Capital Markets Day 2017
CFO Speech

Slide 2 – One Bank, One UniCredit / The five pillars

Thank you TJ, and good morning everyone.

It is a pleasure to be here with you all again.

In the last twelve months, we have been very busy with the implementation of our Transform 2019 plan, which is yielding early and tangible results.

Today, I will focus on the following key topics:

- the accounting changes, which will affect the P&L and balance sheet, from 2018 onwards;
- the outlook on revenues and costs;
- our decisive de-risking, and further improvement in asset quality, to reduce the Group's cost of capital;
- a comprehensive overview of regulatory headwinds up to the end of 2019 and beyond, including our managerial estimates of their impact on our CET1 ratio;
- our revised funding plan, in the context of TLAC and MREL; and, finally;
- the sustainable profitability of the Group after the 2025 rundown of the Non Core

Let's start with a brief overview of where we are with Transform 2019, on the next slide.

Slide 3 – Transform 2019 key targets confirmed with an improved risk profile

The 2019 targets are confirmed, and the plan is fully on track: on the revenues side, higher fees and commissions offset slightly lower net interest income.

Most importantly, net income and RoTE targets are confirmed for 2019, with a better risk profile.

The operating model transformation is ahead of plan.

Costs are down, and we are progressing well on our cost efficiency initiatives, which will result in a sustainably lower cost structure.

We have taken decisive actions to de-risk the balance sheet, and NPEs have been materially reduced. As you heard from TJ, we are planning to reduce our NPEs exposure by an ADDITIONAL €4.0 billion by 2019, and to have a self-funded full rundown of the Non Core credit portfolio by 2025.

Moving on to capital, our SREP Pillar 2 requirement has been lowered by 50 basis points, leading to a new CET1 MDA level of approximately 10 per cent on a fully loaded basis for 2019.

Thanks to our improved capital position, we are able to anticipate some of the additional regulatory headwinds, mostly the new EBA guidelines, while confirming our fully loaded CET1 ratio target above 12.5 per cent in 2019.

After 2019, we have made managerial estimates of the impacts of the confirmed and potential regulatory headwinds, and their phased-in effects on our CET1 ratio.

Finally, and most importantly, on the basis of the results and our outlook on CET1, we will increase the dividend payout to 30 per cent for FY2019, to be paid in 2020.

Beyond FY2019, we are committed to increase the payout ratio up to 50 per cent, once we have better regulatory visibility and confirmation of any future changes, while maintaining a target CET1 ratio above 12.5 per cent.

Let's look at our macroeconomic assumptions on the next slide.

Slide 4 – Supportive economic outlook whilst increase in rates now expected in 2H19

As you can see on slide 4, our updated economic outlook has improved compared to the assumptions on which Transform 2019 was based.

The Eurozone looks increasingly strong, and sentiment is improving in many parts of the continent, especially in Italy. We are seeing increasing GDP growth rates, while investment and consumption are picking up, and unemployment is declining.

In 2018, we expect Eurozone growth of 1.8 per cent, while GDP growth in the CEE should stand at 2.4 per cent.

Moving on to interest rates, we expect the ECB to start raising the deposit rate in the second half of 2019, and bring it back to zero towards the end of 2019. As a result, our NII will start benefiting from the related increase in Euribor starting in the second half of 2019.

Let's move to slide 5.

Slide 5 – Transform 2019 yielding tangible results underpinned by group-wide business momentum

Since last year's Capital Markets Day, the Group has made important progress.

All decisive actions on capital have been successfully completed, generating more than 500 basis points of CET1.

With the objective of further reducing the Group's cost of capital, the balance sheet de-risking is ongoing.

FINO phase 1 closed in July. Regarding phase 2, we have signed binding agreements to sell down our interests to below 20 per cent, with closing expected in Q1 2018.

The gross NPE ratio stands at 10.6 per cent in Q3 2017, down 4.5 percentage points versus Q3 2016, supported by NPE disposals in Italy and CEE.

The transformation of the operating model is ahead of plan. Costs are down, and we are steadily progressing towards our targets.

We have strong commercial dynamics throughout the Group, thanks to the network revamp.

Client liquidity transformation into assets under management is continuing with a significant increase in net sales, reaching €13 billion in the first nine months of 2017, up almost two fold versus the previous year.

We have made important changes, to strengthen our corporate governance and simplify our share capital structure.

And finally, the cost optimisation of our corporate centre continues, decreasing the weight of Group Corporate Centre costs down from 5.1 per cent in 2015 to 3.8 per cent as of Q3 2017.

Overall, we are pleased with the progress we have made in the last twelve months, and are confident that we will achieve our targets.

Let's review, on the next slide, a number of accounting changes which will affect our financials from 2018.

Slide 6 – Line adjustments from accounting changes (1/2)

As already mentioned by Jean Pierre, a number of accounting changes will affect our P&L and balance sheet, starting 2018.

These changes neutralise each other, and have a net effect of zero.

These changes are technical accounting changes, mainly related to Italy, as it converges towards European standards. More specifically:

- First, because of new regulation from the Bank of Italy, acting as the local standard-setter of international accounting principles, there will be a shift in the accounting of the time value release, from LLPs to NII.
  As such, a higher NII will be fully offset by higher LLPs. This was an Italian peculiarity, and this change brings Italian banks in line with European practice;

- Second, accrued interest from UTPs and past due will be calculated on net book value, rather than gross book value. This leads to a reduction of NII which will be fully offset by lower LLPs; and

- Third, customer debt securities will be shifted from "customer loans" to "financial assets" in the balance sheet – also in this case the net effect is zero

We can now move on to the next slide, to show the effect these technical changes have on the financial KPIs presented at the Capital Markets Day last year.

Slide 7 – Line adjustments from accounting changes (2/2)

The restatements are purely accounting driven line shifts, in the P&L and balance sheet, and therefore do NOT affect our confirmed Transform 2019 targets.

For ease of comparison, we have also restated 2015 figures.

In particular, these restatements, which will be effective from 2018, result in:

- NII of €11.1 billion in 2019, versus €10.9 billion;
- An increase in LLPs in 2019 to €2.6 billion from €2.4 billion; and
- Loans to customers, decreasing to €455 billion in 2019 from €467 billion

Just to reiterate, net profit and all other P&L items, except the two mentioned, remain unaffected by these accounting changes.

Because of these restatements, the cost of risk in 2019 will optically increase by 6 basis points, from 49 basis points to 55 basis points.

For the rest of my presentation, figures are shown using the 2018 accounting standards.

Let's move to slide 8.

Slide 8 – 2019 key targets confirmed RoTE target >9% and further 4.0bn reduction of NPEs

Key 2019 targets remain unchanged apart from the NPEs, which are coming down by an ADDITIONAL €4.0 billion on a gross basis, dropping to €40.3 billion, as TJ just explained.

We have also included some targets for 2018 on this slide, namely:

- Total revenues of €20.1 billion;
- Operating expenses of €11.0 billion, on track to meet 10.6 billion in 2019;
- Cost/Income ratio below 55 per cent, a steady reduction towards our target of below 52 per cent in 2019;
- Cost of risk at 68 basis points, as the accounting line adjustments add 7 basis points; and
- CET1 ratio between 12.2 and 12.7 percentage points

On the next slide we will look at revenues.

Slide 9 – 2019 overall revenues target confirmed: higher relative contribution of fees and commissions

Over the next three slides, I will focus on the evolution of total revenues.

Our 2019 revenue target is confirmed at €20.6 billion. That said, we expect a slightly different revenue mix.

Fees will be about €100 million higher than our previous target. This will offset the lower NII, given the current pressure on customer rates, the expected delay to the ECB rate hikes into the second half of 2019 and less dynamic loan growth.

The remaining portion of the revenues line, mainly composed of trading and dividends, is expected to remain stable at approximately €2.5 billion per year.

Let's move to the next slide on the evolution of fees and commissions.

Slide 10 – Increased fee target thanks to higher investment and transactional fees

We expect fees to reach €7.1 billion by 2019, primarily as a result of higher investment services and transactional fees.

The transformation of customer liquidity and assets under custody into assets under management is continuing. This trend is also supported by the addition of the Amundi product catalogue, as mentioned by Gianni.

As such, investment fees will increase thanks to higher assets under management, especially in Commercial Banking Italy.

Transactional fees are also expected to increase, thanks to our leading positions in global transaction banking in our home markets, underlining the recurrent nature and low volatility of these fees.

As a catalyst to investment services fees, the penetration of assets under management as a percentage of TFAs, particularly in Italy, is increasing.

We are already at 36 per cent, up from 33 per cent in 2015. And we are confident of reaching 41 per cent by the end of the plan.

Please note that especially in Italy, starting from 2018, we expect some sector-wide pressure on investment fees, as a consequence of the introduction of MiFiD 2.

We believe that MiFiD 2 will put pressure on both product and distribution factories. However, the fact that we no longer have a captive asset management platform should somewhat mitigate the effect on UniCredit.

Finally, financing fees will remain stable. Our leadership in European debt capital markets will ensure a good flow of commissions. We are less bullish on the leveraged finance business, if the market remains unattractive from a risk return perspective.

We will move on to NII on the next slide.

Slide 11 – NII target affected by lower for longer interest rate scenario and less dynamic loan growth

As we have mentioned previously, we believe that short-term interest rates will remain lower for longer.

We therefore expect NII pick-up to follow a "U" (instead of a "V") shaped curve, remaining stable in the first half of 2018, while increasing in the second half of 2018, thanks to the combined effect of higher volumes, stabilising customer rates, and lower funding costs.

In 2019, NII will start to benefit further from the short-term interest rates pick-up we expect in the second half.

By the end of 2019, NII will reach €11 billion. The NII target has been reduced by €100 million, partially as a result of rates expected to be “lower for longer”, and partially due to less dynamic loan growth.
Please note that, on the basis of our assumptions of higher short-term rates in Q3 and Q4 2019, we expect that Q4 NII “annualised”, will be higher than NII for full year 2019.

Therefore, due to a rates-related timing effect, the pick-up in NII is back-ended.

In this context, I remind you that our sensitivity to a 100 basis points parallel shift in interest rates increased from €681 million, in Q3 2016, to €946 million in Q3 2017.

From a bottom-up perspective, the waterfall chart on the slide clearly illustrates the drivers for 2017 through to 2019:

- The effect of line adjustments from accounting changes for 2017 is about €300 million, as decreasing NPE stocks, and shorter recovery times, are reducing the effect of time value release. Going forward, as a result of our decisive de-risking, we expect this effect to reduce further each year;

- The contribution from loans will be higher than €500 million, primarily as a result of increasing volumes;

- Deposits will have a negative impact of €100 million, given marginally higher volumes and rates;

- Term funding is expected to further improve, thanks to tightened spreads, lower issuance of senior non-preferred and tier 2 instruments versus Plan, as well as, the run-off of bonds issued at higher spreads; and, finally

- Slightly lower contribution of the investment portfolio, following the progressive tightening of spreads

Let’s turn to costs.

Slide 12 – 2019 cost target confirmed: adjusted mix with higher HR savings

The operating model transformation is ahead of plan, and cost efficiency is paying off.

As of November, we have already carried out 72 per cent of targeted branch closures, ahead of the original schedule, which envisaged 68 per cent by end 2017.

Similarly, by year end, we expect FTE reductions to be above 59 per cent of the Transform 2019 target, ahead of the original plan of 48 per cent by end 2017.

As we mentioned in our Q3 results call, we expect that total costs in 2017 will be marginally lower than the targeted €11.7 billion, generating more than 34 per cent of planned savings.

It is worth noting the continued improvement of the cost income ratio, which stood at 57.9 per cent in nine months 2017, improving by 2.1 percentage points since 2015. This is in line with

our target of reaching at least 77 per cent of total cost savings by end of 2018, when total expenses are expected to be €11 billion.

We also confirm the overall cost target of €10.6 billion by end 2019, with a slightly different mix of cost savings. More specifically, HR cost savings are expected to be €100 million higher, primarily as a result of the timing and mix of people leaving.

HR costs are expected to reach €6.3 billion, while Non-HR costs will stand at €4.3 billion, by the end of 2019.

This will allow for additional investments in IT to the amount of €100 million, to support future process optimisation post 2019.

It really is a matter of doing more with less!

Let's move to slide 13.

Slide 13 – FTE and branch reductions ahead of schedule

FTEs are down by more than 7,200 since December 2015, mainly thanks to the operational transformation in the Western European Commercial Banking business.

As far as Non-HR costs are concerned, significant improvements have been achieved, thanks to very tight cost management. Examples include:

- IT decommissioning: securing 75 per cent of our 2019 applications target, while proceeding with the simplification of our IT landscape;

- Significant progress in headquarter space optimisation is being achieved, confirming the Transform 2019 target, to reduce the space per head from 20 square metres in 2015 to 12 square metres by the end of 2019

Although we still have a lot of work ahead of us, we are already becoming a leaner organisation, with a lower weight of real estate expenses, and more focus on IT expenditure and IT development, as digitalisation and automation act as enablers of our bank's transformation.

And now let's move to our risk discipline.

Slide 14 – Improved NPE ratio thanks to decisive de-risking actions

Our main objective to continuously reduce our cost of capital goes hand in hand with the de-risking of our balance sheet.

For the Group as a whole, the gross NPE ratio improved to 10.6 per cent in nine months 2017, down from 16 per cent in 2015.

Asset quality of the Core portfolio is improving, with the gross NPE ratio falling to 5.0 per cent in Q3 2017, nudging closer to the 4.5 per cent June 2017 EBA average.

In this context, the gross NPE ratio is expected to be at 4.7 per cent in 2019, even closer to the EBA average.

Our commitment to strict risk discipline has resulted in the continued reduction of cost of risk.

The headline Group cost of risk is expected to stand at 68 basis points in 2018. This is composed of:

- 53 basis points of underlying cost of risk, of which 7 basis points from accounting line adjustments;

- 15 basis points from model changes

In 2019, Group cost of risk will be 55 basis points. This breaks down into:

- 51 basis points of underlying cost of risk, of which line adjustment equal to 6 basis points;

- 4 basis points from model changes

Let's move to the next slide, where you will see the details of the acceleration of our de-risking strategy.

Slide 15 – Gross NPEs down by a further 4.0bn by end 2019, better than initial Transform 2019 target

Slide 15 shows the decisive de-risking actions we continue to take. In this context, we will improve our Transform 2019 gross NPE target by an additional €4.0 billion.

In Group Core, NPEs will be reduced by an additional €2.0 billion, primarily as a result of increased recoveries and disposals. As such, NPEs will be €23.1 billion by end 2019, with a coverage ratio above 51 per cent.

Moving on to the Non Core portfolio, as you have heard from TJ, we have taken a number of additional measures:

- We have further reduced the gross NPE target by €2 billion to reach €17.2 billion by 2019;

- We also aim to reduce the portfolio by an additional €10.1 billion by 2022

Lastly, and most importantly, we will run down our Non Core portfolio to zero by 2025.

This rundown will be entirely self funded, as the Non Core capital allocation is enough to absorb future losses.

This clearly illustrates that our Non Core is "finite" and, as such, should be valued accordingly.

Let's turn to capital.

Slide 16 – 2019 fully loaded CET1 ratio target confirmed and FY2019 dividend payout increased from 20% to 30%

As we said last year, and Jean Pierre and TJ have already reiterated, we expect the regulatory impact over the plan period to be 1.5 per cent.

In addition, thanks to our strong capital position, we have decided to proactively anticipate additional regulatory headwinds, mostly made up of the new EBA guidelines, which were confirmed at the end of November.

As you can see on the slide, most of the impact will be in 2018, meaning that our CET1 ratio might temporarily dip below 12.5 per cent.

In 2019, CET1 will be above 12.5 per cent, with a dividend payout ratio increased to 30 per cent, payable in 2020.

Our strong capital position will allow us to maintain a CET1 MDA buffer of above 250 basis points from 2019 onwards.

Let's turn to the next slide to look at the outlook on capital post 2019.

Slide 17 – Cumulative organic capital generation above estimated regulatory impacts post 2019

As TJ said, we have made managerial estimates of the regulatory headwinds which we expect after 2019.

We look at these on a yearly basis, as we compare them with our annual internal capital generation.

To make it easy to read, we have illustrated in the centre of the slide both cumulative phased-in impacts and yearly impacts.

If we compare these impacts with our conservative estimate of a yearly post 2019 CET1 generation of 50 basis points, you can see that our cumulative organic capital generation will more than compensate for the confirmed and potential regulatory capital evolution post 2019.

As a result, we can calibrate our dividend payout ratio versus the post 2019 CET1 ratio.

Once we have better regulatory visibility, we will increase the payout ratio from 30 per cent up to 50 per cent, while maintaining our 12.5 per cent post 2019 CET1 ratio target.

As Jean Pierre said, we will make a decision based on our CET1 ratio in 2019, and on the final impact of the remaining EBA guidelines which are still subject to changes.

Please note that every 10 percentage points of payout are roughly equivalent to 10 basis points of CET1 ratio, which we want to keep above 12.5 per cent.

And now let's move back to Transform 2019 and to UniCredit's new SREP guidelines.

Slide 18 – SREP Pillar 2 requirement lowered by 50bps to 200bps, CET1 MDA buffer above 250bps after 2019

We have just received our SREP letter from the ECB, and our Pillar 2 requirement for 2018 has been reduced by 50 basis points - from 2.5 per cent to 2.0 per cent.

This important milestone is thanks to:

- UniCredit's strong capital position after the completion of the €13 billion rights issue in February 2017 as well as the disposals of Pekao and Pioneer;
- The bold initiatives launched with Transform 2019 based on pragmatic targets, robust monitoring, and strong accountability as well as;
- Our decisive actions to de-risk the balance sheet

As a consequence, the relevant MDA CET1 ratio will be 10.07 per cent on a fully loaded basis for 2019.

Now let's turn to our funding plan.

Slide 19 – Optimised TLAC funding plan

As you can see, the Group funding plan has been optimised in light of higher liquidity inflows and a more efficient mix of fixed income instruments.

Let's look at the details, as liquidity has to be managed in the context of TLAC and MREL.

As you can see on the slide, TLAC regulation requires UniCredit to reach a minimum subordination requirement of 17.1 per cent of RWA by January 2019.

The introduction of senior non-preferred legislation in Italy is expected to be approved by year end. This will allow us to optimise our capital structure by substituting a portion of planned Tier 2 issuance, with less expensive senior non-preferred instruments.

So how will these changes impact our funding plan?

On TLAC. Compared to last year's funding plan of €26.4 billion, we have reduced the funding volume by €9 billion to €17.4 billion. senior non-preferred has been reduced from €13.3 to €6 billion. Similarly, Tier 2 issuance has been reduced from €5 to €3.4 billion.

This is possible thanks to a strong total capital ratio, which as of Q3 2017 stood at 18.2 per cent, well above the 17.1 per cent minimum subordination requirement.

On MREL. For the time being, once the SRB has taken into account our lower Pillar 2 requirement of 2 per cent in 2019, we have assumed a fully loaded target close to 26 per cent of RWAs, in line with the average requirement for European banks as per SRB's recently published guidelines. The Binding requirement based on our former P2R should be communicated in Q1 2018.

As a result, the overall funding plan has been reduced from €78.7 billion to €76.0 billion, while remaining fully compliant with our LCR and NSFR requirements.

At the same time, pure liquidity instruments such as covered bonds have been scaled down from €20.0 billion to €5.8 billion, partially offset by an increase of supranational and other bilateral MLT funding from €18.3 billion to €26.3 billion.

Now let's focus on spreads.

The positive market backdrop and recognition of the ongoing progress of Transform 2019, supported by the improved Italian risk perception and macroeconomic environment, has led to a tangible repositioning of UniCredit's credit profile with spreads tightening significantly, on both an absolute and relative basis.

This will clearly have a positive impact on funding costs and thus net interest income.

At the end of October, S&P's upgraded UniCredit SpA to triple B with a stable outlook, which confirms that the financial communityis recognising and taking into account the early results of Transform 2019.

Overall, these factors could be quantified in an average funding spread of approximately 160 basis points versus 3 months EURIBOR vis-à-vis the 175 basis points communicated at Capital Markets Day last year.

Let's move to slide 20.

Slide 20 – 2019 Group Core profitability above 10%

Thanks to the strong Group-wide business momentum, and tangible results of Transform 2019, all business divisions are delivering recurring profitability.

On this slide we show the profitability targets of the various divisions. These have marginally evolved since our last Capital Markets Day, mostly due to a different RWA mix. It is important to stress that all divisions earn their cost of capital.

There are two key points I would like to make here.

First, the capital allocated to the Non Core more than covers all future losses until its finality, which means the rundown is fully funded.

Second, the normalised profitability of Group Core in 2019 stands at above 10 per cent, with a corresponding gross NPE ratio of 4.7 per cent, close to the EBA average for global SIFIs.

Therefore, from this point onwards, we will focus our financial communication much more on the underlying profitability of Group Core, i.e. excluding Non Core.

Let's turn to slide 21 to review our 2019 targets.

Slide 21- 2019 key targets confirmed

As a reminder, here are the key financial targets for 2018 and 2019.

Please be reminded, that these figures are restated for the accounting line shifts that I mentioned on slide 6.

As you can see, the slide also contains key P&L KPIs for 2018.

As far as 2019 is concerned, most importantly, net income and RoTE targets are confirmed.

In terms of changes:

- Gross NPEs will be reduced by an additional €4 billion, and are expected to stand at €40.3 billion by end of 2019;

- As a consequence, the gross NPE ratio for the Group Core will improve further to 4.7 per cent versus the 5 per cent, as communicated at last year's Capital Markets Day

All other P&L and balance sheet items are also confirmed.

Let's move on, to my closing remarks.

Slide 22 – Closing remarks

Before we go for the final round of Q&A let me reiterate the key messages from my presentation:

- Our Transform 2019 programme is yielding tangible results;

- We confirm our key targets for 2019;

- We will accelerate de-risking with a lower NPE target in 2019, and Non Core fully rundown by 2025;

- We will anticipate regulatory headwinds while confirming our 2019 CET1 ratio target at above 12.5 per cent; and, finally;

- We will increase our dividend payout to 30 per cent for full year 2019 and will go up to 50 per cent, as soon as we have better regulatory visibility

Thank you very much for listening.

Now Jean Pierre, Gianni, TJ and I would be happy to take your questions.