Investors Can Clean Up With Italy’s Biggest Bank

UniCredit is asking a lot, but its bad-debt clear out should leave it in good shape

Back In Credit

Uses and sources of funds in UniCredit's restructuring

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Source: the company

Bad loan charges

Restructuring charges

Other charges

Fineco sale

Pekao sale

Pioneer sale

Rights issue

€0 billion

€10

€2.5

€5

€7.5

€12.5

Rights issuex€13 billion

By PAUL J. DAVIES

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2 COMMENTS

Italy’s largest bank is pitching one of the lowest profitability targets of any big strategy overhaul among banks anywhere—and it is asking investors for €13 billion ($13.8 billion) in fresh capital to make it happen.

For investors to back UniCredit’s new proposition, they will have to believe that its low returns come with very low risk, especially in a country that is the byword for fears of instability.

UniCredit should convince them.

The target is for returns on tangible equity above 9% in 2019. For that to make sense, the bank has to drive its cost of equity down below 10%, which means slashing risks.

That is where Jean Pierre Mustier, chief executive, is being most radical. He will use most of the money raised to pay for a deep clean of its balance sheet and restructuring. It will cut 14,000 jobs and close nearly 1,000 branches, mostly in Italy.

UniCredit will take €12.2 billion of charges including a whopping €8.1 billion of losses on its worst bad loans. That prices bad loans for sale, cutting their average net value to just 25.5% of face value, which compares with an Italian average of about 40%. The bank is selling a near €18 billion chunk of its worst loans to vehicles backed by U.S. fund managers Fortress and Pimco.

Action like this, and that being taken by Italy's most troubled lender, Banca Monte dei Paschi di Siena, will put pressure on other Italian banks to clean house.

By 2019, UniCredit will have cut net bad loan exposures by almost €20 billion through sales and write downs, reducing the value of nonperforming loans to a respectable 4% of total loans.

The bank is assuming a weak economy where nothing in Europe gets much better and interest rates remain negative. That presents a challenge. With interest income under pressure, it will need to grow lending to maintain roughly flat net revenues.

Jean Pierre Mustier, chief executive officer of UniCredit, poses for a photograph following a news conference in London on Tuesday. ENLARGE

Jean Pierre Mustier, chief executive officer of UniCredit, poses for a photograph following a news conference in London on Tuesday. PHOTO: BLOOMBERG NEWS

What should emerge, however, is a much simpler retail and commercial bank that makes three-quarters of its money in Italy and Germany, two of Europe's biggest economies.

UniCredit shares are now worth just 31% of forecast book value for 2016, a big discount to Deutsche Bank, where the restructuring is harder and fines for past bad behavior are still due.

UniCredit's targeted returns might look low, but once cleaned up it will be much more attractive than many rivals.

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