

Equity Research

April 25, 2016

Mark Palmer

(212) 588-6582

mpalmer@btig.com

Giuliano Bologna

(212) 588-6583

gbologna@btig.com

Financials

Popular, Inc.

BPOP Misses 1Q16 EPS Estimate by a Penny, But Credit Quality Robust; Shares Appear Inexpensive

Given the challenging economic environment in Puerto Rico and the Commonwealth government's struggles with its \$72bn in debt, many investors have avoided investing in Popular (BPOP, Buy, \$41 PT), the island's largest bank, in the expectation that its credit quality would deteriorate given a customer base under duress.

- ▶ However, Puerto Rico's economy has been in recession for about a decade and BPOP's credit performance first improved and then stabilized at favorable levels during that period. That stability was in evidence again in the 1Q16 report the company released this morning.
- ▶ BPOP reported 1Q16 earnings per share of \$0.81, missing the consensus estimate by a penny and trailing our estimate of \$0.86. Perhaps more important than a \$0.01 earnings miss was another batch of solid credit metrics.
- ▶ BPOP's net charge-off ratio declined by 72bps sequentially to 0.76%, while its non-performing loans (NPLs) fell by \$2mm versus the prior quarter and its NPL ratio remained stable at 2.7%. The company did see a \$9mm increase in NPL inflows (excluding consumer loans) that was attributed to a single corporate borrower on the U.S. mainland.
- ▶ **We reiterate our Buy recommendation on BPOP and \$41 price target** based on 0.85x the sum of the company's 2016E TBV and our estimate of \$0.99 in losses on direct exposure to Puerto Rico government debt. We view BPOP shares as very inexpensive at just 0.68x the company's tangible book value per share of \$43.55 as of March 31, and we believe the company's resilience in the face of a tough environment in Puerto Rico is underappreciated.
- ▶ **Valuation:** Our \$41 price target on BPOP is based on 0.85X the sum of the company's 2016E TBV per share and our estimate of the realizable value of its non-core equity investments, minus our estimate of its losses on Puerto Rico direct government exposure.

BPOP

12 month target

\$30.03

\$41.00

BUY

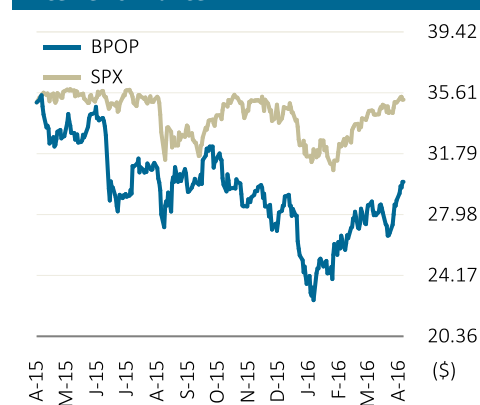
52 week range

\$22.62 - \$35.45

Market Cap (m)

\$3,107

Price Performance



Source: IDC

Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 A	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
Diluted EPS (Adj.)	0.70	5.76	0.82	1.32	3.67	0.81	0.81	0.82	0.83	3.36	3.49
Tangible BVPS	36.33	41.75	42.71	42.18	42.18	43.55	44.17	44.80	45.43	45.43	48.11
Operating Income	106	64	108	121	402	117	118	120	121	486	515

Source: BTIG Research Estimates and Company Documents (\$ in millions, except per share amount)

Please Read: Important disclosures and analyst's certification appear in Appendix

- ▶ In light of the likelihood that Puerto Rico's government will default on a portion of its debt during the next few months, we believe it is important for investors to understand BPOP's \$565mm in direct exposure to the government's debt with some granularity. About \$490mm of that amount is in the form of loans to municipalities, most of which are senior in priority and backed by tax receipts.
- ▶ BPOP has only \$19mm in exposure to securities issued by Puerto Rico's government, including \$15mm in COFINA senior bonds, \$3mm in general obligation bonds and \$1mm in Government Development Bank bonds.

Income Statement

Operating Model - BPOP (\$ in millions)	Dec-10 2010A	Dec-11 2011A	Dec-12 2012A	Dec-13 2013A	Dec-14 2014A	Mar-15 1Q15A	Jun-15 2Q15A	Sep-15 3Q15A	Dec-15 4Q15A	Dec-15 2015A	Mar-16 1Q16A	Jun-16 2Q16E	Sep-16 3Q16E	Dec-16 4Q16E	Dec-16 2016E	Dec-17 2017E
Interest income	1,948.25	1,937.50	1,751.71	1,748.46	1,657.87	390.07	410.30	401.28	401.36	1,606.95	404.02	409.07	410.09	411.12	1,634.30	1,654.78
Interest expense	653.38	505.51	379.09	315.88	691.01	46.88	47.75	50.55	48.86	194.87	51.61	51.35	51.09	50.84	194.69	192.56
Net interest income	1,294.87	1,431.99	1,372.62	1,432.58	966.87	343.20	362.55	350.74	352.50	1,412.08	352.41	357.72	359.00	360.28	1,439.61	1,462.22
Provision for loan losses - non-covered loans	1,011.88	430.09	334.10	533.17	217.24	29.71	60.47	69.57	57.71	217.46	47.94	48.18	48.42	48.66	193.20	186.31
Provision for loan losses - covered loans	-	145.64	74.84	69.40	46.14	10.32	15.77	(2.89)	0.82	24.02	(3.11)	1.00	1.00	1.00	(0.11)	4.00
Post provision interest income	282.99	856.27	963.68	830.02	703.50	303.16	286.32	284.06	293.97	1,170.60	307.58	308.54	309.58	310.62	1,246.51	1,271.91
Service charges in deposit accounts	195.80	184.94	183.03	172.91	160.53	39.02	40.14	40.96	39.99	160.11	39.86	40.26	40.66	41.07	161.86	168.43
Other service fees	377.50	239.72	256.55	246.95	226.49	53.63	59.42	56.12	66.93	236.09	53.38	53.92	54.45	55.00	216.75	223.88
Mortgage banking activities	-	-	-	33.29	30.62	12.85	21.33	24.20	23.43	81.80	10.55	10.66	10.76	10.87	42.84	44.25
Net gain (loss) and valuation adjustments on investment securities	3.99	10.84	(1.71)	7.97	(0.87)	-	(14.44)	0.14	-	(14.30)	-	-	-	-	-	-
Trading account profit (loss)	16.40	5.90	(17.68)	(0.33)	4.36	0.41	(3.11)	(0.40)	(1.63)	(4.72)	(0.16)	(0.16)	(0.17)	(0.17)	(0.66)	(0.68)
Net gain (loss) on sale of loans	15.87	30.89	48.77	(35.72)	47.97	(0.08)	0.68	-	(0.06)	0.54	(0.30)	(0.31)	(0.31)	(0.31)	(1.23)	(1.27)
Adjustments (expense) to indemnity reserves on loans sold	(72.01)	(33.07)	(21.20)	(37.05)	(34.10)	(4.53)	0.42	(5.87)	(8.65)	(18.63)	(4.10)	(4.06)	(4.02)	(3.98)	(16.15)	(15.71)
FDIC loss share (expense) income	(25.75)	66.79	(56.21)	(82.05)	(103.02)	4.14	19.08	1.21	(4.36)	20.06	(3.15)	(3.11)	(1.56)	(1.56)	(9.38)	(4.65)
Fair value change in equity appreciation instrument	42.56	8.32	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gain on sale of processing business	640.80	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other operating income	93.02	45.94	45.94	504.61	(110.13)	9.79	17.25	14.77	16.78	58.59	15.55	15.62	15.70	15.78	62.65	62.32
Non-interest income	1,288.19	560.28	437.48	810.57	221.85	115.24	140.76	131.11	132.44	519.54	111.63	112.81	115.53	116.71	456.68	476.56
Personnel costs	514.20	453.37	465.70	461.87	427.53	116.46	120.98	120.86	119.22	477.52	127.09	127.73	128.37	129.01	512.19	519.26
Net occupancy expenses	116.20	102.32	100.45	99.33	91.04	21.71	23.29	21.28	20.62	86.89	20.43	20.48	20.53	20.58	82.03	82.85
Equipment expenses	85.85	43.84	45.29	47.48	49.29	13.41	15.93	14.74	16.04	60.11	14.55	14.62	14.69	14.77	58.63	59.44
Other taxes	50.61	51.89	50.12	58.29	56.98	8.57	11.11	9.95	10.16	39.80	10.20	10.22	10.25	10.27	40.93	41.34
Professional fees	166.11	194.94	211.89	289.28	284.85	75.53	78.45	77.15	77.85	308.99	75.46	76.21	76.59	76.98	305.24	309.84
Communications	38.91	27.12	26.83	26.29	25.93	6.18	6.15	6.06	6.76	25.15	6.32	6.34	6.35	6.37	25.37	25.63
Business promotion	46.67	55.07	61.58	60.48	54.31	10.81	13.78	12.33	15.16	52.08	11.11	11.14	11.17	11.19	44.61	45.84
FDIC deposit insurance	67.64	93.73	85.70	60.51	41.30	6.40	8.54	7.30	5.39	27.63	7.37	7.39	7.41	7.43	29.59	29.89
Loss on early extinguishment of debt	38.79	8.69	25.20	3.39	0.53	-	-	-	-	-	-	-	-	-	-	-
Other real estate owned (OREO) expenses	46.79	21.78	23.52	80.24	39.36	23.07	44.82	7.69	10.00	85.57	9.14	9.16	9.19	9.21	36.70	37.07
Credit and debit card processing, volume, interchange and other	42.61	17.54	19.73	20.81	21.84	4.82	5.76	6.45	5.82	22.85	5.72	5.74	5.75	5.77	22.97	23.20
Other operating expenses	102.00	70.37	85.07	74.74	74.55	12.53	25.32	19.10	15.27	72.22	11.44	11.47	11.50	11.53	45.94	46.41
Restructuring costs	-	-	-	-	8.68	10.75	6.17	0.48	1.00	18.41	-	-	-	-	-	-
Amortization of intangibles	9.17	9.65	10.07	9.88	26.68	2.10	2.88	3.51	2.52	11.02	3.11	3.12	3.13	3.14	12.50	12.63
Operating expenses	1,325.55	1,150.30	1,211.15	1,292.59	1,202.87	312.34	363.17	306.90	305.81	1,288.22	301.94	303.62	304.92	306.23	1,216.72	1,233.40
Income before income taxes	245.63	266.25	190.01	348.00	(277.52)	106.05	63.90	108.27	120.60	401.92	117.26	117.74	120.19	121.09	486.48	515.07
Income tax expense (benefit)	108.23	114.93	(26.40)	(251.33)	60.90	32.57	(533.53)	22.62	(16.83)	(495.17)	32.27	32.97	33.65	33.90	132.79	144.22
Preferred stock dividends	(191.98)	(3.72)	(3.72)	(3.72)	(3.72)	(0.93)	(0.93)	(0.93)	(0.93)	(3.72)	(0.93)	(0.93)	(0.93)	(0.93)	(3.72)	(3.72)
Net income	(54.58)	147.60	212.69	595.60	(342.15)	72.55	596.51	84.72	136.50	893.37	84.07	83.84	85.60	86.25	349.96	367.13
Diluted EPS	(0.62)	1.44	2.07	5.78	(3.32)	0.70	5.76	0.82	1.32	3.67	0.81	0.81	0.82	0.83	3.36	3.49
Diluted shares outstanding	88.52	102.59	102.80	103.08	103.17	103.49	103.50	103.56	103.62	103.54	103.67	103.93	104.19	104.45	104.06	105.10
BV per diluted share	42.94	38.20	39.98	44.88	41.40	42.30	47.82	48.76	49.27	49.27	50.64	51.24	51.86	52.47	52.47	55.08
TBV per diluted share	34.39	30.77	32.66	37.67	36.04	36.33	41.75	42.71	42.18	42.18	43.55	44.17	44.80	45.43	45.43	48.11
Tax rate	44.1%	43.2%	-13.9%	-72.2%	-21.9%	30.7%	-834.9%	20.9%	-14.0%	-123.2%	27.5%	28.0%	28.0%	28.0%	27.3%	28.0%

Source: BTIG Research Estimates and Company Reports

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

I, Mark Palmer, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Regulatory Disclosures

Analyst Stock Ratings Definitions

BTIG LLC's ("BTIG") ratings, effective May 10, 2010, are defined as follows:

BUY – A stock that is expected at initiation to produce a positive total return of 15% or greater over the 12 months following the initial recommendation. The BUY rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

SELL – A stock that is expected at initiation to produce a negative total return of 15% or greater over the next 12 months following the initial recommendation. The SELL rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

NEUTRAL – A stock that is not expected to appreciate or depreciate meaningfully over the next 12 months.

NOT RATED – A stock that is not rated but that is covered by BTIG.

Distribution of Ratings and Investment Banking Clients

BTIG must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy", "neutral" or "sell" rating. The said ratings are updated on a quarterly basis. BTIG must also disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months. **Stocks under coverage as of the end of the most recent calendar quarter (March 31, 2016): 182**

Distribution of BTIG's Research Recommendations (as of March 31, 2016):

BUY: 62.6%; NEUTRAL: 34.1%; SELL: 3.3%

Distribution of BTIG's Investment Banking Services (as of March 31, 2016):

BUY: 92.9%; NEUTRAL: 7.1%; SELL: 0%

For purposes of FINRA ratings distribution rules, BTIG's stock ratings of Buy, Neutral and Sell fall into Buy, Hold and Sell categories, respectively.

Company Valuation and Risk Disclosures

Popular, Inc. (BPOP, Buy)

Valuation: Our \$41 price target on BPOP is based on 0.85X the sum of the company's 2016E TBV per share and our estimate of the realizable value of its non-core equity investments, minus our estimate of its losses on Puerto Rico direct government exposure.

Risks: Primary risks to our recommendation include weakness in the economy within the company's geographic footprint that could negatively impact its operating results; deterioration in collateral values of properties securing the company's construction, commercial and mortgage loans that could result in credit losses; the potential negative affect on the value of company's loans to the Puerto Rico government and its portfolio of Puerto Rico government securities due to rating downgrades on the government's debt obligations; an increase in

the cost of company's obligations and ability to enter into hedging agreements due to rating agency actions; and increased regulatory scrutiny and limitations on business due to participation in TARP.

Popular, Inc. (BPOP)



Note: Closing Price and Target Price have been adjusted for corporate actions.

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
17-Mar-14	29.18	42	Mark Palmer	Buy
23-Apr-14	31.68	41	Mark Palmer	Buy
06-Jul-15	29.05	39	Mark Palmer	Buy
24-Jul-15	30.98	41	Mark Palmer	Buy

Company-Specific Regulatory Disclosures

BTIG LLC expects to receive or intends to seek compensation for investment banking services in the next 3 months from: Popular, Inc. (BPOP)

Other Disclosures

Additional Information Available Upon Request

General Disclosures

Research reports produced by BTIG LLC ("BTIG") are published for and intended to be distributed solely to BTIG institutional and corporate clients. Recipients of BTIG reports will not be considered clients of BTIG solely because they may have received such BTIG report.

The equity research analyst(s) responsible for the preparation of this report receives compensation based upon a variety of factors, including the quality and accuracy of research, internal/client feedback, and overall Firm revenues.

BTIG reports are based on public information and BTIG considers the same to be reliable, comprehensive information, but makes no representation or warranty that the reports are accurate or complete. BTIG opinions and information provided in this report are as of the date of the report and may change without notice.

This research report is not an offer to buy or sell or solicitation of an offer to buy or sell any security in any jurisdiction where such an offer or solicitation would be illegal. This research report was not drafted specifically for any particular individual or entity and is not a personal recommendation to participate in any particular trading strategy or transaction. Any recipient of this research report should obtain independent advice specific to their personal circumstances before undertaking any investment activity and must make their own independent evaluation of any securities or financial instruments.

Facts, views or opinions presented in this report have not been reviewed by, and may not reflect information known to, employees or other professionals in the “BTIG Group” (BTIG Group includes, but is not limited to, BTIG and its parents, subsidiaries and/or affiliates). BTIG Group employees, including Sales Representatives and Traders, may provide oral or written commentary or advice that may be inconsistent with the opinions and/or views expressed in this research report. BTIG Group employees and/or its affiliates not involved in the preparation of this research report may have investments in securities or derivatives of securities of companies mentioned in this report that are inconsistent with the views discussed in this report.

Investors in securities products bear certain risks in conjunction with those investments. The value of, and income from, any investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors within or beyond the companies control. Recipient of the research reports should be aware that investments in equity securities may pose significant risks due to the inherent uncertainty associated with relying on forecasts of various factors that can affect the earnings, cash flow and overall valuation of a company. Any investment in equity securities should be undertaken only upon consideration of issues relating to the recipient’s overall investment portfolio and objectives (such as diversification by asset class, industry or company) as well as time horizon and liquidity needs. Further, past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. There may be time limitations on the exercise of options or other rights in any securities transactions.

Investing in foreign markets and securities, including ADRs, is subject to additional risks such as currency fluctuation, limited information, political instability, economic risk, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. Non-U.S. reporting issuers of foreign securities, however, may not make regular or complete public disclosure relating to their financial condition or the securities that they issue.

The trademarks and service marks contained herein are the property of their respective owners. Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability of any damages of any kind relating to such data. The report or any portion hereof may not be reprinted, sold or redistributed without the written consent of BTIG. This report is intended only for use by the recipient. The recipient acknowledges that all research and analysis in this report are the property of BTIG and agrees to limit the use of all publications received from BTIG within his, or her or its, own company or organization. No rights are given for passing on, transmitting, re transmitting or reselling the information provided.

Jurisdiction and Dissemination

BTIG is a U.S. broker-dealer and member of FINRA and SIPC.

BTIG Australia Limited ACN 128 554 601, member of ASIC and ASX; BTIG Hong Kong Limited, an Exchange Participant of SEHK and licensed and regulated by the SFC; BTIG Ltd, member of the LSE, authorized and regulated by the FSA; and BTIG Singapore Pte Ltd, registered and licensed with MAS; are all separate but affiliated entities of BTIG. Unless governing law permits otherwise, you must contact a BTIG entity in your home jurisdiction for further information, or if you want to use our services in effecting a transaction.

Issues and approved for distribution in the UK and EEA by BTIG Ltd. to eligible counterparties and professional clients only. Issued and distributed in Australia to “wholesale clients” only by BTIG Australia Limited. In Singapore and Hong Kong, further information may be obtained from BTIG Singapore Pte Ltd and BTIG Hong Kong Limited, respectively.