KBC Group SA/NV KBC (XBRU) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
43.85 EUR	39.00 EUR	19.50 EUR	68.25 EUR	Very High	None	Stable	Standard	BBB	Banks

Growing Net Interest Margin and Low Loan Losses Boost KBC's Earnings in 2Q

See Page 2 for the full Analyst Note from 07 Aug 2014

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

Research as of 07 Aug 2014
Estimates as of 17 Mar 2014
Pricing data through 26 Aug 2014
Rating updated as of 26 Aug 2014

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

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Investment Thesis 17 Mar 2014

KBC has largely righted itself, more so than most banks nearly toppled by the financial crisis. It sold off business after business, which has boosted KBC's capital ratios, helped it repay its three government bailouts totaling EUR 7 billion, and increased its focus on its attractive and profitable Belgium and Czech Republic banking businesses. As of January 2014, KBC had just EUR 2.0 billion of state aid left to repay (plus a 50% penalty) by 2020, which we think it can and will do on an accelerated schedule. While we don't expect a quick turnaround at KBC's troubled International Banking division, we think the EUR 671 million of additional impairments the division took in late 2013 set the stage for a much smaller divisional loss, or even breakeven results, in 2014.

We're fans of KBC's Belgium business, which accounts for more than half of allocated equity. In Belgium, KBC is one of the top financial services groups with an estimated 20% share in banking and a 35% share in investment products. A key player in Belgium's cozy three-bank oligopoly, KBC Belgium maintained good credit quality and high margins throughout the credit crisis--underlying returns on equity are typically above 20%, and sometimes more than 30%. However, Belgium's financial services market offers very little room for growth above the country's modest GDP growth. For this reason, KBC, like other Belgian banks, has historically sought growth abroad. We're glad KBC is now focusing on its core markets, as it has a history of underestimating losses outside of its home markets.

More than many European banks, KBC has taken aggressive action to de-risk and shed its non-core assets. It has reduced its risk-weighted assets by 40% since 2008, and has completed nearly all of its planned divestitures. However, risks to investors remain--KBC's lending in Ireland alone, where one fourth of loans are non-performing, is approximately equal to the bank's total equity. Yet, we're increasingly confident that KBC has put its troubles in the rear-view mirror, and anticipate that the bank will have excess capital available to fund a sizable dividend in 2014. We note, however, that it plans no dividend in 2015.

Vital Statistics

Market Cap (EUR Mil)	18,301
52-Week High (EUR)	46.55
52-Week Low (EUR)	32.33
52-Week Total Return %	26.9
YTD Total Return %	6.3
Last Fiscal Year End	30 Dec 2013
5-Yr Forward Revenue CAGR %	3.6
5-Yr Forward EPS CAGR %	42.8
Price/Fair Value	1.12

Valuation Summary and Forecasts

Fiscal Year:	2012	2013	*2014(E)*	*2015(E)*
Price/Earnings	NM	45.8	*10.7*	*9.5*
Price/Book	1.2	1.5	*1.3*	*1.3*
Price/Tangible Book	1.3	1.7	*1.3*	*1.2*
Dividend Yield %	0.0	1.8	—	—

Financial Summary and Forecasts (EUR Mil)

Fiscal Year:	2012	2013	*2014(E)*	*2015(E)*
Net Revenue	7,736	7,517	*7,012*	*7,166*
Net Revenue YoY %	6.7	-2.8	*-6.7*	*2.2*
Net Interest Income	4,669	4,132	*4,081*	*4,129*
Net Interest Margin %	1.9	1.8	*1.8*	*1.9*
Pre-Tax Pre-Provision Earnings	2,048	3,433	*3,296*	*3,368*
Pre-Tax Pre-Provision Earnings YoY %	-3.4	67.6	*-4.0*	*2.2*
Net Income	-408	375	*1,714*	*1,936*
Net Income YoY %	71.4	NM	*357.0*	*13.0*
Diluted EPS	-1.17	0.90	*4.11*	*4.64*
Diluted EPS YoY %	68.8	-177.0	*356.6*	*13.1*

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 medium-sized 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, Hungary, and Slovakia. KBC suffered large losses in 2008 and 2009 on U.S. mortgage-backed securities and accepted EUR 7 billion in nonvoting government bailout funds and a debt guarantee that has since been largely repaid.

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Morningstar Analysis

Growing Net Interest Margin and Low Loan Losses Boost KBC's Earnings in 2Q 07 Aug 2014

KBC Group reported income attributable to common shareholders of EUR 261 million (EUR 0.63 per share) for the second quarter, an 8.6% return on common equity, reinforcing our opinion that the bank is making good progress on its return to health. We plan to maintain our fair value estimate for the no-moat bank.

The group's Belgium business unit was once again a standout performer, delivering EUR 383 million of profits and a 27% after-tax return on equity. Net interest income was flat sequentially, as a two basis point decline in net interest margin on lower reinvestment yields offset a 2% increase in loans. We're pleased that management is keeping costs contained – expenses ate up just 51% of revenues – and we continue to think the unit will benefit from positive operating leverage when the local interest rate environment begins to normalize. We see less potential upside from loan losses, which, at just 36 basis points in the second quarter, are near the bottom, in our opinion.

KBC's International unit was once again a source of trouble and hope for shareholders. The unit reported a loss of EUR 176 million for the quarter, propelled by a post-tax EUR 183 million provision related to a new law in Hungary that voided the use of foreign exchange rates and currencies in retail loans and required that any such loans be retroactively corrected. The related losses could grow, depending on how guidance develops on how corrections should be calculated. We note that KBC, with the ECB's support, plans to challenge the new law. In Ireland, the group reported a net loss of EUR 57 million on EUR 62 million of loan losses, compared to EUR 48 million in the trailing quarter. Despite the increase in provisions, we're hopeful that results in Ireland are about to improve – Irish nonperforming plus high-risk loans declined for the second quarter sequentially, showing that last quarter's decline was more than a blip.

KBC's capital strength continues to improve from already good levels. The bank's fully loaded common equity Tier 1 ratio was 12.9% at the end of the quarter, up 70 basis points sequentially, although it should be noted this includes the benefit of the government's EUR 2 billion of nonvoting equity. Excluding this benefit, we calculate that the bank's common tangible equity ratio was 4.84% at the end of the quarter, slightly below the 5%-7% we prefer, but within our comfort zone for a retail-focused bank like KBC. We continue to think the bank is on track to pay out a material dividend for 2014.

Valuation, Growth and Profitability 17 Mar 2014

We're raising our fair value estimate for KBC by EUR 3 to EUR 39 as we account for the time value of money since our last update and modestly upgrade our cost/income expectations. Our fair value estimate is about 1.6 times tangible book value and 1.4 times book value as of year-end 2013.

We project that KBC will earn a medium-term return on equity of around 14%-15%. We estimate that the bank will settle in at a medium-term equity/assets ratio near 2013's 6.0% as it repays the government assistance from retained earnings, and that it will repay the remaining EUR 2.0 billion on an accelerated schedule. These repayments will require also paying a 50% penalty. We project that loan losses will fall to a mid-cycle level of 0.5% of loans by 2017 as lower losses in Ireland are balanced by KBC's expansion in Eastern Europe. We expect net interest margin to increase to 2.00% by 2016 compared with 1.75% in 2013, as we calculate it. We anticipate that KBC's efficiency ratio, historically around 60% as we calculate it, will improve to 53% in 2013 and beyond as cost-cutting takes effect and as net interest margins begin to rise.

Scenario Analysis

Our fair value estimate ranges from EUR 30 per share in a downside scenario to EUR 50 per share in an upside one. In our downside scenario, KBC takes an additional 10% haircut

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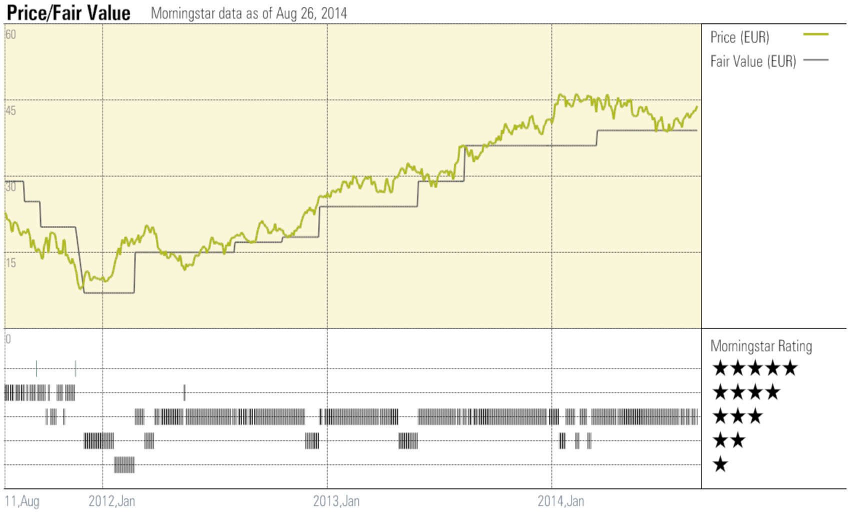
Morningstar Analysis

Price/Fair Value Morningstar data as of Aug 26, 2014



on Irish loans and suffers from slower revenue growth as net interest margin grows only modestly from 2013 levels to 1.80% and assets under management fall 8% in 2014 on bearish markets. Overall, we expect revenues to grow an average of 1.5% annually in this case. Medium-term return on equity falls to 11% (compared with 14%-15% in our base case), and our fair value estimate would be $30, 1.2 times tangible book value and 1.1 times book value as of year-end 2013.

In our upside scenario, however, KBC is able to produce 7% growth in assets under management and a 2.2% net interest margin as Europe turns back to growth, which causes revenues to grow an average of 3.8% annually through 2018. At the same time, the bank, which currently exceeds 2019 capital standards, is able to return more capital and reduce its equity/assets level to 5.5%, from 6.0% in 2013, closer to 2010 levels. As a result, return on equity rises to nearly 18%. In this case, our fair value estimate would be EUR 50, 1.8 times book value and 2.0 times as of year-end 2013.

Economic Moat

We don't think KBC has a moat. While the bank enjoys a healthy market share in many of its markets, it is undergoing a significant transformation as a result of the financial crisis and it is difficult to estimate the firm's future profitability. We note that it is controlled by a cooperative whose social aims may not always support profit-maximizing behavior. In the past, the bank has not been particularly efficient, with an efficiency ratio (noninterest expense/revenue) hovering around 60%. While the bank is a strong underwriter in Belgium, it has struggled in its Eastern and Central European markets.

Moat Trend

We think bank moat trends are driven primarily by regulatory changes or changes in a firm's cost position, and we see KBC's moat trend as stable. While it has no moat in some of the international businesses it entered during the boom years, like Merchant Banking in Ireland, we see little on the horizon that would threaten its comfortable position in its Belgian home market, where KBC's market share is near 20%. 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.

Risk

KBC still faces risks as it continues to slim down. We are especially concerned about the possibility of continued heavy losses in Ireland, where KBC holds EUR 15 billion of loans. 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. KBC may soon be generating excess capital, and management could decide to use it to fund risky growth strategies, given KBC's slow growth at home, as it has done in the past. We'd prefer to see this money returned to shareholders, as we currently see it as most likely.

Financial Health & Capital Structure

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Morningstar Analysis

Nature of Liabilities

	2011	2012	2013	2014(E)	2015(E)
Loan/Deposit Ratio %	80.51	76.27	74.30	68.94	69.22
Short Term Debt (% of Liabilities)	—	—	—	—	—
Liquid Assets (% of Assets)	30.34	28.22	27.05	26.78	25.37

Leverage

	2011	2012	2013	2014(E)	2015(E)
Assets/Equity	17.56	16.47	17.04	16.67	16.67
Tangible Common Equity/Tangible Assets %	2.77	4.21	4.39	4.75	4.91
Tier I Ratio %	10.80	13.80	15.80	—	—

Source: Morningstar Estimates

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. As of year-end 2013, it had a pro forma fully loaded Basel III ratio of 12.5%, well above its 10% target. After a January 2014 repayment, KBC still owes EUR 2.0 million to the Flemish government, which it must repay at a 50% premium. We think it can easily meet the requirement that it do so by 2020.

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Bulls Say/Bears Say

Bulls Say

- KBC's deep roots and loyal customer base in Belgium help sustain its large deposit base and sticky relationships.
- KBC has a sizable market share in Eastern Europe's strongest markets and may benefit from strong growth as their economies recover.
- KBC's long-term shareholder base should allow the bank to focus on a true revitalization rather than short-term profits.

Bears Say

- KBC holds about EUR 15 billion of Irish loans (one fourth of which are nonperforming), including EUR 8 billion of underwater mortgages, compared with the bank's EUR 12 billion of common equity.
- KBC's profits during the boom years were bolstered by excessively risky activities. Without these fat revenue streams, KBC's earnings power will be less impressive.
- KBC has proven to be a weak underwriter outside of its native Belgium. While KBC has shed many of its non-core businesses, there's little reason to believe it won't make the same mistake again.

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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
Fidelity® Diversified International Fund	1.12	0.94	—	30 Jun 2014
Fidelity® Series International Growth	0.85	1.41	243	30 Jun 2014
AXA Financial BGF Euro Markets	0.72	2.49	434	30 Apr 2014
BlackRock European Fund	0.67	1.97	133	30 Apr 2014
Fidelity Active Strategy Europe	0.64	4.19	390	30 Apr 2014
Concentrated Holders				
KBC Multi Track Belgium	0.04	10.35	—	30 Jun 2014
KBC Instl Fd Belgian Eq	0.01	9.40	1	30 Jun 2014
KBC Eq Fd Belgium	0.03	9.31	3	30 Jun 2014
Candriam Eqs B Belgium	0.10	8.35	-14	30 Jun 2014
KBC Eq Fd Flanders	0.01	8.33	4	30 Jun 2014

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
AXA Financial Limited	0.93	2.35	474	30 Jun 2014
Fidelity (FIL Inv Mgmt (Lux) S.A.)	0.65	3.85	392	30 Apr 2014
J.P. Morgan Investment Management Inc.	0.09	0.44	360	31 Jul 2014
BlackRock Investment Management (UK) Ltd.	1.35	1.67	274	30 Apr 2014
Causeway Capital Management LLC	0.29	0.92	227	30 Jun 2014
Top 5 Sellers				
CMI Asset Management (Luxembourg) S.A.	0.02	0.29	-423	30 Jun 2014
AXA Investment Managers Paris	0.24	1.49	-353	30 Jun 2014
AXA Life Europe	0.90	1.64	-312	30 Jun 2014
Principal Management Corp	0.06	0.42	-289	31 Jul 2014
DNCA Finance	0.03	0.79	-274	31 Mar 2014

Management 03 Jun 2013

KBC replaced its CEO and half of its top executives in mid-2009 as it prepared for the restructuring, and we now rate its stewardship of shareholder capital as standard. Current CEO Johan Thijs was appointed in 2012 and formerly served as CEO of the Belgium Business Unit. 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. We have mixed feelings about KBC's corporate governance. We're pleased that top executives did not receive bonuses in 2008 and 2009 following the company's disastrous performance. We're concerned, however, that management's interests may not always be aligned with those of independent shareholders, and that too many long-term employees still run the show despite the bank's massive management failure. The company is controlled by Cera, a Belgian cooperative whose social aims may sometimes conflict with business interests.

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Analyst Notes

KBC Loan Losses Down in 1Q but Trading Revenue Disappoints; Maintaining Fair Value Estimate 15 May 2014

KBC reported profits of EUR 397 million for the first quarter, although we estimate that profits attributable to common shareholders were EUR 185 million, after 8.5% dividends on the non-voting shares and a EUR 170 million penalty on the repayment of EUR 330 million of non-voting stock, which implies a 6.2% return on equity. Bottom-line results were disappointing primarily because of sharply lower trading income following a EUR 86 million mark-to-market writedown on asset liability management derivatives. We see the poor trading results, as well as the repayment penalties, as transitory items, and we plan to maintain our fair value estimate for the no-moat bank.

Despite the disappointing bottom-line results, the first quarter's results reinforced our projection that KBC is likely to modestly outearn its 12% cost of equity in 2014 for the first time since 2010. Net interest margin grew 8 basis points sequentially to 2.00% in the first quarter while net interest income advanced 1% to EUR 1,002 million despite fewer days in the quarter. Net fee and commission income grew 4% sequentially, to EUR 378 million. While we think that these indicate that revenue growth is likely to remain positive for the rest of the year, we think that higher loan losses will temper bottom-line results. This quarter's EUR 107 million of loan losses amounted to just 0.3% of loans, which we see as an unsustainable low level. In the long run, we expect loan losses to be closer to 0.5% of loans, especially given KBC's growth in the Czech Republic and Eastern Europe.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Growth (% YoY)	3-Year Hist. CAGR	Dec 2011	Dec 2012	Dec 2013	Forecast Dec 2014	Forecast Dec 2015	5-Year Proj. CAGR
Net Interest Income	-12.9	-12.3	-14.8	-11.5	-1.2	1.2	3.6
Pre-Tax, Pre-Provision Earnings	-2.5	-42.8	-3.4	67.6	-4.0	2.2	2.6
Net Income	-37.3	NM	71.4	NM	357.0	13.0	42.8
Diluted EPS	-41.4	NM	68.8	NM	356.6	13.1	42.8

Profitability	3-Year Hist. Avg	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015	5-Year Proj. Avg
Net Interest Margin %	1.9	2.0	1.9	1.8	1.8	1.9	1.9
Non-Interest Income (% of Revenue)	36.4	24.5	39.7	45.0	41.8	42.4	41.1
Efficiency Ratio %	63.8	69.1	68.1	54.2	53.0	53.0	53.0
Return on Average Assets %	0.3	0.1	0.2	0.4	0.8	0.9	1.0
Return on Average Equity %	4.3	2.5	3.7	6.8	13.2	14.6	15.9
Return on Tangible Equity %	-0.2	-3.7	0.3	3.0	8.2	13.8	14.5

Leverage	3-Year Hist. Avg	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015	5-Year Proj. Avg
Assets/Equity	17.02	17.56	16.47	17.04	16.67	16.67	16.67
Tangible Common Equity/Tangible Assets %	3.79	2.77	4.21	4.39	4.75	4.91	5.08
Tier I Ratio %	13.47	10.80	13.80	15.80	—	—	—

Valuation Summary and Forecasts

	2012	2013	2014(E)	2015(E)
Price/Fair Value	1.09	1.15	—	—
Price/Earnings	NM	45.8	10.7	9.5
Price/Book	1.2	1.5	1.3	1.3
Price/Tangible Book	1.3	1.7	1.3	1.2
Dividend Yield %	0.0	1.8	—	—

Key Valuation Drivers

Cost of Equity %	12.0
Long-Run Tax Rate %	28.0
Stage II Net Income Growth Rate %	4.0
Stage II Return on New Invested Capital %	10.0
Perpetuity Year	15.0

Discounted Cash Flow Valuation

	EUR Mil	Firm Value (%)	Per Share Value
Present Value Stage I	5,396	34.1	12.94
Present Value Stage II	4,800	30.3	11.51
Present Value of the Perpetuity	5,624	35.6	13.49
Total Common Equity Value before Adjustment	**15,819**	**100.0**	**37.93**
Other Adjustments	—	—	—
Equity Value	**15,819**	—	**37.93**
Projected Diluted Shares	417		
Fair Value per Share (EUR)	—		

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

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Morningstar Analyst Forecasts

Income Statement (EUR Mil)

	Dec 2011	Dec 2012	Dec 2013	*Forecast* Dec 2014	*Forecast* Dec 2015
Net Interest Income	**5,479**	**4,669**	**4,132**	**4,081**	**4,129**
Provision for Losses on Loans	1,333	1,072	1,719	*734*	*539*
Net Interest Income after Provision	**4,146**	**3,597**	**2,413**	**3,347**	**3,589**
Non-Interest Income	1,774	3,067	3,385	*2,931*	*3,037*
Net Revenue	**7,253**	**7,736**	**7,517**	**7,012**	**7,166**
Net Revenue After Provision (excluding Gains on Sale)	5,920	6,664	5,798	*6,278*	*6,627*
Gains on Sale	—	—	—	—	—
Net Revenue After Provision (including Gains on Sale)	**5,920**	**6,664**	**5,798**	**6,278**	**6,627**
Non-Interest Expense	5,134	5,688	4,084	*3,716*	*3,798*
Operating Income (excluding Gains on Sale)	**786**	**976**	**1,714**	**2,562**	**2,829**
Taxes	320	362	685	*692*	*764*
Minority Interest, net of income taxes	34	29	14	*14*	*15*
Income after Taxes	**432**	**585**	**1,015**	**1,856**	**2,050**
Cumulative Effect of Accounting Change	—	—	—	—	—
After-tax Non-recurring Items	—	—	—	*583*	*165*
Discounted Operations	419	-27	—	*100*	—
Preferred Dividends	**670**	**993**	**640**	**142**	**114**
Net Income attributable to common shareholders, Excluding All After-tax items	**-238**	**-408**	**375**	**1,714**	**1,936**
Net Income attributable to common shareholders, including all after-tax items	**-657**	**-381**	**375**	**1,031**	**1,771**
Average Diluted Shares Outstanding	344	349	417	*417*	*417*
Diluted EPS Excluding Charges	**-0.69**	**-1.17**	**0.90**	**4.11**	**4.64**
Diluted EPS Including Charges	**-1.91**	**-1.09**	**0.90**	**2.47**	**4.25**

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Morningstar Analyst Forecasts

Balance Sheet (EUR Mil)

Earning Assets	Dec 2012	Dec 2013	*Forecast* Dec 2014	*Forecast* Dec 2015
Cash and Due from Banks	4,426	4,378	*4,256*	*4,010*
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	68,076	60,907	*57,862*	*55,547*
Investment Securities Held to Maturity	28,510	31,323	*31,010*	*31,940*
Investment Securities Available-for-Sale	—	—	—	—
Financial Instruments Owned, at Fair Value (trading securities)	—	—	—	—
Other Earning Assets	1,429	1,043	*1,033*	*1,064*
Loans Held for Sale	—	—	—	—
Loans and Leases	143,970	138,294	*131,971*	*135,913*
Unearned Discount	—	—	—	—
Allowance for Loan Losses	-4,745	-5,732	*-5,279*	*-4,893*
Net Loans and Leases	**139,225**	**132,562**	**126,692**	**131,020**
Non-Earning Assets				
Premises & Equipment, Net	2,581	2,465	*2,325*	*2,181*
Premises & Equipment, Gross	4,587	2,465	*2,605*	*2,749*
(Accumulated Depreciation)	-2,006	—	*-280*	*-567*
Interest Receivables	—	—	—	—
Goodwill	1,328	1,289	*1,289*	*1,289*
Identifiable Intangibles	—	—	—	—
Deferred Tax Assets	2,188	1,481	*1,481*	*1,481*
Other Non-Earning Assets (Other Real Estate Owned etc.)	9,123	5,858	*6,034*	*6,215*
Total Assets	**256,886**	**241,306**	**231,980**	**234,747**

Liabilities	Dec 2012	Dec 2013	*Forecast* Dec 2014	*Forecast* Dec 2015
Total Deposits	182,551	178,416	*183,768*	*189,282*
Customer Deposits	159,632	164,141	*169,065*	*174,137*
Federal Funds Purchased and Securities Loaned or Sold under Agreements to Repurchase	—	—	—	—
Brokerage Payables	—	—	—	—
Trading Liabilities	19,459	13,119	*28,931*	*27,774*
Financial Instruments Sold, but not yet purchased at Fair Value	—	—	—	—
Other Payables	—	—	—	—
Short-Term Debt	—	—	—	—
Long-Term Debt	11,255	10,459	*-20,197*	*-22,583*
Additional Debt	—	—	—	—
Total Short-Term, Long-Term and Other Debt	**11,255**	**10,459**	**-20,197**	**-22,583**
Deferred Tax Liabilities	647	415	*415*	*415*
Other Liabilities (bank acceptance outstanding, accrued expenses, etc.)	7,282	5,159	*4,901*	*5,048*
Total Liabilities	**240,925**	**226,792**	**217,708**	**220,308**
Equity				
Common Stock	12,099	11,826	*11,826*	*11,826*
Paid-in Capital	—	—	—	—
Retained Earnings	—	—	*420*	*916*
Preferred Equity	3,500	2,333	*1,673*	*1,343*
Treasury Stock	—	—	—	—
Accumulated Other Comprehensive Income	—	—	—	—
Other Equity	—	—	—	—
Shareholders?Equity	15,599	14,159	*13,919*	*14,085*
Total Liabilities & Shareholders?Equity (including Minority Interest)	**256,886**	**241,305**	**231,980**	**234,747**

KBC Group SA/NV KBC (XBRU) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
43.85 EUR	39.00 EUR	19.50 EUR	68.25 EUR	Very High	None	Stable	Standard	BBB	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.

Valuation Analysis

		Price/Earnings				Price/Book				Price/Tangible Book			
Company/Ticker	Price/Fair Value	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*
BNP Paribas BNP FRA	0.8	8.3	15.4	*27.3*	*9.1*	0.8	0.7	*0.8*	*0.9*	0.9	0.9	*1.0*	*1.0*
Average		8.3	15.4	*27.3*	*9.1*	0.8	0.7	*0.8*	*0.9*	0.9	0.9	*1.0*	*1.0*
KBC Group SA/NV KBC BE	**1.1**	**NM**	**45.8**	***10.7***	***9.5***	**1.2**	**1.5**	***1.3***	***1.3***	**1.3**	**1.7**	***1.3***	***1.2***

Returns Analysis

		Return on Average Equity %				Return on Average Assets %				Return on Tangible Equity %			
Company/Ticker	Last Historical Year Total Assets (Mil)	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*
BNP Paribas BNP FRA	1,800,139 EUR	8.1	5.6	*3.1*	*8.6*	0.3	0.3	*0.2*	*0.4*	9.3	6.4	*3.4*	*9.6*
Average		8.1	5.6	*3.1*	*8.6*	0.3	0.3	*0.2*	*0.4*	9.3	6.4	*3.4*	*9.6*
KBC Group SA/NV KBC BE	**241,306** EUR	**3.7**	**6.8**	***13.2***	***14.6***	**0.2**	**0.4**	***0.8***	***0.9***	**0.3**	**3.0**	***8.2***	***13.8***

Growth Analysis

		Net Revenue Growth %				Pre-Tax, Pre-Provision Earnings Growth %				EPS Growth %			
Company/Ticker	Last Historical Year Revenue (Mil)	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*
BNP Paribas BNP FRA	39,430 EUR	-3.1	-4.7	*-2.7*	*2.5*	7.9	-14.1	*-35.7*	*81.5*	7.2	-28.6	*-48.8*	*200.2*
Average		-3.1	-4.7	*-2.7*	*2.5*	7.9	-14.1	*-35.7*	*81.5*	7.2	-28.6	*-48.8*	*200.2*
KBC Group SA/NV KBC BE	**7,517** EUR	**6.7**	**-2.8**	***-6.7***	***2.2***	**-3.4**	**67.6**	***-4.0***	***2.2***	**68.8**	**NM**	***356.6***	***13.1***

KBC Group SA/NV KBC (XBRU) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
43.85 EUR	39.00 EUR	19.50 EUR	68.25 EUR	Very High	None	Stable	Standard	BBB	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)	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*
BNP Paribas BNP FRA	39,430 EUR	1.3	1.3	*1.3*	*1.3*	64.4	68.3	*79.2*	*63.4*	47.4	47.8	*48.3*	*48.5*
Average		1.3	1.3	*1.3*	*1.3*	64.4	68.3	*79.2*	*63.4*	47.4	47.8	*48.3*	*48.5*
KBC Group SA/NV KBC BE	**7,517** EUR	**1.9**	**1.8**	***1.8***	***1.9***	**68.1**	**54.2**	***53.0***	***53.0***	**39.7**	**45.0**	***41.8***	***42.4***

Leverage Analysis

		Assets/Equity				Tangible Common Equity/ Tangible Assets %				Tier I Ratio %			
Company/Ticker	Last Historical Year Total Debt (Mil)	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*
BNP Paribas BNP FRA	195,535 EUR	22.2	20.6	*20.4*	*20.4*	3.8	4.2	*4.2*	*4.2*	13.6	12.8	—	—
Average		22.2	20.6	*20.4*	*20.4*	3.8	4.2	*4.2*	*4.2*	13.6	12.8	—	—
KBC Group SA/NV KBC BE	**10,459** EUR	**16.5**	**17.0**	***16.7***	***16.7***	**4.2**	**4.4**	***4.8***	***4.9***	**13.8**	**15.8**	—	—

Liquidity Analysis

		Loans/Deposits %				Short-Term Debt % of Liabilities				Liquid Assets (% of Total Assets)			
Company/Ticker	Last Historical Year Market Cap (Mil)	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*	2012	2013	*2014(E)*	*2015(E)*
BNP Paribas BNP FRA	63,817 EUR	100.8	102.3	*101.5*	*99.6*	5.5	6.3	*5.6*	*5.2*	56.2	54.8	*51.6*	*51.3*
Average		100.8	102.3	*101.5*	*99.6*	5.5	6.3	*5.6*	*5.2*	56.2	54.8	*51.6*	*51.3*
KBC Group SA/NV KBC BE	**18,301** EUR	**76.3**	**74.3**	***68.9***	***69.2***	—	—	—	—	**28.2**	**27.1**	***26.8***	***25.4***

Research Methodology for Valuing Companies

Components of Our Methodology

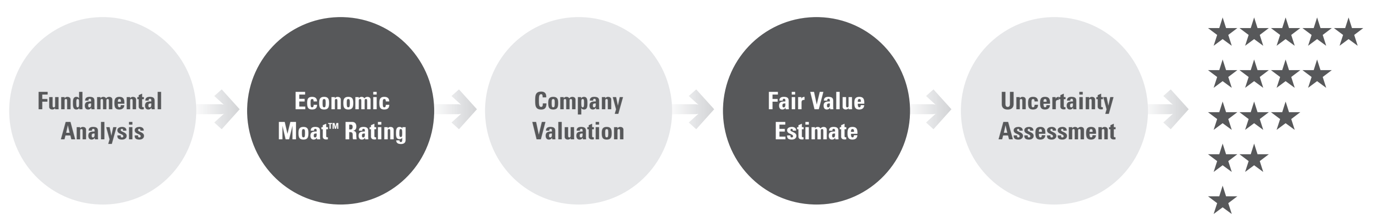
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

Morningstar Research Methodology for Valuing Companies



Analyst conducts company and industry research: ► Financial statement analysis ► Channel checks ► Trade-show visits ► Industry and company reports and journals ► Conference calls ► Management and site visits	Strength of competitive advantage is rated: None, Narrow, or Wide Advantages that confer an economic moat: **High Switching Costs** (Microsoft) **Cost advantage** (Wal-Mart) **Intangible assets** (Johnson & Johnson) **Network Effect** (Mastercard) **Efficient Scale** (Lockheed Martin)	Analyst considers past financial results and focuses on competitive position and future prospects to forecast future cash flows. Assumptions are entered into Morningstar's proprietary discounted cash-flow model.	Analyst uses a discounted cash-flow model to develop a Fair Value Estimate, which serves as the foundation for the Morningstar Rating for stocks.	The analyst then evaluates the range of potential intrinsic values for the company and assigns an Uncertainty Rating: Low, Medium, High, Very High, or Extreme. The Uncertainty Rating determines the margin of safety required before we would recommend the stock. The higher the uncertainty, the wider the margin of safety.	The current stock price relative to Morningstar's Fair Value Estimate, adjusted for uncertainty, determines the Morningstar Rating for stocks. The Morningstar Rating for stocks is updated each evening after the market closes.

Research Methodology for Valuing Companies

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

* Please contact a sales representative for more information.

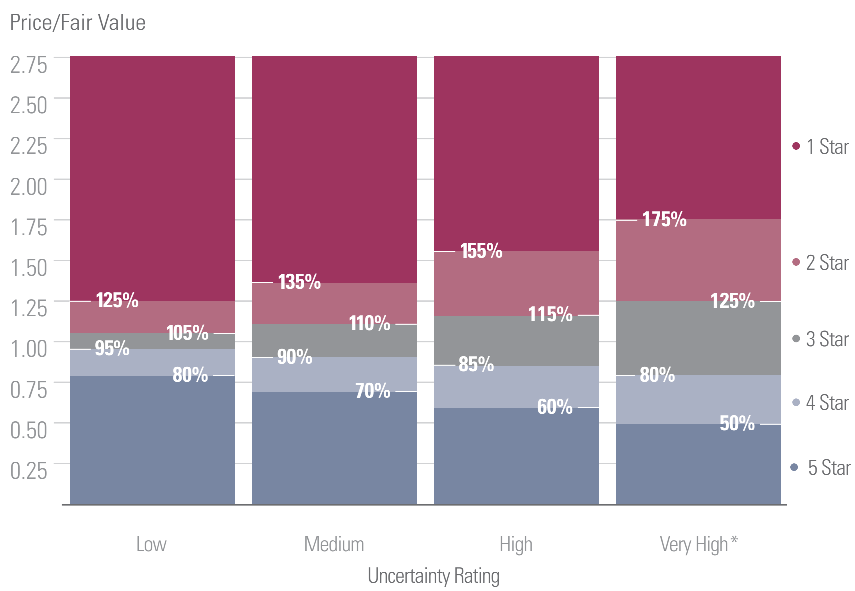
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate 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.

Morningstar Margin of Safety and Star Rating Bands



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

KBC Group SA/NV KBC (XBRU) | ★★★

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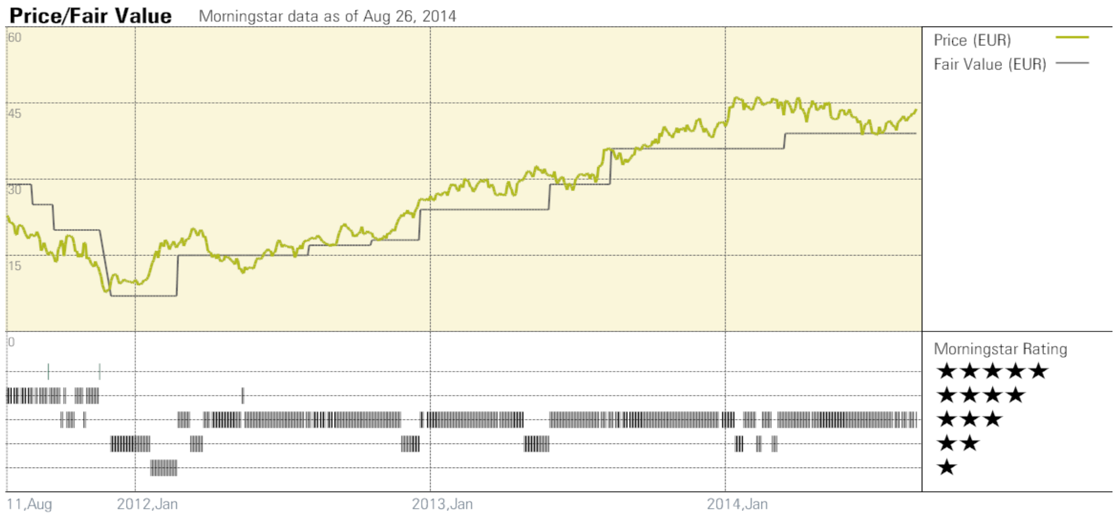

The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value. Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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