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Fitch Affirms UniCredit at 'BBB+'/Positive on Banco BPM Exchange Offer Announcement

Fitch Ratings - Paris - 02 Dec 2024: Fitch Ratings has affirmed UniCredit S.p.A.'s (UniCredit) Long-Term IDR at 'BBB+' with a Positive Outlook and the bank's Viability Rating (VR) at 'bbb+'.

The rating action follows UniCredit's decision to launch a non-binding voluntary public exchange offer on the entirety of Banco BPM S.p.A.'s (Banco BPM, BBB-/Stable/bbb-) ordinary shares. The transaction is subject to exchange offer document filing by mid-December, regulatory approvals and general meetings for the approval of the share capital increase, both of which UniCredit expects to receive during 1H25.

The success of the offer will also depend on UniCredit's ability to acquire a controlling stake in Banco BPM. On 26 November, Banco BPM's board of directors commented that the offer was not agreed upon in advance between the two parties and that it considered the offer's conditions did not reflect Banco BPM's underlying profitability.

A full list of rating actions is detailed below.

Key Rating Drivers

Geographic Diversification, Resilient Financial Profile: UniCredit's ratings continue to reflect the strength of its business profile. This is underlined in the group's international footprint, with large operations in strong economies (Germany and Austria) and a leading position in its Italian home market. The ratings also reflect improvements to profitability to robust levels. We expect the bank's disciplined risk appetite to mitigate asset-quality pressures in an economic downturn and that it will maintain capital ratios commensurate with its risk profile.

Ratings One Notch above Italy: The group's geographic diversification and strength relative to Italian peers support a rating above its domestic sovereign. The ratings reflect our expectations that the bank would likely continue servicing its obligations in a sovereign default, and that the Italian sovereign is unlikely to impose material restrictions on the bank's debt-servicing capacity. The Positive Outlook on UniCredit mirrors that on Italy.

The affirmation of UniCredit's ratings reflects our view that a transaction with Banco BPM would not fundamentally alter the group's credit profile to an extent that affects its ratings. The acquisition would strengthen its position as the second largest bank in Italy, potentially raising its combined market share to 14%-15%, subject to possible anti-trust related reductions.

Acquisition Strengthens Domestic Franchise: Fitch views this potential acquisition as complementary to UniCredit's current franchise, as it would refocus it towards wealthy regions in the north of Italy, where Banco BPM has a well-established presence. The combined group could achieve market shares close to 20% or above in Lombardy, Emilia-Romagna, Piedmont or Veneto, which are among the largest contributors to Italy's GDP. We expect that upon combining with Banco BPM, UniCredit would maintain an impaired loans ratio of around 3%.

A takeover of Banco BPM would increase the contribution of Italy to UniCredit's business mix, at an estimated 45% of exposure and 50%-55% of revenue. However, we believe the benefits of the combination and restructuring of UniCredit's Italian business would contribute to a more resilient performance through the cycle, compensating for the risks related to the increased domestic exposure. We expect the combined group to maintain an exposure to Italian sovereign debt at below 100% of common equity Tier 1 (CET1) capital.

Negative Goodwill to Offset Costs: Given the offer's valuation, UniCredit will likely be able to offset a large part of expected one-off restructuring charges of EUR2 billion in 2025 and additional EUR800 million loan loss provisions aimed at strengthening provisioning levels on acquired assets with the material negative goodwill that will arise from a merger with Banco BPM.

Ambitious Cost Synergies Target: In spite of fairly ambitious targets, Fitch expects UniCredit's management to achieve most cost and revenue synergies from a combination with Banco BPM, given its sound record at managing costs. Anticipated cost synergies of EUR0.9 billion are ambitious, at about 30% of Banco BPM's 2024 cost base or close to 6% of the combined entities' costs, while revenue synergies of EUR0.3 billion are moderate. We forecast a material drop in UniCredit's operating profit in 2025, to 2.5%-3% of risk-weighted assets (RWAs). However, it would remain in line with large European banks', before it recovers to above 3% from 2026 as cost savings are realised.

Acquisition to Reduce Capitalisation: We expect UniCredit's capital ratios to materially decline after a potential integration of Banco BPM. The bank estimates a 70bp decline in the CET1 ratio, assuming authorisation to apply the Danish Compromise is granted. If this authorisation is delayed, another 70bp negative impact could temporarily occur. Considering already announced acquisitions, the impact from expected final Basel III rules, UniCredit's large shareholder distribution commitments and a potential takeover of Banco BPM, we forecast the group's CET1 ratio could fall to just above 14% by end-2025, from 16.1% at end-September 2024.

All key rating drivers from the previous rating action commentary on UniCredit remain applicable (https://www.fitchratings.com/research/structured-finance/covered-bonds/fitch-upgrades-unicredit-to-bbb-outlook-positive-31-10-2024).

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

Fitch could affirm UniCredit's ratings and revise the Outlook to Stable if it sees risks to maintaining performance in line with higher-rated large European banks', or if Italy's sovereign rating is affirmed and the Outlook is revised to Stable.

UniCredit's ratings are sensitive to a downgrade of Italy's sovereign rating, as its ratings are capped at one notch above its home country, or to a material weakening of the operating environment of its key markets, for instance due to severe economic setbacks or geopolitical risks.

The ratings are also sensitive to a material and prolonged weakening of UniCredit's performance and of the benefits of its geographic diversification, which would make it no longer exceptional relative to domestic peers. This could lead to a reduction of its loss-absorption capacity, which would undermine the bank's resilience to a potential stress on the Italian sovereign.

We believe this could result from a material asset-quality deterioration following severe economic setbacks in key countries, or by a durable fall in its earnings generation. This could be the case if the impaired loans ratio increases to above 3% on a sustained basis, and operating profit falls below 2.5%-3% of RWAs, especially if the CET1 ratio falls materially below 13% without prospects of a recovery in the short term.

UniCredit's acquisition strategy could also negatively affect the ratings if execution risks become inconsistent with the bank's rating. For instance, this could be the case if the group undertakes two large integrations simultaneously or if material integration risks relating to Banco BPM materialise.

A materially higher exposure to the Italian sovereign, if durably larger than CET1 capital, would also lead to negative rating action, as this would greatly increase UniCredit's sensitivity to an Italian sovereign distress. Reduced flexibility and capacity to access wholesale funding markets materially affecting liquidity could also lead to negative rating action.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of Italy's sovereign rating and a higher assessment of the operating environment for Italian banks, both of which have Positive Outlooks, are prerequisites for an upgrade of UniCredit's ratings, all else being equal. In addition, an upgrade would be contingent on UniCredit maintaining its strong performance through the cycle. This would be manifested in an operating profit comfortably above 3% of RWAs, without significantly altering the group's risk profile, while maintaining significant capital buffers above requirements (a CET1 ratio that remains comfortably above the bank's 12.5%-13% target.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The Short-Term IDR of 'F2' is the lower of the two options that map to a 'BBB+' Long-Term IDR, as UniCredit's funding and liquidity score is below the threshold for a higher Short-Term IDR.

The long-term deposit rating is one notch above UniCredit's Long-Term IDR. This is because of full depositor preference in Italy, and we believe the bank has sufficient combined buffers of junior and senior debt that result in a lower probability of default on deposits relative to its Long-Term IDR. The one-notch uplift also reflects our expectation that the bank will maintain sufficient buffers, given the need to comply with the minimum requirement for own funds and eligible liabilities (MREL).

The 'F2' short-term deposit rating is the lower of the two options for a 'A-' long-term deposit rating, because the funding and liquidity score is not high enough to achieve a higher equivalent short-term rating.

UniCredit's senior preferred debt and Derivative Counterparty Rating (DCR) are rated in line with its Long-Term IDR because we expect UniCredit to use senior preferred debt to meet its MREL, and the buffer of senior non-preferred and more junior instruments will likely remain slightly below 10% of RWAs (end-June 2024: 8.1%). For the same reasons, UniCredit's senior non-preferred notes are rated one notch below the bank's Long-Term IDR.

The Tier 2 subordinated debt is rated two notches below the VR, which is the baseline notching for these instruments. This is because of loss severity, as we expect recoveries to be poor for this type of debt in a bank failure.

Additional Tier 1 notes are rated four notches below the VR, reflecting Fitch's baseline notching for loss severity (two notches) and incremental non-performance risk (two notches) relative to the anchor. The notching reflects the instruments' fully discretionary interest payment and the bank's comfortable distance to mandatory coupon omission points.

No Government Support

UniCredit's Government Support Rating (GSR) of 'no support' (ns) reflects Fitch's view that although external extraordinary sovereign support is possible, it cannot be relied on. Senior creditors can no longer expect to receive full extraordinary support from the sovereign in the event that the bank becomes nonviable. This is because the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that requires senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

The Short-Term IDR would be downgraded by one notch if both the bank's Long-Term IDR is downgraded and our assessment of funding and liquidity is lowered from the current 'bbb+'.

UniCredit's DCR, senior debt, deposit ratings and subordinated and hybrid debt would be downgraded if the Long-Term IDR and VR are downgraded.

The deposit ratings could be downgraded by one notch and be aligned with the IDRs, in the event of a reduction in the size of the senior and junior debt buffers that would result in weaker protection to deposits so that these would no longer have a lower probability of default relative to the IDRs. However, we view this unlikely in light of current and future MREL requirements.

UniCredit's subordinated debts and hybrid securities ratings are also sensitive to a change in the notes' notching, which could arise if Fitch changes its assessment of their non-performance relative to the risk captured in the VR or their expected loss severity. For additional Tier 1 issues, this could reflect a change in capital management or flexibility, or an unexpected shift in regulatory buffers and requirements, for example.

The Short-Term IDR would be upgraded if our assessment of funding and liquidity is revised higher to at least 'a'.

UniCredit's DCR, senior debt, deposit ratings and subordinated and hybrid debt would be upgraded if the Long-Term IDR and VR are upgraded.

UniCredit's senior debt ratings could also be upgraded if the bank is expected to meet the resolution buffer requirements of the consolidated entity exclusively with SNP and more junior instruments, or if we expect resolution buffers represented by SNP and more junior instruments to be at least 10% of RWAs on a sustained basis, neither of which is currently the case nor expected.

An upgrade of the GSR would be contingent on a positive change in the Italian sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely, although not impossible.

VR ADJUSTMENTS

The operating environment score of 'bbb+' is below the 'a' implied category score due to the following adjustment reasons: international operations (positive), sovereign rating (negative).

The business profile score of 'bbb+' is below the 'a' implied category score due to the following adjustment reason: business model (negative).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visithttps://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
UniCredit S.p.A.	LT IDR	BBB+	Affirmed		BBB+
	ST IDR	F2	Affirmed		F2
	Viability	bbb+	Affirmed		bbb+
	DCR	BBB+(dcr)	Affirmed		BBB+(dcr)
	Government Support	ns	Affirmed		ns
• subordinated	LT	BBB-	Affirmed		BBB-
• Senior non-preferred	LT	BBB	Affirmed		BBB

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• long-term deposits	LT	A-	Affirmed		A-
• junior subordinated	LT	BB	Affirmed		BB
• Senior preferred	LT	BBB+	Affirmed		BBB+
• Senior preferred	ST	F2	Affirmed		F2
• short-term deposits	ST	F2	Affirmed		F2

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	▣	

Applicable Criteria

Bank Rating Criteria (pub.15 Mar 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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