RATING ACTION REPORT

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Dagong Global Upgrades the Long-Term Credit Rating of Unipol Banca S.p.A. to 'BB+' from 'BB', Outlook 'Stable'

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Dagong Global has upgraded the Long-Term Credit Rating of Unipol Banca S.p.A. (UB) to 'BB+' from 'BB', with Outlook 'Stable'. The Short-Term Credit Rating is affirmed at 'B'.

RATING RATIONALE

The Long-Term Credit Rating combines an Individual Financial Strength Assessment (IFSA) of 'bb-' (also upgraded from 'b'), and an External Support Assessment (ESA) that recognises a moderate level of support from the Unipol Group.

The upgrade of UB's Long-Term Credit Rating to 'BB+' recognises the significantly improved, albeit still weak, asset quality of the bank and its return to profitability in 1H18.

The IFSA reflects also UB's satisfactory capitalisation, relatively stable funding profile based on customers' deposits and relatively weak competitive position in the Italian banking market; its traditional banking model focused on retail and SMEs, which should allow the bank to reach stable revenues in the long-term; the possibility to continue strengthening the synergies with its two parents Unipol Gruppo S.p.A (UG) and UnipolSai, the latter being the main insurance subsidiary of UG. The main considerations for the IFSA are laid out below.

Strongly improved, but still weak asset quality

The bank's very high stock of NPL has been its major weakness until the clean-up of the portfolio executed in the second half of 2017. The clean-up was the main reason for recognising a loss of 751.7Mn in 2017 and was enabled by a capital injection from Unipol Group of EUR 900Mn. As of 1H18, UB's gross NPL ratio was 10.1%, compared to the peak of 37.2% as of YE15. While still very high, the NPL ratio is now in line with the average for Italian banks.[1] The coverage ratio has also improved, to now satisfactory 52.9% (Dagong calculation).

We recognise the improved credit process of the bank, which already show results in recoveries and returns to performing loans exceeding new NPL loans by a large margin. However, considering the limited loan growth, we expect only a very moderate further improvement in asset quality metrics in the near-term.

Satisfactory capitalisation

As of 1H18, Unipol Banca showed satisfactory capitalisation. However, while comfortably fulfilling regulatory requirements, its capital ratios are below the average shown by Italian and European banks. Considering the limited potential to further decrease risk-weighted assets and the moderate capital generation capacity of the bank, we do not expect a significant improvement in the capital ratios. In the unlikely case that the bank needs a capital increase for regulatory reasons, we think that there is a moderate likelihood of another capital injection by Unipol Group.

[1] As of 1H18, the average NPL ratio for the sample of Italian banks in the EBA Dashboard is 9.7%

Return to positive bottom line results

For the first six months of 2018, Unipol Banca achieved a net income of EUR 13.8Mn, compared to a net loss of EUR 710Mn for the same period of 2017. The net loss in 2017 was largely due to the NPL restructuring plan, under which the bank booked credit impairments of EUR 934Mn only in the first half of the year, while in the first half of 2018 credit impairments amounted to EUR 19Mn. Considering the recurring sources of income, the strong increase in net commission income in 1H18 (+17% compared to 1H17) more than offset the slight decrease in net interest income (-8%), caused by the ongoing low interest rate environment. The bank also achieved a decrease in operating costs, in line with its strategic plan.

While with the return to positive net result the bank reached a very important milestone, we note that the profitability indicators are still relatively weak. We expect that profitability will continue to improve, but still remain only moderate in the mid-term.

Stable funding and sufficient liquidity

The funding structure is stable and based mostly on customer deposits, which provides stability to sustain its traditional banking model. The deposits to loans ratio has improved consistently during the last periods. The remaining funding comes from Unipol Group deposits and from bonds (senior and subordinated). ECB funding is marginal. Liquidity is adequate and also supported by the parent and the bank’s ability to access ECB funding. The regulatory liquidity ratios are fulfilled by sufficient margins. The maturities of issued bonds are fairly spread, with the majority due in 2 to 3 years, which we consider adequate.

External Support Assessment

The external support for UB incorporates our view of a moderate possibility of support from Unipol Group. This results in a rating uplift of two notches to reach a LTCR of ‘BB+’ from the IFSA of ‘bb-’. Our evaluation is also based on the full ownership, close reputational link through the use of the same name and good integration of both the operational and management structure. However, we do not consider the bank as strategically important for the Group and we cannot exclude that the Group could pursue joint ventures, sell or merge the bank with a larger or complementary Italian player.

RATING OUTLOOK

The ‘Stable’ outlook reflects our expectation that UB’s asset quality, capital levels and profitability levels will continue to improve only slowly, in line also with the expectations of management.

RATING SENSITIVITIES

We would consider a positive rating action on the bank’s IFSA, if UB demonstrates the ability to significantly and sustainably improve the profitability and thus the capital generation capacity of the bank. We would consider a positive rating action on the bank’s Long-Term Credit Rating in the case of: 1) a strengthening of the view on the willingness to support the bank by Unipol Group; and/or 2) an improvement of the credit strength of Unipol Group.

We would consider a negative rating action on the bank’s IFSA if UB’s capital ratios drop closer to the regulatory minimum, with no prospects of recovery from positive profitability. We would consider a negative rating action on the bank’s Long-Term Credit Rating in the case of: 1) a deterioration on the willingness to support the bank by Unipol Group; and/or 2) a weakening of the credit strength of Unipol Group.

COMPANY PROFILE

UB is part of Unipol Group, an Italy-based insurance group. The bank is fully owned by Unipol Group through two different entities: Unipol Gruppo S.p.A., that holds 57.75%, and through UnipolSai Assicurazioni S.p.A., that holds 42.25%[2]. The bank provides traditional banking services to retail and SME clients in Italy through 258 branches distributed in 18 regions, with its largest commercial presence in Emilia-Romagna. The bank has a limited market share since its commercial strategy is linked to Unipol Group in providing mostly complementary products to the customers of the insurance subsidiaries, evidenced by a 0.45% market share in terms of loans and 0.38% in terms of deposits at 1H18.

[2] Of which 27.49% is the subject of a put option granted by UG to UnipolSai and of a call option granted by UnipolSai to UG.

FULL LIST OF SOLICITED RATINGS

Unipol Banca S.p.A.

Long-Term Credit Rating (FC&LC)	BB+
Short-Term Credit Rating (FC&LC)	B
Outlook	Stable
IFSA	bb-
ESA	Moderate, Parent support

FC&LC: Foreign Currency and Local Currency

RATING HISTORY

Unipol Banca S.p.A.	BB/B/Stable (17 November 2017)
Unipol Banca S.p.A.	BB-/B/Stable (25 November 2016)
Unipol Banca S.p.A.	BB-/B/Stable (27 November 2015)

OTHER RELATED RATED ENTITIES

SIAT	BBB+/A-2/Stable (16 November 2018)
UnipolSai Assicurazioni S.p.A.	BBB+/A-2/Stable (16 November 2018)
Unipol Gruppo S.p.A.	BBB-/A-3/Stable (16 November 2018)

CRITERIA APPLIED

Criteria for Rating Financial Institutions (25 July 2018)
General Rating Framework (14 August 2018)

OTHER REGULATORY DISCLOSURES

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For any further information on rating criteria and procedures, please refer to the following links:
http://www.dagongeurope.com/procedures.php
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