

## Equity Research

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## Financials

### Popular, Inc.

#### Downgrading to Neutral (from Buy) After Achievement of PT; Shares Fairly Valued After Strong Rally

We are downgrading Popular, Inc. (BPOP) to Neutral (from Buy) and removing our price target of \$41 following the achievement of that level. We continue to be impressed with the resilience of BPOP's operating performance, particularly with regard to its credit quality, in light of the ongoing economic struggles of its primary market in Puerto Rico. However, the company's shares have appreciated by almost 83% since January 25, leaving them much closer to fairly valued, in our view.

### BPOP

\$41.49

### NEUTRAL

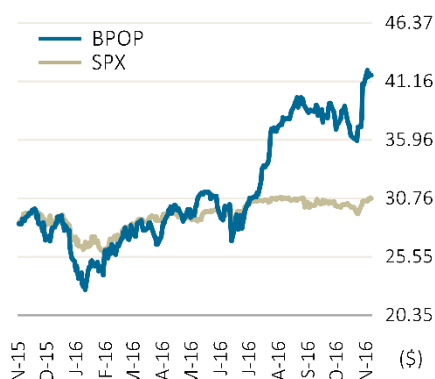
52 week range

\$22.62 - \$42.15

Market Cap (m)

\$4,316

#### Price Performance



Source: IDC

- The lion's share of that stock price appreciation has occurred since June 30 when President Obama signed the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) into law. The appointment of the members of the financial oversight board created by the act, as well as the election of Ricky Rossello as Puerto Rico's new governor earlier this month have raised hopes that the Commonwealth's economy will soon stabilize and return to growth.
- Additionally, BPOP has submitted to its regulator, the Federal Reserve Bank of New York (FRBNY), a capital plan that likely includes a request for the company's first share buybacks since before the financial crisis. While concerns about that request have arisen insofar as some investors believed the FRBNY would have responded to BPOP's request by now, we believe the company is well positioned for approval of a modest amount of buybacks.
- While we believe BPOP should be able to receive approval for some amount of share buybacks, we also note that it will need to retain a larger capital cushion relative to its mainland peers even if the Puerto Rico economy stabilizes given its systemic significance to the Commonwealth. Moreover, we believe the FRBNY's approval of BPOP's requested share buybacks has already been priced into the company's shares to some extent.
- **Valuation:** Our valuation of BPOP is within +/- 15% from current levels over the next 12 months. We believe BPOP trades at an appropriate discount to U.S. mainland regional bank peers. BTIG does not assign price targets to Neutral-rated stocks.

## Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 A	2Q16 A	3Q16 A	4Q16 E	FY16 E	FY17 E
Diluted EPS (Adj.)	0.70	5.76	0.82	1.32	3.67	0.81	0.85	0.90	0.88	2.99	3.53
Tangible BVPS	36.33	41.75	42.71	42.18	42.18	43.55	44.78	44.99	45.67	45.67	48.66
Operating Income	106	64	108	121	402	117	121	63	128	429	515

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

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

- ▶ BPOP on October 17 released Dodd-Frank Act Stress Test results showing that even under a severely adverse scenario the company's Common Equity Tier 1 (CET1) ratio would be 12.56%, well in excess of the regulatory well capitalized minimum of 6.50%. BPOP's CET1 ratio of 16.6% as of September 30 and the company has an estimated \$2bn in excess capital.
- ▶ After the strong rally in BPOP shares they trade at 0.92x the company's tangible book value as of September 30. We believe the stock is close to fairly valued and that some discount to tangible book value is still merited at this point insofar as the economic situation in Puerto Rico remains a source of uncertainty. Moreover, BPOP's return on average common equity was 5.59% through the first nine months of 2016, and we believe the company may struggle to lift this metric in the near term given limited growth opportunities in the Commonwealth.
- ▶ While many bank stocks have rallied in the face of expectations for higher interest rates following the election of President-elect Trump, we believe BPOP's potential benefit from rate increases may be more muted than that of some of its mainland peers. Higher rates likely would translate into higher market returns on BPOP's excess capital, but the resetting of residential mortgages and other floating-rate loans to higher rates amidst an economy that remains challenged could result in higher losses that could undermine the resilience that is one of the stock's main selling points.

## Income Statement

Operating Model - BPOP (in millions)	Mar-15 1Q15A	Jun-15 2Q15A	Sep-15 3Q15A	Dec-15 4Q15A	Dec-15 2015A	Mar-16 1Q16A	Jun-16 2Q16A	Sep-16 3Q16A	Dec-16 4Q16E	Dec-16 2016E	Mar-17 1Q17E	Jun-17 2Q17E	Sep-17 3Q17E	Dec-17 4Q17E	Dec-17 2017E
<b>Interest income</b>	<b>390.07</b>	<b>410.30</b>	<b>401.28</b>	<b>401.36</b>	<b>1,606.95</b>	<b>404.02</b>	<b>412.21</b>	<b>407.30</b>	<b>408.32</b>	<b>1,631.85</b>	<b>406.28</b>	<b>407.29</b>	<b>408.31</b>	<b>409.33</b>	<b>1,631.21</b>
<b>Interest expense</b>	<b>46.88</b>	<b>47.75</b>	<b>50.55</b>	<b>48.86</b>	<b>194.87</b>	<b>51.61</b>	<b>51.66</b>	<b>53.61</b>	<b>53.34</b>	<b>210.22</b>	<b>53.48</b>	<b>53.61</b>	<b>53.75</b>	<b>53.88</b>	<b>214.71</b>
<b>Net interest income</b>	<b>343.20</b>	<b>362.55</b>	<b>350.74</b>	<b>352.50</b>	<b>1,412.08</b>	<b>352.41</b>	<b>360.55</b>	<b>353.69</b>	<b>354.97</b>	<b>1,421.62</b>	<b>352.80</b>	<b>353.68</b>	<b>354.56</b>	<b>355.45</b>	<b>1,416.49</b>
Provision for loan losses - non-covered loans	29.71	60.47	69.57	57.71	217.46	47.94	39.67	42.59	42.81	173.01	40.67	40.87	41.07	41.28	163.89
Provision for loan losses - covered loans	10.32	15.77	(2.89)	0.82	24.02	(3.11)	0.80	0.75	0.56	(0.99)	0.42	0.32	0.24	0.18	1.15
<b>Post provision interest income</b>	<b>303.16</b>	<b>286.32</b>	<b>284.06</b>	<b>293.97</b>	<b>1,170.60</b>	<b>307.58</b>	<b>320.08</b>	<b>310.34</b>	<b>311.60</b>	<b>1,249.60</b>	<b>311.71</b>	<b>312.49</b>	<b>313.25</b>	<b>313.99</b>	<b>1,251.45</b>
Service charges in deposit accounts	39.02	40.14	40.96	39.99	160.11	39.86	40.30	40.78	41.18	162.12	41.60	42.01	42.43	42.86	168.89
Other service fees	53.63	59.42	56.12	66.93	236.09	53.38	56.95	59.17	59.76	229.26	59.91	60.51	61.11	61.73	243.26
Mortgage banking activities	12.85	21.33	24.20	23.43	81.80	10.55	16.23	15.27	15.42	57.47	15.46	15.62	15.77	15.93	62.79
Net gain (loss) and valuation adjustments on investment securities	-	(14.44)	0.14	-	(14.30)	-	1.58	0.35	-	1.93	-	-	-	-	-
Trading account profit (loss)	0.41	(3.11)	(0.40)	(1.63)	(4.72)	(0.16)	(0.21)	-	-	(0.37)	-	-	-	-	-
Net gain (loss) on sale of loans	(0.08)	0.68	-	(0.06)	0.54	(0.30)	1.12	(0.11)	(0.11)	0.59	(0.11)	(0.12)	(0.12)	(0.12)	(0.46)
Adjustments (expense) to indemnity reserves on loans sold	(4.53)	0.42	(5.87)	(8.65)	(18.63)	(4.10)	(5.75)	(4.39)	(4.35)	(18.58)	(4.36)	(4.31)	(4.27)	(4.23)	(17.17)
FDIC loss share (expense) income	4.14	19.08	1.21	(4.36)	20.06	(3.15)	(12.58)	(61.72)	(6.29)	(83.73)	(6.30)	(6.24)	(3.12)	(3.12)	(18.79)
Fair value change in equity appreciation instrument	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gain on sale of processing business	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other operating income	9.79	17.25	14.77	16.78	58.59	15.55	12.87	26.64	26.77	81.82	26.24	26.37	26.50	26.63	105.73
<b>Non-interest income</b>	<b>115.24</b>	<b>140.76</b>	<b>131.11</b>	<b>132.44</b>	<b>519.54</b>	<b>111.63</b>	<b>110.50</b>	<b>75.98</b>	<b>132.39</b>	<b>430.50</b>	<b>132.43</b>	<b>133.84</b>	<b>138.31</b>	<b>139.68</b>	<b>544.26</b>
Personnel costs	116.46	120.98	120.86	119.22	477.52	127.09	116.71	121.22	122.44	487.46	123.66	123.97	124.28	124.59	496.50
Net occupancy expenses	21.71	23.29	21.28	20.62	86.89	20.43	21.71	21.63	21.68	85.45	21.73	21.79	21.84	21.90	87.26
Equipment expenses	13.41	15.93	14.74	16.04	60.11	14.55	15.26	15.92	15.96	61.69	16.00	16.04	16.08	16.12	64.25
Other taxes	8.57	11.11	9.95	10.16	39.80	10.20	10.17	11.32	11.35	43.04	11.38	11.41	11.44	11.47	45.69
Professional fees	75.53	78.45	77.15	77.85	308.99	75.46	80.63	81.27	82.08	319.43	83.31	83.52	83.73	83.94	334.49
Communications	6.18	6.15	6.06	6.76	25.15	6.32	6.01	5.79	5.80	23.92	5.81	5.83	5.84	5.86	23.34
Business promotion	10.81	13.78	12.33	15.16	52.08	11.11	13.71	12.73	13.11	50.65	13.37	13.40	13.44	13.47	53.68
FDIC deposit insurance	6.40	8.54	7.30	5.39	27.63	7.37	5.36	5.85	5.87	24.45	5.88	5.90	5.91	5.93	23.62
Loss on early extinguishment of debt	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other real estate owned (OREO) expenses	23.07	44.82	7.69	10.00	85.57	9.14	12.98	11.30	11.32	44.74	11.35	11.38	11.41	11.44	45.58
Credit and debit card processing, volume, interchange and other	4.82	5.76	6.45	5.82	22.85	5.72	6.62	3.64	3.65	19.63	3.66	3.67	3.68	3.69	14.69
Other operating expenses	12.53	25.32	19.10	15.27	72.22	11.44	16.90	26.11	19.63	74.09	19.68	19.73	19.78	19.83	79.02
Restructuring costs	10.75	6.17	0.48	1.00	18.41	-	-	-	-	-	-	-	-	-	-
Amortization of intangibles	2.10	2.88	3.51	2.52	11.02	3.11	3.10	6.90	3.10	16.21	3.11	3.12	3.13	3.14	12.50
<b>Operating expenses</b>	<b>312.34</b>	<b>363.17</b>	<b>306.90</b>	<b>305.81</b>	<b>1,288.22</b>	<b>301.94</b>	<b>309.15</b>	<b>323.67</b>	<b>315.99</b>	<b>1,250.76</b>	<b>318.96</b>	<b>319.76</b>	<b>320.56</b>	<b>321.36</b>	<b>1,280.63</b>
<b>Income before income taxes</b>	<b>106.05</b>	<b>63.90</b>	<b>108.27</b>	<b>120.60</b>	<b>401.92</b>	<b>117.26</b>	<b>121.43</b>	<b>62.65</b>	<b>128.00</b>	<b>429.35</b>	<b>125.18</b>	<b>126.57</b>	<b>131.01</b>	<b>132.32</b>	<b>515.08</b>
Income tax expense (benefit)	32.57	(533.53)	22.62	(16.83)	(495.17)	32.27	32.45	15.84	35.84	116.39	35.05	35.44	36.68	37.05	144.22
<b>Net income</b>	<b>72.55</b>	<b>596.51</b>	<b>84.72</b>	<b>136.50</b>	<b>893.37</b>	<b>84.07</b>	<b>88.06</b>	<b>45.88</b>	<b>91.23</b>	<b>309.23</b>	<b>89.20</b>	<b>90.20</b>	<b>93.40</b>	<b>94.34</b>	<b>367.13</b>
<b>Diluted EPS</b>	<b>0.70</b>	<b>5.76</b>	<b>0.82</b>	<b>1.32</b>	<b>3.67</b>	<b>0.81</b>	<b>0.85</b>	<b>0.90</b>	<b>0.88</b>	<b>2.99</b>	<b>0.86</b>	<b>0.87</b>	<b>0.90</b>	<b>0.91</b>	<b>3.53</b>
Diluted shares outstanding	103.49	103.50	103.56	103.62	103.54	103.67	103.34	103.47	103.72	103.55	103.83	103.93	104.04	104.14	103.98
BV per diluted share	42.30	47.82	48.76	49.27	49.27	50.64	51.86	52.00	52.66	52.66	53.38	54.11	54.87	55.63	55.63
TBV per diluted share	36.33	41.75	42.71	42.18	42.18	43.55	44.78	44.99	45.67	45.67	46.40	47.13	47.89	48.66	48.66
Tax rate	30.7%	-834.9%	20.9%	-14.0%	-123.2%	27.5%	26.7%	25.3%	28.0%	27.1%	28.0%	28.0%	28.0%	28.0%	28.0%

Source: BTIG Estimates and Company Reports

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## BTIG Covered Companies Mentioned in this Report

POPULAR, INC. (BPOP, Neutral, \$N/A PT; Current Price: \$41.72; Analyst: mark.palmer)

## 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.

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**Distribution of BTIG's Research Recommendations (as of September 30, 2016):**

**BUY: 54.6%; NEUTRAL: 41.8%; SELL: 3.6%**

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**BUY: 78.9%; NEUTRAL: 15.8%; SELL: 5.3%**

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#### Popular, Inc. (BPOP, Neutral)

**Valuation:** Our valuation of BPOP is within +/- 15% from current levels over the next 12 months. BTIG does not assign price targets to Neutral-rated stocks.

**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 and increased regulatory scrutiny. Upside risks include: higher than expected capital return and favorable economic developments in Puerto Rico.

# 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

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