Bankia's (BBB+) new strategic plan looks ambitious but coherent

On 27 February 2018, Bankia presented its new strategic plan for the 2018-2020 period. 2017 had marked the end of its previous restructuring plan which successfully repositioned the bank, materially improving its financial performance and brand perception in Spain. Scope believes that Bankia today can compete independently and on an equal footing with its Spanish peers, showing business and financial characteristics that bear little resemblance to the failed savings banks out of which it originated.

There were few surprises or departures from the bank's recent strategy:

- Customer perception remains firmly in the spotlight. The bank is still focused on customer satisfaction metrics (including net promoter score) despite the fact that the bar for further improvements on these metrics has already risen materially over the past few years.
- Digitalisation is a key strategic element, although Bankia's management has highlighted how difficult it is to achieve enduring competitive advantages in this area. This message squares with our view that the adoption of digital channels has as much to do with customer demographics as with the bank's own strategy.
- The bank is targeting growth in consumer credit and corporate banking, while slowing down its deleveraging in mortgages. The penetration gap between Bankia and the BMN franchise is one key lever for achieving volume growth.
- The asset quality cycle has visibly turned, and Bankia could, in our view, achieve an almost completely clean balance sheet by the end of the plan, assuming that the Spanish economy continues to perform well.
- The plan is based on a more supportive economic backdrop, but net interest income (NII) projections rely on a very modest increase in market interest rates and are reasonable.
- The integration of BMN will provide a useful boost to net profit, with cost synergies more than offsetting cost inflation.
- Bankia is targeting a return on tangible equity of 11% in 2020. We believe that this may be achievable, subject to the business cycle holding up and to competitive dynamics in Spain not heating up further. We also believe cost slippage is possible given the likely tightening of labour market conditions in Spain over the horizon.

In our view, the plan is coherent with the management's recent narrative and, in general, sensible. Most projections look challenging but reasonable. From a credit perspective, we consider the continued focus on balance sheet cleanup to be positive. The likely increase in profitability, driven by the repositioning from mortgages to higher margin, higher risk segments, is offset by the greater cost of risk through the cycle. Our issuer rating (BBB+, Stable) remains well positioned.

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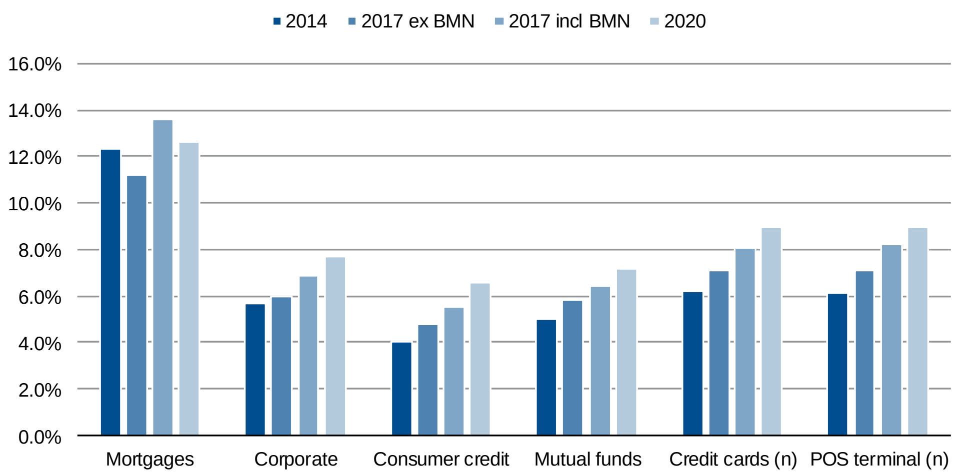
Material change in balance sheet composition

A key pillar in Bankia's strategy (both past and present) is the move from a highly specialised mortgage bank towards a rounder business concept.

In recent years, Bankia has been targeting the higher margin corporate and consumer credit segments, and this has reduced the incidence of mortgages in its loan book (61% in 2017). Under the current strategy, mortgages should come to represent 54% of the loan book by 2020. More specifically, the bank is aiming to achieve double-digit growth in consumer credit, and high single-digit growth in business loans. In our view, these growth targets are demanding, but the potential for growth is there as Bankia's market shares in these products are about half what they are in mortgages. It is also worth noting that Bankia has been restricted, in the past, from lending to certain corporate sectors, and that these restrictions have ceased to apply in 2018, opening up a whole new market for the bank to tap. Whether it has the expertise to do so profitably remains to be seen.

Figure 1: Bankia market shares evolution, selected products



Source: Company data, Scope Ratings

We also note that the targeted shift in business mix, which is expected to boost net interest margins, does not lead to an increase in the cost of risk over the plan horizon and is projected to remain stable over the plan (24 bps).

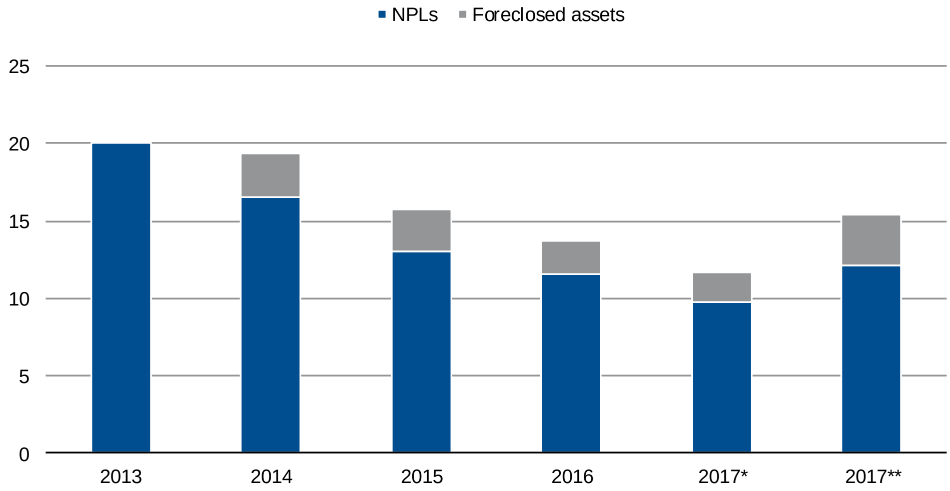
According to Bankia's business plan, the good coverage of the current stock of non-performing assets, and the planned reduction of the non-performing asset stock over the plan period, should mitigate the impact of the higher risk in loan origination. This is possible, given Spain's robust economic performance, which we expect to continue, but we note that the through-the-cycle cost of risk will probably be higher.

Asset quality cleanup to continue

For the past five years, Bankia has been reducing the amount of non-performing assets on its books. Total non-performing loans and foreclosed assets declined at an average rate of EUR 2.8bn per year, partly thanks to sales. In 2017, the acquisition of BMN brought in additional problematic assets, and management is aiming to continue to reduce non-performing assets over the next three years at a similar pace. By 2020, Bankia should, according to management projections, be a clean bank, with a net non-performing asset ratio below 3%.

Scope believes that the asset quality targets are plausible in the current environment.

Figure 2: Bankia's non-performing assets evolution



Source: Company data
*excluding BMN - **including BMN

Conservative approach to capital and funding

Bankia aims to maintain a CET1 ratio of 12%, which is well above its 2018 SREP requirement (9.25% on a fully loaded basis). The bank has currently excess capital which it plans to distribute through extraordinary capital actions on top of an ordinary payout policy of 45-50%.

Bankia expects future regulatory impacts on risk-weighted assets (RWAs) to be manageable and more than offset by RWA releases from model changes in its mortgage portfolio (where the average risk weighting of Bankia is 31.7%, double the level of large Spanish peers).

Despite not having received its MREL targets, Bankia also plans to start issuing non-preferred senior debt (NPS), targeting NPS of 4.5% of RWA by the end of 2020, to reach a total MREL of 20% of RWAs. This is prudent in our view, also in light of the benign market conditions and strong demand for NPS.

Scope's ratings remain well positioned

Scope's issuer rating on Bankia is BBB+ with a Stable Outlook. Our ratings acknowledge the material progress made in restructuring the institution since the crisis, with cost-cutting and the reduction of non-performing assets, steered by a credible management team. Our ratings also acknowledge the tough interest rate environment, which has taken its toll on Bankia's profitability, due to its highly interest rate sensitive mortgage book.

We believe our ratings remain well positioned in light of the newly presented plan. In our view, management targets for 2020 are credible, but we note that the higher revenue margin afforded by business loans and consumer credit as well as the rounder business model are likely to come at the cost of greater loan losses through the cycle.

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