of equity of 10%.

Scenario Analysis

Our fair value estimate ranges from EUR 45 per share in a downside scenario to EUR 93 per share in an upside one. Our downside scenario assumes weaker results in Belgium and the Czech Republic, with the net interest margin declining to around 1.7% in 2020 and assets under management growing by only 3% annually. Medium-term return on equity falls to around 10% (compared with 16% in our base case), and our fair value estimate would be EUR 39, about 1.1 times book value as of March 31 and 9 times our downside-case 2016 EPS estimate.

In our upside scenario, however, KBC is able to produce 7% growth in assets under management and a 2.5% net interest margin by 2020 as Europe returns to growth. We would also anticipate a rapid improvement in the Irish loan book. As a result, return on equity rises to 20%-plus. In this case, our fair value estimate would be EUR 93, 2.7 times estimated book value as of March 31 and 13 times our upside-case 2016 EPS estimate.

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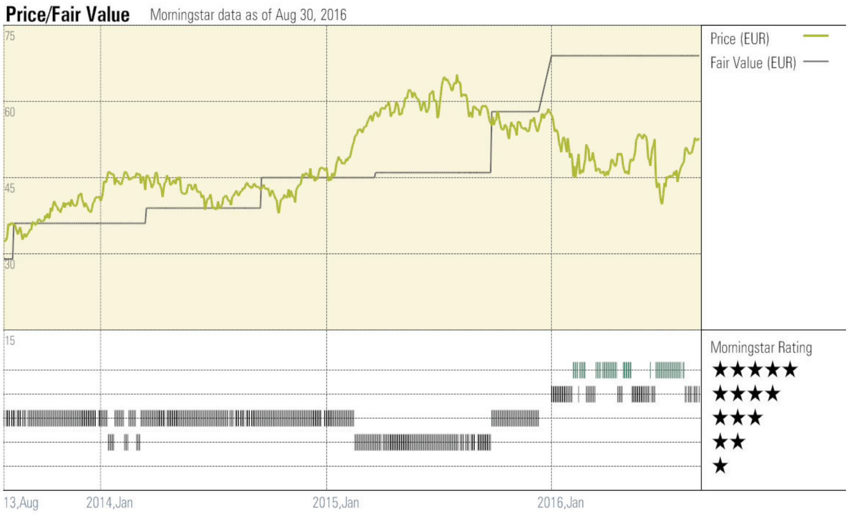
Morningstar Analysis



Economic Moat

We consider KBC to have a narrow moat based on solid cost and switching cost advantages.

KBC and CSOB (Czech Republic entities) have scale in their respective markets, with 20%-25% share of deposits, and operate in a concentrated market. However, neither bank is particularly strong in terms of customer service; in our view, this results in only average levels of switching costs. We would also note that the Czech Republic serves as a test market for all European banks testing their direct banking platforms, exposing the market to disruption.

In terms of cost advantages for a bank, we consider funding costs, operating costs, credit costs, and regulatory costs. On both funding costs and operating costs, KBC scores well, with access to low-cost deposits (about 75% funded via retail and mid-cap customers) and a cost/income ratio around 50% for the two main entities. On the credit side, the impaired loans/total loan book ratio still sits at 9.0%, primarily owing to Ireland, where impaired loans are about 50% of the book. However, the book has largely stabilized since mid-2013, and with Ireland's GDP growth at healthy levels, we anticipate improvements going forward.

On the regulatory side, Belgium and Hungary have imposed harsh levies on its banks. The Belgian government has justified higher bank levies because of its financial involvement in saving the sector after the financial crisis.

In conclusion, we think KBC benefits from scale with its two most important assets, and some switching costs. However, weakness in several key elements of its funding costs (regulatory and credit costs) prevent us from awarding the bank a wide moat.

Moat Trend

KBC's moat trend is stable, in our view. We see little on the horizon that would threaten its comfortable position in its Belgian home market, where KBC's market share is about 20%-25%. At the same time, we think KBC is unlikely to grab additional market share, especially as now as management's focus is on running off bad assets and reducing risk. In terms of cost advantages, we do not anticipate substantial improvements in its efficiency ratio going forward, as bank levies and continued investments in digital and online initiatives are likely to mostly offset cost-cutting elsewhere.

With KBC already well established in the asset management and insurance spaces across its markets, we also think there is limited upside from a switching-cost perspective. It is unlikely that there is much low-hanging fruit left in terms of boosting the number of products per customer. However, the bank has been using net promoter scores since 2014 to gauge client satisfaction, and we believe it currently scores around average on this measure, suggesting further improvement can be obtained.

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Morningstar Analysis

Nature of Liabilities

	2013	2014	2015	2016(E)	2017(E)
Loan/Deposit Ratio %	75.38	75.66	74.74	76.80	76.74
Short Term Debt (% of Liabilities)	—	—	—	—	—
Liquid Assets (% of Assets)	27.05	27.96	27.58	27.16	26.70

Leverage

	2013	2014	2015	2016(E)	2017(E)
Assets/Equity	14.42	15.00	15.96	15.87	15.87
Tangible Common Equity/Tangible Assets %	5.46	5.23	5.91	5.96	5.96
Tier I Ratio %	10.80	13.80	14.90	—	—

Source: Morningstar Estimates

Risk

KBC faces risks from its Eastern European expansion, its Irish book, and its GIIPS exposure. In the longer term, KBC's expansion into Eastern Europe poses risks as political or economic changes in the high-growth region may make earnings unstable. For example, Hungary recently imposed a bank tax that is the EU's highest, and in July 2014 approved legislation that voided retail foreign currency loans, requiring that the costs be retroactively refunded to customers. While we think KBC can absorb these expenses, they underscore the risks of operating in less established markets. In addition, the risks of loan losses in Ireland has declined substantially, as the book is correctly provisioned and the country has returned to strong levels of economic growth. Finally, the bank has about EUR 7 billion of GIIPS government bond exposure that bears continued monitoring.

Financial Health

KBC's financial health has done a 180-degree turn since the financial crisis, and it is now one of the best-capitalized retail-focused banks in Europe. From a funding perspective, we note that 76% of its deposit base is retail and mid-cap customers, a sharp improvement from 64% in 2009. After the full repayment of the government, KBC's common equity Tier 1 ratio is 14.6%, well above the ECB target of 10.25% for 2015, and the 2018 target of 11.25%. We think the bank can easily support a payout ratio of at least 50% from 2016 onward while continuing to build capital toward its goal of 17% by 2017. An leverage ratio of 5.9% in early 2016 is also quite strong.

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Bulls Say/Bears Say

Bulls Say

- We rate Belgium as good in our banking system assessment, just below the very good rating that Switzerland earns.
- The Belgium market is currently very concentrated, and KBC should benefit from its strong position within insurance.
- KBC has a sizable market share in the Czech Republic and benefits both from strong loan growth and healthy margins supported by 300 basis points of net interest margin.

Bears Say

- KBC holds about EUR 11 billion of Irish loans (one fourth of which are nonperforming), compared with the bank's EUR 14 billion of common equity.
- The government aid was costly for KBC. Including penalties, KBC paid slightly more than EUR 13 billion in 2008, in exchange for EUR 7 billion in aid and guarantees.
- KBC is expected to pay around EUR 400 million in bank taxes mainly due to Belgian and Hungarian levies, and Belgian bank levies should increase in 2016.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
NA	NA	NA	NA	NA

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard Total Intl Stock Idx Fund	0.73	0.07	44	31 Jul 2016
Fidelity® Diversified International Fund	0.73	0.78	-44	31 Jul 2016
BGF European Fund	0.32	1.60	-165	31 May 2016
Fidelity® International Discovery Fund	0.35	0.76	—	31 Jul 2016
iShares MSCI EAFE (AU)	0.33	0.12	—	26 Aug 2016
Concentrated Holders				
KBC Multi Track Belgium	0.03	11.34	—	29 Feb 2016
Calypso Fund	—	9.72	2	30 Sep 2015
Candriam Eqs B Belgium	0.11	9.46	89	30 Jun 2016
Petercam Horizon B Equities Belgium Plus	0.01	8.69	—	31 May 2016
iShares MSCI Belgium Capped	0.05	7.50	-2	26 Aug 2016

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
BlackRock Advisors LLC	0.13	2.67	346	31 Jul 2016
Massachusetts Financial Services Co	0.70	0.84	288	31 Jul 2016
J O Hambro Capital Management Limited	0.24	2.48	256	31 May 2016
Ireland National Pensions Reserve Fund	0.06	0.07	220	31 Dec 2009
British Columbia Inv Management Corp	0.06	0.03	213	31 Mar 2010
Top 5 Sellers				
BlackRock Investment Management (UK) Ltd.	1.13	1.21	-638	31 Jul 2016
Morgan Stanley Investment Management Inc	—	0.04	-632	30 Jun 2016
Fidelity Management & Research Company	1.84	0.40	-442	31 Jul 2016
Threadneedle Asset Management Limited	0.02	0.88	-344	30 Jun 2016
THEAM	0.01	3.53	-195	31 Jul 2016

Management 27 Jun 2016

We rate KBC's stewardship of shareholder capital as Standard, as KBC has shed the managers and businesses that caused its near failure during the financial crisis. Current CEO Johan Thijs was appointed in 2012 and formerly served as CEO of the Belgium Business Unit. Under his leadership, the bank has tightened its focus on its core markets, shed the bulk of its noncore assets, and repaid its government bailout well ahead of schedule, which we consider a significant accomplishment. While we're pleased that KBC is reducing risk and streamlining its business model, management can't take all the credit for that--many of the changes were required by the European Union.

Just above 40% of KBC Group's shares are owned by a syndicate of long-term shareholders, the largest of which is KBC Ancora, a cooperative investment company. KBC Ancora guarantees that KBC will not be the subject of a takeover by a foreign bank. It also provides stability in the shareholder structure and alignment with management's long-term plan.

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Analyst Notes

The Brexit Vote Will Have Wide-Reaching Implications for European Financials Coverage 24 Jun 2016

The Brexit vote will have wide-reaching implications for our European financials coverage universe. We plan to lower the fair value estimates for several U.K. banks such as Barclays, Royal Bank of Scotland, and Lloyds, and we will review others such as Banco Santander, which has U.K. exposure. We believe this raises the strong possibility that we may change our moat trend ratings for Lloyds, Royal Bank of Scotland, and Barclays to negative from stable. We do expect the U.K. system and the broader European Union to experience substantial uncertainty and volatility going forward, as the U.K. seeks to renegotiate trade agreements with other countries, unwind other legal agreements with the EU over the next several years, and deal with the political aftermath of Prime Minister David Cameron's resignation. We also now see the strong possibility of Scotland seeking independence, causing further turmoil to the overall system, particularly the Edinburgh-based banks Lloyds and Royal Bank of Scotland, which may need to re-domicile. While the impact of Brexit is far reaching, we do see an undervalued opportunity with HSBC, primarily due to its relative lack of U.K. exposure and its pivot toward Asia.

There are several fairly immediate considerations for banks. We would expect to see higher funding costs for U.K. banks, sharply lower loan growth, as we expect anywhere between a 3%-6% impact to U.K. GDP, and a significant drop-off (potentially 40%-50%) in investment banking fees. Asset management and trading operations will be impacted by the stock, bond, and currency volatility, and we expect trading losses as well as lower asset management fees. Foreign banks, such as JPMorgan Chase, will likely incur millions of dollars in legal and personnel costs as they move employees to other countries from London to facilitate capital markets activity. Again, we see particular risks for Barclays and Royal Bank of Scotland, as these banks have large investment banking operations and are wholesale funded. We would expect to see lower scale and cross-firm synergies for banks in London and ultimately a negative impact on profitability.

Over the longer term, we also see largely negative impacts. We would expect a lower level of normalized GDP growth for the U.K., as it has been one of the strongest beneficiaries of GDP growth in the EU since it was formed. We also believe the reorganizations that will take place at many U.K. banks will lower the overall importance of London as a key financial center, making it harder for banks to compete for talent and the relationships that drive fee income and help retain deposits. There are also renewed concerns regarding several countries in the European Union such as Italy, France, and Spain, where citizens have expressed strong interest in holding in their own referendums and seeking to leave the European Union. Again, the impact for the banks we cover within those systems, such as UniCredit, Intesa Sanpaolo, and Societe Generale would likely result in higher costs and slower growth, which combined with weak capital levels would be quite concerning.

KBC Reports Decent Quarter in Volatile Environment Despite Negative Impact of Bank Taxes 12 May 2016

KBC reported a decent first quarter in a difficult environment, and we remain encouraged by reasonably healthy loan volume across its core markets, as well as excellent loan quality. We plan to maintain our EUR 69 fair value estimate and narrow moat rating. We continue to like KBC as one of the better-positioned and better-capitalized banks in Europe and consider it undervalued.

We were pleased to see stronger loan and deposit volume across KBC's core markets, with standouts being the Czech Republic (3% loan growth), Slovakia (6% deposit growth), and Ireland (4% deposit growth). Net interest income was

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Analyst Notes

basically stable versus last year's levels at EUR 1.1 billion. Like many other asset managers, fee income fell 25% to EUR 346 million over the past year as a result of market volatility and a less profitable product mix, while overall assets under management remained stable as inflows were able to offset lower market valuations. Similar to its peers, KBC had to pay EUR 335 million in bank taxes up front, pushing its cost/income ratio to a high 71% but a more acceptable 57% after averaging the bank taxes throughout the full year. Loan quality was pristine, with loan losses at an all-time low of EUR 4 million during the quarter. The bank's common equity Tier 1 ratio was a strong 14.6%.

ECB Actions Draw Line Under Negative Rates and Are Positive for Banks 11 Mar 2016

The European Central Bank's actions March 10 should be reassuring to bank investors, in our opinion. We're especially pleased that the ECB has drawn a line under negative interest rates, noting that it was mindful that meaningfully harming the banks would be harmful for growth. The longer-term refinancing operations, known as LTRO II, will also be a positive for banks as the ECB will effectively pay banks to borrow money to lend into the real economy; this will help to offset the pain of negative interest rates. European banks rallied as the markets digested the good news, although we think they have further to go. On average, European banks are trading at discounts of about 25% to our fair value estimates, with the largest discounts available on firms like Barclays (55% of fair value) but still attractive discounts on more stable firms like UBS (79% of fair value).

We think the impact of the ECB's actions on the real economy are less clear. Bond buying will lower corporate yields but will only spur borrowing if credit supply was the problem--not demand, as we suspect. Similarly, LTRO II may fail to spur additional lending, and we note that the U.K. funding for lending scheme, launched in 2012, was a mixed success and did not have the clear positive impact on small and medium-size enterprise lending that it was intended to. We continue to think monetary policy is reaching the end of its effectiveness and structural reforms and fiscal stimulus will be necessary, however politically unpalatable. Growth in the eurozone was 0.3% quarter on quarter in the third quarter, and we think it's likely to remain low, perhaps around 1%-1.5% in real terms, in the medium term.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Growth (% YoY)	3-Year Hist. CAGR	Dec 2013	Dec 2014	Dec 2015	Forecast Dec 2016	Forecast Dec 2017	5-Year Proj. CAGR
Net Interest Income	-2.6	-11.5	4.3	0.1	7.3	3.4	3.3
Pre-Tax, Pre-Provision Earnings	17.0	67.6	-13.1	10.0	7.7	2.8	5.8
Net Income	NM	NM	288.8	80.9	-9.7	0.4	2.0
Diluted EPS	NM	NM	288.8	80.4	-9.7	0.4	2.0

Profitability	3-Year Hist. Avg	Dec 2013	Dec 2014	Dec 2015	Dec 2016	Dec 2017	5-Year Proj. Avg
Net Interest Margin %	1.8	1.8	1.9	1.8	1.9	1.9	1.9
Non-Interest Income (% of Revenue)	40.2	45.0	35.9	39.7	39.8	39.4	40.5
Efficiency Ratio %	54.7	54.2	55.6	54.1	54.0	54.0	51.6
Return on Average Assets %	0.7	0.4	0.7	1.1	0.9	0.9	1.0
Return on Average Equity %	10.9	5.5	10.9	16.4	14.7	14.3	15.5
Return on Tangible Equity %	10.0	2.5	9.7	17.8	15.3	15.0	16.3

Leverage	3-Year Hist. Avg	Dec 2013	Dec 2014	Dec 2015	Dec 2016	Dec 2017	5-Year Proj. Avg
Assets/Equity	15.13	14.42	15.00	15.96	15.87	15.87	15.87
Tangible Common Equity/Tangible Assets %	5.53	5.46	5.23	5.91	5.96	5.96	5.97
Tier I Ratio %	13.17	10.80	13.80	14.90	—	—	—

Valuation Summary and Forecasts

	2014	2015	2016(E)	2017(E)
Price/Fair Value	1.03	—	—	—
Price/Earnings	13.3	9.1	9.3	9.2
Price/Book	1.7	1.4	1.7	1.7
Price/Tangible Book	1.9	1.5	1.8	1.7
Dividend Yield %	—	3.5	—	—

Key Valuation Drivers

Cost of Equity %	10.0
Long-Run Tax Rate %	25.0
Stage II Net Income Growth Rate %	3.0
Stage II Return on New Invested Capital %	13.0
Perpetuity Year	15.0

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	EUR Mil	Firm Value (%)	Per Share Value
Present Value Stage I	8,219	29.7	19.66
Present Value Stage II	9,142	33.0	21.87
Present Value of the Perpetuity	10,307	37.3	24.66
Total Common Equity Value before Adjustment	**27,668**	**100.0**	**66.19**
Other Adjustments	—	—	—
Equity Value	**27,668**	—	**66.19**
Projected Diluted Shares	418		
Fair Value per Share (EUR)	—		

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Morningstar Analyst Forecasts

Income Statement (EUR Mil)

				Forecast	
	Dec 2013	Dec 2014	Dec 2015	*Dec 2016*	*Dec 2017*
Net Interest Income	**4,132**	**4,308**	**4,311**	**4,626**	**4,782**
Provision for Losses on Loans	1,719	506	747	*360*	*444*
Net Interest Income after Provision	**2,413**	**3,802**	**3,564**	**4,266**	**4,338**
Non-Interest Income	3,385	2,412	2,835	*3,056*	*3,113*
Net Revenue	**7,517**	**6,720**	**7,146**	**7,682**	**7,895**
Net Revenue After Provision (excluding Gains on Sale)	5,798	6,214	6,399	*7,322*	*7,451*
Gains on Sale	—	—	—	—	—
Net Revenue After Provision (including Gains on Sale)	**5,798**	**6,214**	**6,399**	**7,322**	**7,451**
Non-Interest Expense	4,084	3,737	3,866	*4,148*	*4,263*
Operating Income (excluding Gains on Sale)	**1,714**	**2,477**	**2,533**	**3,174**	**3,187**
Taxes	685	657	-104	*793*	*797*
Minority Interest, net of income taxes	14	25	—	—	—
Income after Taxes	**1,015**	**1,795**	**2,637**	**2,380**	**2,391**
Cumulative Effect of Accounting Change	—	—	—	—	—
After-tax Non-recurring Items	—	—	—	—	—
Discounted Operations	—	—	—	—	—
Preferred Dividends	**640**	**337**	**—**	**—**	**—**
Net Income attributable to common shareholders, Excluding All After-tax items	**375**	**1,458**	**2,637**	**2,380**	**2,391**
Net Income attributable to common shareholders, including all after-tax items	**375**	**1,458**	**2,637**	**2,380**	**2,391**
Average Diluted Shares Outstanding	417	417	418	*418*	*418*
Diluted EPS Excluding Charges	**0.90**	**3.50**	**6.31**	**5.69**	**5.72**
Diluted EPS Including Charges	**0.90**	**3.50**	**6.31**	**5.69**	**5.72**

KBC Group SA/NV KBC (XBRU) | ★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
52.73 EUR	69.00 EUR	Medium	Narrow	Stable	Standard	Banks

Morningstar Analyst Forecasts

Balance Sheet (EUR Mil)

			Forecast	
Earning Assets	Dec 2014	Dec 2015	*Dec 2016*	*Dec 2017*
Cash and Due from Banks	5,771	7,038	*5,700*	*5,786*
Interest Bearing Deposits at Banks	—	—	—	—
Federal Funds Sold and Securities Borrowed or Purchased Under Agreement to Resell	—	—	—	—
Brokerage Receivables	—	—	—	—
Other Receivables (excluding interest receivables)	—	—	—	—
Trading Assets	62,735	62,569	*65,697*	*65,697*
Investment Securities Held to Maturity	31,799	32,958	*36,254*	*38,066*
Investment Securities Available-for-Sale	—	—	—	—
Financial Instruments Owned, at Fair Value (trading securities)	—	—	—	—
Other Earning Assets	1,466	746	*752*	*780*
Loans Held for Sale	—	—	—	—
Loans and Leases	135,784	141,305	*146,659*	*149,475*
Unearned Discount	—	—	—	—
Allowance for Loan Losses	—	—	—	—
Net Loans and Leases	**135,784**	**141,305**	**146,659**	**149,475**
Non-Earning Assets				
Premises & Equipment, Net	2,278	2,299	*2,299*	*2,299*
Premises & Equipment, Gross	2,278	2,299	*2,376*	*2,455*
(Accumulated Depreciation)	—	—	*-77*	*-156*
Interest Receivables	—	—	—	—
Goodwill	1,258	959	*959*	*959*
Identifiable Intangibles	—	—	—	—
Deferred Tax Assets	1,726	2,243	*2,243*	*2,243*
Other Non-Earning Assets (Other Real Estate Owned etc.)	2,163	2,239	*2,306*	*2,375*
Total Assets	**244,980**	**252,356**	**262,870**	**267,681**

			Forecast	
Liabilities	Dec 2014	Dec 2015	*Dec 2016*	*Dec 2017*
Total Deposits	179,475	189,062	*190,953*	*194,772*
Customer Deposits	161,783	170,109	*171,810*	*175,246*
Federal Funds Purchased and Securities Loaned or Sold under Agreements to Repurchase	—	—	—	—
Brokerage Payables	—	—	—	—
Trading Liabilities	23,741	24,426	*24,637*	*24,637*
Financial Instruments Sold, but not yet purchased at Fair Value	—	—	—	—
Other Payables	—	—	—	—
Short-Term Debt	—	—	—	—
Long-Term Debt	2,428	1	*7,041*	*7,109*
Additional Debt	—	—	—	—
Total Short-Term, Long-Term and Other Debt	**2,428**	**1**	**7,041**	**7,109**
Deferred Tax Liabilities	599	658	*658*	*658*
Other Liabilities (bank acceptance outstanding, accrued expenses, etc.)	2,916	2,541	*2,414*	*2,486*
Total Liabilities	**228,653**	**236,548**	**246,210**	**250,717**
Equity				
Common Stock	11,486	14,411	*14,411*	*14,411*
Paid-in Capital	—	—	—	—
Retained Earnings	—	—	*750*	*1,053*
Preferred Equity	2,333	—	—	—
Treasury Stock	—	—	—	—
Accumulated Other Comprehensive Income	—	—	—	—
Other Equity	2,511	1,400	*1,400*	*1,400*
Shareholders?Equity	16,330	15,811	*16,561*	*16,864*
Total Liabilities & Shareholders?Equity (including Minority Interest)	**244,980**	**252,356**	**262,870**	**267,681**

KBC Group SA/NV KBC (XBRU) | ★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
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Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings				Price/Book				Price/Tangible Book			
Company/Ticker	Price/Fair Value	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*
BNP Paribas BNP FRA	0.7	NM	10.2	*8.2*	*7.5*	0.8	0.6	*0.8*	*0.8*	0.9	0.8	*0.9*	*0.8*
Average		—	10.2	*8.2*	*7.5*	0.8	0.6	*0.8*	*0.8*	0.9	0.8	*0.9*	*0.8*
KBC Group SA/NV KBC BE	**0.8**	**13.3**	**9.1**	***9.3***	***9.2***	**1.7**	**1.4**	***1.7***	***1.7***	**1.9**	**1.5**	***1.8***	***1.7***

Returns Analysis

		Return on Average Equity %				Return on Average Assets %				Return on Tangible Equity %			
Company/Ticker	Last Historical Year Total Assets (Mil)	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*
BNP Paribas BNP FRA	1,994,193 EUR	0.2	7.2	*7.4*	*8.0*	0.0	0.3	*0.4*	*0.4*	0.4	8.9	*8.2*	*8.7*
Average		0.2	7.2	*7.4*	*8.0*	—	0.3	*0.4*	*0.4*	0.4	8.9	*8.2*	*8.7*
KBC Group SA/NV KBC BE	**252,356** EUR	**10.9**	**16.4**	***14.7***	***14.3***	**0.7**	**1.1**	***0.9***	***0.9***	**9.7**	**17.8**	***15.3***	***15.0***

Growth Analysis

		Net Revenue Growth %				Pre-Tax, Pre-Provision Earnings Growth %				EPS Growth %			
Company/Ticker	Last Historical Year Revenue (Mil)	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*
BNP Paribas BNP FRA	44,523 EUR	0.8	12.1	*-4.8*	*3.4*	-44.0	106.8	*3.1*	*10.7*	NM	NM	*7.9*	*9.3*
Average		0.8	12.1	*-4.8*	*3.4*	-44.0	106.8	*3.1*	*10.7*	—	—	*7.9*	*9.3*
KBC Group SA/NV KBC BE	**7,146** EUR	**-10.6**	**6.3**	***7.5***	***2.8***	**-13.1**	**10.0**	***7.7***	***2.8***	**288.8**	**80.4**	***-9.7***	***0.4***

KBC Group SA/NV KBC (XBRU) | ★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
52.73 EUR	69.00 EUR	Medium	Narrow	Stable	Standard	Banks

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

		Net Interest Margin %				Efficiency Ratio %				Non Interest Income % of Revenue			
Company/Ticker	Last Historical Year Revenue (Mil)	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*
BNP Paribas BNP FRA	44,523 EUR	1.2	1.3	*1.2*	*1.2*	81.9	65.9	*65.3*	*62.9*	48.9	49.4	*49.7*	*49.2*
Average		1.2	1.3	*1.2*	*1.2*	81.9	65.9	*65.3*	*62.9*	48.9	49.4	*49.7*	*49.2*
KBC Group SA/NV KBC BE	**7,146** EUR	**1.9**	**1.8**	***1.9***	***1.9***	**55.6**	**54.1**	***54.0***	***54.0***	**35.9**	**39.7**	***39.8***	***39.4***

Leverage Analysis

		Assets/Equity				Tangible Common Equity/ Tangible Assets %				Tier I Ratio %			
Company/Ticker	Last Historical Year Total Debt (Mil)	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*
BNP Paribas BNP FRA	175,991 EUR	23.2	20.7	*20.6*	*20.4*	3.4	3.8	*3.8*	*3.9*	10.3	10.9	—	—
Average		23.2	20.7	*20.6*	*20.4*	3.4	3.8	*3.8*	*3.9*	10.3	10.9	—	—
KBC Group SA/NV KBC BE	**1** EUR	**15.0**	**16.0**	***15.9***	***15.9***	**5.2**	**5.9**	***6.0***	***6.0***	**13.8**	**14.9**	—	—

Liquidity Analysis

		Loans/Deposits %				Short-Term Debt % of Liabilities				Liquid Assets (% of Total Assets)			
Company/Ticker	Last Historical Year Market Cap (Mil)	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*	2014	2015	*2016(E)*	*2017(E)*
BNP Paribas BNP FRA	56,482 EUR	94.1	90.8	*89.9*	*89.9*	5.7	4.2	*4.3*	*4.2*	57.5	54.7	*54.5*	*54.3*
Average		94.1	90.8	*89.9*	*89.9*	5.7	4.2	*4.3*	*4.2*	57.5	54.7	*54.5*	*54.3*
KBC Group SA/NV KBC BE	**22,046** EUR	**75.7**	**74.7**	***76.8***	***76.7***	—	—	—	—	**28.0**	**27.6**	***27.2***	***26.7***

Research Methodology for Valuing Companies

Overview
At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss short-term market-price movements), but we believe these negatives are mitigated by deep analysis and our long-term approach.

Morningstar, Inc. and its affiliates ("Morningstar", "we", "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our single-point star rating.

1. Economic Moat
The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

To assess the sustainability of excess profits, analysts perform ongoing assessments of the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

2. Estimated Fair Value
Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast
In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in working-capital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade
The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity
Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total pres-

Morningstar Research Methodology for Valuing Companies

Research Methodology for Valuing Companies

ent value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty around that fair value estimate
Morningstar's Uncertainty Rating captures a range of likely potential intrinsic values for a company and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case, and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate.

Our recommended margin of safety widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

- **Low:** margin of safety for 5-star rating is a 20% discount and for 1-star rating is 25% premium.
- **Medium:** margin of safety for 5-star rating is a 30% discount and for 1-star rating is 35% premium.
- **High:** margin of safety for 5-star rating is a 40% discount and for 1-star rating is 55% premium.
- **Very High:** margin of safety for 5-star rating is a 50% discount and for 1-star rating is 75% premium.
- **Extreme:** Stock's uncertainty exceeds the parameters we have set for assigning the appropriate margin of safety.

4. Market Price
The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more detail information about our methodology, please go to http://global.morningstar.com/equitydisclosures

Morningstar Star Rating for Stocks
Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time, generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

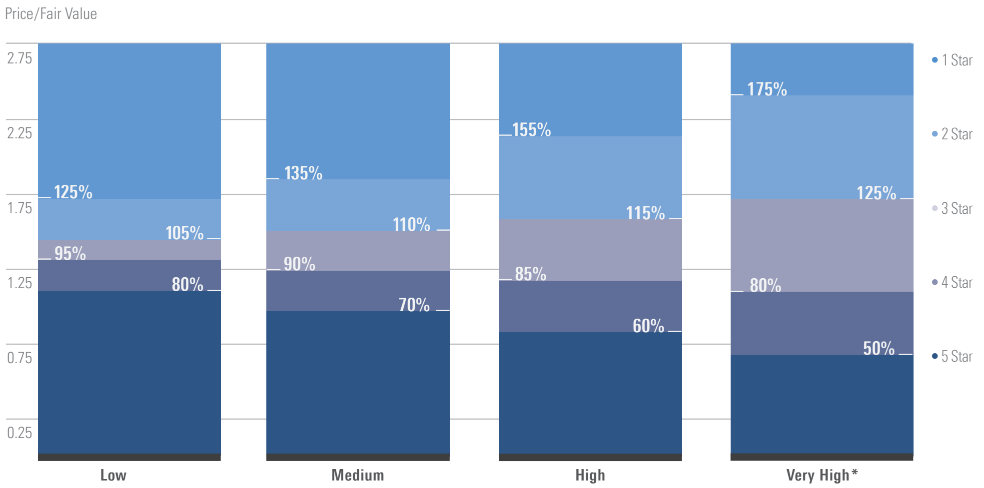
The Morningstar Star Ratings for stocks are defined below:

Five Stars ★★★★★
We believe appreciation beyond a fair risk-adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

Four Stars ★★★★
We believe appreciation beyond a fair risk-adjusted return is likely.

Three Stars ★★★
Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

Morningstar Research Methodology for Valuing Companies



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Research Methodology for Valuing Companies

Two Stars ★★
We believe investors are likely to receive a less than fair risk-adjusted return.

One Star ★
Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions:

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Stewardship Rating: Represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

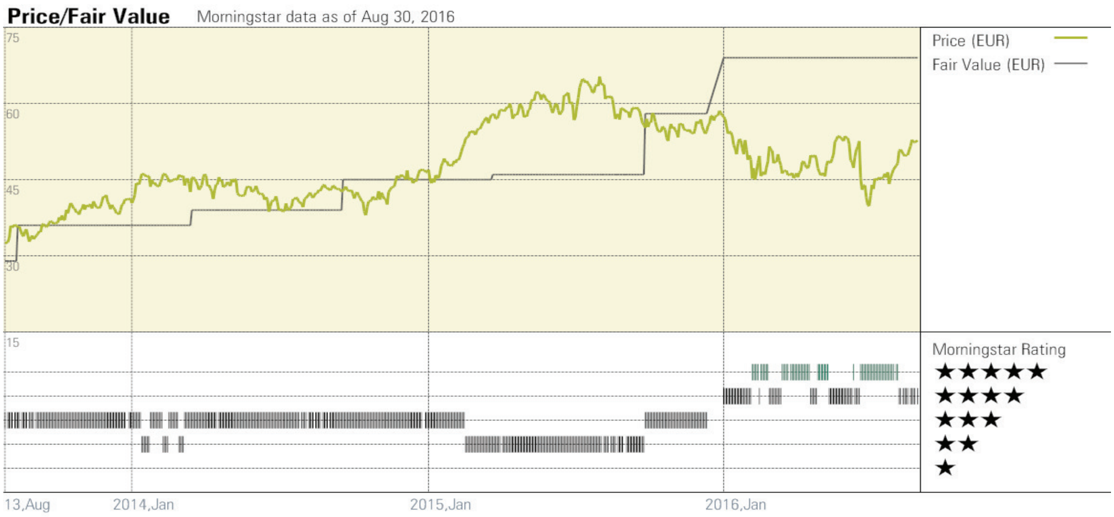
Quantitative Valuation: Using the below terms, intended to denote the relationship between the security's Last Price and Morningstar's quantitative fair value estimate for that security.

- **Undervalued:** Last Price is below Morningstar's quantitative fair value estimate.
- **Farily Valued:** Last Price is in line with Morningstar's quantitative fair value estimate.
- **Overvalued:** Last Price is above Morningstar's quantitative fair value estimate.

Risk Warning
Please note that investments in securities are subject to market and other risks and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost. A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's Uncertainty Rating serves as a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

KBC Group SA/NV KBC (XBRU) | ★★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
52.73 EUR	69.00 EUR	Medium	Narrow	Stable	Standard	Banks



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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
52.73 EUR	69.00 EUR	Medium	Narrow	Stable	Standard	Banks

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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
52.73 EUR	69.00 EUR	Medium	Narrow	Stable	Standard	Banks

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