Unicredit Capital Markets Day: On Track to Deliver Promised Turnaround

On 12 December 2017, Unicredit (A, Stable) held a capital markets day in London, updating analysts and investors on its progress towards strategic targets set out a year earlier and outlined in its 'Transform 2019' plan.

In essence, Unicredit is on track to clean up its balance sheet and implement a turnaround as promised, with most goals for 2019 well within reach. In our view, two key milestones in this regard were the capital increase and the launch of the FINO[1] transaction earlier in 2017, which will allow the bank to hit capital and asset quality objectives. In fact, Unicredit is overdelivering in several areas, and especially in terms of NPE reduction, which led it to revise down its 2019 gross NPE target by EUR 4bn.

Delivering the turnaround

The core message at the capital markets day was a substantial confirmation of all P&L targets for 2019[2]. The bank expects group revenues of EUR 20.6bn and net income of EUR 4.7bn – thus an RoTE of over 9%. These targets as credible in our view, given the 8% adjusted RoTE in the first three quarters of 2017, upcoming benefits from further cost reductions, and the continued growth in fee revenue.

The outlook on asset quality continues to improve, with Unicredit entering the second phase of the FINO transaction (reducing its stake to below 20%). In addition, the bank expects a complete rundown of the non-core division through 2025. The 2019 asset quality targets were revised down, with a further EUR 4bn reduction in gross NPEs expected and a gross NPE ratio foreseen at 7.8% in 2019 (previous target was 8.4%).

Welcome visibility on capital strategy and upcoming regulatory impacts

The key 12.5% CET1 target was confirmed despite a 50bps drop in the Pillar 2 requirement, effectively meaning the bank is now considering a 250bps management buffer over the MDA-relevant threshold. This, in our view, is a welcome development for AT1 investors. Unicredit also detailed the expected impacts from several regulatory developments, including IFRS 9, anticipation of impacts from the EBA guidelines on credit risk regulatory models, Basel IV and calendar provisioning for NPEs. As anticipated, the current CET1 ratio of 13.8% will initially decline to absorb some of these impacts in 2018 and 2019; beyond 2019, organic generation should suffice to absorb the phasing-in of the other requirements.

Unicredit's CEO signalled the possibility of raising the dividend payout post-2019, once regulatory impacts are confirmed, subject to meeting its 12.5% CET1 target. Importantly, the dividend policy seems to be subordinated, in management's order of priorities, to the maintenance of the ample management buffer over requirements.

The messages conveyed at the capital markets day support our view on Unicredit: We believe the 'Transform 2019' plan, if executed well, puts it on the right path to leave behind its difficult past. Medium-term challenges, which are not unique to Unicredit, include adapting its business model to the rapid changes in technology and customer behaviour. The ability of the group to stay ahead of both traditional competitors and (likely) new entrants will be key to Unicredit's longer-term success.

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[1] Project FINO entails the disposal of EUR 17.7bn of bad loans.
[2] Aside from a minor accounting restatement of NPEs accrued interest, which will add to both NII net interest income and loan loss provisions, with no impact on the bottom line.

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